



HIGH-LEVEL WORKING GROUP ON EDIS

THE CHAIR

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Letter by the High-Level Working Group on a European Deposit Insurance Scheme (EDIS) Chair to the President of the Eurogroup

Further strengthening the Banking Union, including EDIS: A roadmap for political negotiations

1. Introduction

Significant progress towards a single rulebook for banks across the European Union and the establishment of the Banking Union was made over the last years. A Single Supervisory Mechanism (SSM), and a Single Resolution Mechanism (SRM) including a Single Resolution Fund (SRF) were set up and are now operational. In December 2019, the Eurogroup in inclusive format is also expected to agree to a full package of changes to the European Stability Mechanism (ESM) Treaty, including the establishment of a backstop to the SRF. These measures have reinforced banking-sector resilience across the EU, thereby safeguarding financial stability and protecting taxpayers from the costs of any future crises. Moreover, risks in the banking sector are being further reduced significantly, lately with the implementation of the Banking Package of April 2019 and of the non-performing loans Action Plan of July 2017.

Despite the significant progress and efforts made, the Banking Union is not complete and scope remains for further strengthening it in a number of areas to make it more stable and resilient to shocks, while limiting the need for public support. This includes a European deposit insurance system. It is important that we move forward to unlock the Banking Union's benefits in terms of private risk sharing, financial integration, financial stability and economic growth, while reducing opportunities for arbitrage between Member States. Ultimately, we should ensure Europe's financial and economic sovereignty.

A more integrated and efficiently functioning Banking Union will allow companies and consumers to access better, cheaper and more efficient financial services on a cross-border basis. It will thus lead to better private sector risk sharing across Member States, a smoother response to economic cycles and increase Europe's global competitiveness, including by fostering the role of the euro as an international currency. A more resilient banking sector will reinforce financial stability, both within the Member States participating in the Banking Union and in the European Union as a whole. Ultimately, a robust banking sector which efficiently channels savings to the most productive uses will also mean better job opportunities and growth for European citizens.

In June 2019, the High-Level Working Group on EDIS (HLWG) set out the goals for the Banking Union in the steady state, including a European deposit insurance scheme (EDIS), as well as the basic principles on which further work could be based, namely: a Banking Union that ensures financial stability, protects the taxpayers, and where resources are allocated in an efficient manner, cross-border

integration is enhanced, an effective and uniform protection for covered depositors is achieved, and consistency across the overall architecture is ensured. We identified the areas where further work was needed. These include EDIS, crisis management, cross-border integration and the regulatory treatment of sovereign exposures and financial stability aspects. This work should take place in a context of continued risk reduction to be monitored on an ongoing basis.

The Eurogroup in inclusive format in June 2019 mandated the HLWG to continue technical work to define a transitional path to the steady state Banking Union for relevant elements and their sequencing, adhering to all the elements of the 2016 roadmap, and to define a roadmap for beginning political negotiations on a European deposit insurance scheme.

2. A roadmap for political negotiations

Work has continued in all areas identified, which resulted in the roadmap set out in annex. We will need to work on all these areas in parallel and launch a political discussion on the further development of the Banking Union. In many of these areas additional work is still required to define the specific measures, calibrations and timeline.

Ideally, the further work set out in the roadmap should, at the European level, be carried out within the current institutional cycle (2019-2024), taking into account the legislative processes involved, implementation, including at the national level, could go beyond this period.

