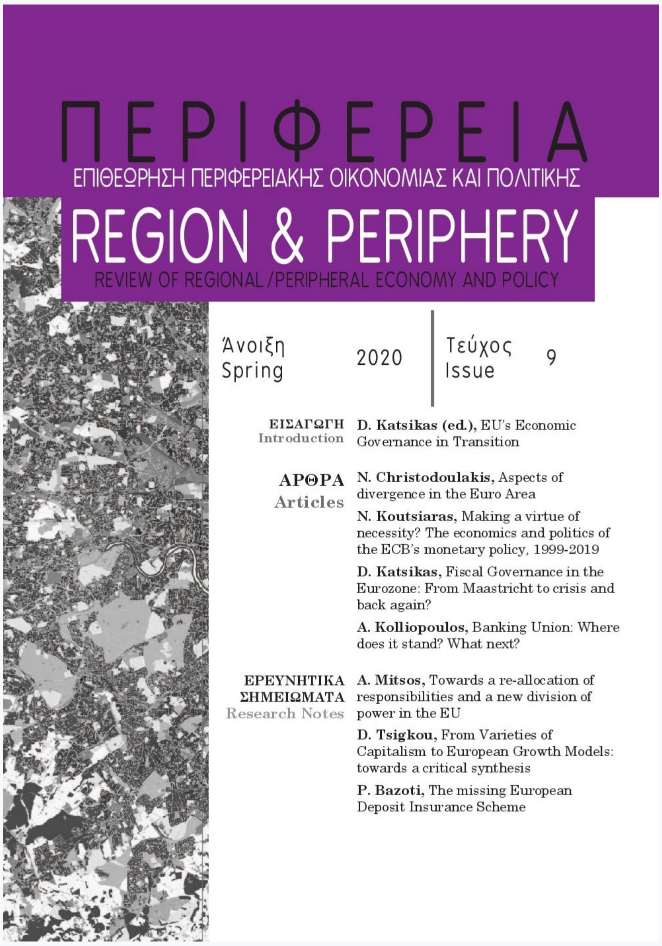
Περιφέρεια | Regional Integration: Politics, Economics, Governance

Αρ. 9 (2020)

Περιφέρεια | Region & Periphery



Η απουσία ενός Ευρωπαϊκού Συστήματος Ασφάλισης Καταθέσεων

Πέρη Μπαζώτη

doi: [10.12681/rp.23789](https://doi.org/10.12681/rp.23789)

Περιφέρεια Τεύχος 2020 (9), 151-158
Region & Periphery Issue 2020 (9), 151-158

The missing European Deposit Insurance Scheme

Pery Bazoti, *Junior Research Fellow*
Hellenic Foundation for European and Foreign Policy (ELIAMEP)

Abstract

The European Banking Union embarked as a highly ambitious project of the European Union as a response to the significant flaws and weaknesses in the original architecture of the European Monetary Union that became apparent during the economic crisis. However, the establishment of a single European banking system has stumbled upon the creation of a common deposit insurance scheme that could safeguard depositors and create a more stable financial framework in the euro area.

The European Deposit Insurance Scheme (EDIS) was firstly introduced by the European Commission in 2015. As a bold proposal that comprises wide risk mutualization among the euro area member states, it has spurred a vivid discussion in the European public speech and many proposals have been made since then altering its original planning in an effort to tackle the moral hazard concerns that have risen. The present article, after discussing the reasons that keep obstructing EDIS, presents these suggestions that move around, primarily, the role of the national deposit guarantee schemes. However, as highlighted in the article, before moving to any alterations on the structure and role of a proposed common deposit insurance scheme, significant risk minimization on behalf of the national banking systems, must precede by limiting the sovereign exposures of banks and the size of the Non-Performing Loans. Such steps of risk minimization are critical for addressing concerns and the political unwillingness demonstrated by several European countries in moving forward towards deeper integration.

KEY-WORDS: European Banking Union, European Deposit Insurance Scheme, risk mutualization, moral hazard.

