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REPORT

From:	Presidency
To:	Delegations
Subject:	European Deposit Insurance Scheme *- Presidency progress report*

PRESIDENCY PROGRESS REPORT ON WORK IN THE AHWP ON STRENGTHENING THE BANKING UNION

1. INTRODUCTION

Pursuant to the Council Conclusions on the Roadmap to complete the Banking Union as adopted by the Council on 17 June 2016 (doc. 10460/16, 'June 2016 Roadmap'), and building upon the Progress Reports prepared respectively by the Dutch Presidency (doc. 10036/16), the Slovak Presidency (doc. 14841/16), the Maltese Presidency (doc. 9484/17) and the Estonian Presidency (doc.14808/17), the Council continued to work constructively at a technical level on the Commission proposal for the establishment of a European Deposit Insurance Scheme (EDIS), while monitoring progress on risk reduction and other measures outlined in the June 2016 Roadmap, and in particular:

- progress on discussions in the Financial Services Working Party on the package of proposals for risk reduction measures, including amendments to Regulation (EU) No 575/2013 (the Capital Requirements Regulation or CRR), Directive 2013/36/EU (the Capital Requirements Directive or CRD), to Directive 2014/59/EU (the Bank Recovery and Resolution Directive or BRRD), and to Regulation (EU) No 806/2014 (the Single Resolution Mechanism Regulation or SRMR);

- progress on measures to tackle non-performing loans (NPL) in Europe;

- on-going work of the TFCA related to the backstop for the Single Resolution Fund.

The Ad Hoc Working Party on the Strengthening of the Banking Union (the 'AHWP'), established on 13 January 2016 (doc. 5006/16), met 4 times under the Bulgarian Presidency (on 12 January, 15 March, 04 May and 07 June). The discussions related to the EDIS proposal were of a technical nature as political discussions on EDIS will only start after sufficient progress has been made on risk reduction measures in line with the June 2016 Council Conclusions.

This Progress Report has been prepared under the responsibility of the Bulgarian Presidency having regard to the opinions expressed by delegations and to address various calls for a written record of progress achieved by the Presidency on EDIS and measures to strengthen the Banking Union. This report may not be relied upon as binding on the delegations and, instead, should be viewed as the Presidency's assessment of the outcome of the discussions held at those meetings. This report is intended to provide continuity and facilitate the task of the incoming Presidency.

EDIS PROPOSAL

2.1. GENERAL CONSIDERATIONS

The Presidency followed up on the work of the previous Dutch, Slovak, Maltese and Estonian Presidencies with the aim of progressing to the extent possible on the pending technical elements, and where necessary also revisiting and building upon past discussions.

The Bulgarian Presidency proposed to thoroughly explore the technical issues linked to different alternatives for the initial model of EDIS, including i. the technical aspects of the ideas put forward in the October 2017 Communication of the Commission to introduce EDIS in a more gradual manner, starting with a re-insurance phase and ii. as suggested by some Member States, liquidity support based on mandatory lending between national Deposit Guarantee Schemes (DGS). **The proposed approach for the continuation of the work of the AHWP received an overall support under the condition that the participation in the discussion of the possible elements of the alternatives for the initial model of EDIS would not be interpreted as Member States support for any of the alternatives and related topics discussed, and that the technical work should in no way pre-empt the future negotiations at political level but should rather provide the necessary basis for informed political discussion.** In this respect many delegations stressed that the discussion shouldn't lose the overarching objective of establishing a fully-fledged EDIS.

Topics related to the risk-based contributions, the way of functioning of the IPS and the possibility to use DIF for alternative measures under article 11 (6) DGSD were also included in the agenda of the AHWP under the Bulgarian Presidency. In this respect, the Presidency considered it beneficial to, wherever possible, undertake discussions on the basis of experiences and input from other relevant institutions and organisations, including the National Association of German Cooperative Banks (on institutional protection schemes (IPS)), the Single Resolution Board (SRB) (on alternative measures) and the European Central Bank (ECB) (on quantitative assessment related to the adequacy of EDIS size and possible country cross-subsidisation).

In parallel with the above, the Bulgarian Presidency monitored the progress achieved on other risk reduction and risk sharing measures.

