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The Polish deposit insurance scheme
compared to arrangements adopted in other EU countries

Adam Pawlikowski

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Adam Pawlikowski – Economist, Financial System Department, National Bank of Poland.
e-mail: Adam.Pawlikowski@mail.nbp.pl

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Abstract

Despite their relatively short history, deposit insurance schemes (DISs) are currently a common element of the banking system. In 2004, 83 explicit DISs operated around the world.

The Bank Guarantee Fund (*Bankowy Fundusz Gwarancyjny – BFG*) – the Polish institution guaranteeing household deposits – is celebrating its 10th anniversary this year. Over its 10 years of active operation the BFG has proved that, along with the National Bank of Poland and the Commission for Banking Supervision, it is among the most important institutions protecting the Polish financial system from destabilisation.

The introductory part of this paper presents the position of the Bank Guarantee Fund within the Polish financial safety net. Other guarantee schemes operating in the Polish financial services sector have also been presented. Moreover, the paper explains the reasons for the launching of a DIS and points out the purposes for the establishment of the BFG. Further, it describes the evolution of Polish deposit guarantee arrangements since 1982. Special emphasis has also been put on the analysis of Bank Guarantee Fund administration.

The main aim of this paper is to describe Polish deposit insurance scheme. Particular features of the Polish scheme are discussed with reference to the Community regulations in this field and also arrangements adopted in the remaining 24 countries of the European Union.

The third chapter of this paper describes the fundamental area of the Fund's activity, i.e. guarantee activities consisting in making compensation payouts to depositors in the event of a bank's bankruptcy. The scope of coverage (eligible types of deposits and depositors) offered by the Polish scheme has been analysed. The scope of the BFG's guarantee activities from 1995 to 2004 has also been presented.

In the fourth chapter, the BFG's activities aimed at minimising risk in the banking sector have been presented. The principles and experience of the Fund regarding financial support for the rehabilitation of banks threatened with insolvency have been discussed in greatest detail here.

The fifth chapter describes the principles and procedures regarding the financing of guarantee and assistance activities of the Bank Guarantee Fund.

In the summary, the paper indicates possible directions for changes in the BFG legislation. It has been pointed out that despite the fact that Polish regulations comply with EU requirements, they must be adjusted to suit the changing domestic conditions.

JEL classification: G21, G28, G29, G33

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1

BFG as an important element of the safety net

1.1 Polish financial safety net

Considered as a public good, stability of the financial system is in the interest of all participants of political and economic life. However, market mechanisms sometimes fail to guarantee this stability in all circumstances. This is the reason why in every country a set of institutional and regulatory arrangements has been established, which aims to protect the financial system from destabilisation – the **financial safety net.**[1]

The most important institutions constituting the Polish financial safety net include:

1) The **National Bank of Poland** (*Narodowy Bank Polski* – NBP) – being a central bank, it fulfils the role of the lender-of-last-resort, also referred to as Emergency Liquidity Assistance. The role of the NBP consists in providing discretional liquidity supply to a single bank or the entire banking system in response to an unfavourable shock leading to an extraordinary increase in demand for reserve money, which cannot be met by other sources.

2) The **Commission for Banking Supervision** (*Komisja Nadzoru Bankowego* – CBS) – as an institution supervising the banking sector, it fulfils three basic functions: the licensing, regulatory, and audit and administrative ones. It should be noted here that the General Inspectorate of Banking Supervision, which is organizationally autonomous within the structure of the NBP since January 1, 1998, is the executive body of the CBS.

3) The **Bank Guarantee Fund** – being a deposit guarantee fund[2] whose mission is to protect deposits accumulated at the banks covered by the Polish scheme and to support the safety and stability of the banking system in Poland.

The **Ministry of Finance** – the main institution regulating the financial system – little doubt, also participates in the operation of the Polish safety net. Moreover, the government, which is referred to as the "owner-of-last-resort," may directly inject capital into a bank or the entire banking system where a systemic crisis threatens. However, the government's involvement in crisis management is usually not formalised. Moreover, the Office for Competition and Consumer Protection as well as payment systems and bankruptcy law procedures may be listed as institutions and regulations forming the safety net.

With a view of ensuring efficient operation of the safety net construction, which protects the financial system from destabilisation, all its parts must cooperate at particular crisis management stages. The design of the Polish financial safety net also includes several links between the DIS and its other elements. For example, a bilateral agreement between the BFG and the NBP, which pertains primarily to the exchange of information between these institutions, has been in force since May 27, 1997[3]. A closer cooperation between the Polish Fund and banking supervision authorities is ensured by the fact that the President of the BFG Management Board is a member of the Commission for Banking Supervision. The Ministry of Finance supervises the operation of the Fund, while annual reports of the BFG are submitted for review to the Polish Parliament by the Council of Ministers.

[1] More on this subject in: Szczepańska, Sotomska-Krzysztofik, Pawliszyn and Pawlikowski (2004).

[2] According to *Guidance for Developing Effective Deposit Insurance Systems* (2001): Financial Stability Forum, a DIS is an important component of the financial safety net.

[3] The agreement was amended on January 31, 2005.

It should be remembered, however, that financial stability is a much broader concept than banking sector stability. This means that potential threats to the stability of the entire financial system may emerge not only within the banking sector but within the insurance sector and the capital market as well. In Poland, a **sectoral supervision model** has been implemented and thus the supervision authorities and guarantee schemes operating in those sectors are also factors in financial stability (Table 1).

Table 1
Position of the BFG in the Polish financial safety net

SECTOR	PARTICIPANTS	SUPERVISORY INSTITUTION	GUARANTEE INSTITUTIONS
BANKING	COMMERCIAL AND COOPERATIVE BANKS	COMMISSION FOR BANKING SUPERVISION	BANK GUARANTEE FUND
PARA-BANKING	COOPEARTIVE SAVINGS AND CREDIT UNIONS	NATIONAL ASSOCIATION OF COOPEARTIVE SAVINGS AND CREDIT UNIONS	NATIONAL ASSOCIATION OF COOPEARTIVE SAVINGS AND CREDIT UNIONS MUTUAL INSURANCE COMPANY
CAPITAL	BROKERAGE HOUSES, INVESTMENT FUNDS, STOCK EXCHANGES	THE POLISH SECURITIES AND EXCHANGE COMMISSION	NATIONAL DEPOSITORY FOR SECURITIES
PENSION FUNDS	OPEN PENSION FUNDS	INSURANCE AND PENSION FUNDS SUPERVISORY COMMISSION	NATIONAL DEPOSITORY FOR SECURITIES
INSURANCE	INSURANCE COMPANIES	INSURANCE AND PENSION FUNDS SUPERVISORY COMMISSION	INSURANCE GUARANTEE FUND

Source: own research.

The Bank Guarantee Fund, which has already been listed among the three most important institutions of the Polish safety net, is also no doubt the most important guarantee institution. This is corroborated by the fact that the scope of the BFG's powers relates to the banking sector, which is the key (albeit its position is steadily diminishing) component of the Polish financial sector. Additionally, the banking services market is particularly prone to **systemic risk** due to the fact that a crisis at one financial institution may spread to other market participants (contagion), which may severely disrupt the operation of the entire system.

The other guarantee institutions operating within the Polish financial system are:

• The **National Depository for Securities,** which operates the following guarantee schemes[4]:

– *Compulsory Investor Compensation Scheme*, which ensures payouts to investors should a brokerage house declare bankruptcy — 100% for amounts of up to 3,000 euro and 90% for amounts from 3,000 euro to 11,000 euro[5];

– *Securities Settlement System* which ensures proper performance of obligations arising from transactions concluded in the regulated securities market;

– *Pension Guarantee Fund*, which protects the interests of open pension fund members.

• The **Insurance Guarantee Fund**, which settles claims arising from compulsory insurance where the party which has caused damage is not insured or its identity cannot be determined (protection of the insured party) as well as claims arising from compulsory insurance and life insurance in the amount of 50% of the claim (not exceeding the equivalent of 30,000 euro) where an insurance company declares bankruptcy, pursuant to certain principles.

[4] See: *Financial System Development In Poland 2002–2003*, NBP, September 2004.

[5] The projected evolution towards cover compliant with Directive 97/9/EC stipulated in the Law on the Public Trading of Securities consists in raising the upper guarantee limit to 15,000 euro from January 1, 2006, to 19,000 euro from January 1, 2007 and to 22,000 euro from January 1, 2008.

1

• The institutions operating the so-called Savings Protection Programme, i.e. the **National Association of Cooperative Savings and Credit Unions and the Mutual Insurance Company**. The aim of the Programme is to ensure safe operation of all cooperative savings and credit unions. The Programme covers deposits received by them up to the equivalent to 22,500 euro[6].

It should be emphasised that guarantee institutions which protect the interests of depositors and investors in the capital market are common in European Union countries[7]. The establishment of guarantee schemes covering customers of insurance companies is not a standard arrangements, however. On the other hand, the example of Great Britain[8] indicates that it is possible to abandon the sectoral approach and create a joint guarantee institution covering customers of all financial institutions.

1.2. Purpose for establishment of the BFG

The **need to limit the systemic risk** caused by the phenomenon known as the bank run is the most important premise for creation of a DIS worldwide. A mass withdrawal of deposits from a single bank can trigger the domino effect and thus spread to other banks, causing a systemic threat. Depositors are less prone to withdraw deposits en masse where they are aware that their savings are covered by legal guarantees.

The **protection of bank customers** is also an important reason for the establishment of a DIS. Due to the fact that depositors only have access to limited information about the institution to which they entrust their savings, they encounter the information asymmetry problem. This is because in practice complete information necessary in order to thoroughly evaluate the current financial standing of a bank is not made publicly available[9]. The presence of banking supervision institutions somewhat mitigates this market imperfection. In practice, however, retail bank customers are unable to interpret the data and assess in a fully rational and correct manner the trustworthiness of individual financial institutions operating on the market as well as compare all their products on offer[10].

The Bank Guarantee Fund was established primarily **in order to adjust the Polish arrangements to European Union requirements**. The most important Community regulations in this respect are included in Directive 94/19/EC of May 30, 1994 on deposit-guarantee schemes. In general, this directive harmonises only selected issues, leaving individual Member States certain discretion in shaping their national regulations. As a consequence, DISs operating in particular European Union countries exhibit significant differences.

The **need to introduce systemic arrangements** in place of provisional ones and thus eliminate the discrepancies regarding deposit guarantees in banks operating in Poland was also an important objective guiding the establishment of the Polish Fund. The model of regulations regarding the DIS which had been in force in Poland before the BFG was established has been described in the next chapter of this paper. The establishment of the Fund has also made it possible to create systemic possibilities for extending financial support to banks which either become insolvent or are threatened with insolvency.

It should bekept in mind, however, that the existence of a DIS as an additional institution protecting the financial system from destabilisation also entails certain costs apart from obvious advantages. The presence of the financial safety net may lead to diminishing a market discipline through the increased probability of **moral hazard**. Banks, which are aware of the potential

[6] See: Jurkowska (2003).

[7] This is a requirement of Directive 97/9/EC of March 3, 1997 on investor-compensation schemes.

[8] The Financial Services Compensation Scheme, which was established in September 2001.

[9] The Banking Act only requires banks to publish their balance sheets, together with the opinion of the certified auditor, for the most recent period subject to audit, at their places of business (Art. 111, para. 1, item 5).

[10] Cf. Zaleska (2002).

protection afforded by the institutions constituting the safety net, may take decisions which maximise their profits and often involve greater risk. However, proper principles of designing a DIS, which have also been adopted in the case of the BFG, make it possible to limit moral hazard. In their paper, R. Gropp and J. Vesala[11] present a slightly different approach to the relationship between the existence of a DIS and the problem of moral hazard. Following their research conducted on the basis of the experience of EU countries, they claim that a formalised DIS may be a tool contributing to better monitoring of the banks' standing and limiting moral hazard.

The main objective of this paper is to describe the Polish DIS as an important component of the financial safety net operating in Poland. The regulations and procedures of operation of the Bank Guarantee Fund will be presented with reference to EU regulations in this field and compared to those of other guarantee institutions operating in the remaining European Union countries. The comparative analysis covers 25 mandatory DISs operating in all EU countries; in the case of Germany, the voluntary scheme has been also included due to its popularity.

