Fondo Interbancario di Tutela dei Depositi

Interbank Deposit Protection Fund

REPORT ON DEPOSIT INSURANCE:
AN INTERNATIONAL OUTLOOK

Working Paper

8

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Collana di Working Papers

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REPORT ON DEPOSIT INSURANCE: AN INTERNATIONAL OUTLOOK[1]

Working Paper n. 8, January 2005

Manuela De Cesare
Interbank Deposit Protection Fund

[1] *This second Working Paper on Deposit Insurance is an update of the research carried out by the Fitd's Research and Analysis Department in July 2001.*

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1. Introduction

Deposit Insurance is currently a subject of major interest within the scientific and academic communities.

A Deposit Insurance System (DIS) has the specific aim to protect small depositors; within the domestic safety net, DIS can also enhance financial system stability when it is adequately funded and when other safeguards, such as a strong bank supervisory program, are also in place.

Although there are various critical standards to ensure the effectiveness of deposit protection schemes, these are not sufficient to assure stability of the system, because deposit insurance is only one component, though crucial, of the financial safety net[2] that exists in most countries, particularly developed ones.

As recent studies[3] have focused on, countries that have an explicit scheme for deposit insurance have increased in the last few years; in other countries, deposit

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[2] On the topic, see Hefler R.T. (1999), "*What Deposit Insurance can do and cannot do*" in *Finance and Development*, March 1999, volume 36, number 1: "The safety net is intended to maintain the stability of the financial system by protecting the critical financial intermediation function of banks and their role in the national payments system. Typically, in addition to deposit insurance, a safety net also includes short-term lending by a central bank to assure bank liquidity (…). The role of deposit insurance is to stabilise the financial system in the event of bank failures by assuring depositors they will have immediate access to their insured funds even if their bank fails. Thereby reducing their incentive to make a 'run' on the bank. By discouraging bank runs, deposit insurance can prevent panic from spreading through a financial system. Such panic can threaten healthy banks as well as troubled banks (…)".

See also the FSF WGDI: deposit insurance is one component of many countries' financial safety-net, which also includes prudential regulation and supervision, the lender of last resort function and, in many countries, a department of the government (generally, the ministry of finance or the treasury); depending on the institutional, economic, financial and historical situation of a country, the characteristic of these relationships can vary substantially. The experience of various deposit protection schemes around the world shows that information sharing, coordination and exchange arrangements among safety-net players are essential to an effective deposit insurance system; the more complex the safety-net institutional set-up is, the more relevant the "interrelationship issue" becomes. On related topics, see: Kahn C. M. - Santos J. A. C. (2001), "*Allocating bank regulatory powers: lender of last resort, deposit insurance and supervision*", Bis Working Papers, n. 102; Pages H and Santos J. A. C. (2003), "*Optimal supervisory policies and depositor-preference laws*", Bis Working Papers, n. 131.

[3] See Garcia G. H. (2001), "*Deposit Insurance. Actual and good practices*", International Monetary Fund. See also Cull R., Senbet L. and Sorge M. (2004), "*Deposit insurance and Bank intermediation in the long run*", Bis Working Papers, no. 156: many governments in both developed and developing countries grant explicit deposit insurance in the hope of reducing the risk of systemic failure. An explicit system is a formal detailed system enacted by law as opposed to an implicit unwritten agreement between governments and banks. By boistering depositors' faith in the stability of the system, deposit insurance is

protection is implicitly (and therefore ambiguously) provided by either the central bank or the government.

The financial crises experienced in the '80s and '90s have surely contributed to the diffusion of explicit systems of deposit insurance in recent times, as well as to the revision of those already existing.

An explicit Deposit Protection System may be designed to achieve different policy targets, to the extent that it can be seen as an expression of government support for a nation's banking system, that mainly reflects a concern about potential costly bank runs[4].

Two main objectives are consumer protection and macroeconomic stability. Small depositors have to be, preferably and at least partially, insured against losses, as they lack the ability to monitor the banks where they place their money. Additionally, depositors have to be provided with a mechanism to quickly recover the funds, so that stability and confidence in the banking system are maintained.

Furthermore, given the strong links among banks due to the working of the payment system and the management of monetary policy, it is necessary to avoid, or at least minimise, the risk of financial contagion in the event of a bank failure, that may cause depositors to withdraw their funds even from safe and solid banks. Depending upon this need, deposit insurance systems are designed to minimise or eliminate the risk that depositors will suffer a loss, in order to remove the incentives to participate in a bank run that may degenerate and result in contagion runs.

It's worth noticing that the guarantee provided by deposit insurance is also deemed to have negative effects, as it eliminates the need for depositors to monitor bank risk-taking.

Banking insolvency is a crucial topic. Banks are uniquely dependent on public trust for funding; deposit insurance should contribute to maintain public confidence in the

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generally believed to contribute in the long run to a deeper financial system, which could lead to higher economic growth rates.

[4] As banks typically fund illiquid assets with more liquid liabilities, bank runs are an ever-present threat in the absence of deposit insurance and they are costly because they interfere with the financial intermediation performed by banks. On the topic, see Nicholas J. K., "*Deposit insurance system design and considerations*", 1999.

banking system in times of stress caused by a single institution crisis or by broader systemic troubles.

The IMF has recently discussed the matter, assessing that deposit insurance has a pre-eminent role in contributing to the banking system stability and soundness. Nevertheless, it could also generate disadvantages, as in the absence of an effective insolvency system, and enhance moral hazard (costs of pursuing riskier strategies are reduced and excessive risk-taking may be encouraged). So, in order to limit perverse effects, a bank insolvency process should be quick enough and "*focus on promptly returning insured funds to depositors, maintaining critical bank function and ensuring public confidence in the equity of the resolution process*"[5].

To this extent, the Basel Committee has focused on some principles that supervisors should follow in dealing with weak banks, including: speed, cost efficiency, flexibility, transparency and co-operation, consistency and avoiding moral hazard[6].

As a consequence of institutional, cultural, historical and legal differences among countries that may affect the design of the system, deposit protection is not offered to depositors homogeneously across countries and various structures may be appropriate for different institutional settings.

Therefore, the currently adopted schemes differ widely according to many aspects: deposit insurance is definitely a function of public interest, even if its provision can be assigned either to a public or to a private (or mixed) agency; membership in the DIS can

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[5] See M. H. Krimminger, "*Deposit Insurance and Bank Insolvency in a changing world: synergies and challenges*", International Monetary Fund Conference, May 28, 2004.

[6] See Basel Committee on Banking Supervision (2002), "*Supervisory guidance on dealing with weak banks: report of the task force on dealing with weak banks*". About the principles: ***speed*** means that supervisors should act promptly in order to avoid that problems could grow rapidly, making the eventual resolution efforts more difficult and more expensive, with the possibility of becoming systemic; ***cost-efficiency*** refers to a *least-cost criterion* that the supervisor should follow when making choices between alternative actions in achieving supervisory objectives; about ***flexibility***, legislation frequently adopts a rules-based approach, but discretion could be helpful in using supervisory tools; ***transparency and co-operation*** are important, as inadequate or incorrect information from the bank increases uncertainty and both the bank and the authorities should aim for a high degree of information sharing and transparency about their intended actions; about ***consistency***, well-understood and consistent supervisory actions don't distort the competitive environment, as similar problems in different banks, large or small, private or state-owned, should receive similar treatment; ***avoiding moral hazard*** means that supervisory action should not create incentives for banks to incur costs that they do not have to bear entirely. See also: Basel Committee on Banking Supervision (2004), "Bank failures in Mature Economies", Working Paper n. 13.

be mandatory or voluntary; financial resources for payoffs can be collected via ex-ante contributions or by raising funds only in the event of a bank failure (ex-post); among the three categories into which deposit insurers may be divided (pay-boxes, intermediate models and risk minimizers), a DIS can be given only the task of reimbursing depositors or can be assigned a broader mandate to participate in data collection, crisis management and supervisory activities in the banking sector; different categories of deposits can be considered eligible for reimbursement; different limits of coverage can be applied and, in the event of failure, payoff can be partial or full.