2.2. MAIN ISSUES

2.2.1. Technical elements of explored alternatives

The Presidency focused the discussions on several selected technical issues related to the two alternatives for the initial model of EDIS outlined above - re-insurance based on the ideas expressed in the Commission Communication of October 2017 and mandatory lending:

- Funding possibilities: how could the funding be structured under the two options considered;
- Entry requirements;
- EDIS governance and accordingly role of national DGSs
- Accession to and departure from EDIS;
- How would these two models cater for various national options and discretions such as Temporary High Balances (THBs).

- **Re-insurance phase**

The Commission presented the Banking Union Communication already under the Estonian Presidency. The Bulgarian Presidency proposed to pursue the technical discussion of EDIS starting with the re-insurance phase. The broad majority of delegations agreed with the Presidency. In this context, one delegation stressed that expressions like “stages” or “phases” are misleading and should be avoided given that the design of EDIS has not been decided yet by the Council.

Against this background, the Commission prepared a non-paper on the re-insurance phase along the ideas set out in the Banking Union Communication to discuss possible features of the first phase in more detail. This was followed by a questionnaire for written comments and a second non-paper with more concrete options. The topics tackled were the following:

- nature of the liquidity support.
- possible sources of financing and a repayment plan, including priority of EDIS claim,
- access to EDIS coverage,
- governance issues and the role of DGSs,
- accession and departure to/from EDIS and
- treatment of options and national discretions.

In its non-papers, the Commission specified the nature of the liquidity support provided by EDIS in its first phase (re-insurance phase). More specifically, the national DGSs would be required to reimburse the liquidity provided and therefore all potential losses stemming from pay-outs would be borne entirely at the national level. Ultimately, DGSs could recoup the losses from the recovery of the insolvency estate of the failed bank and from ex-post contributions collected from the banks affiliated to them. The Commission clarified that such a re-insurance design would not involve any mutualisation and should not be made conditional upon additional requirements going beyond the compliance with the EDIS regulation and the DGSD. A few delegations questioned the assessment of the Commission that the re-insurance phase, based on liquidity support only, would not involve risk mutualisation. Some delegations stressed that any form of EDIS, including re-insurance, would require prior sufficient risk reduction in accordance with the Banking Union Roadmap of June 2016.

The Commission presented two main sources of financing – ex-ante contributions from banks and short-term funding from capital markets.

First, EDIS would raise ex-ante contributions from banks. As regards the modalities of collecting contributions, the majority of Member States favoured the collection by national DGSs with subsequent transfer to the central level, similar to the model used for the Single Resolution Fund. One Member State, however, expressed concerns that this option could undermine the legal basis of EDIS according to the Commission's proposal (Article 114 TFEU). In the opinion of this Member State, DGS should remain 'executive arms' of the Board with respect to collection of contributions to the DIF and should just invoice on behalf of the SRB.

Although many Member States supported a national reference measure for risk-based contributions and a few explicitly supported a Banking Union reference, some delegations on both sides were open to discussing a hybrid measure (mix of national and BU). In this context, concrete funding arrangements such as a funding path would need to be further discussed in order to define the amount of contributions to be collected from banks during the re-insurance phase. As regards the funding path for the DIF, Member States were split: while several supported as a starting point for further discussions the example in the non-paper (with 50% of funds at BU level), several others favoured a lower share or had no formal position at this stage or stressed that the funding path for the DIF is a highly political issue and that in any case, a significant share of the funding should remain in the national DGS.

Second, the SRB could on behalf of the DIF borrow on the capital markets to obtain short-term funding so as to provide liquidity assistance to DGSs in need. In this context, the Commission compared such mechanism with the funding from third-parties in place in the SRF system. Few delegations opposed the short-term funding since this would imply risk mutualisation. However, many Member States agreed with recourse to short-term market financing of EDIS, among which two stressed that this option should be used only in exceptional cases as a last resort in a severe crisis scenario.