[11] See: Gropp and Vesala (2004).

2
Characteristics of the Polish deposit insurance scheme

2.1. Year of establishment

The history of the Polish deposit guarantee regulations goes back to 1982 when the then Banking Act stipulated that the **Treasury was liable for bank liabilities** arising from savings and deposits of natural persons. The corresponding act from 1989 retained the liability of the Treasury for savings held at state-owned banks and other banks which had been covered by this scheme before the act came into force. However, along with the development of the two-tier banking sector, many private banks and banks with mixed capital structure were established at that time, which were not covered by any guarantees pursuant to those regulations. This distorted the competition between banks because banks protected by the Treasury were privileged compared to newly established banks[12].

In such circumstances, a **provisional guarantee** of sorts was introduced in 1994. The Resolution of the Parliament on Monetary Policy Guidelines for 1994 included a clause stating that until appropriate legal acts were issued, the President of the NBP would guarantee 100% of deposits from natural persons for amounts up to ECU 1,000 and 90% for amounts ranging from ECU 1,000 to ECU 3,000.

The Polish DIS only acquired its current structure after the passage of the Law on the Bank Guarantee Fund of December 14, 1994, which came into force on February 17, 1995. The Fund itself started to operate as a **separate institution** in April 1995, where its authorities were constituted (the Fund Council met for the first time on April 7 and on April 19, the Fund Management Board was appointed).

The first European DIS was established nearly 30 years earlier (in 1966) in Germany. It should be noted that this was the initiative of the banking sector. In the 1970s, DISs were established in Finland, Belgium, Spain, Austria, Great Britain and the Netherlands. As a result, only eight DISs operated in current European Union countries in 1980 (Figure 1).

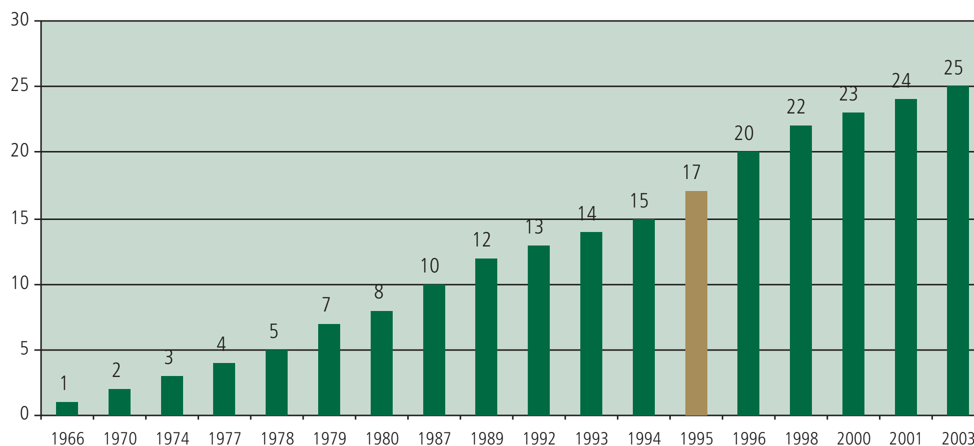
As regards the regulations of the European Communities concerning DISs, their history dates back to the mid-1980s. In 1986, the European Commission issued Recommendation 87/63/EEC including guidelines for Member States.[13] The most important regulation was the requirement to adopt DISs in the countries which had no such schemes in place. As a result of the aforementioned Recommendation, DISs were established in next European countries. By 1992, such schemes were adopted in Italy, Denmark, Ireland, Luxembourg and Portugal. In 1993, the first guarantee institution in Central and Eastern Europe – the Hungarian fund – was established.

The adoption in 1994 of the aforementioned **Directive 94/19/EC of the European Parliament and the Council of May 30, 1994 on deposit-guarantee schemes** was a breakthrough in the evolution of the Community regulations on deposit protection. This document has provided for the current level of harmonisation between the European DISs.

[12] See: Baka (2005).

[13] See: Obal (2004).

Figure 1
Total number of explicite DISs in current EU countries by year



Source: own research.

The **fundamental requirements of the directive** include the following principles:

- each member state must establish a scheme which guarantees the depositors' funds;
- membership in the DIS must be compulsory for all credit institutions which take deposits;
- the costs of financing the scheme should in principle be borne by scheme participants, i.e. credit institutions;
- the level of coverage offered must not be lower than 20,000 euro;
- co-insurance must not exceed 10%;
- compensation must be paid within 3 months of the date on which the deposit becomes unavailable[14].

The adoption of the directive triggered another wave of DISs establishment. At that time, such schemes were launched mainly in Central and Eastern European countries (including Poland). DISs are currently in place in all European Union Member States – the last one was adopted in Malta in 2003.

2.2. Fund administration

Pursuant to the Law on the BFG, the Fund is a juridical person with its registered office in Warsaw. Despite the statutory clause stating that the Fund is not a state legal person, doubts remain regarding this issue[15].

The Bank Guarantee Fund was established on the initiative of public authorities, i.e. in an administrative procedure. The procedure of establishment of a scheme typically has a direct impact on the way in which it is administrated. This was also the case of the Polish fund, which is managed both by the representatives of both public institutions and banking sector. Thus its administration is of a joint, public-private type. 10-year experience with the BFG indicates that the adopted composition of the Fund Council is appropriate – the membership of representatives of various institutions ensures proper representation and objective decision-making. Moreover, the joint administration of the DIS offers numerous advantages compared to exclusively private or public administration[16].

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[14] However, the Directive allows for two extensions of the payout period, neither of which shall exceed 3 months.

[15] See: Dobaczewska (2000).

[16] More on this subject in: Pawlikowski (2004).

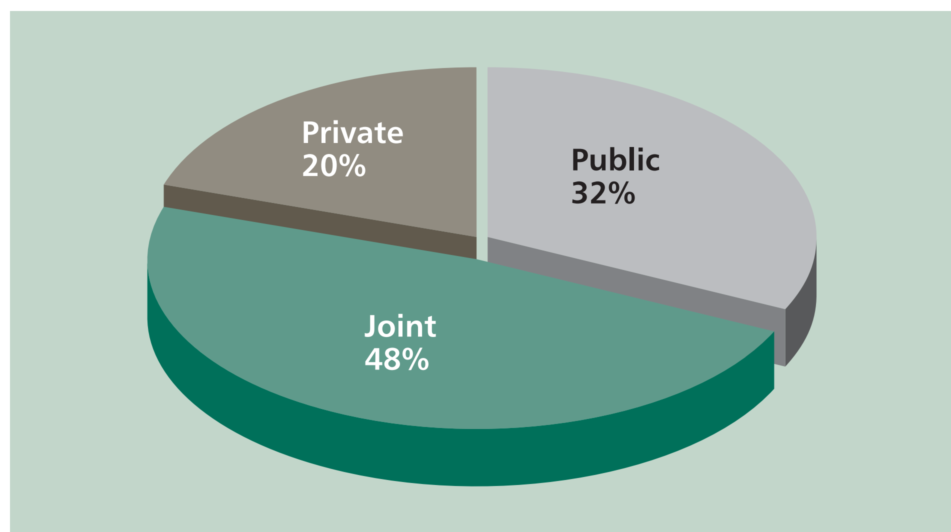
The Fund Council and the Fund Management Board are main bodies of the BFG. **The Fund Council** comprises the chairman, who is appointed and removed by the Prime Minister on recommendation agreed between the Minister of Finance and the President of the NBP, as well as 10 members appointed and removed by the President of the NBP (4), the Minister of Finance (3) and the Polish Banking Association (3). The term of office of the Fund Council shall be four years. The scope of the Council's activities is relatively broad and includes i.a.:

- supervision over the the Management Board activities;
- appointing and removing the Management Board members;
- setting the annual rates of the banks' contributions to the Guaranteed Deposit Protection Fund;
- setting the amounts of the banks' mandatory annual contributions to the assistance fund;
- stipulating annual plans of operations and financial plans of the Fund;
- stipulating the principles, form, terms and conditions and procedure of extending financial support to banks and the principles and forms of enforcing the return of funds due to the BFG in connection with such support.

The Fund is directly managed and represented by the **Management Board**, which consists of 5 members, including the president and his deputy. The term of office of the Fund Management Board shall be three years but its members may be removed by the Fund Council at any time.

The EU directive does not stipulate the manner in which the guarantee fund is to be managed. Moreover, it does not even require that the scheme be managed by a separate institution, as is the case in Poland. The DIS must be "officially recognised" in a given country. As a result, there are significant differences regarding the administration of DISs. In the overwhelming majority of European Union countries, separate institutions (guarantee funds) have been established in order to manage the DIS. Exceptions include Cyprus, the Netherlands, Ireland and Slovenia, where central banks assumed the responsibilities related to deposit guarantees as well as Malta and Latvia, where the bodies responsible for the operation of the scheme operate within the structures of supervisory institutions.

Figure 2
DIS administration in EU countries



Source: own research.

With respect to the manner in which the authorities are appointed, the administration of a guarantee institution may be of a public (fund authorities include only representatives of public authorities), private (only bank representatives run the scheme) or joint type. In the EU, the joint model which assumes that the representatives of both banks and public authorities participate in the management of the guarantee fund, currently prevails – it has been adopted in 12 countries. In 8 countries (the Netherlands, Ireland, Lithuania, Latvia, Portugal, Slovenia, Sweden and Great Britain) the DIS is under public administration. In only 5 countries (Austria, Finland, France, Luxembourg and Italy) the authorities of the DIS are appointed exclusively by the banking sector (Figure 2).

3
Scope of BFG coverage

3.1. Institutions covered by the scheme

Membership in the Polish DIS is compulsory for all **domestic banks**, i.e. those with registered offices in the territory of Poland. It should be emphasised that this principle applies both to commercial and cooperative banks. However, credit unions remain outside the BFG scheme. This arrangement should be considered compliant with EU regulations, since Polish credit unions, similarly as credit unions in other countries, lay outside the scope of the definition of credit institutions. These institutions have been exempt from EU directives regulating credit institution operations[17].

Moreover, **branches of foreign banks registered in non-EU countries** are required to joint the BFG scheme unless they participate in a scheme offering a limit of coverage equivalent to that in force in Poland[18]. Pursuant to the spirit of the directive, the Polish DIS also covers deposits held at **foreign branches of Polish banks operating in EU countries**. On the other hand, the Polish law does not require the branches of Polish banks which operate in non-EU countries to participate in the BFG scheme; until now, their participation has been voluntary. **Branches of banks with registered offices in EU countries**[19] **operating in the territory of Poland** may, pursuant to the topping-up principle, participate in the BFG scheme in cases where a limit of coverage in such countries is lower than in Poland (this regulation has not been applied yet).

Banks which fulfil the obligations arising from the mandatory DIS may also undertake (within the framework of the statutory guarantee scheme) to extend their fund guarantee obligations beyond the minimum stipulated in the regulations. The establishment of a contractual DIS and the principles of its operation must be approved by the Fund Council (this has also not been implemented as yet and remains a statutory clause).

The EU Directive on deposit-guarantee schemes stipulates fairly precise principles regarding the banks' participation in individual DISs. Pursuant to the Community legislation, a credit institution is required to participate in a DIS in the country where it has its registered office. Pursuant to the home country control principle, the DIS in the home country also covers foreign branches of domestic banks operating in other EU countries. On the other hand, the topping-up principle makes it possible for a foreign bank from an EU country operating in another EU country to participate in the host country DIS on a voluntary basis in order to supplement the level and scope of coverage. Appropriate bilateral agreements between the guarantee institutions of the home and the host country are usually concluded to this purpose.

The directive does not lay down principles regarding participation of branches of foreign banks from non-EU countries and branches of domestic banks operating outside the territory of the EU in the scheme. Pursuant to the Community legislation, Member States may require full participation from branches of foreign banks from non-EU countries where the DIS of the home country is not equivalent to the scheme in the host country. Some countries (e.g. Italy) require full

[17] Including e.g. the most important one — Directive 200/12/EC relating to the taking up and pursuit of the business of credit institutions.

[18] Where such branches participate in a DIS offering a limit lower than the Polish one, their participation in the BFG is of a supplementary character.

[19] According to the terminology used in the Banking Act, these are credit institution branches.

participation in such circumstances, even if a DIS is in place in the home country. EU regulations leave the issue of regulating the participation of branches of domestic banks operating in non-EU countries to the Member States' discretion.