In order to achieve this goal, a stepwise process has been developed which, **in a preparatory and negotiation phase**, could involve different elements:

- We need to discuss and agree the main features and set-up of the different stages, including loss coverage, of an EDIS. EDIS could be built based on a hybrid model, relying on the existing national Deposit Guarantee Schemes (DGSs) and complemented by a central fund to reinsure national systems. It could start with a model providing liquidity support to national schemes within limits to be decided and could move in a second stage to a system including loss coverage following a path to be discussed further. The parameters that would need to be discussed and agreed include: the scope of the scheme, the total size of the national DGS and the central fund and the allocation between them, their relationship, the governance, the repayment modalities such as interests, and the treatment of Options and National Discretions. Based on the outcome of discussions, this could be followed by formal negotiations on the basis of a legislative proposal accompanied by an impact assessment. We also need to continue in parallel with the gradual build-up of national DGSs, in line with the revised DGS Directive and in line with the outcome of the above mentioned discussions on the parameters of EDIS, to further strengthen our national systems. In order to timely complete a targeted Asset Quality Review (AQR)/comprehensive assessment, it could already be designed and start during this first phase and be followed by the appropriate and effective remedial actions where needed and stretching into the implementation phase.
- We also need to address the bank-sovereign loop by incentivising banks to diversify their portfolios with regard to risks including those relating to sovereign exposures on their balance sheets. Several options have been identified and could provide for gradually taking sovereign risk exposures better into account in EU legislation. Whereas the individual supervisory process (pillar 2) and the transparency requirements (pillar 3) for sovereign exposures could be further strengthened, we need to further analyse and carry out an impact assessment of the available options, including factoring in concentration sovereign exposures in the risk-based

contributions (RBC) to EDIS based on an agreed methodology, including also other risk factors. We also need to study further the introduction of concentration charges. In calibrating RTSE measures, consideration could be given to the importance of not putting European banks in a position of competitive disadvantage as well as to the potential impact on national sovereign debt markets. The phasing-in of measures could be gradual and take due account of financial stability concerns, and avoid any abrupt changes or cliff effects. More work is needed to assess the potential impact on national sovereign debt markets, in particular those of small and medium size. RTSE measures might need to be supplemented by accompanying measures. Further analysis on a European safe portfolio to address possible financial stability issues could therefore also be carried out.

- We also need to improve our crisis management legislation to ensure a strong, effective and consistent, framework that protects tax payers, preserves a level playing field and ensures financial stability at national, Banking Union and EU level. It is now time to assess the adequacy, effectiveness and the overall consistency of the framework for dealing with all types of credit institutions, specifically taking into account the experience with the implementation of the Bank Recovery and Resolution Directive (BRRD) so far. At this stage, there is no necessity for fundamental changes but rather for targeted enhancements and clarifications such as between the early intervention measures and other supervisory measures as well as on the conditionality for precautionary recapitalisation. We need to look at the suitability of the instruments for dealing with banks that do not meet the public interest test, and identify appropriate solutions, also including DGSS' alternative measures. We also need to review bank insolvency laws to identify parts in need of harmonisation (looking at least at creditor hierarchy, insolvency triggers, depositor preference, including its interactions with DGSS' alternative measures and cross-border banking group failures).
- We need to continue work to further enhance integration and address the remaining barriers to cross-border flows of capital and liquidity, enabling private risk sharing throughout the Banking Union. This should not be to the detriment of financial stability at national, Banking Union or EU level. Further work could be carried out in this area to identify the underlying causes for fragmentation and assess potential measures we could implement to enhance cross-border integration. We need to assess both prudential and non-prudential obstacles, the effect of gradually removing them together with introducing appropriate safeguards including a parent support mechanism for groups and a group insolvency regime for banks.

Once the preparatory work and negotiations have been completed in all areas, in a second, implementation phase, the agreed measures would be applied, including:

- A gradual implementation of EDIS through a hybrid model, providing liquidity support within certain limits. There could be a gradual increase of the loss coverage in line with progress on risk reduction, and reflecting the relative competences of the national level and EU institutions in the Banking Union. The implementation of the remedial actions following the targeted AQR/comprehensive assessment would have to be properly completed.
- Implementation of risk-based contributions to EDIS, factoring in concentration in sovereign exposures as one factor. Concentration charges on sovereign exposures could be phased in gradually and take into account possible effects on national debt markets. An impact assessment of a European safe portfolio could be undertaken in this context.
- Implementation of the identified measures to revise the crisis management framework, ensuring its adequacy, effectiveness and efficiency, also in respect of DGS involvement through alternative

measures, while ensuring alignment of State Aid rules and the revised framework; and, targeted harmonisation of key elements of bank insolvency law for a consistent treatment of creditors in the Union and an efficient handling of cross-border group insolvencies whilst ensuring financial stability in home and host countries.