The non-papers of the Commission suggested a repayment plan to ensure full repayment of any liquidity support provided by EDIS. This arrangement would include a number of elements, such as the determination of a repayment period and instalments, the expected amount to be recovered from the insolvency estate of the failed bank, a refunding path for the DGS concerned to return to its target level and an obligation that any reimbursement to EDIS has priority over the refunding of the DGS, applicable also to transfers of proceeds from the insolvency estate ("priority of EDIS claims"). Overall, delegations were positive regarding the introduction of a repayment plan as a good starting point for further discussions. As regards the repayment modalities, two Member States called for super-priority of DIF claims while others called for caution and consistency with creditor hierarchy aspects in national insolvency regimes. Few delegations suggested charging an interest rate on the liquidity provided to (further) encourage the DGSs to repay the liquidity support in full, while others were in favour of not charging interest at all.

The Commission referred to the SRF system and argued that this is interest free. In this context, some Member States pointed out that according to the Intergovernmental Agreement (IGA) for the SRF, the SRB shall, in its decision on temporary transfer, specify the rate of interest and other conditions concerning the transfer. According to the Commission, liquidity support by EDIS should be interest free because the liquidity would be provided from a pool of money to which the same banks, whose DGS is about to receive liquidity support, already have contributed (via ex ante risk-based contributions). Otherwise, banks (via their DGSs) would be asked to pay interests on funds they initially provided. In addition, risk-based contributions and the repayment plan itself are, in the Commission's view, already strong incentives to mirror the risk of the banking sector and to ensure the pay back of the liquidity support provided by EDIS in the re-insurance phase. While none of the two options discussed gathered a majority, many Member States showed openness to the option of imposing interest only if repayment delays occur. One Member State pointed out that should the re-insurance phase entail no risk or cost-sharing, the loss of revenue when drawing funds from other DGS or the costs incurred by the EDIS when having to recourse to the 3rd party financing should be compensated for by the beneficiary DGS.

Under the 2015 EDIS proposal, in order for the DGSs to get access to liquidity coverage from EDIS, Member States need to comply with the DGSD and the provisions set out in the EDIS regulation, in particular on the funding path (still to be defined for the suggested re-insurance phase). There was a broad support for the outlined conditions to access liquidity coverage from EDIS under the suggested re-insurance phase. Some, however, asked for stronger conditionality. In this context, one delegation reiterated its call for prior sufficient risk reduction.

From a governance perspective, including the role of the DGS in the EDIS system, the Commission referred to a number of provisions set out in the 2015 proposal that could continue to apply to the re-insurance phase (e.g. notification requirements of the DGS in case of a pay-out according to Art. 41 l). The Commission also pointed to a non-paper prepared by the Estonian Presidency, which elaborates on governance provisions and the role of DGS in very detail. The delegations had different views on governance aspects. For some, the discussion was premature due to the governance being dependent on the final decision on the EDIS design.

Other delegations underlined the importance of national DGS. According to one delegation, DGSs should be fully accountable for pay-out procedures, the recovery from insolvency proceedings and the collection of contributions. One delegation underlined the role of the National Designated Authority. Another delegation however stressed the role of the SRB, which should be the preferred decision making body.

The Commission also addressed in its non-papers for discussion the issue of the accession to EDIS of non-Banking Union Member States and the transfer of financial means to the central fund along the lines of suggestions made by some delegations under previous Presidencies. A possible solution could be that each newly participating DGS would transfer an amount equal to the share of EDIS funds to total covered deposits in all Member States at the time of accession. Risk-based adjustments would be reflected after accession of the new Member State following the procedure set out in Art. 74c (5) of the 2015 proposal, i.e. the calculation of the contributions in the re-insurance phase would take into account the degree of risk of each bank relative to all other banks affiliated to the same DGS.

As regards the departure of a non-Euro Area Member State and the transfer of funds to the departing DGS, the Commission referred to Art. 4(3) of the 2015 proposal. Accordingly, the transferred amount must not exceed the amount necessary for the available financial means of the DGS to reach two-thirds of its target level. Several delegations considered the suggested approach on accession and departure as a good basis for further discussion. According to some delegations, equal treatment between Banking Union Member States and the new entrants was key. Other delegations asked for more clarification, in particular on the concrete funding path and the methodology for calculating risk-based contributions. Also, one delegation suggested to take into account specific situations under which accession (and departure) of new entrants could be possible (e.g. a pay-out event prior to accession). Another delegation proposed to establish a “cooling-off period” to prevent non-euro area DGS from leaving EDIS in a too short time-frame on opportunistic grounds. Some delegations also called for a cost neutrality for existing members. One delegation stressed that the issue of accession and departure of non-Banking Union Member States to/from EDIS should be subject to an Intergovernmental Agreement (IGA).

