BRIEFING

Funding of national Deposit Guarantee Schemes in the EU – State of Play

The Deposit Guarantee Schemes Directive harmonises a minimum requirement for the funding of Deposit Guarantee Schemes through available financial means, a reserve paid in ex-ante. The Deposit Guarantee Schemes must observe the harmonised minimum target levels as of July 2024.

The latest EBA data shows progress in that direction at most Deposit Guarantee Schemes. Three considerations should in particular be borne in mind when assessing the level of funding through available financial means: First, the guarantee provided to covered depositors is not conditional on the availability of financial means paid in ex-ante. Second, available financial means are complemented by alternative financing arrangements (loan arrangements). There is only very limited information publicly available about the specifics of such alternative financing arrangements, though. Third, there are scenarios of large or multiple bank failures where any national Deposit Guarantee Scheme will face difficulty funding its intervention from contributions of its member banks alone, keeping in mind the need to safeguard the banking sector's profitability.

Introduction

Deposit guarantee schemes (DGSs) are regulated under the Deposit Guarantee Schemes Directive (DGSD, DIRECTIVE 2014/49/EU) to guarantee payment on certain "eligible" bank deposits in case the bank itself cannot pay. The payment from the DGS to the individual depositor is in general[i] limited to EUR 100.000. DGSD calls the eligible deposits up to this limit "covered deposits".

This note takes stock of how those guarantee schemes are funded. Under the DGSD, a DGS is in principle funded by the banks that are its members. There is at least one DGS per Member State. Two Member States, Italy and Poland, have two DGS each, and a further two Member States, Austria and Germany, have three, respectively. Accordingly, the membership and thus the collective financial strength that funds any given DGS is limited to the banks in a Member State or a subset thereof.

This note summarises how these DGS are funded and what the current requirements of the DGSD are in relation to their funding. It then turns to the data published by EBA in August 2022 to summarise the state-of-play and conclude about what we know of the current funding status of European DGSs.

Economic Governance Support Unit (EGOV)
Author: Kai Gereon SPITZER
Directorate-General for Internal Policies
PE 733.714 - October 2022

How to fund a DGS - some basic features

There are essentially two ways how the member banks of a Deposit Guarantee Scheme can fund the liabilities of the Deposit Guarantee Scheme when one of its member banks is not able to pay out its all or part of its covered deposits: namely, by ex-ante or by ex-post contributions. While the former are collected from member banks to build up a reserve in the DGS for future pay-outs, the latter are collected from member institutions after the DGS has made a pay-out beyond any reserves build-up ex-ante. Funding through ex-post contributions usually requires the DGS to take out a loan that it pays back afterwards from member banks' contributions. Such loans could be from the market, from member banks, from the public sector or from other DGSs. A firm commitment, possibly collateralised, from a potential lender could underpin the DGS funding abilities, or the DGS could look for a loan ad-hoc.

As concerns such loans, DGSD refers to them as "alternative funding". It imposes a responsibility on Member States to ensure that DGSs have in place adequate alternative funding arrangements enabling them to obtain short-term funding to meet claims. The directive offers no further guidance as to how such arrangements should look like and who should provide such loans. The provision should also be considered in light of Recital 45 of the DGSD that explains that the directive should not result in the Member States being made liable if they have ensured that DGS under the conditions prescribed in DGSD have been set up.

Once the DGS has made pay-outs for a failed bank's deposits, payments from the failed bank or its estate become a further source of funding since the failed bank becomes liable to the DGS for the pay-out. From resolution and insolvency,[ii] the DGS may receive less than due, but it will in all likelihood not have to collect the whole sum paid out from its other members because it will receive something from resolution or insolvency. In any case, it will take time until the DGS can expect any payment. Again, the DGS will need a loan to bridge the timing gap and it will need recourse to paid-in reserves or ex-post contributions to cover an eventual loss.

