# 4 The European Deposit Insurance Scheme (EDIS)

## A plan to complete the unfinished banking union

**On 24 November, the European Commission released a legislative proposal outlining the road-map towards common European deposit protection, to be achieved by 2024. The proposal envisages three stages: i) from 2017 to 2020, a system of reinsurance, ii) progressive mutualisation through a system of co-insurance until 2024, and iii) full mutualisation with a single EDIS in 2024. This move constitutes an ambitious step in the right direction towards a fully-fledged banking union[3].**

A European system for deposit insurance has been the neglected pillar of the banking union. Although it was first included in the original version of the Four Presidents' Report in June 2012, a common EDIS was soon dropped from the official agenda. The final version of the Report endorsed in December only called for a quick adoption of the new (harmonising) Deposit Guarantee Scheme (DGS) Directive. Three years later, the Five Presidents Report[4] brought the debate back on the table, this time under a staged and more pragmatic approach.

The proposed European scheme would initially (from 2017 to 2020) be built on a system of reinsurance at European level for national schemes. However, the reinsurance would only be triggered in the event of a bank collapse once the national fund has been depleted and up to a specified limit (the minimum of 20% of its initial target level or 10 times the target level of the national DGS). From 2020 to 2024, the Commission proposes a system of co-insurance under which the pay-outs would be shared from the first euro by the European and national funds. The share of the loss to be borne by the European fund will increase at a 20% annual rate until 2024. The endgame, a fully mutualised EDIS, would be operational by 2024. After this point, EDIS would cover all losses in the event of a pay-out or a resolution procedure. Access to EDIS would be made conditional on compliance by the national DGS with the DGS Directive, including with the required funding levels. Furthermore, this scheme which would be *ex ante* funded by risk-based contributions from all banks, with a target level of 0.8% of covered deposits, and will not increase the overall costs for the banking sector. Finally, the EDIS will be managed by the Single Resolution Board and its scope will coincide with that of the SSM (so it would be mandatory for all Eurozone Member States and open to non-Eurozone countries willing to join the banking union).

## Assessment

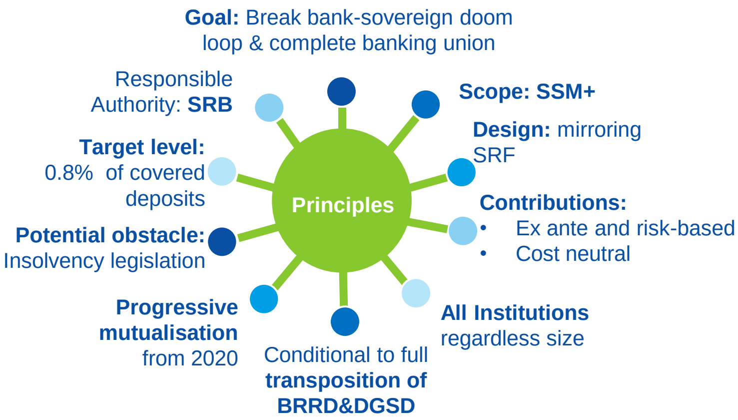
A European Deposit Insurance Scheme will strengthen the European financial safety net, overcoming certain weaknesses of the current system based on national DGSs that remains vulnerable to local systemic crises. Furthermore, it ensures that the same level of deposit protection is effectively guaranteed across countries. Ultimately, it contributes to finally ending the vicious circle between banks and sovereigns and completes the European financial architecture built up with the banking union.

Therefore, the proposal brought forward by the European Commission represents a milestone, as it lays down the steps towards truly single deposit protection in Europe by 2024. Even if the reinsurance system envisaged for the first stage does not represent a significant improvement over the current system of national DGSs in terms of mitigating the risks of financial fragmentation that arise from the vicious circle, the gradual approach proposed by the Commission is a pragmatic one and could be effective in achieving a common EDIS. Having a fully mutualised EDIS, up and running by 2024, is an ambitious and very welcome goal. Nevertheless, the main missing element in the proposal would be the establishment of a common fiscal

3: See related BBVA Research Flash: https://www.bbvaresearch.com/wp-content/uploads/2015/11/Flash_EDISProposal_2015.11.24_vf.pdf
4: See related BBVA Research Watch: https://www.bbvaresearch.com/wp-content/uploads/2015/06/Watch_5-Presidents-Report_20151.pdf

backstop to be used as a last resort. As in the case of the Single Resolution Fund, this is a politically difficult, albeit necessary, element.

Figure 4.1
**Essential principles for developing an EDIS**




Source: BBVA Research

## Next steps

The Commission's proposal is probably going to be followed by an intense political debate in the coming months, especially given the well-known German opposition to the idea of increased mutualisation of banking risks. Furthermore, there are still some areas where further work is needed, including the methodology for calculating the contributions and how to deal with the lack of harmonization of national insolvency legislations.

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