- A phasing-in of measures and binding safeguards for resolution of cross-border banking groups, enhancing legal certainty and enforceability. Depending on the outcomes of the analysis and negotiations conducted during the preparatory phase, this could encompass, notably, formalising parent support arrangements for groups in EU legislation and a group insolvency regime for banks; phasing out of no longer justified national options and discretions, implementing measures to facilitate cross-border banking and addressing prudential regulatory barriers, including in regard of capital, liquidity waivers and waivers for internal Minimum Requirements for own funds and Eligible Liabilities (MREL) as well as non-prudential barriers. As we move forward towards a strengthened Banking Union, we may also need to review the governance of the Single Resolution Board.

As of the preparatory phase and throughout the implementation of the roadmap, we should continue our efforts to further address risks in the banking sector and increase its resilience. Good progress has been made in reducing non-performing loans (NPLs) and in building up MREL. The reduction of NPLs and adequate provisioning should continue, in line with our objectives. The implementation and application of already agreed measures should continue, also in areas such as anti-money laundering (AML), implementation of the Banking Package and the NPL Action Plan. We should also implement the Basel III reform, in line with the ECOFIN Council conclusions. Risk reduction should continue to be closely monitored, including on NPLs, MREL and on level 2 and level 3 assets, through the twice-yearly risk reduction monitoring reports from the institutions.

In the long term vision for the Banking Union we could have full implementation in all these areas.

3. Next steps

As we enter the preparatory and negotiation phase, the required analysis and technical work will have to be carried out in all these areas. Regular discussions at the political level will frame this work.

Work could start immediately on the following actions:

- **On EDIS:** Negotiations on the set-up and features of an EDIS could be taken forward by the Eurogroup in inclusive format, supported by the HLWG, in particular to agree among Member States on the main features and set-up of EDIS. The Commission could be invited to conduct technical work in the context of the Expert Group on Banking, Payments and Insurance (EGBPI) to facilitate the political negotiations. Following this work, negotiations could take place on the basis of a legislative proposal, accompanied by an impact assessment;
- **On incentivising banks to diversify their portfolios, including sovereign exposures:** The Commission and ECB could be invited to come with further analysis and impact assessments on the options identified for RTSE (including risk-based contributions factoring in concentration in sovereign exposures and concentration charges) as well as on what a European safe portfolio could look like. The aim should be to incentivise banks to further diversify their portfolios with regard to sovereign debt and other assets, while safeguarding financial stability. Work on the options and calibrations for RTSE could be further discussed at HLWG level and negotiated on the basis of the outcome of the above and subsequently, on the basis of legislative proposals by the Commission, accompanied by an impact assessment.

- **On crisis management:** The overlaps between **early intervention** measures and their interaction with other supervisory measures could be removed in this phase. The Commission, where needed with the ECB and the SRB, could be invited to carry out the required assessments with respect to the crisis management framework, and report back to the HLWG, in order for negotiations to take place. This includes an assessment of the adequacy, effectiveness and overall consistency of the crisis management framework including reviewing the public interest assessment, dealing with non-systemic institutions within the framework, availability of resolution tools and the use of alternative measures, identifying the parts of bank insolvency laws that need to be harmonised and reviewing the conditionality of precautionary recapitalisation. With a view to negotiations on the basis of the outcome of the above, the Commission could be invited to present legislative proposals accompanied by an impact assessment.
- **On cross-border financial integration:** The Commission, and where needed the ECB and EBA, could be invited to come with an assessment of the current state of play on obstacles to further integration, an impact assessment of the effect of gradually removing the identified obstacles and on potential safeguards. In parallel, an assessment of potential measures to enhance cross-border integration could be undertaken, including possibly further incentivising geographical diversification in prudential regulation and whether adjustments to prudential requirements (risk weighted assets (RWA) and leverage ratio) within a group are unduly inflated due to internal MREL and if adjustments to prudential requirements are justified to strengthen cross-border integration. A stocktake could be carried out on the use of existing capital and liquidity waivers and treatment of intragroup flows in the liquidity coverage ratio, the obstacles to “branchification” and the impediments of operationalising resolution strategies in relation to cross-border banking groups whilst ensuring financial stability in home and host Member States. This work could be further discussed in the HLWG and negotiated on the basis of the outcome of the above and subsequently on the basis of legislative proposals by the Commission, accompanied by an impact assessment.