2. Overview of Deposit Insurance Practices

Since 2001 the *Interbank Deposit Protection Fund* (FITD) has been involved in research aimed at updating and supporting the scientific and institutional debate on deposit insurance and related subjects, especially those concerning the role that the financial safety net plays in preventing and possibly solving bank crises. Deposit Protection is considered an essential component in the financial safety net, together with the lending of last resort provided by the central bank, standard banking regulation and supervisory controls.

In 2004 the FITD undertook new research on deposit insurance in order to update the study published in 2001. The first issue of the "*Report on Deposit Insurance*" focused on collecting data on those deposit protection Schemes that were in place in 2001, as well as describing innovations which may have been introduced in monitored countries.

The current update of this study is based upon data collected using a specific Questionnaire created by the FITD and sent to all members of the *European Forum of Deposit Insurers* (EFDI)[7] in July 2004.

The results show that, despite harmonisation efforts made recently, many relevant differences still characterise the institutional framework in which deposit insurers work, as well as their operational activities.

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[7] The European Forum of Deposit Insurers was established in Vienna on October 11, 2002, for the purpose of facilitating discussion, exchanging information and opinions on issues of mutual interest and improving co-operation among Deposit Insurance Schemes operating in Europe. Moreover, the aim of the Forum is to become a valid area for discussions on the application of the EU Directive 94/19/EEC and any proposed changes to it, particularly those concerning the minimum level of protection and related topics. In addition, it would assist those countries that wish to develop their deposit insurance schemes, with specific concern for countries that are preparing to enter the EU. Even if EFDI has a relevant role, it does not have the power to set guidelines or make compulsory pronouncements for its members. Participation in EFDI is voluntary and free of charge. Initially, 25 European Deposit Insurance Systems joined the EFDI, while currently there are 45 member Schemes, corresponding to 35 countries, and many more were invited to join the Forum on the occasion of its second Bi-Annual Meeting (Padua, November 8-9, 2004).

2.1 The Questionnaire on Deposit Insurance

This report summarises the results of the FITD survey on deposit insurance based on the Questionnaire that was sent to all EFDI members in July 2004.

In detail, the Questionnaire was sent to Deposit Insurance Schemes[8] operating in 32 different countries, including 24 current EU members, 6 Central-Eastern European countries (Albania, Bosnia Herzegovina, Bulgaria, Croatia, Macedonia and Romania) and 2 Northern European countries (Norway and Iceland).

Its objective is to highlight similarities and differences within the existing European deposit insurance Schemes, also in the perspective of further harmonisation, at least at the EU level.

The Questionnaire is composed of ten sections[9]. After the introductory section I, where general information on the Deposit Protection Scheme is collected, sections II and III describe its structure and governance. Section IV contains information about member institutions, while V is about insured funds. Quantitative information on available resources for payoffs is provided in section VI; sections VII and VIII collect, respectively, data about recent interventions undertaken by the Scheme and information connected with either legal or regulatory institutional changes and proposed changes to the system. Section IX refers to some important supplementary information regarding the existence and types of risk-based deposit insurance premiums, the participation of foreign branches in the Scheme and bilateral agreements. Some Schemes have provided explanatory and additional informal notes in section X.

[8] See Annex II for the list of interviewed Deposit Insurance Schemes. Although there are currently 45 EFDI member Schemes, corresponding to 35 countries, this research refers to 42 members and does not involve Armenia, Montenegro and Serbia, which have recently applied for membership.

[9] See Annex I for contents.

2.2 Results

The answers given to the Questionnaire vary considerably across the interviewed Schemes. Often, missing answers are due to confidentiality restrictions of national law, so a comparative analysis can only focus on the main institutional features. Moreover, the computed figures often reflect different samples of countries, hence they must be interpreted with caution. In any case, the data collected may be used by researchers and policy makers to stimulate further debate on desirable features of deposit protection schemes and about the most valuable way to implement such schemes in different countries.

Most of the questions refer to the practical implementation of the principles in Deposit Insurance Directive 94/19/EEC.

The Directive supplements the overall harmonisation of banking supervisory regulations in the EU while specifying minimum requirements for deposit insurance schemes in member countries. These minimum requirements, such as banks' mandatory membership in a national deposit guarantee scheme, harmonised minimum coverage (20,000 Euro) per depositor rather than per deposit, and responsibilities for deposit protection lies primarily with the home country and must be provided by each EU DIS.

Research results are depicted in the section below, which uses graphs and tables to summarise the answers from the 31 Schemes, out of 42, that responded to the Questionnaire.

2.2.1 Section I - General information on the Scheme

The aim of this section is to collect basic information about Deposit Insurance Schemes, mainly relating to the European Directive 94/19 on deposit insurance and its implementation in each country's banking system.

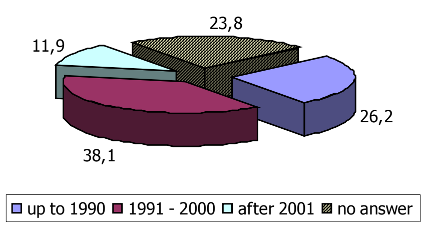
This section also contains few questions about the existence of an Investor Compensation Scheme (ICS) within the same system, in accordance with Directive 97/9/EEC. As additional data concerning the relationships between DIS and ICS are collected in section IV of the Questionnaire, results on the topic are detailed in the discussion of results from section IV.

As shown in graph I.1, most European Deposit Insurance Schemes were established in the '90s (38.1%), 11.9 % after 2001 and a significant 26.2% before 1990.

Most of the countries in which the interviewed DIS is active implemented European Directive 94/19/EEC before 2000 (graph I.2), compared with just 14.3% in the last few years. In 7.1% of the cases, efforts to implement it gradually are still in progress. Nevertheless, the information provided does not offer a complete picture of the matter, as a significant 30% of the Schemes did not answer this question.

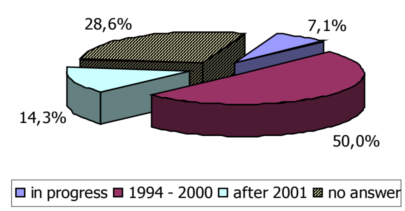
Graph I.1

Year of Introduction



Graph I.2

EU Directive 19/94/EEC implementation

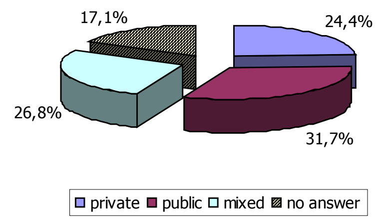


2.2.2 Section II - Structure of the Scheme

Section II deals with the nature of Deposit Insurance Scheme and contribution system in use (ex-ante, ex-post or mixed). Furthermore, this section provides information about the DIS's independence of intervention and its institutional relationships with other supervisory authorities; these data relate to the existence of possible arrangements for exchanging information and statistics about member institutions between the Scheme and other authorities.

The graph below presents the answers relating to the nature and administration of the Schemes (graph II.1), of which 31.7% are public, 24.4.% private and 26.8% mixed.

Graph II.1 - Nature of the Scheme

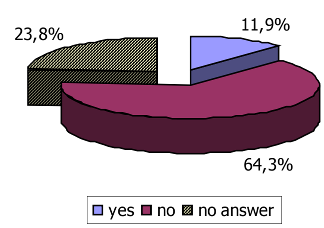


Usually, a private scheme is under the control of the banking system. That provides the correct incentives to maintain soundness and prevent participants from shouldering the cost of bank failures.

However, in the event of financial contagion, the banking system may lack resources to reimburse the obligations of a large number of banks; therefore, additional government guarantees or use of public funds, at least implicitly and possibly up to a certain amount, could be desirable in order to avoid the repercussions of bank failures. Anyway, these extraordinary measures should be generally avoided, and required only in response to a systemic crisis, as they can distort the market and create perverse incentives while weakening, rather than strengthening, the banking system.

As graph II.2 shows, 11.9% of the Schemes answering the Questionnaire receive public contribution to actual funding.

Graph II.2
Public Contribution to Actual Funding



It is worth noticing that graphs II.1 and II.2, quantifying respectively the public nature of a DIS and public contribution to actual funding, do not contradict each other. The reason is that even a public scheme's funding is often based on resources collected from member banks both for interventions and for operating expenses, as in a private scheme.