Η απουσία ενός Ευρωπαϊκού Συστήματος Ασφάλισης Καταθέσεων

Πέρη Μπαζώτη, *Βοηθός Ερευνήτρια*
Ελληνικό Ίδρυμα Ευρωπαϊκής και Εξωτερικής Πολιτικής (ΕΛΙΑΜΕΠ)

Περίληψη

Η Ευρωπαϊκή Τραπεζική Ένωση αποτελεί ένα από τα πλέον φιλόδοξα σχέδια ως απάντηση στις σημαντικές αδυναμίες στο οικοδόμημα της Ευρωπαϊκής Νομισματικής Ένωσης οι οποίες έγιναν προφανείς κατά την οικονομική κρίση. Ωστόσο, η εγκαθίδρυση ενός ενιαίου Ευρωπαϊκού τραπεζικού συστήματος δεν έχει ακόμα καταστεί δυνατή λόγω της έλλειψης ενός κοινού συστήματος προστασίας των καταθέσεων. Ένα τέτοιο σύστημα θα ήταν ικανό να προσφέρει ασφάλεια στους καταθέτες και να δημιουργήσει ένα πιο σταθερό χρηματοοικονομικό πλαίσιο στην Ευρωζώνη.

Το Ευρωπαϊκό Σύστημα Ασφάλισης Καταθέσεων (ΕΣΑΚ) προτάθηκε για πρώτη φορά το 2015 από την Ευρωπαϊκή Επιτροπή ως ένα σύστημα που περιλαμβάνει ευρύ διαμοιρασμό κινδύνου μεταξύ των κρατών μελών. Έκτοτε, έχουν κατατεθεί στον ευρωπαϊκό δημόσιο διάλογο, αρκετές αντιπροτάσεις που τροποποιούν τον αρχικό σχεδιασμό σε μια προσπάθεια να αντιμετωπιστούν οι ανησυχίες περί «ηθικού κινδύνου» που έχουν προκύψει. Το παρών άρθρο συζητά τους λόγους πάνω στους οποίους εδράζεται ο «ηθικός κίνδυνος» και αποτρέπουν την ολοκλήρωση του ΕΣΑΚ και παρουσιάζει τις εναλλακτικές προτάσεις οι οποίες αφορούν κυρίως το ρόλο των εθνικών αρχών ασφάλισης καταθέσεων. Ωστόσο, όπως υπογραμμίζεται στο άρθρο, είναι ζωτικής σημασίας να προηγηθεί της εγκαθίδρυσης οποιουδήποτε σχετικού συστήματος, σημαντική μείωση κινδύνου μέσω της ελάττωσης της έκθεσης των τραπεζών στα εγχώρια κρατικά χρέη και της μείωσης των Μη Εξυπηρετούμενων δανείων. Αυτό θα συμβάλλει σημαντικά στο να περιοριστούν οι φόβοι και οι πολιτικές ασυμφωνίες μεταξύ των ευρωπαϊκών κρατών σχετικά με τη βαθύτερη οικονομική ολοκλήρωση που επιχειρείται μετά την οικονομική κρίση.

ΛΕΞΕΙΣ-ΚΛΕΙΔΙΑ: Τραπεζική Ένωση, Ευρωπαϊκό Σύστημα Ασφάλισης Καταθέσεων, αμοιβαιοποίηση κινδύνου, ηθικός κίνδυνος.

1. Introduction

The European Union embarked on the highly ambitious plan of establishing a Banking Union back in 2012, when the severe economic crisis highlighted in the most apparent way the need for reforms in the original design of the European Monetary Union. The introduction of such an institutional framework was intended to break the close financial links between banks and their own sovereigns and promote the creation of a single banking market. However, after eight years, the European Banking Union is still not completed and neither of the stated objectives has been achieved.

Despite the progress achieved so far -the creation and operation of the Single Supervisory Mechanism (SSM) and of the Single Resolution Mechanism (SRM)- the European Deposit Insurance Scheme (EDIS), which is crucial for the effective operation of the Banking Union, is far from completed.