In theory, a DGS could fully rely on loans for its funding, to repay them from a combination of proceeds from the failed bank and ex-post contributions from the other members. In fact, some European DGS worked that way before the DGSD's 2014 revision introduced a minimum requirement for ex-ante funding. However, having some paid-in reserve amount in the DGS is prudent, since it limits the need of the DGS to find a loan to pay depositors and to collect large ex-post contributions from member banks. This is particularly true since the DGS might have to do so possibly in a stressed market environment and any difficulties in the process may have a negative impact on depositor confidence. At the same time, the larger this reserve, the more costly it is for the member banks - eventually a factor that influences the competitiveness of banks that are in different DGSs requiring diverse levels of ex-ante contributions. Since the DGS is potentially liable for 100% of the covered deposits, any reserve will only be a small part of the total liability of the DGS.

Against this background, when we assess whether the funding of a DGS is adequate we have to consider the available reserve from ex-ante contributions together with the available alternative funding arrangements.

A further perspective to take into account is the ability of member banks to afford ex-ante contributions following a major failure. A DGS should be able to shoulder the failure of a small member bank, or even of a number of smaller member banks, out of accumulated ex-ante contributions or with a combination of ex-ante contributions and ex-post contributions that do not materially dent the remaining banks' profitability. Consider, however, the situation of a DGS that had to fund the fallout of the failure of a single very large member bank, or simultaneous failures of several smaller member banks. In that case, post-pay out contributions could seriously undermine banking sector profitability.

No data is publicly available on individual banks' covered deposits. However, just to get an idea of orders of magnitude, one may look at the overall non-bank customer deposits of some major banks. They can be large double-digit multiples of the pre-tax profits of all banks in any given Member State (see Table 1).

Table 1: A comparison of banking sectors' aggregate pretax-earnings to the size of total customer deposits of large banks in DE, FR and IT

Average 2016-2020 Pretax-Earnings of the German Banking Sector		€14 bn
Total Customer Deposits	Deutsche Bank	€467 bn
	Commerzbank	€239 bn
Average 2016-2020 Pretax-Earnings of the French Banking Sector		€37 bn
Total Customer Deposits	BNP Paribas Fortis	€199 bn
	Credit Agricole	€1.168 bn
	BPCE	€665 bn
	Societe generale	€509 bn
Average 2016-2020 Pretax-Earnings of the Italian Banking Sector		€5 bn
Total Customer Deposits	Intesa Sanpaolo	€458 bn
	Unicredit	€501 bn

Source: ECB, annual reports, own calculations

On the one hand, when considering this relation, we need to discount that only a part of a major bank's total deposits will be domestic covered deposits, and, in the event of failure, the DGS will be able to recover a share of its initial outlay during the resolution of the bank. On the other hand, it is difficult to envisage that all or even the majority the pre-tax profits of all member banks of a DGS could go, for a number of years, into ex-post contributions to service repayment and interest for a loan that the DGS has taken out. After all, the Member State continues to need a banking system that operates profitably and attracts shareholders in order to finance households and businesses. On balance, it shows that there are scenarios of large or multiple bank failures where any national Deposit Guarantee Scheme will face difficulty funding its intervention from contributions of its member banks alone, keeping in mind the need to safeguard the banking sector's profitability going forward.

Harmonising DGS Funding in the EU

For the Single Market, diverse levels of ex-ante funding are of potential detriment to the level playing field and at odds with a desire to ensure a minimum level of prudence in operating DGS, limiting reliance on loans and ex-post funding and smoothening out charges to banks over time. Against this background, the DGSD seeks limited harmonisation. It requires the amount of ex-ante funding, called "available financial means", to be "proportionate" to the DGS' potential liabilities. For this purpose, particular low risk assets held by the DGS count as available financial means, but the DGSs may also count in collateralised payment commitments up to 30% of the total – therefore, available financial means are not actually all ex-ante funded, to be precise.[iii] Finally, the DGSD harmonises a minimum level of available financial means, setting a so-called "target level" as a proportion of covered deposits.