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	EDIS	RTSE and Financial Stability	Crisis management and enhanced cross-border integration		Risk reduction and monitoring
			Crisis management	Enhanced cross-border integration	
Preparatory & negotiation phase	<p>Negotiations on the main features of a European Deposit Insurance Scheme (EDIS) on the basis of a hybrid model, relying on existing national DGSs and a central fund. These should amongst others cover the set-up, scope, the total size of the national DGS and the central fund and the allocation between them, their relationship, the governance and repayment modalities.</p> <p>This should be followed by negotiations on the basis of the outcome of the above and on the basis of a legislative proposal, accompanied by an impact assessment.</p> <p>Gradual build-up of the national DGSs.</p> <p>Design and launch of a targeted AQR/comprehensive assessment, followed by appropriate and effective remedial actions where needed.</p>	<p>Further strengthening of individual supervisory review process (pillar 2) and transparency requirements (pillar 3) for sovereign exposures.</p> <p>Negotiations on options and calibrations, to incentivise banks to diversify their portfolio with regard to risks including sovereign exposures. These incentives could include Risk Based Contributions (RBC) for EDIS factoring in amongst other elements concentration in sovereign exposures and/or concentration charges, following further analysis and impact assessment.</p> <p>Further analysis on a European safe portfolio to address possible financial stability issues.</p>	<p>Implementation and application of the current BRRD/SRMR.</p> <p>Remove overlap and clarify interaction between early intervention and other supervisory measures.</p> <p>Assessment of the adequacy, effectiveness and overall consistency of the crisis management framework to ensure the protection of tax payers by consistent application of the current framework to create a level playing field for all banks and preserve financial stability, while respecting the principle of proportionality including by:</p> <ul style="list-style-type: none"> - Reviewing the existing rules in light of these objectives, including the interpretation of the Public Interest Assessment (PIA); - Looking into the handling of non-systemic institutions within the crisis management framework, including availability of resolution tools, and the use of the DGS for alternative measures; - Identifying parts of bank insolvency laws in need of harmonisation (looking at least at creditor hierarchy, insolvency triggers, depositor preference and its interaction with DGSs' alternative measures and cross-border banking group failures); and - Reviewing the conditionality for precautionary recapitalisation <p>Negotiations on the basis of the outcome of the above and on the basis of legislative proposals accompanied by an impact assessment.</p>	<p>Identification of potential underlying grounds for fragmentation and impediments to cross-border banking including:</p> <ul style="list-style-type: none"> - An analysis of prudential obstacles, including ONDs, of the use of capital and liquidity waivers, and a stocktake of existing provisions on intragroup flows in the liquidity coverage ratio; - An analysis of non-prudential obstacles relating to areas such as company law, consumer protection, taxation and employment law; - A stocktake on impediments to potential "branchification"; and operationalising resolution strategies in relation to cross-border banking groups whilst ensuring financial stability in home and host Member States. <p>Assessment of potential measures to enhance cross-border integration, including:</p> <ul style="list-style-type: none"> - Further incentivising geographical diversification in prudential regulation; - Assessing whether prudential requirements (risk weighted assets (RWA) and leverage ratio) within a group are unduly inflated due to internal MREL, and if adjustments would be justified to strengthen cross-border integration. <p>Comprehensive impact assessment of the effects of gradually removing the identified prudential and non-prudential obstacles to integration, including on financial stability at the national and EU level, and on depositor and investor protection, and introduction of safeguards including a parent support mechanism and a group insolvency regime for banks.</p> <p>Negotiations on the basis of the outcome of the above and on the basis of legislative proposals accompanied by an impact assessment.</p>	<p>Implementation of the Banking Package and accumulation of MREL in line with the 2022 intermediate targets and the 2024 targets.</p> <p>Implementation of the NPL Action Plan / package and steady NPL trends.</p> <p>Implementation of Basel III in line with the ECOFIN Council conclusions.</p> <p>Build-up of the SRF to the target level.</p> <p>Implementation of all relevant AML measures in line with the AML Action Plan and the December 2019 ECOFIN Council conclusions.</p>
Continuous					