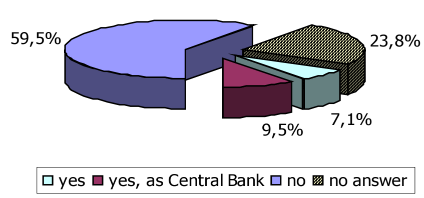
Obviously, the nature and features of the scheme also shape the kind of mandate and powers that are given to the DIS.

Establishing an independent entity for deposit insurance requires particular attention to the balance of power among the various authorities in the banking system, especially with regard to the attribution of direct supervisory power on member institutions. Whether the DIS is not also a bank supervisor, it should be provided with the necessary information concerning the current condition and practices of all insured banks.

The survey indicates that supervisory powers are usually not given to deposit insurers in Europe (graph II.3), while intervention decisions are taken independently in 37.5%[10] of the cases (graph II.4) and are subject to explicit authorisation in the remaining 40%.

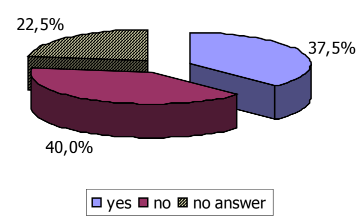
Graph II.3

Supervisory Powers



Graph II.4

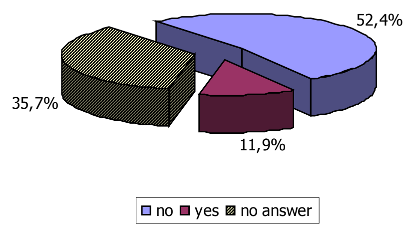
Independent Intervention Authority



In addition, results show that deposit insurers have no authority to set standards and guidelines for member banks in 52.4% of the sample (graph II.5). This could be a consequence of the DIS's not being assigned supervisory powers. Nevertheless, this information may not be complete because a relevant number of Schemes did not answer this question.

[10] This percentage also includes schemes administered directly by supervisory authorities.

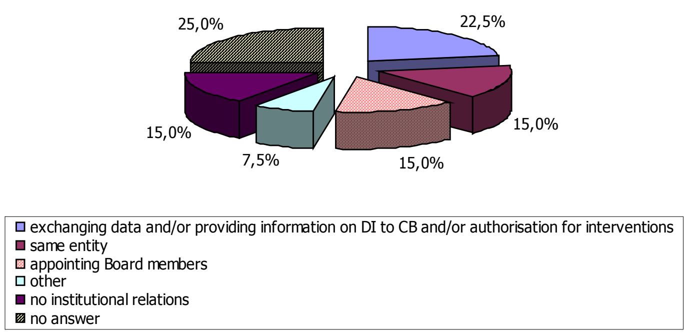
Graph II.5 - Authority to set guidelines



Most Schemes have close institutional relationships with supervisory authorities (graph II.6). In 22.5% of cases, they relate to central bank approval of certain DIS documents and to arrangements for sharing information about member banks, as well as to supervisory authorisation to intervene in the event of a bank failure.

In 15% of cases, one or more members of the DIS Board are appointed by, or come from, the central bank. This topic is discussed further in section III on the form of governance adopted by deposit insurers.

Graph II.6 - Institutional relationships



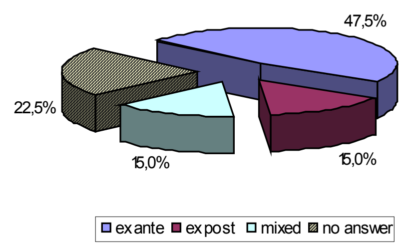
In all monitored countries, banks' participation in a system of deposit protection is mandatory. This helps avoid serious adverse selection problems linked to voluntary participation systems, where only the riskier entities may be attracted.

In many countries more than one DIS is active, but this doesn't mean that banks are free to choose their insurer simply as a result of competition. In fact, in most countries the market is segmented ex-ante, and certain types of institutions are required to use one system while others have to join a different scheme.

Clearly, the existence of a fund makes depositor reimbursement quicker and easier. It also helps increase confidence in the protection scheme and consequently in the banking system.

According to the results of the Questionnaire, most Schemes are based on an ex-ante contribution mechanism (47.5%); as shown in graph II.7, 15% of the Schemes have adopted an ex-post system[11] or a mixed one.

Graph II.7 - Contribution Mechanisms



There are various methods of intervention that can be used by deposit insurers across Europe, even if around 53% of the Schemes use just one method (generally depositor payoff) and only 15% report systems using more than one method[12].

Another important topic analysed in section II is the existence of formal information channels between DIS and member institutions, as well as information sharing agreements among domestic supervisory authorities and deposit guarantee systems. As shown in the graph below, 54.8% of Schemes collect data directly from members, 4.8% from third parties and 11.9% from banks and third parties alike.

Data provided by banks mainly concern reimbursable funds, while additional information might derive from formal agreements with central banks or other financial authorities within the same system. These information sharing arrangements are in place for 52.5% of the sample and they represent, as previously depicted in this section, one of

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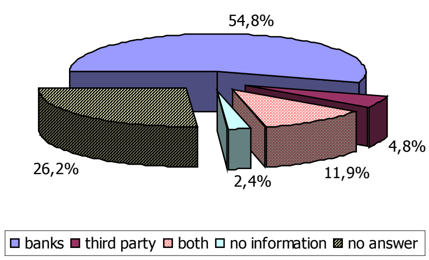
[11] This percentage relates to DIS in Austria, Italy, Luxembourg, The Netherlands, and Slovenia.
[12] This percentage goes up to 85% if we assume that missing answers can be considered as “one method”.

the forms that the relationships between deposit guarantee schemes and supervisory authorities may assume (graph II.8b).

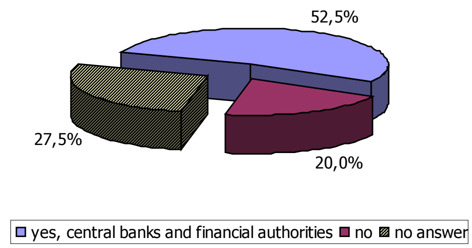
Graph II.8a

Source of data



Graph II.8b

Formal agreements

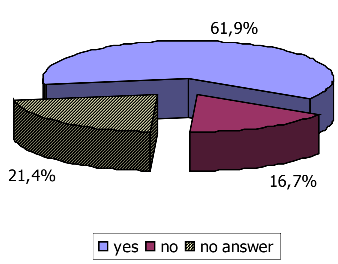


2.2.3 Section III - Governance

This section of the Questionnaire provides basic information about the governance used by the Schemes, relating to the appointing system and tenure of Board members and the Chairman as well as accountability and other information on staffing.

The DIS is a legally separate entity in 61.9% of the sample (graph III.1), while in 16.7% it is part of another organisation, mainly a supervisory authority or banking association.

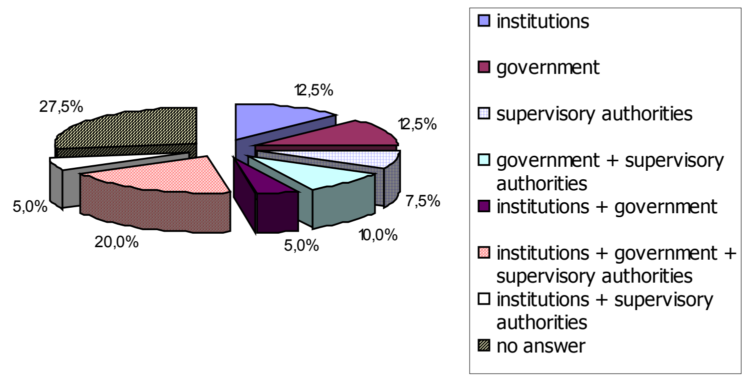
Graph III.1 - Legally separate Organisation



The form of governance used by the interviewed Schemes generally consist of a Board or Administrative Committee (53.4%) whose members can be appointed by member institutions, supervisory authorities, the government or some combination thereof (graph III.2).

Often, external officers are allowed to attend Board meetings without voting rights; they are usually auditors (internal or external) or belong to supervisory authorities or banking associations. In a few cases, representatives of governative departments or attorneys may attend as well.