Finally, based on the Commission's non-paper, Member States also discussed how to treat certain options and national discretions (ONDs), notably Temporary High Balances (THBs), which have the potential to increase the exposure to the central fund. The Commission recognised that if EDIS acted only as a liquidity provider under the suggested re-insurance phase, the liquidity provision from EDIS to a DGS in need could potentially extend to cover also THBs at national level. Delegations were split between those favouring THBs coverage in the reinsurance phase, and those asking for a general exclusion or harmonisation of ONDs. The ONDs such as failure prevention measures and alternative measures according to Art.11 (3) and (6) DGSD were not subject to analysis in the Commission's non-papers, as they are currently subject to a separate discussion in the Council AHWP.

Among the other issues raised, one Member State asked for a discussion of the Asset Quality Review in one of the forthcoming AHWP meetings. Another delegation pointed out that the EDIS coverage is highly political and questioned the full liquidity coverage at the end of the third year of the reinsurance phase as it deviates from the Communication of the Commission where 100% liquidity coverage is only provided for in a possible second phase, conditional on further risk reduction requirements. Lastly, few Member States called for full visibility on EDIS phases before discussing the modifications needed to the 2015 EDIS proposal.

- **Mandatory lending**

The Bulgarian Presidency presented for discussion non-papers outlining the mandatory lending as a possible alternative to a re-insurance phase ideas set out in the Banking Union Communication. Similarly to the discussion on the re-insurance phase based on the Banking Union Communication, the technical elements of the following main topics were covered: sources of financing, access to EDIS coverage, EDIS governance and role of DGS, accession and departure of non-Banking Union Member States to/from EDIS, and national options and discretions.

Similar to the possible design of the re-insurance phase based on the Banking Union Communication, as outlined above, through mandatory lending only liquidity but no loss coverage would be provided to a national DGS in need. National DGSs would first exhaust their funds before they could rely on liquidity support provided by other DGSs within the Banking Union. Other DGSs would lend to the DGS in need pro-rata to the total amount of their covered deposits. These amounts would be considered assets from accounting point of view and would count for the DGS target level. The amounts lent should also count in case of a subsequent pay-out event within the jurisdiction of a lending DGS for the purpose of determining whether this DGS has exhausted its available means for access to liquidity support. These funds should quickly be available before the DGS would have to borrow from other sources.

Such liquidity support through mandatory lending arrangement should not lead to any loss-sharing or moral hazard risk. The borrowing DGS would be required to reimburse the amounts borrowed within a reasonable period of time and therefore all potential losses stemming from pay-outs would be borne entirely at the national level. Ultimately, DGSs could recoup the losses from the recovery in insolvency proceedings and from contributions paid by the banks affiliated to them. One Member State expressed the view that also mandatory lending implies elements of risk sharing (repayment risk) and that therefore prior sufficient risk reduction would be required.

Depending on the funding arrangements, the Presidency outlined two basic options for the mandatory lending arrangements: mandatory lending by a network of national DGSs (as outlined in the 2010 Commission proposal for a Directive on Deposit Guarantee Schemes) and mandatory lending through a central body. The discussion in the AHWP followed by the written comments of the Member States showed that the more feasible and operationally sounder option to be further discussed is mandatory lending through a central body where the SRB would play a coordinating, process managing and monitoring role.

Two types of risks were identified in the Presidency non-paper: the risk stemming from the inability or ‘unwillingness’ of the national DGS to repay the amounts borrowed by the agreed deadline and the risk that the creditor DGSs may be hesitant to lend, especially in times of widespread pay-out events within several or all Banking Union members .