EDIS		RTSE and Financial Stability	Crisis management and enhanced cross border integration		
		Crisis Management		Enhanced Cross-border integration	
Implementation phase	<p>Completion of the build-up of national DGSs.</p> <p>Based on the outcome of the above negotiations, gradual implementation of EDIS through a hybrid model providing liquidity support within certain limits. The model will rely on existing national DGSs and include the progressive build-up of a central fund.</p> <p>Completion of implementation of remedial actions following the targeted AQR/comprehensive assessment.</p> <p>Gradual increase of loss coverage in EDIS, in line with progress on risk reduction.</p>	<p>Based on the above negotiations, incentivise banks to diversify their exposures:</p> <ul style="list-style-type: none"> - Implementation of risk based contributions (RBC) factoring in amongst other elements the concentration in sovereign exposures. - Gradual phasing-in of concentration charges on sovereign exposures taking duly into account possible effects on national debt markets and financial stability. <p>Impact assessment of a European safe portfolio.</p>	<p>Alignment of the Banking Communication to the revised framework, thus ensuring consistency and efficiency of the crisis management framework.</p> <p>Based on the outcome of the above negotiations, implementation of the identified measures, including through:</p> <ul style="list-style-type: none"> - An amendment of the legislative crisis management framework; - Targeted harmonisation of key elements of bank insolvency law in line with the outcome of the above-mentioned assessment, including a cross-border group insolvency approach and ranking of creditors to enhance enforceability; and - An effective use of DGS alternative measures in line with agreed parameters. 	<p>Based on the outcome of the above negotiations, phasing-in of measures together with binding safeguards for cross-border banking groups:</p> <ul style="list-style-type: none"> - Formalising parent support for groups in EU legislation and a group insolvency regime for banks in order to enhance legal certainty and enforceability; - Phasing out no longer justified Options and National Discretions; - Review of the governance of the resolution pillar; - Prudential and non-prudential measures to facilitate cross-border banking, including in regard of capital, liquidity and internal MREL requirements. 	<p>Twice yearly risk reduction monitoring reports from the institutions including NPLs, MREL and level 2 and level 3 assets.</p>
Long-term vision for the Banking Union	<ul style="list-style-type: none"> • The crisis management framework, including resolution and insolvency, has been reinforced so that any bank failure can be tackled efficiently and effectively, without recourse to taxpayers' money and ensuring a level playing field for all banks, while safeguarding financial stability; • The banking sector is able to operate cross-border in an integrated manner, while financial stability at national, Banking Union and EU level is ensured; • The risks in the banking sector have been significantly reduced and are monitored on a regular basis, including regarding NPLs; • Banks' balance sheets are sufficiently diversified with regard to sovereign exposures, thanks to the above-mentioned measures in RTSE and a European safe portfolio; • Full implementation of EDIS with loss coverage, reflecting the relative competences of EU and national levels in the Banking Union, to ensure the protection of covered deposits. 				