Graph III.2 - Members of the Board



2.2.4 Section IV - Information on member institutions

The purpose of this section is to describe what kinds of institution are covered by deposit insurance schemes and in which way. Each question refers to quantitative information, to particular characteristics of member institutions and to possible relationships among deposit insurers operating in different countries in the event of a member bank’s failure. Relevant topics concern the nature of membership (mandatory or voluntary) and the rules for membership of EU and non-EU foreign banks’ branches in the DIS.

Deposit insurance Schemes are invited to disclose whether they have or not bilateral agreements with other EU Schemes on the subject of “topping-up” (mechanism provided by Directive 94/19/EEC that occurs when the host country scheme offers a higher level of coverage than that of the home country). Basic information on bilateral agreements, collected in this section, can be integrated with the answers given in section IX, which refer to possible contacts and formal or informal arrangements among domestic and foreign schemes.

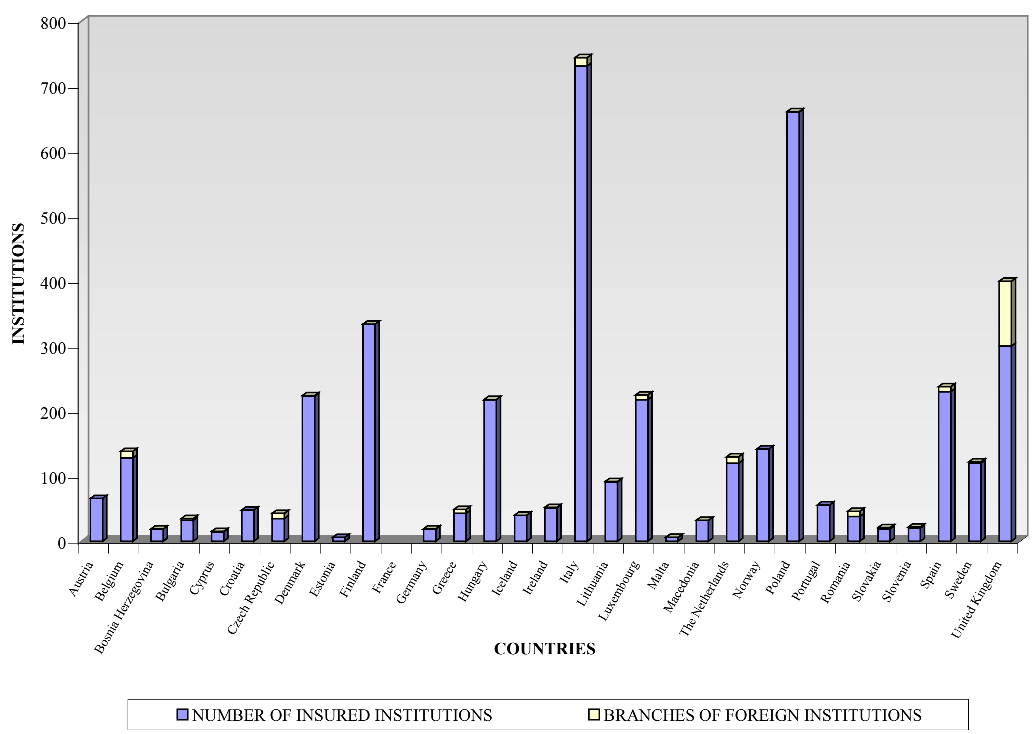
Graph IV.1 lists the number of insured institutions in all 32 countries completing the Questionnaire, including domestic banks as well as branches of foreign banks if they participate in the DIS[13].

To this extent, it's worth noticing that DIS membership is mandatory in all countries involved in the Questionnaire, as mentioned earlier in this report. Exceptions to this principle are only provided for EU banks operating in foreign EU countries (in accordance with Directive 94/19/EEC) and sometimes for the branches of non-EU banks.

Given the number of insured institutions, a protection system is more stable where the banking sector is less concentrated, as the payoffs for a failed bank can be spread over a larger number of institutions of adequate size.

In countries where few banks have high market shares, the risk of failure of a larger entity within the system can result in an increased payoff from other participating members.

Graph IV.1 - Number of Insured Institutions (as of end 2003)



[13] The number of banks shown in the graph relate only to schemes that answered the questionnaire (31 out of 42), so data may be partial or out of date. When more than one DIS answered from the same country,

According to EU Directive 94/19, European banks must join the home country DIS, while membership in a foreign EU scheme is voluntary.

Current participation of EEA branches in the host country DIS is infrequent[14], perhaps due to levels of coverage that do not encourage the topping-up mechanism.

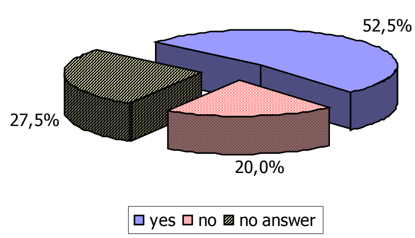
On the contrary, participation of extra-EEA branches is required or simply allowed in approximately 61% of cases, and several branches participate in some of the responding Schemes (around 20% of the sample).

Information on relationships between deposit insurance and investor guarantee schemes are collected in section I and section IV.

Section I refers to the existence, within the same system, of an Investor Compensation Scheme (ICS) in accordance with Directive 97/9/EEC; results show that an ICS exists in 25 countries and that 11 entities, among the 31 Schemes answering this part of the Questionnaire, manage both deposit and investment insurance[15]. Among the other 14 countries where ICS are in place, there are often no relations between the two schemes.

Section IV provides information about membership in both deposit and investor guarantee systems. As shown in graph IV.2, credit institutions are required to join both Schemes in 52.5% of the sample.

Graph IV.2 - Deposit/Investment insurance



figures are aggregated.

[14] Around 21% of total respondents, corresponding to branches active in Bulgaria (1), the Czech Republic (1), Denmark (2), Italy (1), Luxembourg (4), Romania (8) Slovakia (1), Sweden (1) and the United Kingdom (6).

[15] This is the case for Austria, Belgium, Denmark, Estonia, Lithuania, Luxembourg, Malta, the Netherlands, Slovenia, Spain, Sweden and UK. The list is not complete due to a non-response rate of 27%.

As regards bilateral agreements, in regions where economies are closely related or in closely integrated regions, such as the European Union, special considerations may be made for the branches of one country's bank that operate in another.

Directive 94/19/EEC establishes that the home country DIS protects all branches set up by EU banks in other member states.

When the coverage provided by a host country DIS is higher or more extensive, branches may join this scheme, extending deposit protection in order to avoid possible unequal conditions of competition with domestic institutions.

According to the guiding principles of Directive 94/19/EEC, "*when a branch applies to join a host Member State scheme for supplementary cover, the host member state scheme will bilaterally establish with the home Member State scheme appropriate rules and procedures for paying compensation to depositors at the branch.*

Home Member State and host Member State will cooperate fully with each other to ensure that depositors receive compensation promptly and in the correct amounts. In particular, they will agree on how the existence of a counterclaim, which may give rise to set-off under either scheme, will affect the compensation paid to the depositor by each scheme"[16].

Several bilateral agreements already exist between deposit protection systems within the EU. More arrangements should be established on the grounds that a formal channel, through which a domestic DIS can exchange information about member institutions with its counterpart in another EU country, is a good practice to follow in the case of bank branches operating abroad.

This issue is even more relevant now as 10 new countries joined the European Union on May 1, 2004.

Existing bilateral agreements deal with procedures for insolvency notification, payment suspension, the calculation of insured deposits, depositor compensation, communication guidelines and other possible procedures to be established through negotiation.

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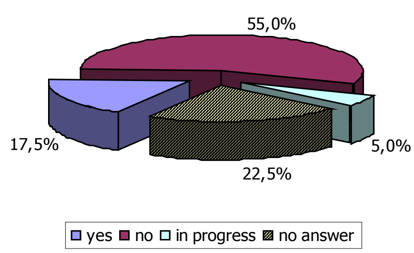
[16] See Annex II of EU Directive 94/19/EC on deposit guarantee schemes.

In the Questionnaire, information about existing bilateral agreements is found in section IV and section IX.

The first provides a few data on the topic, mainly relating to whether the DIS has adopted any bilateral rules or procedures for topping-up and, if so, with whom.