While only one fund operates in the case of the Polish DIS, this does not always apply to the schemes in place in other European Union countries. Although in most EU countries one fund was established within the framework of a given DIS, in 5 countries (Germany, Austria, Spain, Italy and Portugal) **separate sub-schemes covering various credit institution categories** (e.g. public, private, cooperative, savings, mortgage or agricultural banks) operate.

Apart from the 25 compulsory DISs operating in all EU countries, there is one (German) **voluntary scheme**. Due to its considerable popularity, this scheme has been additionally included in comparative analyses in this paper.

3.2. Level of coverage

The level of coverage is a very important element of any DIS and thus it should be discussed in detail. Currently, the guarantees offered by the Bank Guarantee Fund cover the following deposit amounts:

- **100%** of deposit value up to the equivalent of **1,000 euro;**
- **90%** of deposit value within the range **from 1,000 euro to 22,500 euro**.

Although the upper limits of covered amounts are expressed in euro, compensation for depositors is not paid out in the European currency. Regardless of the currency of the deposit, **guaranteed amounts are paid out in zloty** after the value of the foreign currency deposit has been converted according to the exchange rate on the date of the bank's bankruptcy.

The aforementioned amounts include funds held in accounts as of the date on which the operations of the bank have been suspended **together with accrued interest** up to the date on which the decision concerning the declaration of bankruptcy of the bank is issued. From that date onwards, interest on the funds held at the bank is no longer accrued.

The amount of deposit covered by the BFG is determined according to the following principles:

- the sum of funds deposited by one person in all accounts (e.g. time deposits, current accounts, personal transaction accounts) at a given bank constitutes the basis for the calculation of the compensation;
- the bank's liabilities to a given depositor are summed up and then offset against their liabilities to the bank.

Within the Polish DIS, the **co-insurance**, i.e. incomplete protection of depositors regarding the part of the deposit in excess of 1,000 euro (but not exceeding 22,500 euro) has been adopted. Within the aforementioned range, the BFG covers only 90% of deposit amount, while the depositor bears the risk related to the loss of the remaining part, i.e. 10% of deposit amount. The introduction of co-insurance necessitates a distinction between the level of coverage and the maximum compensation paid (payout limit). In the DISs without co-insurance, these two amounts are equal, while if co-insurance is present, the maximum compensation paid equals the level of coverage less the co-insurance amount. As a result, **the potential maximum amount of compensation paid out in Poland is equivalent to 20,350 euro**.

It should be noted that the level of coverage, which initially amounted to ECU 3,000 only, was systematically raised in line with the gradual adjustment to European Union directive requirements. The currently in force level of coverage offered by the Bank Guarantee Fund was reached at the beginning of 2003. Table 2 presents the upper limits of guaranteed amounts in particular years.

Table 2
History of the level of coverage offered by the BFG

Guaranteed amount, EUR	In force until
3 000	30.06.1997
4 000	31.12.1997
5 000	31.12.1998
8 000	31.12.1999
11 000	31.12.2000
15 000	31.12.2001
18 000	31.12.2002
22 500	currently

Source: Annual reports of the BFG.

The fact that the level of coverage is set at 22,500 euro does not mean, however, that the depositor automatically loses the amount in excess of the limit should the bank in which they have deposited the funds declare bankruptcy. In certain circumstances, it is possible to recover the part of the deposit which is not covered by the BFG scheme. It constitutes the depositor's claim on the bankruptcy estate of the bank and may be recovered in the course of bankruptcy proceedings foreseeing reorganisation arrangement or the liquidation of the estate of the bankrupt bank. The part of deposit which is not covered by BFG guarantees may be recovered as a result of distribution of the estate of the bankrupt bank[20], and where the failed bank has been acquired by another bank, the new owner assumes its liabilities to customers.

The level of coverage in European Union countries has been harmonised by the regulations of Directive 94/19/EC. Pursuant to its requirements, **the level of coverage offered by individual schemes must not be lower than 20,000 euro**. It should be noted that the regulations of the directive are not precise enough in this respect, i.e. it is not clear whether the amount of 20,000 euro pertains to the level of coverage or to the amount of compensation received by the depositor (level of coverage less co-insurance amount). The first interpretation has been adopted by two countries (Slovenia and Malta) where the level of coverage has been set at 20,000 euro and additionally the co-insurance at 10%. As a result, the maximum potential amount of compensation paid in these countries is 18,000 euro.

The figure below presents payout limits, i.e. the maximum amounts of compensation paid to depositors offered by individual DISs in European Union countries.

As evidenced by the figure below, payout limits in most European Union countries have been set at the minimum level or slightly higher than required by Directive 94/19/EC. The level of coverage offered by the Bank Guarantee Fund (shown in yellow) is average and equal to the median value for European Union countries.

Payout limits in Italy, France, Great Britain and Denmark (shown in brown), which are much higher than 20,000 euro, deserve mention. Very high level of coverage is also offered by the voluntary DIS in Germany, which covers deposits up to 30% of a bank's own capital. The complementary character of the German compulsory and voluntary schemes makes the combined level of coverage offered by both practically unlimited[21].

The opposite is true with regard to the level of coverage offered by the DISs operating in the Baltic states – Lithuania, Latvia and Estonia (shown in grey). The payout limits currently in force in these countries are much below EU requirements. This is a consequence of the transitional periods negotiated by these countries with regard to the level of coverage in force until the end of 2007.

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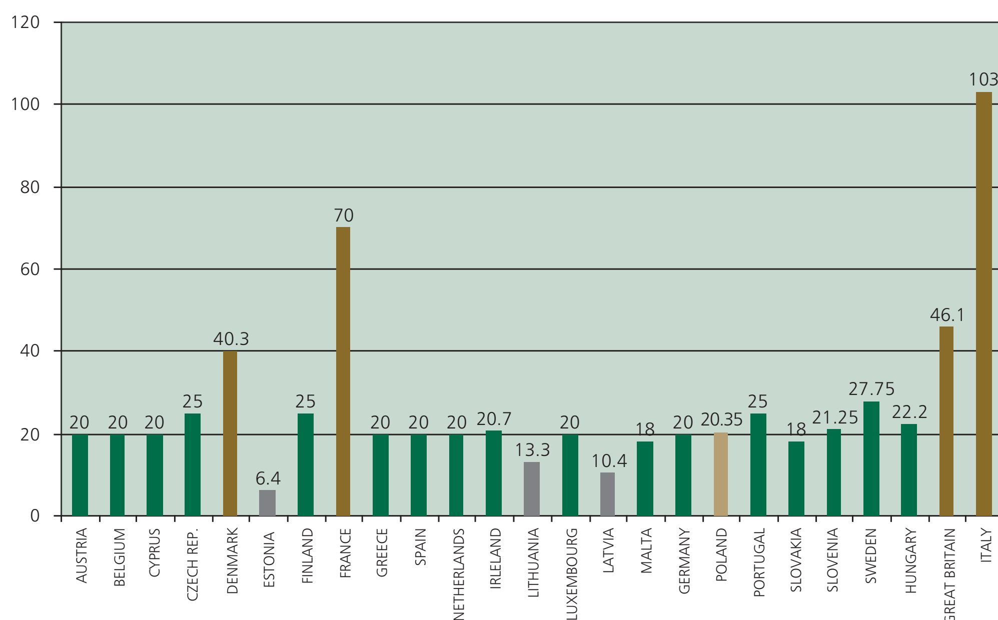
[20] Pursuant to the bankruptcy law, the BFG has an extremely privileged position with regard to the order of satisfying creditors during bankruptcy proceedings — the BFG's claims are settled directly after the costs of bankruptcy proceedings and the remuneration for the bank's employees' work are settled (Art. 30 of the Act on the BFG, Art. 440, para. 2 of the Bankruptcy and Recovery Act).

[21] The voluntary DIS in Germany is complementary to the compulsory scheme operating in this country. Where a bank declares bankruptcy, compensation is first paid by the compulsory scheme, while unsatisfied claims are covered by the voluntary one. Where banks participate in both German schemes at the same time, the level of coverage is practically unlimited.

Figure 3
Payout limits in EU countries (thousand euro)



Source: own research. In the case of Germany, only the level of coverage offered by the mandatory DIS has been accounted for.

Pursuant to legal regulations in force, differences between the levels of coverage offered may be used as an instrument of competition between banking sectors in individual European Union countries. Pursuant to the home country control principle, foreign branches of a bank registered in an EU member state operating in another EU country are covered by guarantees under the DIS implemented in the home country. Although Directive 94/19/EC includes the export prohibition clause[22], it only remained in force until December 31, 1999. It is currently accepted that foreign branches of Italian or French banks operating in EU countries with lower level of coverage offer depositors better guarantees than local banks.

While comparing the level of coverage currently in force, one should not only look at face values. In order to assess the **real level of guarantees offered to depositors**, the level of coverage should be viewed against the background of the parameters of a given economy. Such parameters may include the average deposit amount, national product per capita or the average annual disposable income in a given economy. The figure below presents the ratio of payout limits to GDP per capita (2003 figures) calculated for individual European Union countries.

Although the face value of the level of coverage offered by the BFG is not very high, in real terms (compared to GDP per capita) it is one of the highest among European Union countries (Figure 4). Only the Italian DIS is more generous in real terms; the face value of its payouts is over five times higher than in Poland. The Polish ratio of payout limit to GDP per capita is 4.2 and significantly exceeds the unweighted average for EU countries, which is 1.9, and the corresponding worldwide ratio, which stands at 2.4[23].

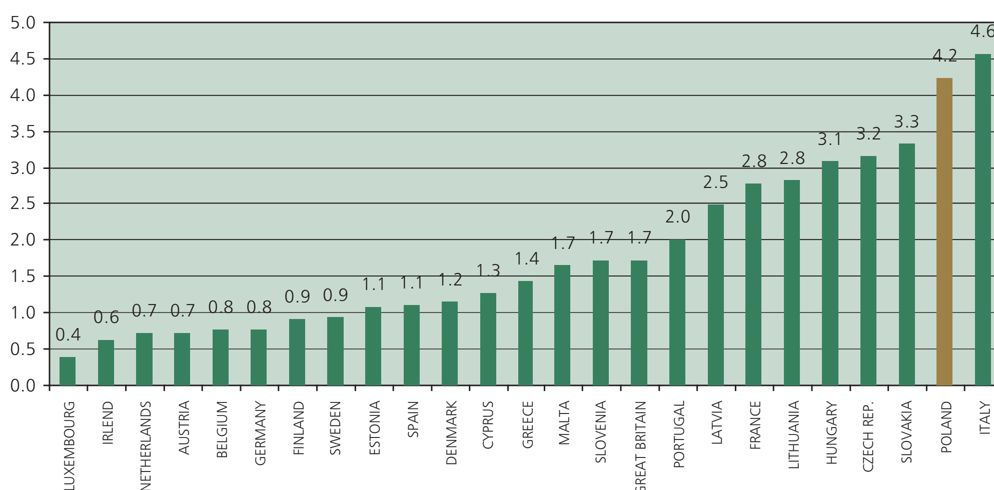
These data indicate that the level of coverage offered by the BFG is relatively high. Such a situation may cause a relaxation in market discipline and increase the probability of moral hazard; IMF research indicates that the level of coverage ranging from one to two times the GDP per capita in a given country helps strengthen market discipline and avoid moral hazard.[24] Therefore Poland

[22] The clause concerned both the level and scope of coverage offered.

[23] See: Garcia (2000).

[24] See: Garcia (2000).

Figure 4
Ratio of payout limits to GDP per capita in EU countries



3

Source: own research; GDP per capita figures from Eurostat web pages; figures for Spain, Great Britain and Italy are estimates.

should actively seek to prevent any increase in the minimum coverage amount harmonised by the regulations of Directive 94/19/EC in the immediate future.

Pursuant to the regulations of Directive 94/19/EC, DISs in Member States may make the depositor partially liable for its deposit. The **co-insurance** must not exceed 10%, however. In practice, over a half (13)EU countries have taken advantage of this. It should be noted that the depositor's joint liability has been introduced relatively more often (in 80% of the cases) in the DISs of new European Union Member States.