Possible safeguards to ensure timely repayment of borrowed amounts were discussed, including setting proper and realistic repayment plans, payment of interest, obligation of the borrowing DGS to pass on to the lending DGS recoveries from insolvency proceedings and contributions collected from banks thus ensuring priority of repayment of the liquidity support over other DGS commitments. However, given that these issues were subject to a more detailed discussion under the re-insurance alternative and they do not differ depending on the type of financing of the liquidity support, a separate discussion was not necessary at this stage.

The consequences of preceding pay-out events should be taken into account for both borrowing and lending DGSs: when determining whether the borrowing DGS has exhausted its financial means and when calculating the amount to be lent by each DGS. Further work is needed to specify the conditions and procedures in this respect.

In order to ensure provision of liquidity support to a national DGS in need within a very short time frame (7 working days), there should be reliable sources of financing and mandatory lending arrangements that should not depend on the willingness of any given DGS to lend at the time of the pay-out event. Sound and robust funding arrangements are crucial for the effectiveness of deposit insurance and the preservation of depositors' confidence and financial stability.

In this respect, the Presidency presented a non-paper providing further technical details and safeguards for the two alternatives of the mandatory lending through a central body – 1) where financial resources to be used for provision of liquidity support would be transferred to a centralised fund and managed by SRB while remaining part of the available financial means of national DGSs; and 2) where contributions would be collected, kept and managed at national level but national DGS would be engaged with clear lending commitment arrangements to ensure timely provision of necessary resources for liquidity support of the borrowing DGS.

Most Member States agreed with the suggestion of the Presidency that the amount of liquidity support funded through mandatory lending should be capped to avoid putting creditor DGSs' capacity to withstand a future possible pay-out event in their jurisdictions at risk. As to the parameters of such cap, further work is necessary to analyse which cap would be most adequate. However, some Member States expressed the view that it would be difficult to set a cap ex-ante without taking into account the liquidity shortfall of the DGS in need.

Member States expressed divergent views as regards the necessity of an Intergovernmental Agreement (IGA) between Banking Union members along with EDIS Regulation as a legal ground for mandatory lending. According to several Member States, such an agreement would be necessary as mandatory lending would create commitment for the Member States to transfer existing national resources. Others considered that EDIS Regulation should remain the core legal basis and Article 114 of the TFEU gives a sufficient legal ground for any alternative EDIS model.

On the role of SRB and national DGS, outlined in the two non-papers of the Presidency, Member States generally agreed regarding the need for crucial role of national DGS, which will remain fully responsible for the timely pay-out and will bear all losses. National DGS would also keep on collecting contributions nationally. SRB would need coordinating and monitoring powers to provide the liquidity support on time and ensure its timely reimbursement. Strong cooperation mechanisms would thus be necessary to overcome operational risks in time of crisis. Some Member States were sceptical about possible powers of the SRB related to recovery of amounts paid from national insolvency proceedings.

The powers of the SRB to address deficiencies in the functioning of the national DGS, including possibility for peer reviews suggested by the Presidency, did not gather sufficient support. Further work is necessary on both cooperation mechanism between the SRB and national DGSs, and with respect to the powers of the SRB to address deficiencies.

As regards access to EDIS coverage, the Presidency suggested that the DGS should be able to access the liquidity coverage from EDIS under the following conditions: compliance with the DGSD and other relevant laws and with a funding path to be defined in the EDIS Regulation. The Presidency sees merit in further technical work to examine powers and procedures for derogation from the funding path for duly justified reasons, e.g. in case of a pay-out event at national level.

In the view of the Presidency, under a mandatory lending alternative, the issue of accession and departure of non-Banking Union Member States is less relevant. The DGS from the Member State joining the Banking Union on the basis of close cooperation or following accession to the Eurozone would have to comply with DGSD and the funding path provided in the EDIS regulation.

The Commission highlighted possible drawbacks of the mandatory lending schemes presented in the non-paper. First, according to the Commission, it would be essential to establish a pre-funded central fund that would be readily available to ensure prompt reimbursement of depositors´ claims. Also, the Commission expressed the view that the level of funding contemplated in the non-paper would be insufficient for dealing with a banking crisis episode. Second, according to the Commission, the scheme would be subject to serious operational uncertainties in times of financial stress, which could undermine the credibility of the system and possibly dent depositor confidence, in particular due to potential hesitance of creditor DGS to lend, possible cross litigations, and coordination challenges in the case of multiple pay-out events in different Member States.