Few Schemes, among those replying to section IV[17], are involved in bilateral agreements. As shown in the graph below, bilateral agreements exist in 17.5% of cases and for 5% of respondents the documents are still in progress. No agreements are in place in 55.5% of cases, including countries in which EU branches participate in the DIS to supplement coverage. The data, although relevant, are incomplete due to missing answers.

Graph IV.3 -Bilateral Agreements



Section IX provides additional information on this subject. Although a bilateral agreement usually aims to set operative rules concerning topping-up and its implications, it may also facilitate and encourage good relations among the schemes through information exchanging, co-operation when dealing with compensation claims, and representation of one scheme by the other in dealings with third parties.

2.2.5 Section V - Information on the insured funds

Section V of the Questionnaire collects information on insured funds. Questions are related to the existence of a formal definition of guaranteed deposits, the specific

[17] The percentage of existing bilateral agreements refers to DIS active in Denmark, Finland, Hungary, Ireland, Luxembourg, the Netherlands, Sweden and the United Kingdom.

features of both deposits and depositors eligible for coverage, the nature and level of coverage and information about the total amount of insured deposits.

Different systems may be appropriate for different countries, depending on institutional and cultural factors that usually influence depositors' tolerance of risk exposure and their reaction to destabilising economic events.

The Schemes that answered this part defined what type of deposits and depositors are eligible for coverage in their system, and provide protection through a "per depositor per institution" system of coverage (71.9%). Coinsurance is not adopted in 65.6% of the sample.

In this respect, the EU Directive allows schemes to limit coverage to a specified percentage of deposits; anyway, this percentage must be at least equal to 90% of aggregate deposits, until the amount to be paid under the coverage reaches the minimum provided (20,000 Euro). This is the case for 18.75% of the Schemes in the survey.

At a conceptual level, coverage provided by a DIS should be wide enough to prevent bank runs, but not so extensive as to eliminate all effective market discipline on the bank's attitude to risk.

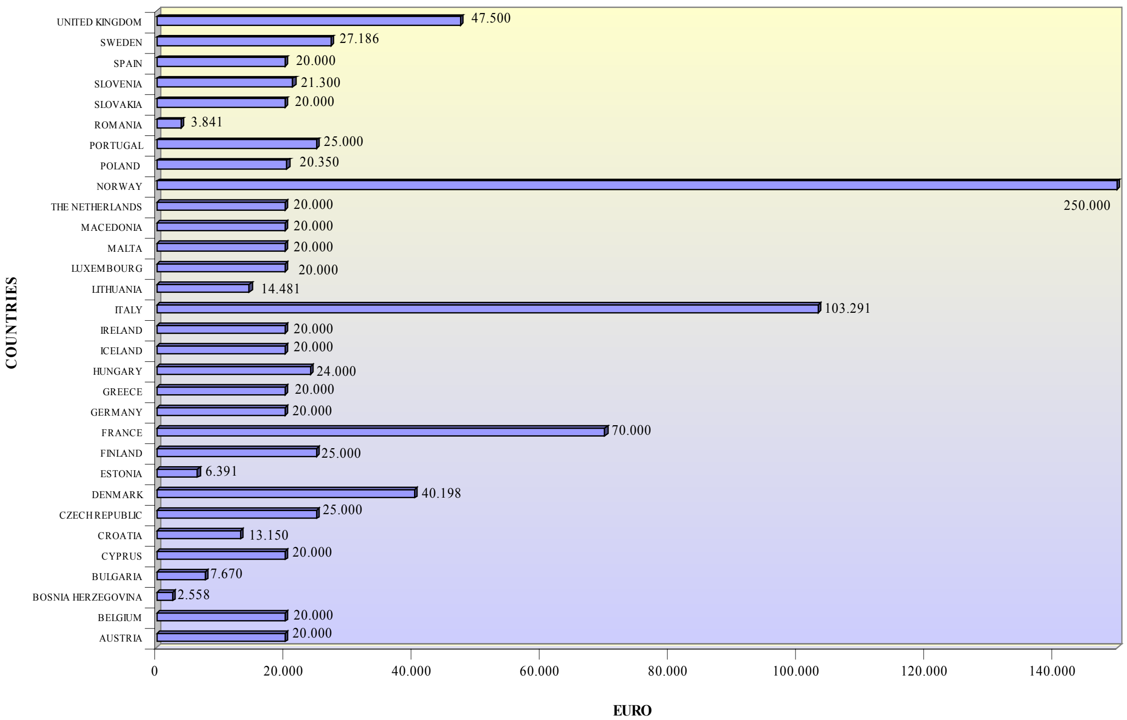
The level of coverage varies from the lows provided by Eastern European deposit insurers to the highs offered by Schemes in Norway, Italy and France, as shown in graph V.1.

The average level of coverage for the whole sample is around 31,554 Euro, while 20,000 Euro is the minimum required by Directive 94/19/EEC.

In a few countries the level of coverage is below the minimum allowed by the EU Directive, so an institutional change will be required if they join the EU or may already be in progress if they have recently entered the Union. In this case, limited transitional arrangements might be necessary to enable DIS to comply with the harmonised minimum coverage.

Treatment of deposit accounts, in terms of the coverage provided, may differ among countries. As a matter of fact, insurance may be denied for selected types of deposit, such as interbank deposits, government deposits, illegal deposits or deposits with high rates of return.

Graph V.1 - Level of Coverage



Summing up, an ideal protection scheme should provide limited but extensive coverage. Most depositors should be protected, but the level of individual protection should not be excessive, so that wealthier depositors (who are supposed to be better informed) will monitor banks and thus actively participate in supervision and help reinforce market discipline.

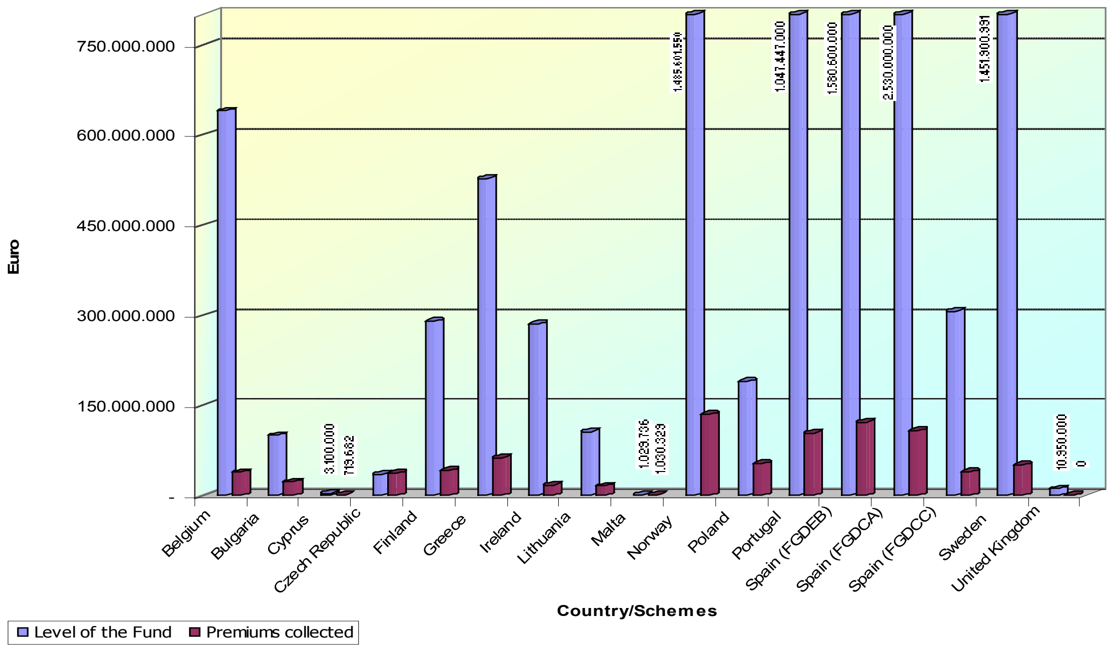
2.2.6 Section VI - Information on available resources

A deposit insurance scheme can adopt different contribution systems, namely ex-post, ex-ante or mixed.