A single deposit insurance scheme -meaning a common and uniform guarantee for bank depositors across the monetary union- will provide a greater sense of security to depositors in the weaker economies of the Eurozone by disconnecting banks from the national deposit insurance authorities that constitute today banks' backstop. The relevant legislative proposal was published by the European Commission in 2015;[1] EDIS is supposed to be completed in three stages by 2024: re-insurance, co-insurance and full direct insurance. The final stage will consist of full risk mutualization where the losses and liquidity needs of the participating national deposit guarantee schemes will be fully covered by a European Deposit Fund (EDF) which will be based on banks' risk-based contributions. As expected, the bold proposal of a mechanism that comprises such wide risk sharing has triggered vivid debates in the European public discourse.

This short paper reviews the most prominent proposals that have been made towards the completion of EDIS. All of them seek to effectively address two major obstacles: the doom loop and the moral hazard.

2. The "doom-loop" and the moral hazard issue

The first and most important goal not only of EDIS, but of the banking union as a whole, is to disconnect the banking sector from the public finances, breaking thus the so-called "doom-loop" that proved to be a major source of instabilities. In the years prior to the crisis capital inflows increased within the euro area, mostly due to the introduction of the common currency. This fueled large imbalances in some countries' fiscal and current accounts making them susceptible to crises. These imbalances were financed by domestic banks, which ended up being the biggest holder of the public debt of their own governments, rendering thus the state the greatest debtor of many European banks. Counting in the fact that the task of bank supervision was entrusted to the national authorities, a vicious circle was created whereby the banking system and public finances were intertwined in a precarious way. Fears on the solvency of the former were translated in fears on the solvency of the latter and vice versa, making them both fragile. In this negative feedback process, sovereigns are responsible to bail-out their national banks, something that has a direct impact on the national debt level and an indirect impact on the yields of the sovereign bonds as their prices fall. In turn, this will lead to a deterioration of the banks' balance sheets due to their high exposure to sovereign debt. The cases of Portugal, Spain, Ireland and Greece are indicative of the doom-loop's detrimental results.[2] Elevating main responsibilities of the banking sector, such as supervision and resolution, from the national to the central, supranational level, gives room to harmonized practices within a so far fragmented system, where the weight for banks' support during the crisis was mainly carried by European taxpayers.

Although banking supervision has now moved to the European level, which allows for the establishment of more sound practices regarding banks' portfolios, the national deposit insurance authorities still have a strong role as banks' backstop and the 'doom loop' between banks and sovereigns still exists. This not only affects the quality of bank supervision but it also creates the conditions for contagion from the banking to the public sector. This strong link between banks and sovereigns was a key source of the instabilities that seriously aggravated the Eurozone debt crisis, since European banks remained exposed to the debt of their own governments instead of diversifying their sovereign exposures within a currency risk-free area. Despite the fact that this tendency seemed halt prior to 2008, during the crisis it was revived especially in countries with evident debt problems (Véron, 2017) that were also more likely to face financing difficulties. Today, and after the European leaders have repeatedly highlighted the importance of breaking this 'doom-loop', the vicious circle between banks and sovereigns seems to be still strong, although slowly declining from 2017. Looking at the EBA's latest EU-wide transparency exercises, banks' domestic sovereign exposures stood at 46% in June 2018 a number that fell to 42% a year later. Almost 40% of these exposures respond to 5-year maturity or more, raising thus the risk stemming from interest rate fluctuations. It is evident that the "home-bias problem" is present, triggering fears about the resiliency of banks, especially in high-debt countries such as Italy.

It is then no wonder that the EDIS has not proceeded yet. Member states with more robust economies and healthy bank sectors, are unwilling to share the same risk with more "fragile" countries that saw their banking sectors on the brink of collapse due to the sovereign crisis and sought external financial assistance. Their unwillingness is rooted in concerns of moral hazard, and the perception that certain sovereigns will seek to ensure preferential funding from their domestic banks under a regime of supranational deposit security, which would facilitate the fiscal deviations observed in some countries before the crisis.

One more critical point to address in regard to moral hazard are the Non-Performing Loans (NPLs) that in the aftermath of the financial crisis have become a major concern for policymakers and supervisors. Although total NPLs have decreased by almost 50% since 2015, their volume still remains alarmingly high in some member states. As such, according to some, the process of "cleaning" banks' balance sheets should be continued in order to achieve risk minimization before moving on to potential risk-sharing through the full participation in the EDIS mechanism.