In practice, co-insurance in EU countries involves:

covering 90% of deposit amount – in Austria, Cyprus, the Czech Republic, Estonia, Ireland, Luxembourg, Malta, Germany and Slovakia;

covering deposits in full up to a relatively small amount and partial (90%) guarantees for the remaining part – apart from Poland, this solution has been adopted by Lithuania, Hungary and Great Britain.

The adoption of this arrangement in the Polish DIS should be assessed positively – by distributing the risk between the depositor and the scheme, co-insurance strengthens market discipline as well as creates incentives to monitor the economic and financial standing of the bank, and consequently reduces the probability of moral hazard.

3.3. Deposits covered by the scheme

The scope of deposits covered is another important element of a DIS. The BFG scheme covers funds deposited by residents and non-residents in bank accounts registered under their names. Claims resulting from other bank operations, which are substantiated by documents made out by the bank in the owner's name (e.g. certificates of deposit, savings bonds), are also covered by guarantees. Joint accounts are also covered by the scheme – in such cases, the value of compensation is calculated for each account co-holder separately. It should be remembered that the bank's liabilities to a given depositor are summed up and then offset against their liabilities to the bank.

In general, the BFG scheme covers zloty and foreign currency deposits registered under their owners' names, deposited by:

- natural persons;
- juridical persons;
- non-corporate organisational units provided they have legal capacity (e.g. partnerships, establishments within multi-establishment enterprises, company branches and representative offices, branches of state juridical persons, municipal units and various informal organisations pursuing specific objectives);
- school savings programmes and employee savings-and-loan associations.

On the other hand, the BFG scheme does not cover deposits from undertakings which, in the legislators' view, are able to professionally assess the economic and financial standing of a bank, such as:

- organisational units of the Treasury;
- financial intermediaries such as: banks, brokerage houses, pension funds, investment funds, National Investment Funds and undertakings providing insurance services;
- undertakings which are not permitted to draw up abridged balance sheets and profit and loss accounts, i.e. "large" non-financial institutions;
- the bank's management and its major shareholders (holding at least 5% of the bank's shares).

Funds which are not covered by the BFG scheme include as well:

- securities other than for money claims (e.g. options);
- mortgage bonds;
- funds with regard to which an absolute and final court decision has been passed pronouncing them to originate from money laundering crimes.

The definition of covered deposits (although not entirely precise)[25], and the list of excluded funds and depositors adopted in the Polish scheme conform to the requirements of Directive 94/19/EC. Due to the need to limit the costs of the scheme and also in order to minimise moral hazard, the directive stipulates that **certain categories of deposits must be excluded from guarantees**. The following must not be covered by any scheme:

- deposits made by other credit institutions on their own behalf or for their own account, i.e. interbank deposits;
- all instruments which would fall within the definition of own funds (e.g. bonds included in own funds);
- deposits arising out of money laundering transactions.

Apart from deposits which must be excluded from coverage, the directive indicates types of deposits which a given member state may exclude from coverage **at its discretion**. The list of such deposits, included in Annex I to the directive, includes the following deposits:

- by financial institutions;
- by insurance undertakings;
- by government and central administrative authorities;
- by provincial, regional, local and municipal authorities;
- by collective investment undertakings;

[25] E.g. with regard to the coverage by the BFG scheme of bonds issued by banks.

- by pension and retirement funds;
- by management and large shareholders of the bank and their relatives;
- by other companies in the same group;
- non-nominative deposits;
- yielding excessive benefits where they contributed to aggravation of the bank's financial situation;
- in currencies other than the euro or Member States' currencies;
- by large enterprises.

In practice, particular EU Member States took advantage of the optional exclusions listed above to varying extents. In the overwhelming majority of countries (around 90% of schemes), deposits made by financial institutions have been excluded from coverage. On the other hand, deposits in currencies other than the euro or Member States' currencies are excluded relatively rarely (around 30% of cases).

While exclusions with regard to covered deposits employed in various schemes are compared, the schemes may be divided into:

- liberal ones, which offer relatively broad coverage (few exclusions) – these are mostly Scandinavian schemes (Sweden[26], Finland and Denmark[27]);
- restrictive ones, where a relatively large number of deposit categories have been excluded from coverage (Austria, France and Malta).

The scope of coverage offered by the Polish DIS appears moderate compared to the arrangements adopted in other EU countries. Therefore, the BFG is neither very liberal nor restrictive in this respect. Such a solution should be assessed as positive as it aims for the golden mean between the liberal model, which gives better protection to depositors, and the restrictive one, which usually places a greater burden on its members and makes the DIS more prone to moral hazard.

3.4. BFG guarantee activities

As their name suggests, the basic function of all DISs are guarantee activities. This function consists in **paying out compensation**, i.e. guaranteed amounts, where a bankruptcy is declared in the banking sector.

Where bank's assets are insufficient to cover its liabilities, the Commission for Banking Supervision decides to suspend the bank's operations. The CBS motions the court with the jurisdiction over the seat of the bank to **declare the suspended bank bankrupt**. The court should consider the motion within one month. Where bankruptcy is declared, the court appoints a trustee and a judge-commissioner. The trustee takes over, administers and liquidates the estate of the bankrupt bank. The judge-commissioner directs bankruptcy proceedings and supervises the trustee's activities.

Within 30 days of the date on which the bank has been declared bankrupt, the trustee determines in accordance with the bank's books and submits to the BFG, among other things, **the list of depositors** together with the information on guaranteed amounts due to each depositor and the amount of the bank's liquid funds included in the bankruptcy estate. Having approved the list of depositors, the Fund Management Board passes a resolution regarding the payment of guaranteed amounts. Subsequently the trustee, having received appropriate funds from the BFG,

[26] Although the number of discretionary exclusions indicated in Directive 94/19/EC is relatively low in the Swedish scheme, it only covers short-term deposits, contrary to the regulations of the directive.

[27] The Danish fund even covers funds held in pension accounts.

makes payouts to the depositors of the failed bank. Payouts are made according to the timetable approved by the BFG Management Board but not later than 3 months after the funds become unavailable[28]. Where unfavourable circumstances occur, the court may grant two 3-month extensions of the payout period at the request of the Fund Management Board, i.e. the entire payout procedure may not exceed 9 months. Compensations are paid out by the receiver or trustee in locations and on dates which have been made publicly known. Subsequently, during 5 years from the date on which the bank was declared bankrupt, the compensations due are paid out by the BFG. It should be noted that claims related to guaranteed amounts expire 5 years after the date on which the bank was declared bankrupt.

The scope of Bank Guarantee Fund guarantee activities is presented in Table 3.

Table 3
BFG guarantee activities during the years 1995-2004

YEAR	NUMBER OF BANK BANKRUPTCIES	AMOUNT OF COMPENSATION PAID, m zloty	NUMBER OF ENTITLED DEPOSITORS
1995*	50	103.7	88.7
1996	31	50.8	59.4
1997	6	6.4	10.4
1998	4	8.2	6.8
1999	1	4.7	1.6
2000	1	625.1	147.7
2001	1	12.2	2.5
2002	0	0.5	0.3
2003	0	0.1	0.0
2004	0	0.0	0.0
TOTAL	**94**	**811.7**	**317.4**

Source: Annual Report of the BFG, 2003.
* 50 banks went bankrupt in 1995 during the period when the Law on the BFG was in force; 60 banks failed during the entire year.

During the operation of the BFG, i.e. since April 1995, **94 banks have gone bankrupt**, including 5 commercial banks and 89 cooperative ones. The number of pay-outs makes the BFG the most experienced guarantee institution operating in an EU country[29]. The overwhelming majority of failures happened during the first two years of the Fund's operation. The most serious bank failure (in terms of the number of entitled depositors and the amount of compensation paid) occurred in 2000, however. The bankruptcy of a medium-sized commercial bank (*Bank Staropolski SA*) was declared at that time. From 1995 to 2004, the BFG paid out a total of 811.1m zloty in guaranteed deposits to the depositors of bankrupt banks. Compensation was paid out to 317,400 entitled depositors.

[28] Funds are unavailable where the covered deposits are due but cannot be withdrawn from the date on which the bank's operations have been suspended.

[29] Based on the results of a survey conducted by the Italian guarantee fund presented during the *European Forum of Deposit Insurers* seminar in Padua on November 8–9, 2004.

4
BFG as a risk minimiser

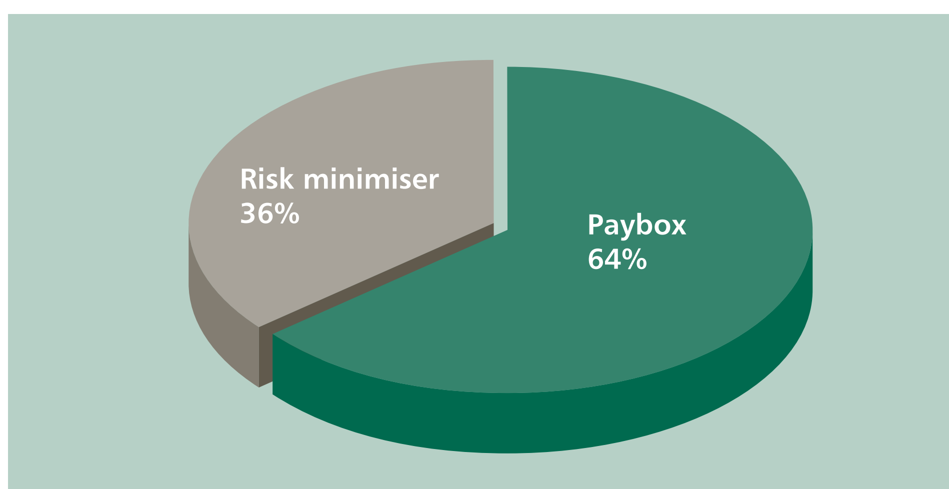
The DISs operating in various countries exhibit significant differences with regard to their powers and the types of activities undertaken. In accordance with the international terminology, such schemes may be divided into two categories:

- *paybox* – their powers are limited to paying out guaranteed deposits where a credit institution declares bankruptcy;
- *risk minimiser* – such institutions have wide-ranging powers including the option of extending financial support to prevent a bank from failure. It should be noted here that there are significant differences between individual schemes with regard to the assistance instruments employed.

According to the classification above, the BFG comes within the risk minimiser category. Apart from its guarantee-related function, the Polish fund is equipped with powers to financially support the rehabilitation of banks which are threatened with insolvency. Moreover, the BFG is authorised to conduct audits at banks under rehabilitation and extend loans in order to support merger processes at cooperative banks which are not threatened with insolvency.

The capacity to undertake any activities apart from guarantee-related ones (including e.g. rehabilitation operations to prevent bank failure) has not been regulated in any way by Directive 94/19/EC. As a result, DISs operating in European Union countries exhibit significant differences with regard to their admissible scopes of activity (Figure 5). Most (16 out of 25) operate as a paybox, and are only authorised to pay compensation to depositors after a bank's bankruptcy has been declared. The remaining 9 guarantee funds have been granted powers to conduct assistance activities aimed at preventing bankruptcies in the banking sector. Apart from the BFG, wide-ranging prerogatives have been granted to the Austrian, Danish, French, Spanish, Lithuanian, German, Hungarian and Italian funds.

Figure 5
Range of DIS powers in EU countries



Source: own research.

The assistance activities conducted by the Bank Guarantee Fund[30] consist in extending **repayable financial support** to banks where a threat of insolvency emerges. The BFG assesses the threat of the bank's insolvency upon an analysis of its economic and financial standing, on considering both the scale and the causes of the bank's financial difficulties. Insolvency is deemed a threat where the capital adequacy ratio falls below supervisory requirements and balance sheet loss has been recorded at the bank.

The list of available forms of assistance offered by the BFG is a closed one and includes extension of a loan, endorsement or guarantee and acquisition of debts of the banks, except for irregular ones[30].

The circumstances in which the Bank Guarantee Fund may extend repayable financial support are specifically stipulated in legal regulations. **The aid granted by the BFG may only be allocated to the following purposes:**

- elimination the danger of insolvency (the so-called self-rehabilitation of the bank);
- acquisition of a bank or part thereof or a merger between banks if the bank being acquired is threatened with insolvency;
- purchase of shares in a bank, which is threatened with insolvency, by new shareholders.