The vast majority of Schemes in the sample have an ex-ante or mixed system, where funds are raised and managed before a crisis arises. Only seven deposit insurers have an ex-post contribution system, where member banks are required to intervene only in the event of failure.

Graph VI.1 shows fund levels at the end of 2003 for Schemes with an ex-ante or mixed system[18].

Graph VI.1 - Fund levels and premiums collected in 2003



Most of the schemes with an ex-ante or mixed contribution system allocate the funds to government bonds, while only two entities maintain 100% of their funds in cash.

In the previous graph the fund level is compared with the amount of premiums collected from each Scheme in 2003. The average ratio is around 10%, with the exception of the Czech Republic and Malta, where the fund may have been re-established after interventions during the year.

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[18] This graph does not include schemes that expressed the fund level as a percentage when answering the questionnaire.

2.2.7 Section VII - Interventions

At a conceptual level, institutions within the banking system may suffer from troubles caused by microeconomic, macroeconomic or structural issues.

Microeconomic problems are due to poor banking practices and inadequate management of credit and other risks; conversely, when unexpected macroeconomic shocks arise, even the most prudent and soundly managed banks can be threatened and experience serious trouble. Furthermore, underlying microeconomic or structural weaknesses may be brought to the surface by cyclical macroeconomic shocks. Structural causes relate to factors that prevent the banking sector from efficiently developing, such as market distortions or inadequate supervision[19].

In the event of a bank failure, a wide range of actions may be undertaken by the supervisory authorities in order to manage the crisis and preserve the essential banking function in the system. Apart from restructuring prior to intervention, common techniques may include purchase and assumption transactions[20], deposit transfer and payoff, or financial assistance that the authorities might provide in flexible structural forms (loans, cash contributions, asset purchases or other) in order to prevent a troubled bank from failing.

This section of the Questionnaire refers to possible interventions by the interviewed Schemes. The information provided here regards the amount of insured deposits, the date and type of intervention and its cost.

Answers may vary considerably as regards the number of months between activation of the procedure and both start of reimbursement and total fulfilment of committed intervention.

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[19] See Andrews M. Josefsson M*., "What happens after supervisory intervention? Considering bank closure options*", IMF Working Papers, January 2003.

[20] When a healthy insured institution purchases some or all of the assets of a failed bank and assumes all insured deposits; these transactions generally "minimise disruption in the local community by avoiding interruptions of banking operations and allowing credit relationships to be maintained", Nicholas J. K., "*Deposit insurance system design and considerations*", 1999.

As shown in the following table, 11 Schemes out of 19 intervened during the period 1999-2003, always in the form of depositor pay-off. Schemes that did not answer this section are not included in the table below.

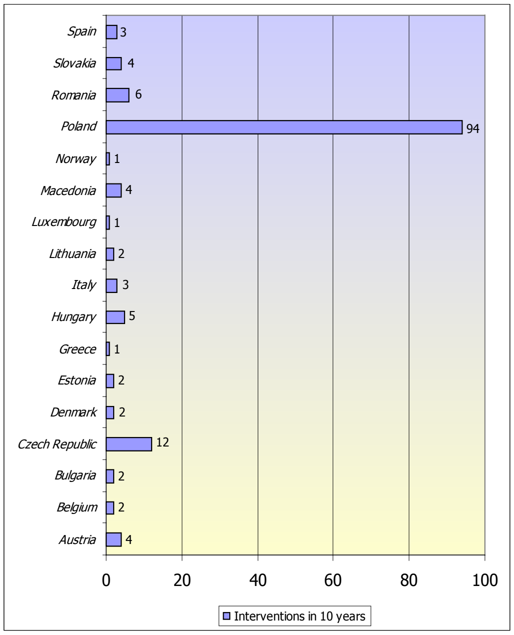
Countries	number of interventions 1999-2003	date of intervention	type of intervention	amount of insured deposits
Austria	1	2001	pay-off	not finished yet
Bosnia Herzegovina	0	-	-	-
Bulgaria	2	1999; 2000	pay-off	5 mil €; 154.358 €
Croatia	21	1999/2000; 2002	pay-off	500 mil €
Cyprus	0	-	-	-
Czech Republic	4	1999 (2); 2003 (2)	pay-off	N/A
Denmark	1	1999	N/A.	N/A
Estonia	0	-	-	-
Hungary	2	1999; 2000	pay-off	N/A
Ireland	0	-	-	-
Italy	0	-	-	-
Lithuania	1	1999	pay-off	5.7 mil €
Luxembourg	1	2003	pay-off	4.1 mil €
Macedonia	4	1999; 2000; 2003 (2)	pay-off	N/A
The Netherlands	0	-	-	-
Poland	0	-	-	-
Slovakia	4	1999; 2000 (2); 2001	pay-off	41 mil €; 102 mil €; 51.5 mil €; 284 mil €
Spain	1	2003	pay-off	131.3 mil €
Sweden	0	-	-	-

The following two graphs provide data about interventions in Europe over a period of ten years[21]: Graph VII.1 shows the number of interventions, while graph VII.1a refers to the ways of intervention the answering Schemes used in dealing with member banks' crises.

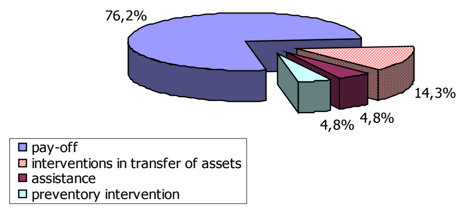
Additional information on the topic comes from section IX of the Questionnaire, where a number of questions investigate who determines whether a member institution has failed or can be considered insolvent, as well as who makes decisions to pay depositors' claims.

[21] Schemes that did not answer this question, as well as answering schemes with no interventions during the period, are not included in the graphs.

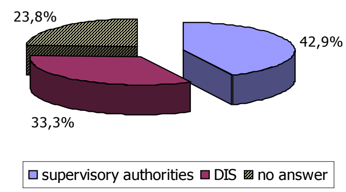
Graph VII.1 - number of Interventions



Graph VII.1a - Forms of Intervention

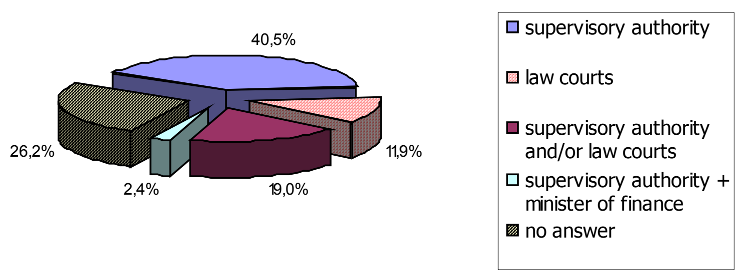


Graph VII.2 - Who decides



According to the results, the DIS itself decides whether to reimburse depositors in 35% of the sample; in around 43% of cases the authorisation of the supervisory authority is necessary and no intervention can be undertaken without it (see graph VII.2). This may be a consequence of the significant role that supervisory authorities usually play in determining whether a member institution is failed or insolvent, as shown in graph VII.3.

Graph VII.3 - Insolvency



2.2.8 Section VIII - Changes in the system

Section VIII of the Questionnaire deals with possible changes to DIS regulations. The answers may refer to proposed changes as well.

The changes listed in this section mainly derive from the process of implementing Directive 94/19/EEC, which countries joining the Union have to plan even before entering the EU. Actual or potential changes may entail increasing the level of coverage to nearly the minimum required; excluding some deposits from protection and including those in foreign currency; allowing for topping-up by foreign bank branches; and addressing other principles of the Directive.

2.2.9 Section IX - Supplementary information

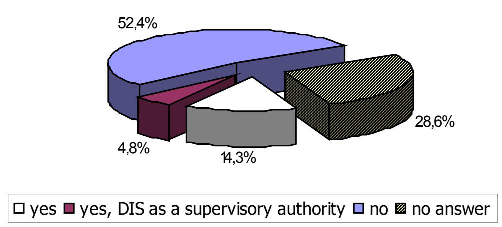
Section IX adds further details to the answers to previous questions. Some results, such as those on bilateral agreements and forms of intervention, have been discussed above in sections IV and VII.

Moreover, this section analyses crucial aspects concerning the risk monitoring function a DIS may use in order to assess the riskiness of each member institution.