Many Member States also expressed doubts about the complicated organisational features and management of the system, as well as to the operational difficulties that the functioning of such system would raise. These Member States only engaged initially in exploring mandatory lending at a purely technical level as a potential option in comparison with the re-insurance but considered it inferior and not clearly linked to any subsequent stages of EDIS.

However, they did not want to engage in the follow-up discussion of this alternative on the basis of the second and more detailed non-paper prepared by the Presidency. In their view, shared also by the Commission, SRB and ECB, this approach adds complexity and could make a transition to a fully-fledged EDIS more difficult. For the sake of the technical discussion, while reiterating their reluctance and strong disagreement with the mandatory lending option, some of these Member States favoured mandatory lending through a centralised fund against the alternative implying management of the resources at national level, as well as for a more prominent coordination role of SRB as a single counterparty to the borrowing DGS.

In contrast, three Member States were of the view that mandatory lending is a possible and feasible alternative to be explored in more detail, stating that the non-paper of the Presidency has addressed many of the operational concerns raised, and recalling that these concerns are similar for both mandatory lending through a central body and the re-insurance as outlined in the October 2017 Communication of the Commission. Among these Member States, two did not see a need for a centralised fund with national compartments. Moreover, one Member State considered that the Commission should perform an effect analysis on the mandatory lending with a central body alternative.

2.2.2. Risk based contributions and technical issues

- **Risk-based contributions methodology**

The Presidency continued the work on the development of a methodology for calculating risk based contributions based on a data collection launched by the Commission at the request of the Maltese Presidency. Following the requests of some delegations, the Commission presented specific analysis on:

- possible redistribution effects among Member State when moving from a purely national system to a European scheme (re-insurance approaches, fully-fledged EDIS) as a result of the computation of the contributions,

- the introduction of country specific indicators (recovery rates),

- the potential mitigation of the risks to the insurance fund by introducing certain indicators such as MREL proxies and

- the fact that (large) banks are likely to be rather subject to resolution than liquidation and hence less likely to recourse to the fund in case of payout event

To identify possible redistribution effects, the Commission computed risk-based contributions under a purely national system and compared the results with those calculated under re-insurance approaches, where a certain share of the funds would be kept at national level (e.g. 50% of available financial means), and a fully-fledged EDIS.

The analysis showed that the magnitude of such effects depends on the share of funds allocated to the European level, i.e. the greater the share the stronger is the redistribution effect. Hence, Member States where banks are per average less risky would pay the least under a fully-fledged EDIS (and vice versa).

Contributions under the re-insurance approaches would be in between contributions calculated under a purely national system and a fully-fledged EDIS. Some Member States were sceptical about this approach and argued that the contributions for banks should be calculated and invoiced at national level and that the overall contribution of each national DGS might be based on a Banking Union comparison of the total risk of national DGSs.

The Commission tested the effects of including country-specific indicators, notably recovery rates of Member States published by the World Bank in its Doing Business Report 2017[1].The analysis showed that, as expected, lower recovery rates would result in higher contributions. Some delegations questioned the introduction of country-specific indicators in principle. In particular, they raised level-playing field issues since banks with similar risk profiles across the Banking Union would be treated differently due to their place of incorporation. Some Member States also pointed to the unreliability of indicators related to the recovery rate due to distortion and incomparability of results given the different the size and level of concentration of the national banking systems, frequency and magnitude of pay-out events, the fact that the statistic is based on non-harmonised insolvency frameworks, etc. Other Member States supported the inclusion of country specific indicators and asked to explore in more detail other possible factors in this context.

The Commission considered certain indicators to assess the potential risk of individual banks to the Deposit Insurance Fund. As regards the introduction of the MREL II proxy indicator[2] the analysis did not yield an unequivocal result. However, the analysis indicated that small and medium-sized banks would pay less since they tend to have relatively larger MREL II proxy holdings as compared to large banks. Some delegations asked for further analysis on the role of MREL in the contribution regime. Other delegations were sceptical about the inclusion of a MREL factor and pointed out that MREL has no relevance for the likelihood of a bank's failure.