Fundamental principles underlying the assistance activities undertaken by the BFG include:

- equal access to assistance funds for all banks;
- transparent criteria and procedures for granting assistance;
- making funds available to banks at the earliest possible stage in order to minimize losses;
- supporting merger processes by extending assistance to the bank which acquires a bank threatened with insolvency;
- involving bank owners in financial support for the rehabilitation process;
- creating incentives for banks to seek additional financing sources apart from the BFG;
- granting assistance solely at the request of the interested bank, on the basis of a formal application submitted to the BFG;
- financial support granted by the BFG may only be used to remove the threat of the bank's insolvency;
- in order for financial support to be granted, a bank must provide collateral.

The Bank Guarantee Fund extends repayable financial support to banks **on more-favourable-than-market terms**. Therefore the Fund may extend loans with lower interest rates, charge lower fees on guarantees and endorsements extended and set time limits for debt repayment which are favourable for banks. Since June 2002, the annual interest on loans extended by the BFG has ranged from 0.1 to 0.4 of the NBP rediscount rate. It should be noted that in the case of delinquency in the payment of principal or interest, statutory interest is accrued. The fee for commercial banks has been set at 0.3% and for cooperative banks at 0.1% of the loan amount. The fee on endorsements and guarantees extended is 0.5% of the endorsement or guarantee amount. The period during which the borrower avails of loans should not exceed 5 years in principle, but it may be extended to 10 years in exceptional circumstances. In duly founded cases, the Fund Management Board may decide to grant a grace period for the repayment of loan principal.

[30] Detailed regulations regarding the assistance activities of the BFG are included in Resolution No. 35/97 of the BFG Council on the stipulation of principles, forms, conditions and procedure of extending financial support to undertakings covered by the mandatory scheme of November 20, 1997.

[31] Detailed regulations are included in the Ordinance of the Council of Ministers on BFG's trade in claims purchased from banks where a threat of insolvency has emerged of September 22, 1999.

However, the BFG requires the beneficiary bank to meet a number of conditions when granting financial support. The most important requirements include:

- submitting the results of the audit of the bank's financial statement to the Fund;
- obtaining the approval of the Commission for Banking Supervision concerning the rehabilitation proceedings programme (or the advisability of an acquisition or merger, as applicable);
- demonstrating that the amount of financial support applied for is not higher than the amount of covered deposits held by the bank (the least-cost resolution principle);
- utilising the bank's existing regulatory capital to cover losses.

Table 4
BFG assistance activities during the years 1995-2004

YEAR	NUMBER OF LOANS EXTENDED	AMOUNT OF LOANS EXTENDED, m zloty
1995	0	0.0
1996	9	129.2
1997	28	343.7
1998	17	219.1
1999	11	284.1
2000	6	205.4
2001	6	749.0
2002	5	132.8
2003	14	751.0
2004	1	450.0
TOTAL	**97**	**3 264.3**

Source: Annual reports of the BFG.

As evidenced by Table 4, during its period of operation the BFG extended financial support to banks totalling 3,264.3m zloty. By the end of 2004, 97 loans in total were granted, of which 43 amounting to 2,980.4m zloty to commercial banks and 54 amounting to 283.9m zloty to cooperative banks. This amount was allocated to:

- self-rehabilitation of cooperative and commercial banks (2,249.0m zloty);
- consolidation activities of cooperative banks (100.8m zloty);
- acquisitions conducted by commercial banks (914.4m zloty).

The assistance activities of the BFG directly contributed to limiting the scale of bank failures. As a result of such activities, **deposits amounting to much more than the total amount of loans were salvaged** (Table 5). Had all the banks which used the BFG's financial support declared bankruptcy, compensation to depositors totalling 62,090.9m zloty would have had to be paid. Another 21,143.7m zloty would have been lost by entities whose deposits were (partially or fully) excluded from the BFG coverage.

Moreover, the assistance activities of the BFG from 1995 to 2004 contributed to preserving 1,927 bank field branches and 63,940 jobs. The Fund's financial support also translated to ensuring continued access to banking services as well as an improvement in the efficiency and effectiveness of the banks' operations.

Apart from guarantee and assistance activities, other areas of activity of the Bank Guarantee Fund should be mentioned. In 2000, the Polish fund gained new powers[32] to extend loans in order to **support merger processes at cooperative banks which are not threatened with insolvency**.

[32] Pursuant to the Act on the Operations of Cooperative Banks, their Affiliation and Affiliating Banks of December 7, 2000.

Table 5
Effects of BFG assistance operations over the years 1996-2004 (m zloty)

YEAR	AMOUNT OF LOANS EXTENDED	GUARANTEED AMOUNTS HELD BY BANKS ASSISTED BY THE BFG	AMOUNT OF DEPOSITS NOT COVERED BY FUND'S GUARANTEES
1996	129.2	162.3	282.3
1997	343.7	1 297.2	828.2
1998	219.1	8 228.8	2 783.5
1999	284.1	1 343.8	1 399.9
2000	205.3	305.1	265.3
2001	749.0	49 275.8	11 170.8
2002	132.8	166.7	62.2
2003	751.0	752.1	121.5
2004	450.0	559.1	4 230.0
Razem	**3 264.2**	**62 090.9**	**21 143.7**

Source: Annual report of the BFG, 2003. It should be taken into account that in 2001 assistance was granted to PKO BP SA, which significantly distorts comparisons between amounts of loans extended and amounts of guaranteed deposits.

These loans are primarily aimed at financing investments consisting in the uniformisation of computer software and hardware, banking technologies, financial and accounting procedures and the range of banking products and services on offer as well as the purchase of shares in the affiliating bank. The loan term is 3 years and the interest rate is equal to 0.1 of the NBP rediscount rate, while the fee is 0.1% of the loan amount. The total amount of such support extended by the BFG from 2001 to 2004 was 176.1m zloty, of which 170.3m zloty was allocated to financing mergers and investment and 5.8m zloty to the purchase of affiliating bank shares.

The powers of the Bank Guarantee Fund include **conducting audits** (also direct ones) at the banks which use the Fund's financial support. The BFG verifies whether the loans extended to banks are properly (expediently and efficiently) utilised and whether the rehabilitation, merger or restructuring programmes are properly implemented. Audits conducted by the BFG concern:

- proper loan utilisation;
- the progress made with regard to the loan utilisation plan and the rehabilitation programme;
- the bank's economic and financial standing;
- the fulfilment of additional conditions stipulated in the loan agreement.

Where frequent and thorough audits fail to yield desirable results, the Bank Guarantee Fund may be appointed **conservator** by a decision of the Commission for Banking Supervision. The conservator exercises constant control over the bank's operations and the implementation of the rehabilitation programme. The BFG Management Board appoints attorneys who assume the conservator's responsibilities. The conservator's attorney attends the meetings of the Management Board and the Supervisory Board of the bank and has access to all documents related to the bank's operations. The conservator's most important prerogative is the right to challenge the decisions of the bank's authorities in court if in their view such decisions jeopardise the achievement of the objectives set out in the rehabilitation programme.

Another area of the Fund activity is **monitoring** the overall condition of the banking sector and of individual banks. The monitoring conducted by the BFG aims to identify threatened banks or banks whose financial situation is deteriorating[33]. The BFG also monitors the condition of the banks using its assistance[34].

The comparison of the number and scale of interventions of the Polish Fund regarding its various activity areas from 1995 to 2004 reveals certain evolution in the BFG task hierarchy. Over

[33] More on this subject in: Konat and Sowińska (2002) and *Ocena sytuacji finansowej sektora bankowego w 2003 roku (na podstawie danych audytowanych) w świetle analizy BFG* (2004).

[34] More on this subject in: Zborowska (2004).

years of the BFG's operations, the focus gradually shifted from the guarantee function to assistance activities. While in the first two years of the Fund's operation pay-outs dominated, since 1997 the number of assistance interventions has exceeded the number of pay-outs.

The experience of other countries shows that wider-ranging powers of the DIS, and in particular the capacity of extending assistance to threatened banks, usually translate to **lower operating expenses** of a given scheme in the long run. It should be noted, however, that this relationship only holds when a DIS is obliged to choose the least costly method, also taking the bank's bankruptcy and the pay-out into consideration. Canadian experience shows that due to the extension of powers of the Canadian fund (which took place in 1987), the operating expenses of the DIS were reduced from around 52 cents to around 17 cents per every dollar in premiums[35].

The 10-year experience of the Bank Guarantee Fund allows a favourable assessment of the assistance activities of the Fund. These interventions, based on the formula described above, largely contributed to stabilising the banking sector and actively supporting structural reforms within it. It should be noted, however, that the system in its present form, which is based on extending low interest loans to banks, has steadily become less efficient. Banks invest the loans obtained from the BFG in Treasury securities and the spread between the interest on such securities and the interest on the loan granted is their real income from the support extended. The efficiency of such loans has declined due to a significant decrease in the yield of these securities. Therefore achieving a comparable income in present circumstances would require a sharp increase in the amount of loan granted by the BFG[36].

There is a general consensus that the **list of assistance instruments available to the BFG must be extended**. Much hope is attached to the Fund being able to purchase a majority stake in the bank threatened with insolvency. Thus the BFG would become (for a limited period) the strategic investor whose aim would be to restructure the bank and then sell the shares it holds on market terms. The possibility of the Fund extending subordinated loans is also considered. The extension of the BFG's scope of activity may also consist in entrusting it with the additional responsibility of liquidating the banks which cannot be rehabilitated.

The experience of other countries also indicates that the powers of the BFG, and particularly the list of assistance instruments available, should be extended. Most European DISs operating as a risk minimiser enjoy wider powers than the BFG with regard to extending assistance to banks threatened with insolvency. In 2 countries (Italy and France) the list of available instruments is open-ended – it is assumed that the authorities of the guarantee institution are responsible for selecting the specific form of assistance[37]. However, regardless of the manner in which the list of assistance forms is specified (a closed list or the principle of arbitrary choice), the fund's authorities are obliged to choose a specific method according to the **least-cost resolution principle**, just as in Poland[38].

The scope of powers of a given DIS obviously influences the **number of persons employed by the guarantee institution**. There is wide variation between DISs in this regard – the Swedish paybox scheme normally employs 2 persons, while the Korea Deposit Insurance Corporation, which acts as a risk minimiser, has around 800 employees. The Bank Guarantee Fund employs 91 persons. This is a relatively large number compared to guarantee institutions in European Union countries – even those with wide-ranging powers. The BFG's large payroll partly results from the scale of interventions undertaken by the Fund, which in turn stems from the number and standing of individual banks.

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[35] See: Sabourin (2003).

[36] See: Baka (2004a).

[37] More information on the most frequently employed forms of assistance for problem banks in: Pawlikowski (2004).

[38] See: Obal and Polijaniuk (2003).

5
BFG Financing

5.1. General BFG financial management principles

The mode of financing is a very important aspect of every DIS. In each case, however, the scheme should be financed in a way that ensures its smooth operation. Financing encompasses five fundamental issues:

- providing the initial capital of the DIS;
- the entities financing the scheme (under normal and contingency conditions);
- the time when funds are accumulated;
- types and structure of contributions;
- regulations concerning the fund's investments.

The financial management of the Bank Guarantee Fund is based on the **annual financial plan** drawn up by the Fund Management Board and approved by the Fund Council by the end of the financial year preceding the year which it concerns. The financial plan includes, among other things, information on the planned amounts of individual funds as well as the planned earnings and assets of the BFG. Moreover, the Fund Management Board draws up the **report on the Fund's activities and the financial statement** for the previous financial year by March 31 of each year, which is first accepted by the BFG Council and then approved by the Council of Ministers.

According to financial management principles, the BFG establishes the following funds[39]:

- **statutory fund** – established in order to ensure money for acquisition of the Fund's tangible fixed assets and to make compensation payouts after other sources have been exhausted. The statutory fund was established by a joint contribution of the National Bank of Poland and the Ministry of Finance. In 1995, these institutions paid contributions of 50m zloty each to the BFG, thus supplying its initial capital;
- **assistance fund** – established in order to ensure money for financing the Fund's tasks entailing the provision of assistance to entities covered by the scheme;
- **guaranteed deposit protection fund (GDPF)** – designed to finance the guarantee activities of the BFG. It should be emphasised that this is the only fund in this group not included in the BFG's own funds;
- **fund for restructuring of cooperative banks** – used to extend loans in order to support merger processes at cooperative banks which are not threatened with insolvency;
- **reserve fund** – established in order to secure funds to cover potential balance sheet losses as well as to make pay-outs and supply the assistance fund after other financing sources have been exhausted;
- **revaluation reserve** – is used to record movements in the value of fixed assets due to their revaluation. The amount of this fund increases with each increase in the value of fixed assets.