Among the 31 Schemes completing the Questionnaire, just a few have a risk monitoring function in place.

As reported in graph IX.1, only 14.3% of respondents are independent institutions and use a warning system to assess member banks' riskiness, while 4.8% are also supervisory authorities.

Graph IX.1 - Risk Monitoring function



2.2.10 Section X - Notes

The last section of the Questionnaire is an open section where each DIS had the opportunity to add further data on topics not otherwise addressed. It was also available for comments on the questionnaire itself.

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Kahn C. M. and Santos J. A. C. (2001), "*Allocating bank regulatory powers: lender of last resort, deposit insurance and supervision*", Bis Working Papers, no. 102.

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Pages H. and Santos J. A. C. (2003), "*Optimal supervisory policies and depositor-preference laws*", Bis Working Papers, no. 131.

Annex I - Questionnaire on Deposit Insurance

Section I - General information on the Scheme

I.1 Name of the Scheme (home-country language)		
I.2 Name of the Scheme (English version)		
I.3 Country		
I.4 Year of founding		
I.4.1 Did your country have a deposit compensation scheme in place prior to the implementation of the European Directive on deposit insurance?	*Yes/No*	
If the answer is Yes, please state the date on which the scheme was established and provide a short description of any major changes to the scheme as a result of the Directive.		
I.5 Laws or Norms establishing and regulating the scheme:		
1.		
2.		
3.		
4.		
I.5.1 Year of implementation of the European Directive (94/19/EC)		
I.6 Address		
I.7 City		
I.8 Zip Code		
I.9 Country		
I.10 Telephone number		
I.11 Fax-number		
I.12 E-mail-Address		

I.13 Web-Address	
I.14 Chairman	
I.15 Contacts:	

I.15.1 Name	*I.15.2 Position*	*I.15.3 Phone nr.*	*I.15.4 Fax*	*I.15.5 e-mail*

I .16 Is this the only scheme active in the country?	*Yes/No*	
I .16.1 If not, list other active domestic schemes:		

a)	
b)	
c)	
d)	
e)	

I.17 Is any investor guarantee scheme in place in your country, in accordance with European Directive 97/9/EEC?	*Yes/No*	
If yes, please cite name(s):		
I.17.1 If yes, is the investor guarantee scheme managed by the same body as the deposit insurance scheme? Please provide a short description of the relationship, if any, between the two schemes.	*Yes/No*	

Section II - Structure of the Scheme

II.1 Nature:	*Private/ Public/ Mixed*	
II.2 Contribution:	*Ex Ante/ Ex Post/ Mixed*	
II.3 Funding includes public contribution:	*Yes/No*	
II.4 Independence:	*Yes/No*	
If no, please explain:		
Independent intervention decision	*Yes/No*	
Intervention decision subject to authorisation (name of the authorising Institution(s))		
II.5 Supervisory Powers over Member Institutions:	*Yes/No*	
Limited (Jointly with...)		
II.6 Describe the kind of institutional relationships with the Central Bank or the European Central Bank		
II.7 Describe the kind of institutional relationships with other supervisory authorities		
II.8 Who makes decisions to pay depositor claims?	*Government*	
	Central Bank	
	Private Sector	
	Regulator	
	Supervisor	
	The scheme	
	Other - Please explain	
II.9 Does the scheme use various methods of reimbursing depositor claims?	*Yes/No*	
In case of various methods, please explain		

II.10 Authority to set standards or guidelines for member banks	*Yes/No*	
If yes, please explain		

II. 11 Does the Scheme receive information/data/statistics directly from member banks or from a third party?	*Yes/No*	
If yes, please describe what information is received and how often:		
Member banks		
Third party (central bank, regulator, supervisor etc.)		

II.12 Are there formal or informal arrangements in place between the deposit insurance scheme and other parties (e.g. central bank, supervisor, regulator or other) regarding the sharing of information on member banks?	*Yes/No*	
If yes, please provide details of these agreements.		

Section III - Governance

III.1 Is the Scheme a legally separate organisation from other public or private bodies?	*Yes/No*	
If no, please explain		

III. 2 What is the organisational governance of the scheme?	
Administrative Board or Committee/ Board of Directors/ Advisory Board or Committee/ Other, please explain	

III.3 Members of the board appointed by:				
Member institutions	*Yes/No*		*number*	
Government	*Yes/No*		*number*	
Supervisory authority (name)	*Yes/No*		*number*	
III.4 Chairman appointed by:				
Member institutions	*Yes/No*		*number*	
Members of the board (election)	*Yes/No*		*number*	

Government	*Yes/No*		*number*	
Supervisory authority (name)	*Yes/No*		*number*	
III.5 Tenure (in years):				
Chairman				
Board				
III.6 Accountability:				
To whom:				
When:				
How:				
III.7 Other information:				
III.7.1 External officers allowed to attend meetings of the board:	*Yes/No*		*number*	
If Yes, to which authority do these officers belong:			*number*	
			number	
			number	
			number	
If Yes, do they have voting rights in board decisions?			*Yes/No*	
III.7.2 Please indicate the number of employees at the scheme:				
III.7.3 Are the majority of employees dedicated staff (as opposed to staff seconded by other organisations)?			*Yes/No*	
If no, where do they come from? (government, central bank, private sector, etc):				

Section IV - Information on insured member institutions

IV. 1 What kind of institutions are covered by your scheme?				
IV.2 Please provide the following information:				
	Dec. 2001	*Dec. 2002*	*Dec. 2003*	
IV.2.1 Number of insured institutions				
IV.2.2 Number of branches of foreign institutions				
IV.2.3 New members (joined in the last 12 months)				
IV.2.4 Merged institutions				
IV.2.5 Failed institutions				
IV.3 Is membership mandatory or on a voluntary basis?				
If mandatory, is there any exception (please explain)?	*Yes/No*			
IV. 4 Are branches from EEA member states required to participate in your scheme or is participation voluntary?				
IV.4.1 Are EEA branches currently participating?	*Yes/No*		*number*	
IV.4.2 Has your scheme established bilateral rules and procedures for topping-up? With which countries?	*Yes/No*			
IV. 5 Does your scheme allow or require participation by non-EEA branches?				
IV.5.1 Are non-EEA banks currently participating?	*Yes/No*		*number*	
IV.6 Is membership by foreign institutions (i.e. foreign bank branches and/or subsidiaries) covered in the same way as domestic institutions?	*Yes/No*			
If No, please describe the differences				
IV.7 Are member institutions required to re-apply for membership after a certain time?	*Yes/No*			
IV. 8 Are credit institutions providing investment services required to belong to both a deposit guarantee scheme and an investor compensation scheme?	*Yes/No*			

Section V - Information on the insured funds

V.1 Does your scheme use a formal definition of deposit and/or insured deposit?	*Yes/No*	
If Yes, please cite.		
V.1.1 What types of deposit are eligible for coverage?		
V.1.2 What types of depositor are eligible for coverage? (Foreign – Non residents; Corporate – domestic/foreign; etc., please explain)		
V.1.3 Coverage is:		
per depositor account; per depositor; per institution; per depositor per institution; other, please explain:		
V.2 Please specify the statutory level of coverage of your scheme:		

V. 3 Please provide the following details:		
	Dec. 2002	*Dec. 2003*
V.3.1 Total amount of insured deposits:		
Sight deposits		
Term deposits		
V.3.2 Total amount of insured deposits up to 20,000 €:		
Sight deposits		
Term deposits		
V.3.3 Insured deposits as a percentage of the total liabilities of member institutions		

V.4 Does your scheme use coinsurance?	*Yes/No*	
If Yes, please describe the approach employed		

Section VI - Information on available resources

A. If the scheme provides for ***ex-ante contribution****, please fill in the form below:*

VI.1 Minimum fund level (as percentage of reimbursable funds)	
VI.2 Maximum fund level (as percentage of reimbursable funds)	

	Dec. 2002	*Dec. 2003*
VI.3 Fund level		
VI.4 Scheme borrowings		
VI.5 Scheme assets (as percentage of total)		
VI.5.1 Cash and cash equivalents		
VI.5.2 Government bonds		
VI.5.3 Other		
VI.6 Revenues		
VI.6.1 Amount of premiums collected in the period		
VI.6.2 Interest on government bonds		
VI.6.3 Recoveries		
VI.6.4 Other receipts		
VI.7 Expenses and losses		
VI.7.1 Operating expenses		
VI.7.2 Disbursements for interventions		
VI.7.3 Other disbursements		