The DGSD obliges DGSs to reach this target level by July 3, 2024 (which can be extended under certain circumstances) and requires them to collect contributions whenever they are below the target level. The target level is in general 0,8%, but some DGS observe a higher target level. Member States can also lower the target level to 0,5%. The directive considers such a reduction is justified where banks operate in a highly concentrated market. In such circumstances, the recitals argue that most banks are of such a size and degree of interconnection that their winding up under normal insolvency proceedings would be unlikely compared to resolution proceedings. This seems to imply that in the resolution process, which aims to safeguard critical functions of the failed bank, swift repayment of the deposits can be assured without resorting to the DGS, thus reducing the need to take recourse to paid-in reserves of the DGS. Nevertheless, the Bank Recovery and Resolution Directive (Directive 2014/59/EU) expressly envisages the DGS absorbing losses in resolution and it is an interesting question what role resolution plans of larger banks envisage in practice for the DGSs. In this context, the Single Resolution Board considers the "use" of DGS in resolution to be currently "unlikely in practice", chiefly due to what it refers to as the "least cost test", namely that the losses to the DGS must not exceed those in insolvency; it suggests "[the use] could therefore be made more realistic".[iv]

The DGSD also harmonises ex-post contributions to not exceed 0,5% of the stock of covered deposits, but the limit can be raised with the consent of the competent authority. In connection with the discussion in the previous section, this limits in principle the collective burden that the banks in a Member State have to shoulder in any given year, while leaving open what happens if this level of contributions is insufficient to service a loan that the DGS had to take out.

Finally, the DGSD requires, 5 years after its entry into force, a report from the Commission to the European Parliament and to the Council on the target level taking into account the failures of EU banks in the past.

Latest data on DGS funding

The following section assesses the actual funding of the different DGSs in the EU. It is intended as a factual stock take relative to the requirements of the DGSD, but not to compare in any way the quality of the DGSs.

On August 4, 2022, EBA has released the latest data on available financial means and covered deposits. Those are time series of yearly data from 2015 until 2021. For 2021 only, EBA also shows "qualified available financial means", which EBA explains is a narrower notion that excludes monies obtained other than from banks' contributions and possibly through loans. EBA notes that only this narrower definition should count towards the target level. It seems better to look at this narrower definition, however when comparing with the available financial means data of earlier years, the latter might be overstated for some DGS[v] and hence the progress of the relevant DGS in reaching target levels may be understated.

Box: EBA Data on DGSs

Every year, starting in 2016, the EBA collects data showing how much money is available in each DGS's fund. As mentioned in its press release when publishing the data for the first time, the aim is "to enhance transparency and public accountability of DGSs across the EU". However, EBA underlines that the data does not allow a direct comparison of the adequacy of funding of each DGS in the EU – which somewhat limits the usefulness of the whole exercise – arguing that different starting points, different levels of recent DGS use, even different target levels, and finally different alternative sources of DGS funding all need to be taken into account in any comparison.

See [EBA Deposit Garantee Schemes data webpage]

Chart 1 shows for each DGS in operation the target level and a ratio of available financial means to covered deposits. We have calculated the ratios from EBA data per end 2015 and 2021. We use their available financial means data for the former and their qualified available financial means for the latter.