As requested by some delegations, the Commission also introduced a binary indicator in order to provide separate analysis on banks that are relatively likelier to be subject to resolution than liquidation. Banks were qualified as "resolution banks" if they fulfil certain criteria in terms of size, for example, total assets of a bank exceeding €30 billion.

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[1] http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB17-Report.pdf

[2] The MREL II proxy indicator includes regulatory capital, subordinated debt and senior unsecured bonds with a remaining maturity of at least 12 months divided by items providing stable funding according to the COREP template C61.00.

The inclusion of a binary indicator has the potential to reduce the contributions for "resolution banks" based on the idea that such banks pose a lower risk to the central fund. Accordingly, the analysis showed a reduction in contributions for "resolution banks". Several delegations questioned this analysis. In their view "resolution banks" would get a discount simply because they are big. In addition, the analysis would ignore the fact that (large) banks nevertheless could be subject to liquidation depending on the decision of the SRB (public interest test). Other delegations stressed that there is no need to distinguish between resolution and liquidation banks. Covered deposits are the base for DGS contributions and are subtracted from the base for SRF contributions. Hence, both systems would be already linked with each other.

According to one Member State, IPS membership should also be taken into account when calculating risk-based contributions and further analysis should be carried out on this issue.

Some delegations expressed their reserved views on the way forward as regards further discussions related to RBC. They deemed it premature to present a more detailed analysis or even a certain model in the upcoming meetings. In their view, further technical work on the methodology for calculating risk-based contributions should be postponed pending a political decision on the final design of EDIS. The Bulgarian Presidency shared this view and proposed to postpone the work on risk-based contributions.

- **IPS**

In order to facilitate the discussions on technical issues related to institutional protection schemes, the Bulgarian Presidency invited the National Association of German Cooperatives Banks to present the functioning of an IPS and its interaction within the German financial network.

- **Alternative measures**

In line with the conclusion of the Estonian Presidency that several aspects related to the possible use of alternative measures in the context of EDIS need to be further discussed; the Bulgarian Presidency invited the SRB to present its views.

The non-paper prepared by the SRB focused on the potential benefits of alternative measures, the scope (including of non-covered deposits), the potential risks and options to address them (including an enhanced role for the SRB) and the potential consequences of not including alternative measures as part of EDIS. Some Member States opposed the idea of using EDIS for alternative measures and the possibility to extend the scope of such measures beyond covered deposits. These Member States were in doubt whether the United States approach presented by FDIC during the Estonian Presidency can apply and be comparable in the European context. Others were reluctant to discuss any resolution-like schemes for small banks in general. However, some Member States were in favour of further analysis as to whether there are alternatives to the pay-out liquidation that would be less costly to the system of deposit insurance over the long run. In this respect, the Presidency sees merit in further discussion on the basis of data to be provided by SRB that can be used to assess the relative cost and feasibility of alternative measures in comparison with pay-out and liquidation.

- **ECB analysis**

At the meeting of the AHWP on 4th May 2018, the ECB presented its updated analysis on EDIS with a focus on quantitative assessment based on conservative assumptions related to historical losses. The purpose of the quantitative assessment was to show whether the size of a fully-fledged EDIS according to the Commission proposal was adequate to absorb potential losses stemming from pay-out events and whether there would be cross-subsidisation by country.

The analysis also provided comparison between a fully-fledged EDIS and a "mixed" deposit insurance scheme with a view to potential cross-subsidisation of costs. Based on the analysis, which concerned 1675 banks representing 75% of the total euro area banking sector assets, the ECB concluded that the size of a fully-fledged EDIS would be sufficient to cover pay-out events in a very severe crisis, and there was no evidence of unwarranted systematic cross-country subsidisation within EDIS, including when considering country-specific shocks. Many Member States found the analysis useful and subscribed to the main findings while pointing out that the assumptions are overly conservative and do not take into account recent positive developments.

Some other Member States questioned the methodology and variables used for the estimation, and the representativeness of the database, pointing in particular to the fact that smaller banks were not included in the sample and the ECB study did not look at historical recovery rates. Thus, this group of Member States remained skeptical about the ECB findings and conclusions, though at this stage they did not provide further details on what, in their view, the proper methodology should be.