**If the scheme administers more than one fund, please fill in one form for each of them*

B. If the scheme provides for ***ex post contributions or has an emergency fund****, please specify:*

VI.8 Minimum level of commitment	
VI.9 Maximum level of commitment	

Section VII - Interventions during the period

VII.1 Name of institution	*VII.2 Date of intervention*	*VII.3 Type of intervention**	*VII.4 Amount of insured deposits*	*VII.5 Disbursement for intervention*	*VII.6 Cost of intervention*

VII.7 Time Lag 1: number of months between activation of the procedure and start of disbursement	
VII.8 Time Lag 2: Number of months between activation of the procedure and total fulfilment of committed intervention	

**PO = Deposits Pay-off; PA = Purchase & Assumption; OBA = Open Bank Assistance, BB= Bridge Bank; O = Other.*

Section VIII - Changes to the systems

VIII.1 Date of change	*VIII.2 Reference to legal provisions*	*VIII.3 Text of the change*

VIII.4 Date on which proposal was made	*VIII.5 Date on which proposal is expected to come into force*	*VIII.6 Reference to legal provisions*	*VIII.7 Text of the Proposal*

Section IX - Supplementary information

IX.1 Does the Scheme have a risk monitoring function to analyse and assess the risk of member institutions?	*Yes/No*	
If Yes, please provide details:		

IX.2 If the scheme has a system to classify its member institutions by risk class, please indicate the number of institutions for each class and the percentage of corresponding deposits		
IX.2.1 Class	*IX.2.2 Number of institutions*	*IX.2.3 % of insured funds*

IX.3 If the scheme has a system of enforcement actions, please indicate the number of institutions and their percentage of insured funds for each kind of action applied. Also cite the provisions that regulate the scheme and provide for this kind of action.			
IX.3.1 Type of action	*IX.3.2 Reference to provisions*	*IX.3.3 Number of institutions*	*IX.3.4 Insured funds*
A			
B			
C			
D			
E			

IX.4 Total amount of the insured institutions' non-performing loans:	

IX.5 Total amount of the insured institutions' non-performing loans as a percentage of their capital:	

IX.6 If the system adopts risk based deposit insurance premiums, please indicate the number of institutions for each class of premiums below:

IX.6.1 Premium Class	*IX.6.2 Number of institutions*	*IX.6.3 % of insured funds*

IX.7 If the system allows the participation of branches of foreign institutions, please indicate below the number of these branches for each country:

IX.7.1 Country	*IX.7.2 Number of institutions*

IX. 8 Who determines whether a member institution has failed or is "insolvent"?	

IX.9 Who makes decisions to pay depositor claims?	

IX. 10 How many member institutions have failed in your country in the last 10 years?	
IX. 10.1 In which way did the scheme intervene?	

IX.11 How often do you contact other deposit insurance Schemes? (Never, occasionally, regularly, etc.)	

IX. 12 Are formal or informal bilateral arrangements in place between your scheme and other deposit insurance organisations operating in the same country or another one?	*Yes/No*	

If Yes, please provide details of these agreements:	
Other Countries' Deposit Insurance Schemes:	

Object of the agreements:	

Section X - Notes

X.1 ID - Field number	*X.2 Note*

Annex II - Deposit Insurance Schemes invited to answer the Questionnaire

Country	*UE Member*	*EFDI Member (DIS)*	
Albania	-	*Yes*	*The Deposit Insurance Agency of Albania*
Armenia	-	*Yes*	*Central Bank of Armenia*
Austria	*Yes*	*Yes*	*Einlagensicherung der Banken und Bankiers GmbH (Austrian Banker Association) **
			Österreichische Raiffeisen-Einlangensicherung reg. Gen.m.b.H.
			Hypo-Haftungsgesellschaft m.b.H.
			Sparkassen-Haftungs AG
Belgium	*Yes*	*Yes*	*Deposit and Financial Instrument Protection Fund **
Bosnia Herzegovina	-	*Yes*	*Deposit Insurance Agency of Bosnia and Herzegovina*
Bulgaria	-	*Yes*	*Deposit Insurance Fund (DIF)*
Croatia	-	*Yes*	*State Agency for Deposit Insurance and Bank Rehabilitation*
Cyprus	*Yes*	*Yes*	*Cyprus Deposit Protection Fund*
Czech Republic	*Yes*	*Yes*	*Deposit Insurance Fund*
Denmark	*Yes*	*Yes*	*The Guarantee Fund for Depositors and Investors **
Estonia	*Yes*	*Yes*	*Guarantee Fund of Estonia **
Finland	*Yes*	*Yes*	*Deposit Guarantee Fund*
France	*Yes*	*Yes*	*Deposit Guarantee Fund **
Germany	*Yes*	*Yes*	*Depositor Indemnification Fund of the Association of German Public Sector Banks (Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken e. V) **
			Bundesverband deutscher Banken e. V.Einlagensicherungsfonds (Deposit Protection Fund)
			*Entschädigungseinrichtung deutscher Banken GmbH (The German Private Commercial Banks´Compensation Scheme for Depositors and Investors) **
			Sicherungseinrichtung des Bundesverbandes der Deutschen Volksbanken und Raiffeisensbanken e.V.
			Deutscher Sparkassen und Giroverband (DSGV) Sicherungseinrichtung
Greece	*Yes*	*Yes*	*Hellenic Deposit Guarantee Fund*
Hungary	*Yes*	*Yes*	*National Deposit Insurance Fund of Hungary*
Iceland	-	*Yes*	*Depositors' and Investors' Guarantee Fund **
Ireland	*Yes*	*Yes*	*The Irish Deposit Protection Scheme*
Italy	*Yes*	*Yes*	*Interbank Deposit Protection Fund*
			Credit Cooperative Depositors Guarantee Fund
Lithuania	*Yes*	*Yes*	*Deposit and Investment Insurance **
Luxembourg	*Yes*	*Yes*	*Deposit Guarantee System **
Macedonia	-	*Yes*	*Deposit Insurance Fund of Republic of Macedonia*
Malta	*Yes*	*Yes*	*Malta Financial Services Authority **
Montenegro	-	*Yes*	*Deposit Protection Fund*

The Netherlands	*Yes*	*Yes*	*The Netherlands National Bank* *
Norway	-	*Yes*	*Norwegian Banks Guarantee Fund*
Poland	*Yes*	*Yes*	*Bank Guarantee Fund*
Portugal	*Yes*	*Yes*	*Deposit Guarantee Fund*
Romania	-	*Yes*	*Deposit Guarantee Fund*
Serbia	-	*Yes*	*Agency for Deposit Insurance, Rehabilitation, Bankruptcy and Liquidation of Banks*
Slovakia	*Yes*	*Yes*	*Deposit Protection Fund*
Slovenia	*Yes*	*Yes*	*Bank of Slovenia* *
Spain	*Yes*	*Yes*	*Deposit Guarantee Fund for Banking Institutions* *
			Deposit Guarantee for Saving Banks
			Deposit Guarantee for Credit Cooperative Banks
Sweden	*Yes*	*Yes*	*Deposit Guarantee Fund* *
United Kingdom	*Yes*	*Yes*	*Financial Services Compensation Scheme* *
	24	***35***	***45***

<u>Current EFDI members</u> => <u>45 Schemes active in 35 countries</u>:

35 Schemes active in 24 EU countries and 11 in non-EU countries.

The Questionnaire was sent to all EFDI members in July 2004; 31 Schemes replied and 11 did not. This study is based on information from the 31 completed Questionnaires.

EFDI members as of July 2004: 42 Schemes, corresponding to 32 countries, as Armenia, Montenegro and Serbia have recently applied for membership. New members were not involved in this study.

*EFDI members that also provide investment guarantee are marked on the above list with *; they are also members of the EFDI Investment Associates together with 7 Investment Compensation Schemes active in 7 EFDI member countries (Germany, Greece, Hungary, Ireland, Italy, Poland and Portugal).*