[39] Ordinance of the Council of Ministers on the Statute of the Bank Guarantee Fund of February 28, 1995.

The GDPF and the assistance fund are the most important ones for the operation of the Polish DIS. Therefore these funds will be described in more detail later in this paper.

Moreover, the financial management principles of the Bank Guarantee Fund stipulate **the manner in which the funds held by the Fund are invested**. The BFG's funds and securities are held at the NBP in a current account, time deposit accounts, a separate special account for guarantee settlements, in the Central Treasury Bill Registry and the NBP Money Market Bill Registry as well as the National Depository for Securities or a brokerage house selected by the Fund. The BFG may only invest available funds by purchasing securities issued or fully guaranteed by the Treasury or the NBP as well as money market fund units.

It should be mentioned that the Bank Guarantee Fund is exempt from corporate income tax.

5.2. Financing of guarantee activities

The Bank Guarantee Fund may dispose of funds accumulated by banks in the form of the **guaranteed deposit protection funds** in the course of its guarantee activities. All the banks covered by the BFG scheme are obliged to establish this fund. The GDPF is a **dormant one** because the BFG only requests banks to make appropriate funds available when a bankruptcy is declared in the banking sector. Specified amounts from the GDPF are transferred by banks to the BFG's special account and are the basic source from which the depositors' claims are satisfied. Therefore, taking the time when funds are accumulated into account, **the guarantee activities of the BFG are financed in an ex post mode**.

5

The **size of the GDPF** during a given year is determined in accordance with the amount of the bank's funds which form the basis for calculating the amount of reserve requirements and the percentage rate set annually by the Fund Council. The maximum GDPF rate is 0.4%. In subsequent years, the size of GDPF is determined in accordance with the amount of funds in October of the previous year and then adjusted in accordance with the data for April of the current year. The GDPF is increased or decreased on July 1 of each year. Only the banks which have declared bankruptcy are exempt from the obligation of establishing the GDPF.

Banks are required to invest the funds which constitute the GDPF in **Treasury securities and NBP money market bills as well as money market fund units** only. Except for money market fund units, these assets are held in deposit accounts (separate for each bank) with the National Bank of Poland or the National Depository for Securities. It should be emphasised that the funds constituting the GDPF are a source of interest income to banks and are included in their balance sheets – therefore they are not own funds of the BFG.

It should be noted that a bank's bankruptcy does not always necessitate payouts from the GDPF. Compensation for depositors is paid in the first place from the liquid assets of the failed bank as well as assets recovered from bank bankruptcy estates of previous years. Such a situation occurred in 1999 and 2001 where, despite failures in the banking sector, there was no need to use GDPF funds (Table 6). If, however, the amount of compensation exceeds the amount of the funds mentioned above, banks contribute appropriate amounts to the BFG in proportion to the amounts of the GDPF established by each of them.

Information concerning the percentage rates, amounts and the utilisation rates of the GDPF is presented in Table 6.

As it has already been mentioned, 94 banks have gone bankrupt during the operation of the Bank Guarantee Fund, i.e. since April 1995. From 1995 to 2004, the Fund paid out a total of 811.7m zloty of compensations to the depositors of failed banks. Out of this amount, 626m zloty (i.e. 77.2%) were GDPF funds, while the remaining 185m zloty (i.e. 22.8%) were liquid assets of failed banks and funds recovered from bankruptcy estates.

In the operations of the BFG to date, the GDPF has proved sufficient to finance the bankruptcies which occurred in the banking sector. If, however, the amount of compensation to be

Table 6
Guaranteed deposits protection fund from during the years 1995-2005

Year	GDPF percentage rate		GDPF amount	GDPF utilisation rate
	Other banks	PKO BP, Pekao SA and BGŻ SA		
	%		m zloty	%
1995	0.40	0.20	225.7	38.0
1996	0.40	0.20	317.1	14.9
1997	0.18	0.12	198.8	2.4
1998	0.10	0.05	128.3	3.2
1999	0.16	0.08	271.6	0.0
2000	0.40		999.5	48.4
2001	0.30		873.6	0.0
2002	0.40		1 245.4	0.0
2003	0.40		1 264.3	0.0
2004	0.25		826.5	0.0
2005	0.13			

Source: Annual reports of the BFG. In 1999 and 2001, all deposits covered by the BFG were paid out from assets recovered from bank bankruptcy estates and placed no burden on the banking sector.

paid exceeded GDPF funds, the BFG would have to satisfy the depositors' claims from its remaining funds, including the statutory fund. If also those funds were to prove insufficient, the Fund could be supplied by the following **emergency financing sources**:

- A loan extended pursuant to a decision of the President of the NBP in the amount not exceeding *the amount equal to one half of the Fund's receipts from annual contributions payable by the undertakings covered by the guarantee scheme*[40];
- An increase in annual contributions and the GDPF percentage rate pursuant to a decision of the Council of Ministers, having sought the opinion of the President of the NBP, to the maximum of 0.8%.

Despite the potential support from the central bank, in principle the guarantee activities of the BFG are financed by its participants, i.e. commercial banks.

5

5.3. Financing of assistance activities

The assistance activities of the Bank Guarantee Fund are financed in an entirely different manner than guarantee interventions. The funds allocated to financial support extended by the BFG are accumulated in the assistance fund. This fund, in turn, is financed by **mandatory annual contributions** payable by all banks participating in the DIS. Only the banks which have declared bankruptcy are exempt from the obligation to contribute annual contributions to the BFG. Therefore, given the time when funds are accumulated, **the assistance activities of the BFG are financed in an ex ante mode**.

The **amount of the annual contribution** is determined in accordance with the risk-weighted assets of each bank and the percentage rate set annually by the BFG Council. The maximum rate for total balance sheet assets and risk-weighted guarantees and endorsements is 0.4%, while for other risk-weighted off-balance sheet liabilities[41] it is 0.2%. The calculations are based on the aforementioned amounts as of December 31 of the previous year. These contributions are payable within the time limits set by the BFG but not later than by March 31 each year. The assistance fund is managed at the BFG and each year its unused part is carried over to the next year. The assistance

[40] Art. 34, para. 3 of the Law on the Bank Guarantee Fund.

[41] Except for revolving credit facilities.

fund is additionally supplied by repayments of the loans previously extended to banks and receipts from the sales of previously acquired debts.

Commercial banks are not the only entities which finance the assistance fund of the Bank Guarantee Fund. From 1998 onwards, **the National Bank of Poland has also contributed to the assistance fund**. In 1998, its share was 30%, and in 1999 and 2000 it grew to 40%. Since 2001, the banks' assistance fund payments have been reduced by **50%** and the remaining amount has been contributed by the NBP.

Three commercial banks – PKO BP, Pekao SA and BGŻ SA – were covered by Treasury guarantees until the end of 1999[42]. As a result, the amounts of annual contribution paid by them to the BFG were reduced by 50% compared to the rest of the banking sector. These banks were also granted temporary "relief" with regard to the establishing of the GDPFs.

It should be noted that the following assets are exempt from the mandatory annual contribution:

- assets from contract credits agreements in banks keeping housing credit associations;
- assets derived from the issuance of mortgage bonds and public debentures;
- the National Housing Fund;
- the National Fund for Credit Guarantees;
- the Thermo-modernization Fund;
- the National Highway Fund;
- the Student Loans and Credits Fund;
- the assets held in the account for provisions for endorsement and guarantees kept by the State Treasury with Bank Gospodarstwa Krajowego.

Information concerning annual contributions and the amounts of the assistance fund in subsequent years is presented in Table 7.

Table 7
Assistance fund during the years 1995-2005

Year	Annual contribution rate, %		Banks contributions (1)	NBP contributions (2)	Total (1) + (2)	Loan repayment
	Other banks	PKO BP, Pekao SA, and BGŻ SA	m zloty			
1995	0.40	0.20	173.8	0.0	173.8	0.0
1996	0.40	0.20	230.0	0.0	230.0	0.0
1997	0.40	0.20	261.2	0.0	261.2	0.0
1998	0.28	0.14	209.2	89.8	299.0	3.9
1999	0.24	0.12	203.4	135.6	339.0	46.2
2000	0.23	0.23	258.5	172.4	430.9	71.4
2001	0.14	0.14	158.6	158.6	317.1	148.4
2002	0.08	0.08	95.5	95.5	191.0	280.3
2003	0.10	0.10	122.6	122.6	245.2	647.2
2004	0.075	0.075	93.1	93.1	186.2	365.6
2005	0.05	0.05				

Source: Annual reports of the BFG.
Between 1995 and 1999, a reduced rate applied to the banks whose deposits were covered by Treasury guarantees (PKO BP, Pekao SA and BGŻ SA). In 1995, a reduced rate also applied to cooperative banks.
From 1995 to 1997, a uniform rate of 0.4% applied to risk-weighted assets, guarantees and endorsments.
In 2001, the rate for savings and building societies was 0.10.%

[42] The Treasury guarantees for those banks applied to amounts exceeding the guarantees extended by the BFG, so they were supplementary ones.

From 1995 to 1997, the maximum annual contribution rate applied. In subsequent years, as a result of an improvement in the banking sector condition, the rate steadily declined to reach 0.05% in 2005. The annual contribution rate was slightly increased only once, in 2003.

5.4. BFG financing compered to other EU schemes

The provisions of Directive 94/19/EC do not discuss the issues of financing national DISs in much detail. It is stipulated that the costs of financing the scheme should in principle be borne by its participants, i.e. the banking sector. Moreover, the European Union Member States shall establish DISs whose financial assets are sufficient to meet potential liabilities. The latter, in turn, depend on the size of the banking sector and the position of individual banks. On the other hand, a certain limit must not be exceeded with regard to accumulating funds as this would pose a threat to the banking sector. The accumulation of funds by the DIS entails commensurate costs for the banking system. If the costs mount too high, the condition of the financial system may deteriorate and thus its safety may be compromised[43]. Therefore the guidelines concerning financing contained in the Directive are very general and leave Member States much leeway.

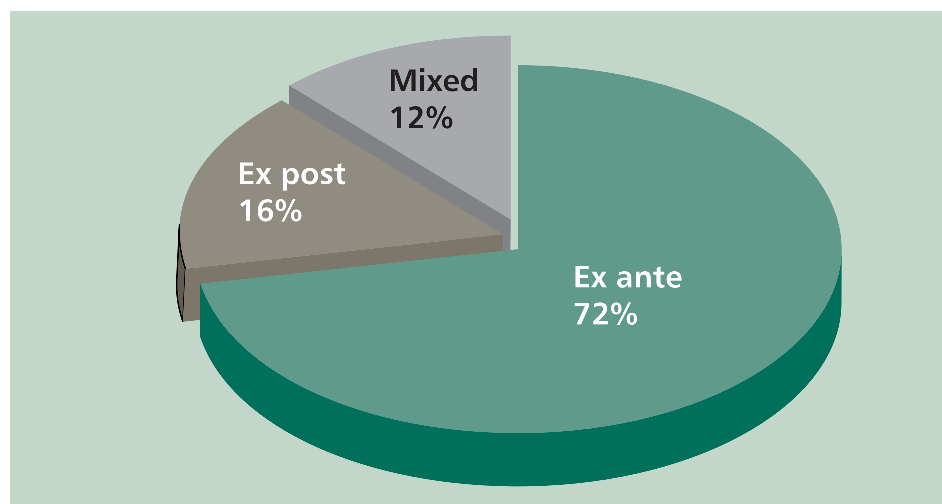
In practice, DISs operating in European Union countries exhibit significant differences with regard to financing. On considering the time where funds are accumulated, DISs can be divided into those financed:

in an ex ante mode, where the funds allocated to potential compensation payouts arising from guarantees are accumulated beforehand, according to the plan for each financial year;

in an ex post mode, where funds are only accumulated after the conditions triggering the guarantee have been met, i.e. after a bank has declared bankruptcy.

5

Figure 6
DIS financing in EU countries



Source: own research.