3. Different proposals for an effective and moral hazard-free deposit insurance system

The diverging views on the structure and role of EDIS reflect a much deeper division among euro area members and mainly between Germany and France, as the two largest member states. The former, along with states such as Finland and the Netherlands, have showed unwillingness in promoting further risk-mutualization based on the notion that most failings of the euro area stem from inadequate national fiscal policies that should be addressed with a stricter regulatory framework. On the other hand, France, and states mostly from the European periphery such as Italy, have over time called for deeper integration and stronger governance and accountability at the EU level. Attempting to reconcile these two positions has brought the completion of the banking union to a deadlock.

However, this is a false dichotomy, which oversees the fact that both domestic fiscal discipline by governments and risk sharing among the euro area member states of a monetary union should be complementary elements of the same architecture and not substitutive, since the lack of the one undermines the effectiveness of the other.

In an effort to break this deadlock several proposals have been made on the way that EDIS development should be altered and proceed. An alternate regulatory regime has been proposed by Véron (2017) based on sovereign concentration charges. It is suggested that euro area banks' sovereign exposures, weighted by coefficients (the concentration charges) should be included in banks' risk-based capital ratio as a second component alongside with the total risk weighted-assets of each bank. The coefficients should increase accordingly to the exposure ratio, beginning from zero, with an "exemption threshold" standing at 33%. Such a scheme can give banks incentives to diversify their portfolios, within the euro area, and limit their sovereign exposure in order to stay above the exemption threshold guaranteeing market discipline and balanced risk-sharing (Véron 2017).

Bénassy-Quéré et al. (2018) suggest keeping national compartments of EDIS under a single institutional framework as the first ones to bear any potential losses since the sources of risk remain national. Insurance then should be unconditional and full for all member states, building up depositors' trust to the system, a crucial element for the success of any deposit insurance system. This scheme of re-insurance by the national deposit guarantee authorities was also put forward by Gros (2015) as a long-run solution, funded by the Deposit Insurance Fund that is meant to be established according to the European Commission's proposal. In both proposals, authors suggest that the ESM should act as EDIS' fiscal backstop as is the case for the SRM. On the contrary, Schnabel and Véron (2018) despite their suggestion that national deposit insurance schemes should remain functional, propose that they are phased out after a transition period and replaced by a European single-authority system, the Single Resolution Board. Any direct payouts to individuals would be made by the national authorities which will remain in place for implementation purposes. While Gros' (2015) planning maintains autonomous decision making, entrusted to the national authorities, Schnabel and Véron (2018) argue that responsibility should be at a central level, where country-blind protection is guaranteed for all banks, in order to build depositors' trust.

In all three proposals deposit insurance fees for banks are differentiated in line with their risk exposure. Preserving national deposit guarantee schemes keeps a significant degree of accountability at the national level easing thus fear about moral hazard under a full EDIS. Schoenmaker (2018) however, treats this arrangement as a potentially destabilizing factor of the national banking systems on the notion that during a recession, the surviving banks have to refill the national scheme through future contributions. As a result, the credit function of banks is compromised as well due to the credit crunch they experience. Addressing the justified concerns on moral hazard by limiting banks' exposure on sovereign debt will better create the proper circumstances within which deeper risk sharing can arise.

4. Future prospects of EDIS and the completion of the banking union

The completion of EDIS remains a politically charged issue in the euro area. Keeping the national authorities involved and moving gradually towards a fully supranational deposit insurance guarantee mechanism could balance out the lack of political willingness due to moral hazard issues, but only temporarily as its effectiveness will be constantly under question. So far, the building of a more resilient European banking sector has stumbled upon the lack of political will and compromise grounded on different national interests on one hand and upon the fragility of national banking sectors and the fear of contagion on the other. At the same time, the flaws in the original design of the monetary union and the poor effort to manage the debt crisis and deal with insolvent countries have spurred political controversies and have given rise to Eurosceptic and populist parties in many member states.

In this landscape of political fragmentation, consensus is a challenging task. This is evident even in the recent EU summits where budget negotiations did not bear any results indicating the difficulty of bridging all individual interests. The funding gap that the Brexit leaves constitutes a friction point as compromise should be achieved between the member states that want to maintain the rebates on their contributions and the need to restrain spending in order to fill the Brexit gap. Once more it is laid bare that economic and monetary issues, especially those that require extensive consensus, are not free of political sensitivities especially in the aftermath of a severe financial crisis.

The choice of Christine Lagarde as the new ECB president has also been discussed as a potential moving force towards deeper integration and the completion of the banking union. Her time as the Fund's managing director during times of economic turmoil equipped her with critical leadership skills and strong relationships with her German counterparts (Wolff and Christie 2019). As a result, and since the main obstacles that hold behind the wider reform agenda are of political nature, Lagarde can use this "space" provided to her to make a shift on economic policy and pursue the consent on the completion of the banking union.

On the other hand, recent statements of the German Finance Minister Olaf Scholz have reignited the hopes that maybe a full European Banking Union is not far. In light of the UK's withdrawal from the European Union, Scholz highlighted the importance of a complete banking union as a shield against external shocks alongside with the necessary risk sharing through a common European deposit insurance mechanism. Counting in the fact that the UK was the financial centre of the EU, further integration among the Eurozone member states could enhance the Union's international financial role. However, Scholz noted as an indispensable precondition that in such a case all sovereign debt of the participating banks should be risk-free. Additionally, he proposed capital requirements for banks that buy euro area governments' bonds, a suggestion that prompted Italy's reaction as it would be harmful for the competitiveness of its banks.

German proposals mean that a wider context of reforms, regarding the banks' balance sheets, should be established before Germany can agree to proceed to some form of risk sharing. As a result, and although the willingness to move forward has been expressed by the EU's net contributor, it will not do so until specific and strict requirements have been met, and risk sharing is realised under its own conditions.

Notes

1. COM/2015/0586 final- 2015/0270 (COD).
2. Portugal received in 2011 from the EU and the IMF financial aid of up to €78 billion for fiscal financing needs and support to the banking system. Simi-

larly, Spain in 2012 was provided financial aid of up to €100 billion for the recapitalization of financial institutions, while Ireland received a package of up to €35 billion for the support of the banking system. Greece had to recapitalize its banking system twice. In 2012 all four systemic banks received the total amount of €18 billion and in 2015 two of them received the total amount of €5.4 billion.

Bibliographical References

Bénassy-Quéré A., M. Brunnermeier, H. Enderlein, E. Farhi, M. Fratzscher, C. Fuest, P.-O. Gourinchas, P. Martin, J. Pisani- Ferry, H. Rey, I. Schnabel, N. Véron, B. Weder di Mauro and J. Zettelmeyer (2018), "Reconciling risk sharing with market discipline: A constructive approach to euro area reform", *CEPR Policy Insight* No. 91.

Gros D. (2015), "Completing the Banking Union: Deposit Insurance", *CEPS Policy Brief* No. 335.

European Banking Authority (2019), *Risk Assessment of the European Banking System*. Luxembourg: Publications Office of the European Union.

European Banking Authority (2018), *Risk Assessment of the European Banking System*. Luxembourg: Publications Office of the European Union.

Schnabel I. and N. Véron (2018), Breaking the stalemate on European deposit insurance. Bruegel, 7 April, https://www.bruegel.org/2018/03/breaking-the-stalemate-on-european-deposit-insurance/

Schoenmaker D. (2018), Building a stable European Deposit Insurance Scheme. VoxEU, 17 April, https://voxeu.org/article/building-stable-european-deposit-insurance-scheme

Véron N. (2017), Sovereign Concentration Charges: A New Regime or Banks' Sovereign Exposures. European Parliament, Directorate-General for Internal Policies.

Wolff G.B. and R. Christie (2019), Politics not policy will help Lagarde save the Eurozone. Bruegel, 4 November, https://www.bruegel.org/2019/11/politics-not-policy-will-help-lagarde-save-the-eurozone/