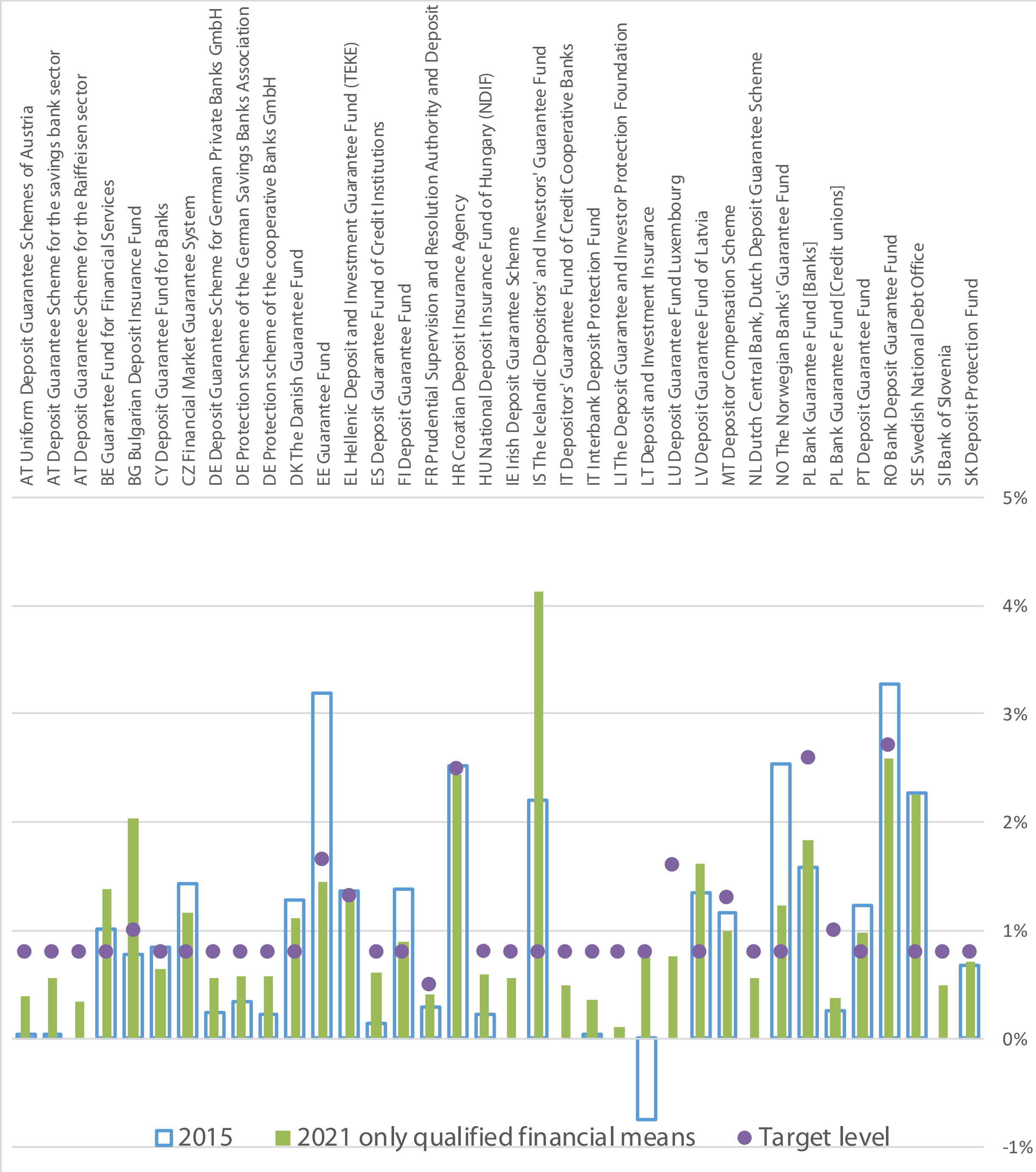
Out of 36 active DGS in the European Economic Area, 26[vi] aim for the DGSD's standard target level of 0,80%, 9 observe higher target levels between 1,00% and 2,71% and one French DGS works with the lower allowable target level of 0,50%. We recall:

- that the minimum target levels of the DGSD *have to be reached only by July 3, 2024*;
- that the DGSs had very different starting points in 2015, when in fact 7 of them had no available financial means to begin with; and
- that it is normal that pay-outs reduce the available financial means temporarily.

Against this background, we see that by end 2021, 11 had reached or exceeded their own particular target ratios and 17 had reached the DGSD minimum target levels of 0,8%. The majority of DGSs have made progress towards their current target level during the period; by end 2021, 29 were closer to it than they were in 2015, or have reached their target. Nevertheless, 6 DGS are now farther away from their current target level than they were in 2015[vii] as a result of pay-outs. The EBA data does not show to what extent available financial means are paid in and invested in liquid assets or consist of collateralised payment commitments of their member banks, which are allowable for up to 30% of the minimum target level.

Overall, there are 16 DGSs that are currently below the DGSD's minimum of 0,8% or 0,5%, respectively. They will have to maintain or increase their efforts to reach the minimum required by the DGSD, collecting sufficient contributions from banks. As discussed, the obligation to guarantee deposits is not conditional on the available financial means of the DGS. Therefore, the covered deposits are protected as required, and the DGSs in question need to fund themselves from other sources if the available financial means do not suffice.

Chart 1: DGS (qualified) financial means as a percentage of covered deposits, 2015 and 2021, and the 2024 target levels of the DGSs (Source: EBA, own calculations)



The EBA data also entails qualitative references as to whether arrangements for alternative financing have been made. In the EBA nomenclature, such arrangements are:

- mandatory lending from member banks in 2 cases;
- a credit line (or similar) from the central bank in 2 cases;
- a credit line (or similar) from the government in 6 cases;
- a credit line (or similar) with (commercial) bank(s) in 5 cases; and
- “other” in 7 cases.

A number of DGSs has more than one type of arrangement in place. By contrast, 17 DGSs did not report arrangements in place. Further details on the arrangements are not systematically provided.

Conclusions and open questions

The DGSD has harmonised a minimum requirement for the funding of DGSs through available financial means, which is good for depositor confidence and the level playing field. Harmonised target levels must be observed by July 2024 and the latest EBA data shows progress in that direction at most DGSs, but also that roughly half of the DGSs were short of the minimum target level by end 2021.

However, comparing where DGSs stand relative to the minimum target level is only one possible perspective on DGS funding. A number of DGSs aim at higher target levels than the DGSD's minima. More generally, the DGSD requires that DGSs determine their potential liabilities and have proportionate available financial means. No information is available about how this is done in practice and DGSD contains no guidance either.

The EBA data also offers very limited information on the financing arrangements beyond available financial means, such as loans and lending commitments. However, those constitute an essential element of funding in particular in stress situations when the funding requirements exceeds available financial means. However, it is unlikely that a direct request to the DGSs or any other sources would yield additional insights. Most likely, DGSs often rely on informal arrangements or ad-hoc solutions.

To better understand how the combination of funding sources works in practice, one might look at the experience of DGSs with bank failures to judge how different levels of financial means have been able to fund interventions and how they had to be combined with other sources. One might also consider stress scenarios such as hypothetical difficulties at larger banks to understand what contribution different levels of available financial means could make to the funding of interventions. Any such analysis is likely to point out the challenges of

Box: DGS funding in recent payout cases

Sberbank Europe AG, Austria

On 1 March 2022, the Austrian Financial Market Authority (FMA) has prohibited Sberbank Europe AG to continue business operations. Einlagensicherung Austria paid out EUR 926 mio for the covered deposits. Comparing to the EBA data for this DGS per year end 2021, this corresponded to 0,89% of covered deposits and about 2,3 times qualified available financial means. Sberbank Europe AG in Abwicklung (Sberbank Europe AG in winding down) has in the meantime fully repaid the amount the DGS had paid out (Source: Sberbank Europe AG in Abwicklung, EBA data)

Sberbank CZ, a.s., Czech Republic

The Czech Garanční systém finančního trhu (Financial Market Guarantee System) reports that it has paid out CZK 25,9 bn (about EUR 1 bn) for covered deposits of Sberbank CZ, a.s., which is now in liquidation. Comparing to the EBA data for this DGS per year end 2021, this corresponded to 0,81% of covered deposits and about 69% of qualified available financial means; the Financial Market Guarantee System mentions that this is its largest payout amount so far; it does not report having received liquidation proceeds at this point in time (Source: Garanční systém finančního trhu, EBA data).

Sberbank Magzarország ZRT, Hungary

The Hungarian Országos Betétbiztosítási Alap (National Deposit Insurance Fund of Hungary) does not provide public information on the total payout and funding in this case. (Source: its website)

Greensill Bank AG, Germany

The German Entschädigungseinrichtung deutscher Banken GmbH (Deposit Guarantee Scheme for German Private Banks) does not provide public information on the total payout and funding in this case. A press report mentions a payout of EUR 2 bn. Comparing to the EBA data for this DGS per year end 2021, this corresponded to 0,28% of covered deposits and about 51% of qualified available financial means. The press report also mentions liquidation proceeds of EUR 550 mio. (Source: Press, funding in case of larger bank failures. For such larger bank failures, bank resolution is more likely to apply than for smaller banks (which is not to rule out that also the resolution of smaller banks can be in the public interest). Bank resolution may constitute a mitigating factor for the impact on DGS funding in some cases, relative to bank insolvency. On the other hand, a DGS may also be called upon for funding or may have to absorb losses in resolution, even if it enjoys particular seniority as a creditor. And given the particular seniority of the DGS in insolvency, too, it cannot generally be established that the insolvency administrator of a smaller bank can conserve, in relative terms, less value for the DGS than the resolution authority in the case of a larger bank.

In this context, the boundary when the challenges of larger banks arise changes with the size of the DGS relative to its largest member banks. The European Deposit Insurance Scheme (EDIS), as proposed by the Commission in 2015[viii] but to date un-adopted, would push this boundary as far as possible. The perspective that the DGS in one Member State may have to stand in for losses at a bank in another Member State has made progress on this file difficult.

However, short of standing in for losses, mandatory liquidity support among DGSs could at least help address funding challenges.[ix] In 2021, the Portuguese Council Presidency reported of discussions about what was at the time referred to as a hybrid model that would have allowed DGSs to access additional funding from a central Deposit Insurance Fund via mandatory lending from other DGSs an intermediate step towards EDIS.[x] However, after press reports this year suggested discussion on the idea are ongoing,[xi] the Eurogroup statement of 16 June 2022[xii] merely acknowledged that the group had explored ways to create a more robust common protection for depositors, without mentioning progress. At the same time, the Eurogroup invited the Commission to present proposals for further harmonisation of the use of DGS in crisis management, but not on their funding.

Extract: Eurogroup statement on the future of the Banking Union of 16 June 2022

In December 2021, the Leaders reiterated the ***mandate to the Eurogroup in inclusive format*** *to agree on a work plan charting the way towards the completion of the Banking Union.*

Today, we have agreed that, ***as an immediate step****, work on the Banking Union should focus on* ***strengthening the common framework for bank crisis management and national deposit guarantee schemes*** *(CMDI framework).*

Drawing on the experience of the last decade, ***the Eurogroup in inclusive format agrees on the following broad elements to underpin a strengthened CMDI framework****:*

- *A clarified and harmonised* ***public interest assessment****.*
- ***Broadened application of resolution tools in crisis management at European and national level****, including for smaller and medium-sized banks, where the funding needed for effective use of resolution tools is available, notably through MREL and industry-funded safety nets.*
- ***Further harmonisation of the use of national deposit guarantee funds in crisis management****, while ensuring appropriate flexibility for facilitating market exit of failing banks in a manner that preserves the value of the bank's assets. A harmonised least-cost test, administered by national authorities, to govern the use of DGS funds outside payout to covered depositors, to ensure consistent, credible and predictable outcomes.*
- ***Harmonisation of targeted features of national bank insolvency laws*** *to ensure consistency with the principles of the European CMDI framework.*

[i] DGSs also protect higher amounts as “temporary high balances”, for a limited period of time and as scoped in Article 6(2) of DGSD.

[ii] The DGS cannot be left worse off in resolution than in insolvency, but can be exposed to losses in resolution up to the amount of losses it would have suffered in insolvency.

[iii] Unless one considers the collateralised payment commitments as funded since they are collateralised in principle by the same types of assets the DGS is required to invest the remainder of financial means in.

[iv] c.f. its reply to the Commission’s targeted consultation on the crisis management and deposit insurance framework of April 2021: https://www.srb.europa.eu/en/system/files?file=media/document/2021-04-20_srb_replies_consultation_cmdi_review.pdf

[v] In 2021, only 4 DGS show a difference between the two; this suggests that the comparability issue for the previous years might not be widespread.

[vi] We have counted in one DGS in Iceland for which EBA reports the target level is not yet defined since in our understanding it is nevertheless bound by the standard target level. We note that its actual ratio exceeds this minimum level.

[vii] Finally, one AT DGS did not exist in 2015 and is not counted here.

[viii] https://finance.ec.europa.eu/publications/commission-proposal-european-deposit-insurance-scheme-edis_en

[ix] On a voluntary basis, the DGSD already foresees loans between DGSs, but the EBA data do not show that the option is used across borders.

[x] https://data.consilium.europa.eu/doc/document/ST-9311-2021-INIT/en/pdf

[xi] https://pro.politico.eu/news/eurogroup-chief-eyes-banking-union-breakthrough-by-2024

[xii] https://www.consilium.europa.eu/en/press/press-releases/2022/06/16/eurogroup-statement-on-the-future-of-the-banking-union-of-16-june-2022/

Contact: egov@ep.europa.eu

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