A large majority (18 out of 25) of DISs operating in European Union countries are financed in an ex ante mode (Figure 6). This means that in those countries the DIS physically holds the funds, which can be used pursuant to the regulations applicable in a given country. Only 4 countries – the Netherlands, Luxembourg, Slovenia and Italy – have adopted the ex post mode, i.e. DISs do not

[43] See: Obal (2004).

have significant[44] funds at their disposal if there are no failures in the banking sector. In the remaining countries, i.e. in Austria, Poland and Great Britain, the financing of the DIS exhibits both types of features, i.e. is a mixed one.

Therefore Polish regulations in this respect may be considered original compared to the arrangements adopted in other European Union countries. **In the case of the BFG, mixed financing has been adopted**, because guarantee activities are financed in an ex post mode and assistance activities in an ex ante one. Based on the 10-year experience of the BFG, the adopted method of financing should be assessed favourably. However, taking into account both the arrangements adopted in European Union countries and worldwide trends in this regard, it appears that the regulations concerning the BFG should evolve towards financing its activities in an ex ante mode. Moreover, this solution would promise numerous advantages, e.g. bank payments would be more evenly timed, it would be anti-cyclical and compensation would be paid sooner.

In some European Union countries where the DIS is financed in an ex ante mode, the **safe (target) amount of the fund** has been set. This is usually considered a limit and no further charges are collected after it is reached. The target fund amount is usually set with reference to the amount of deposits covered by the scheme and ranges from 0.5% in Belgium to 3% in Estonia. On the other hand, the limit within the Danish DIS has been set in absolute terms and amounts to DKK 3.2bn. Such amounts are determined on the basis of analyses taking the long-term stability of the banking sector into account. In the case of the financing mode changing from mixed to the ex ante one, the adoption of the concept of the target amount of accumulated funds within the Polish DIS appears absolutely reasonable. This would allow the BFG to build up a larger potential should more severe disruptions occur within the banking system. The appropriate amount of this fund remains an open issue but it appears that it should not be particularly high[45]. It should be kept in mind that adopting a relatively high ceiling translates into more security for the banking sector, since the assets of the DIS would be sufficient to cover bank bankruptcies on a larger scale. On the other hand, this would result in increased costs for the banking sector and the permanent outflow of funds from the sector to the DIS.

While discussing the financing of a DIS, other original arrangements employed in the case of the BFG, which have not been adopted by other European Union countries, should be pointed out. **Poland is the only European Union country where the operation of the DIS is co-financed by entities other than commercial banks under normal conditions**. As it has already been mentioned, 50% of funds contributed to the BFG assistance fund are supplied by the National Bank of Poland. It seems that this should only be a temporary arrangement since a rule included in Directive 94/19/EC stipulates that the costs of financing the scheme must in principle be borne by its participants, i.e. the banking sector. The supply of central bank funds also raises doubts concerning the issue of public aid, which is generally prohibited under the European Union legislation.

When it comes to the arrangement functioning in European Union countries, the establishment of only one fund within a given DIS is a standard solution. This fund is then used to finance both pay-outs and also to interventions related to assistance activities. The BFG operates several funds used to finance various areas of its activity. On considering the European experience, **all BFG funds should be amalgamated into one consolidated fund**, which would be used to finance all tasks of the Polish DIS. This solution should be assessed as advantageous as it would simplify the Fund's financial management and expectedly improve efficiency of fund management by the BFG.

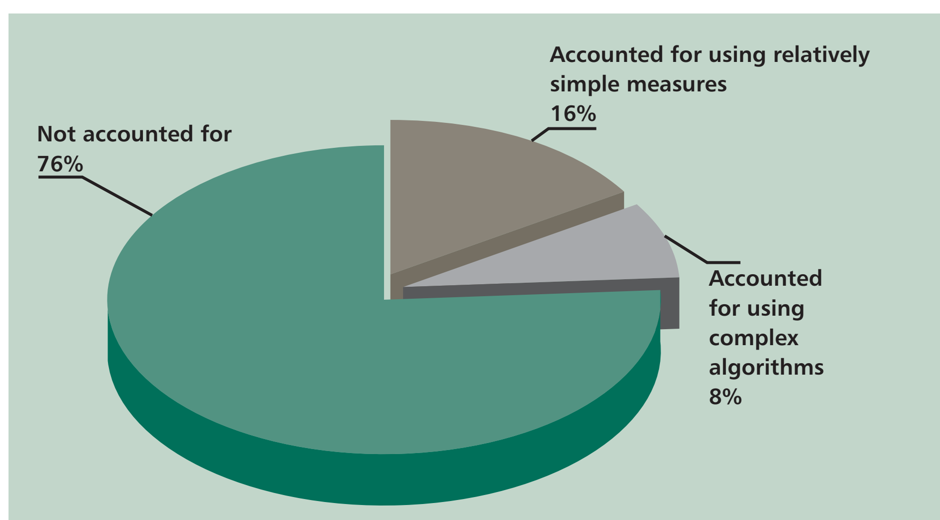
Differences between DISs in European Union countries also include the structure of contributions payable by their participants. There are differences with regard both to the base for calculating premiums and the manner of including the risk borne by a given bank. In a vast

[44] In such cases, DISs only have at their disposal the funds necessary to meet typical administrative expenses (e.g. running an office).

[45] See: Baka (2004b) and Zygierewicz (2004).

majority of countries, the amount of covered deposits held by a given bank is **the premium calculation base**. In some schemes the contributions are calculated on total deposits, i.e. both covered and not. A slightly different approach has been adopted in Germany and Italy, where the amount of a bank's liabilities is taken into account. In comparison, the BFG employs a very original method: annual contributions are determined on risk-weighted assets and the GDPF rate applies to the amount of the bank's funds which form the basis for establishing the mandatory reserve. It seems that if a single, consolidated fund is established, the most appropriate arrangement for the BFG would be to adopt the amount of covered deposits as the basis for determining contributions. The amount of covered deposits is the most adequate measure in such circumstances, since it is directly related to the amount of potential compensation paid by the BFG to the bankrupt bank's depositors. In this way, the formula for calculating contributions payable to the DIS would be significantly simplified and a typically supervisory measurement (risk-weighted assets) would be abandoned.

Figure 7
Accounting for risk level when calculating premiums payable to the guarantee scheme in EU countries



Source: own research.

A relatively new arrangement with regard to DISs (it was first employed in the U.S. in 1993) is **differentiating the amount of premiums payable by banks according to their risk levels**. In this way, the institutions which generate a higher risk for the scheme, i.e. those which are more likely to be threatened with bankruptcy, bear the operating costs of the DIS to a larger degree. The concept of risk-based premiums has not yet gained much popularity in European Union countries — it has only been adopted in 6 schemes (Figure 7). The amount of premium may be related to the risk level using various indicators. In practice, 4 European Union countries — Finland, Germany, Portugal and Sweden — have adopted a relatively simple risk measure, i.e. the capital adequacy ratio. The voluntary German scheme additionally differentiates premiums depending on a bank's scheme membership period. Much more complicated regulations have been employed in the Italian and French schemes, where the risk of a given credit institution is determined using complex multivariate algorithms. In the remaining 19 countries, including Poland, contributions to DIS are calculated on a linear basis, and therefore do not account for the risk borne by banks.

The adoption of risk-based premiums in the Polish scheme should also be considered due to their numerous advantages. The fundamental advantage of risk-based premiums is that they create

incentives for banks to limit their risks and therefore reduce moral hazard. This regulation also eliminates the cross-subsidising of the weakest banks by the strongest ones. It should, however, be borne in mind that the idea, although praised in theory, may lead to certain difficulties in practice. The most important problem is the selection of the method which would best reflect the risk to the DIS generated by individual banks – no universally accepted risk assessment methodology exists. The adoption of this concept may cause practical problems with determining premiums because wide-ranging information is required. Moreover, a question arises: how widely should premiums be differentiated in order to effectively limit moral hazard and not destabilise the situation of threatened banks at the same time? It is currently difficult to provide an adequate answer to such doubts, primarily because the experience of other countries in this regard has been relatively modest so far[46].

[46] More on DIS financing in: Polijaniuk and Obal (2001a).

6
Summary

Over its 10 years of active operation the **Bank Guarantee Fund has proved that, along with the National Bank of Poland and the Commission for Banking Supervision, it is among the most important institutions protecting the Polish financial system against destabilisation.** This is evidenced by the scale of pay-outs and assistance activities undertaken by the Fund. Though an important safety net component, the BFG should not be seen as a panacea for all banking and economic problems. A DIS can usually cope with a limited number of bankruptcies but it cannot be expected to remedy a crisis of the entire banking system. Therefore comprehensive solutions must be designed, which will encompass all parts of the safety net, including the government.

The regulations regarding the Polish DIS **comply with EU requirements** set out in Directive 94/19/EC on deposit-guarantee schemes. This compliance has been achieved through the gradual adjustment of Polish DIS regulations to the Community legislation. The directive, however, is a very general one and leaves many issues at the discretion of Member States. An overview of DISs operating in European Union countries indicates that the practical arrangements adopted exhibit significant variation. There are important differences between individual countries regarding in particular the level of coverage, the mode in which the operating costs of the DIS are financed and the structure of contributions payable to the scheme. As a result, **one cannot currently state that there is a European DIS model**.

Though Polish regulations comply with EU requirements, they must be adjusted to suit the changing domestic conditions. The relatively low interest rates and the resulting decrease in yield on Treasury securities have reduced the efficiency of the low interest rate loan system used to date. Therefore there is a general consensus that the **list of assistance instruments available to the BFG must be extended**, which may be reflected by amendments to the Law on the BFG.

Changes are also anticipated with regard to the Fund's financial management. The establishment of a **single consolidated fund** within the BFG, which would finance all tasks of the Polish DIS, is currently under consideration[47]. This fund would be **financed in an ex ante mode** by charges determined on the amount of covered deposits held by individual banks. In line with international practice, the target amount of the fund should be set with reference to the amount of covered deposits held by the entire banking system. Moreover, **the co-financing of the BFG's activities by the National Bank of Poland appears untenable in the long run** due to doubts regarding the issue of public aid, which is generally prohibited in European Union legislation.

Certain changes in the operation of the BFG may also reflect indirectly the regulations of the **New Basel Capital Accord** coming into force. The change in risk assessment methodology will force the Polish scheme to adjust the method of calculating contributions payable to the scheme, which is currently based on risk-weighted assets. Moreover, as a risk minimiser, the BFG will have to enhance the monitoring and early warning system currently in place[48].

Despite its relatively short history, the Bank Guarantee Fund boasts **considerable experience** with regard not only to guarantee but also rehabilitation activities. On considering the number of pay-outs and assistance interventions undertaken, the BFG is the most experienced DIS operating in a European Union country. This, together with the fact that Poland is already a European Union member, should give the Polish fund significant influence on potential future amendments to the Community regulations regarding DISs.

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[47] See: Baka (2005).

[48] See: Iwanicz-Drozdowska M. (2004).

7
Details of DISs in EU countries

COUNTRY	YEAR ESTAB-LISHED	ADMINISTRATION	RESPONSIBILITIES	LEVEL OF COVERAGE[1]
AUSTRIA	1979	private	risk minimiser	EUR 20,000
BELGIUM	1974	joint	paybox	EUR 20,000
CYPRUS	2000	joint	paybox	EUR 22,222
CZECH REPUBLIC	1994	joint	paybox	EUR 27,777
DENMARK	1987	joint	risk minimiser	DKK 300,000 (ca. EUR 40,300)
ESTONIA	1998	joint	paybox	EEK 111,111 (ca. EUR 7,111)
FINLAND	1970	private	paybox	EUR 25,000
FRANCE	1980	private	risk minimiser	EUR 70,000
GERMANY compulsory	1998	joint[3]	paybox	EUR 22,222
GERMANY voluntary	1966	private	risk minimiser	30% of the bank's own capital
GREAT BRITAIN	1979	public	paybox	GBP 35,000 (ca. EUR 50,900)
GREECE	1995	joint	paybox	EUR 20,000
HUNGARY	1993	joint	risk minimiser	HUF 6m (ca. EUR 24,200)
IRELAND	1989	public	paybox	EUR 23,000
ITALY	1987	private	risk minimiser	ca. EUR 103,000
LATVIA	1998	public	paybox	LVL 6,000 (ca. EUR 10,400)
LITHUANIA	1996	public	risk minimiser	LTL 50,000 (ca. EUR 14,500)
LUXEMBOURG	1989	private	paybox	EUR 22,222
MALTA	2003	joint	paybox	EUR 20,000
NETHERLANDS	1978	public	paybox	EUR 20,000
POLAND	1995	joint	risk minimiser	EUR 22,500
PORTUGAL	1992	public	paybox	EUR 25,000
SLOVAKIA	1996	joint	paybox	EUR 20,000
SLOVENIA	2001	public	paybox	SIT 5.1m (ca. EUR 21,250)
SPAIN	1977	joint	risk minimiser	EUR 20,000
SWEDEN	1996	public	paybox	SEK 250,000 (ca. EUR 27,750)
Summary	Period: 1960s–1 1970s–6 1980s–5 1990s–11 2000s–3	public – 8 private – 6 joint– 12	paybox – 17 risk min. – 9	–

[1] Covered deposit amount.

[2] Maximum amount of compensation paid.

[3] Two subsystems administrated privately and one publicly.

CO-INSURANCE	PAYOUT LIMIT[2]	FOREIGN CURRENCY DEPOSITS	FINANCING	RISK-BASED PREMIUMS
90% for deposits other than from individual entities	EUR 20,000 for individual entities	YES	mixed	NO
–	EUR 20,000	Only in EEA countries' currencies	ex ante	NO
90%	EUR 20,000	NO	ex ante	NO
90%	EUR 25,000	YES	ex ante	NO
–	DKK 300,000 (ca. EUR 40,300)	YES	ex ante	NO
90%	EEK 100,000 (ca. EUR 6,400)	YES	ex ante	NO
–	EUR 25,000	YES	ex ante	YES
–	EUR 70,000	Only in EEA countries' currencies	ex ante	YES
90%	EUR 20,000	Only in EEA countries' currencies	ex ante	NO
–	30% of the bank's own capital	YES	ex ante	YES
90% for amounts over GBP 2,000	GBP 31,700 (ca. EUR 46,100)	YES	mixed	NO
–	EUR 20,000	YES	ex ante	NO
90% for amounts over HUF 1m	HUF 5.5m (ca. EUR 22,200)	Only in EU and OECD countries' currencies	ex ante	NO[4]
90%	EUR 20,700	YES	ex ante	NO
–	ca. EUR 103,000	YES	ex post	YES
–	LVL 6,000 (ca. EUR 10,400)	YES	ex ante	NO
90% for amounts over LTL 10,000	LTL 46,000 (ca. EUR 13,300)	Only in EU countries' currencies and USD	ex ante	NO
90%	EUR 20,000	YES	ex post	NO
90%	EUR 18,000	NO	ex ante	NO
–	EUR 20,000	YES	ex post	NO
90% for amounts over EUR 1,000	EUR 20,350	YES	mixed[5]	NO[6]
–	EUR 25,000	YES	ex ante	YES
90%	EUR 18,000	YES	ex ante	NO
–	SIT 5.1m (ca. EUR 21,250)	YES	ex post	NO
–	EUR 20,000	YES	ex ante	NO
–	SEK 250,000 (ca. EUR 27,750)	YES	ex ante	YES
co-insurance – 13 none – 13	–	YES – 19 Some currencies only – 5 NO – 2	ex post – 4 ex ante – 19 mixed – 3	YES – 6 NO – 20

[4] The rate is increased, however, if the capital adequacy ratio of a given bank falls below a certain minimum.

[5] Pay-outs (GDPF) are financed in an ex post mode, while assistance activities in an ex ante one.

[6] Charges account for risk level to a small extent — annual contributions payable by banks depend on risk-weighted assets.

7

8
Glossary of deposit insurance scheme concepts

Adverse selection – the tendency of higher-risk banks to opt for deposit insurance and lower-risk banks to opt-out of deposit insurance when a DIS is voluntary.

Bank run – a massive withdrawal of deposits caused by public fear that a bank may fail and depositors may suffer losses.

Blanket guarantee – a government's declaration that all deposits are covered by guarantees.

Bridge bank – an entity created in place of a problem bank under liquidation, which takes over its selected assets and liabilities and continues banking operations during the transition period – before acquisition or sale.

Co-insurance – incomplete protection, a situation where a DIS only pays out a pre-specified portion of the covered deposit (e.g. 90%) and the depositor bears the risk of loss of the remaining part of the deposit.

Ex ante financing – a mode of DIS financing where premiums are accumulated beforehand, according to the plan for each financial year.

Ex post financing – a mode of DIS financing where contributions are payable only after the conditions triggering the guarantee are met, i.e. a bank declares bankruptcy.

Explicit system – a formalised DIS with predetermined procedures, usually organised as a guarantee institution.

Financial safety net – a set of institutional arrangements and regulations whose aim is to prevent the financial system from destabilisation.

Financial stability – a state in which the financial system performs its fundamental functions properly, i.e.: (1) ensures an efficient flow of funds between participants – from those who have surpluses (savers) to those who borrow funds in order to invest or consume; (2) ensures the correct valuation of assets, i.e. no sudden changes in asset prices or changes are predictable; (3) ensures safe and efficient payments.

Implicit system – the absence of a formalised DIS with the implicit assumption that when a systemic threat emerges, public institutions will take provisional action.

Information asymmetry – a situation where market participants do not have equal access to information and as a result, some of them may make less than optimum decisions.

Least-cost resolution – a procedure that requires the deposit insurer to implement resolution alternative that is determined to be less costly to the system than all other resolution alternatives, including the liquidation of the failed bank.

Lender of last resort (LoLR) – a function which is nowadays also referred to as Emergency Liquidity Assistance (ELA) – providing liquidity supply to a single bank or the entire banking system in response to an unfavourable shock leading to an extraordinary increase in demand for reserve money, which cannot be met by other (e.g. private) sources. Acting as lender of last resort is one of the most fundamental and oldest functions of central banks.

Market discipline – a situation where depositors or creditors assess the bank's economic and financial standing and respond to it by making deposits or withdrawing funds from a bank.

Moral hazard – a relaxation in market discipline resulting in players taking excessive risk in order to maximise profits, based on the conviction that the potential detrimental effects of such actions will be mitigated by financial assistance from public institutions.

Offsetting – a reduction in the amount of compensation paid to the depositor by the amount of their liabilities to the failed bank.

Open-bank assistance – a resolution method whereby the threatened bank is supported by a direct loan, an assisted merger or a purchase of assets.

Paybox – a guarantee institution whose activities are limited to paying out covered deposits where a credit institution declares bankruptcy.

Purchase & assumption – an acquisition by a healthy bank or a group of investors of some or all the obligations and some or all assets of a threatened bank.

Risk minimiser – a guarantee institution which, apart from guarantee activities (paybox), may undertake assistance activities aimed at preventing bank failures.

Risk-based premiums – premiums payable by banks to the DIS calculated by taking the level of risk borne by individual banks into account.

Systemic risk – the possibility that a crisis at one financial institution may spread to other market participants, resulting in a severe disruption of the operation of the entire financial system.

9
Deposit guarantee institutions in EU countries

COUNTRY	DEPOSIT GUARANTEE INSTITUTION	WEB PAGE
AUSTRIA	Deposit Protection Company of the Austrian Commercial Banks *(Einlagensicherung der Banken und Bankiers Gesellschaft mbH)*	www.einlagensicherung.at
	Hypo-Haftungesellschaft mbH	www.hypoverband.at
	Österreiche Raiffeisen-Einlagensicherung reg Gen.m.b.H	www.rzb.at
	Sparkassen-Haftungs Aktiengesellschaft	www.sparkasse.at
BELGIUM	Protection Fund for Deposits and Financial Instruments *(Le Fonds de protection des dépôts et des instruments financiers)*	www.protectionfund.be
CYPRUS	Central Bank of Cyprus *(Deposit Protection Scheme)*	www.centralbank.gov.cy
CZECH REPUBLIC	Deposit Insurance Fund of the Czech Republic *(Fond poji_t_ní vklad_)*	www.fpv.cz
DENMARK	The Guarantee Fund for Depositors and Investors *(Garantifonden for indskydere og investorer)*	www.garantifonden.dk www.gii.dk/
ESTONIA	Guarantee Fund *(Tagatisfond)*	www.tf.ee
FINLAND	Deposit Guarantee Fund *(Talletussuojarahasto)*	www.fba.fi/ sisalto_eng/common/ showpage.asp?id=602
FRANCE	Deposit Guarantee Fund *(Fonds de Garantie des Dépôts)*	www.garantiedesdepots.fr
GERMANY	Association of German Public Sector Banks *(Einlagensicherungsfonds des Bundesverbandes Öffentlicher Ban- ken e.V.)*	www.voeb.de
	Deposit Protection Fund *(Bundesverband deutscher Banken e.V. Einlagensicherungsfonds)*	www.bdb.de
	Federal Association of German Cooperative Banks *(Sicherungseinrichtung des Bundesverbandes der Deutschen Volks-banken und Raiffeisenbanken e.V.)*	–
	German Saving Banks Association *(Deutscher Sparkassen und Giro Verband Sicherungseinrichtung)*	www.dsgv.de
	Investor Protection of Public Banks *(Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken e.V.)*	www.voeb.de
	The German Private Commercial Banks Compensation Sche- me for Depositors and Investors *(Entschädigungseinrichtung Deutscher Banken GmbH)*	www.bdb.de
GREAT BRITAIN	Financial Services Compensation Scheme	www.fscs.org.uk
GREECE	Hellenic Deposit Guarantee Fund	www.hdgf.gr
HUNGARY	National Deposit Insurance Fund of Hungary *(Országos Betétbiztosítási Alap)*	www.oba.hu
IRELAND	Deposit Protection Scheme *(Central Bank and Financial Services Authority of Ireland)*	www.ifsra.ie/frame_ main.asp?pg=/industry/ in_bci_dps_intr.asp&nv=/ industry/in_nav.asp
ITALY	Interbank Deposit Protection Fund *(Fondo Interbancario di Tutela dei Depositi)*	www.fitd.it
	Deposit Protection fund for Co-operative Banks *(Fondo di Garanzia dei Depositanti del Credito Cooperativo)*	www.confcooperative.it
LATVIA	Financial and Capital Market Commission *(Finan_u un kapit_la tirgus komisija)*	www.fktk.lv/law/credit/laws/ article.php?id=3512
LITHUANIA	Deposits and Investment Insurance *(Indeliu ir Investiciju Draudimas)*	www.tdd.lt
LUXEMBOURG	Deposit Guarantee Association *(Association pour la Garantie des DŹpòts Luxembourg)*	www.agdl.lu

MALTA	Depositor Compensation Scheme *(Skema Ta'Kumpens Lid-Depozitant)*	www.compensationsche-mes.org.mt
NETHERELANDS	The Bank of Netherlands *(De Nederlandsche Bank)*	www.dnb.nl/dnb/pagina.jsp?pid=tcm:13-40504-64
POLAND	Bank Guarantee Fund *(Bankowy Fundusz Gwarancyjny)*	www.bfg.pl
PORTUGAL	Deposit Guarantee Fund *(Fundo de Garantia de Depósitos)*	www.fgd.bportugal.pt
SLOVAKIA	Deposit Protection Fund *(Fond ochrany vkladov)*	www.fovsr.sk
SLOVENIA	Deposit Guarantee Scheme *(Banka Slovenije)*	www.bsi.si/html/eng/deposit_insurance_system/index.html
SPAIN	Deposit Guarantee Fund for Banking Institutions *(Fondos de Garantía de Depósitos en Entidades de Crédito)*	www.fgd.es
	Deposit Guarantee Fund for Credit Cooperative Banks *(Fondos de Garantía de Depósitos en Cooperativas de Crédito)*	
	Deposit Guarantee Fund for Saving Banks *(Fondos de Garantía de Depósitos en Cajas de Ahorro)*	
SWEDEN	Swedish Deposit Guarantee Board *(Insättningsgarantinämnden)*	www.ign.se
EUROPEAN FORUM OF DEPOSIT INSURERS		www.efdi.net
INTERNATIONAL ASSOCIATION OF DEPOSIT INSURERS		www.iadi.org

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