- **Analysis of the effect of EDIS on the Internal market: Use of the data collected under the RBC exercise**

Several delegations continued to underline the importance of equal treatment of euro area and non-euro area Member States, and the need to analyse the possible impact of the EDIS proposal on the functioning of the Internal market. For the purpose of the analysis of the effects of EDIS on non-Banking Union Member States and the Internal market that the Commission engaged to perform as soon as possible, Member States consented to allow the use of the data collected by the Commission for the development of the methodology for calculating risk based contributions, subject to the required procedural arrangements and safeguards in terms of confidentiality of data.

3. MONITORING PROGRESS ON RISK REDUCTION MEASURES UNDER THE 2016 ECOFIN ROADMAP

3.1. BANKING PACKAGE

On 23 November 2016 the Commission presented a Risk Reduction Measures Legislative Package (the 'RRM Package' or 'RRM Proposals') comprising the following 5 proposals to amend existing legislation:

- a draft Regulation amending Regulation (EU) No 575/2013 (the 'CRR') as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements (the 'CRR Proposal');

- a draft Directive amending Directive 2013/36/EU (the 'CRD') as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (the 'CRD Proposal');

- a draft Directive amending Directive 2014/59/EU (the 'BRRD') and other Directives on loss-absorbing and recapitalisation capacity of credit institutions and investment firms (the 'BRRD Proposal');

- a draft Directive amending the BRRD as regards the ranking of unsecured debt instruments in insolvency hierarchy (the 'Bank Creditor Hierarchy Proposal');

- a draft Regulation amending Regulation (EU) No 806/2014 (the 'SRMR') as regards loss-absorbing and Recapitalisation Capacity for credit institutions and investment firms (the 'SRMR Proposal').

On 25 October 2017, the Council and the European Parliament reached a political agreement on two elements of the package that were fast tracked: a draft Directive amending the BRRD as regards the ranking of unsecured debt instruments in insolvency hierarchy and a draft Regulation on transitional arrangements for IFRS 9 and large exposures.

The Council reached a General Approach on the rest of the legislative proposals in the package at the ECOFIN meeting on 25 May 2018. The negotiations with the Parliament have not started yet.

3.2. MEASURES TO TACKLE NPL

In response to the call by the Council for further measures to address the problem of non-performing loans in the EU as set out in its Action Plan to tackle non-performing loans in Europe of July 2017, the Commission proposed in March 2018 a package of measures to address the NPLs issues, including:

- a draft Regulation amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures for newly originated loans that become non-performing. This measure will make banks set aside funds to cover the risks associated with future NPLs

- a draft Directive on credit servicers, credit purchasers and the recovery of collateral. This measure aims at providing banks with an efficient mechanism of out-of-court value recovery from secured loans and encouraging the development of secondary markets where banks can sell their NPLs to investors and make use of specialised credit servicers

- a Commission services' staff working document containing a blueprint on the set-up of national asset management companies (AMCs). The document provides non-binding guidance to national authorities on how they can set up AMCs dealing with NPLs.

The Financial Services Working Party started the discussions on the legislative elements of the NPL package on 20 April 2018.

3.3. MONITORING PROGRESS ON OTHER MEASURES

At the meeting of the AHWP on 15 March 2018, the Chair of the TFCA presented an update of the work of the task force on the SRF backstop.

The AHWP was also updated on the work related to the "insolvency directive"[3]. The Justice Ministers successfully reached an agreement on a partial general approach on the "insolvency directive" in their Council meeting of 4 June.

Under the Bulgarian Presidency the AHWP has not been updated on the progress of the Basel Committee work on regulatory treatment of sovereign exposures, neither has there been any discussion in this respect. However, two Member States insisted on referring to the on-going Basel review and recommended potential policy options, while many others strongly rejected any such reference.

4. CONCLUSIONS

The Bulgarian Presidency invites the Council to take note of this Report, with a view to progressing work further.

The Austrian Presidency is invited to build on the progress made when taking over and continue to work towards strengthening the Banking Union, addressing its various work-streams as agreed in the June 2016 Roadmap.

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[3] Proposal for a directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU