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Evaluation of the effectiveness of the Bank Guarantee Fund's deposit guarantee activities

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Abstract

Motivation: The Bank Guarantee Fund (BFG) operates by following two formulas, one of which is the implementation of the disbursement of guaranteed amounts. The BFG has been changing the limits of the guaranteed amounts, streamlining and improving the way in which the disbursements are made, as well as conducting information activities. The interest in analysing these activities is the original motive that prompted the present topic.
Aim: The aim of the article is to evaluate the effectiveness of the BFG's deposit guarantee activity by: showing the history of the limit of guaranteed amounts, reviewing selected items of the BFG's balance sheet and the collateral ratio of the deposit guarantee scheme. The 28 years of the BFG's existence have forced the Fund to make progress with computerisation, which is analysed on the basis of the implementation of payouts of two failed banks in Poland. The purpose of the survey is to verify the indirect information activity of the BFG.
Materials and methods: The research tasks were made possible through the use of descriptive analysis, financial analysis, a case study and a survey. The information contained in academic articles, annual reports of the BFG and in the BFG acts was used.
Results: High stability and security of the banking sector is crucial. The BFG's main investment is in securities of the State Treasury and the NBP, which guarantees the deposits of bank customers. The small institutions that are covered by the BFG regime show the highest level of safety, due to the limited risk of contagion in case of their failure. However, large banks have to look after their own interests, as most companies have accounts in these banks. The survey showed low public awareness of deposit guarantees. The BFG should improve its information activities, e.g. with TV and radio advertisements.

Keywords: *BFG; deposits; guarantee*
JEL: *G21; G28; G33*

1. Introduction

The deposit guarantee scheme in Poland was established relatively recently, in 1995, shortly after the political transformation initiated in 1989. Throughout its 28 years of operation, the Bank Guarantee Fund (BFG) has been continuously working towards a sustainable financial system. The Fund guarantees deposits held in commercial and co-operative banks, as well as in Co-operative Savings and Loan Associations (SKOKs) and branches of foreign banks. The BFG has implemented two formulas for the operation of the system — a narrower one, the so-called pay box, i.e. coming down to the disbursement of guaranteed deposits, and a broader one, the so-called risk minimiser, which aims to protect the stability of the entire banking structure (Szambelańczyk, 1998, p. 70). Guaranteed institutions cooperate closely with the BFG through: quarterly contributions to the funds, obligatory reporting on the financial situation of the bank and carrying out information activities on the protection of customer deposits, to the extent obliged by legal acts.

The aim of this article is to assess the effectiveness of the BGF's deposit guarantee activity. The achievement of the objective was subordinated to the research tasks consisting in (1) showing the reasons for changes in the level of guaranteed amounts, (2) analysing selected items of the BGF's balance sheet and the deposit guarantee scheme's security ratio, (3) analysing the method of disbursement of guaranteed amounts against the background of legal changes and the progress of the BGF's computerisation on the example of two selected banks in Poland, (4) assessing the BGF's information activity.

Section 2 reviews the literature on the subject. Section 3 highlights the research materials and methods used. Section 4 discusses the results and presents the conclusions, and Section 5 provides a summary of the critical analysis of the literature and the study conducted.

2. Literature review

2.1. Guaranteed amount limits

In 1989, the Banking Act (1989) was enacted, under which the State Treasury was liable for the liabilities of state-owned banks and those that had benefited from state guarantees before the Act came into force. The previous legal provisions of 1982 were therefore maintained (Banking Act, 1982). In 1994, in the face of the banking crisis that had begun two years earlier, the Sejm enacted a guarantee provision (Resolution, 1994), according to which the guarantor of deposits was the President of the National Bank of Poland (NBP). The amounts and share of the guarantee were the same as in the later enacted law. The deposit guarantee scheme in Poland was established in 1995 under the Bank Guarantee Fund Act (1994). The original system guaranteed 100 per cent of the equivalent amount up to ECU[1] 1,000 and 90 per cent of funds between ECU 1,000 and ECU 3,000, except for privileged banks where the State Treasury was the guarantor above the scope of the BFG. This privilege expired at the beginning of 2000 (Zdanowicz, 2007, p. 124).

The introduction of such rather than other guaranteed amounts in 1995 was the result of several factors. First, the need for any legally sanctioned guarantee scheme. Secondly, an increase in international banking credibility. Thirdly, the desire to harmonise the guaranteed amounts to those existing in other European countries. One may wonder whether ECU 3 000 is a lot or a little. At present it is probably not, but even after 10 years of the existence of the BFG the average deposited funds in bank accounts was the equivalent of EUR 1 500 (Pawelska, 2005, p. 32). Poland joined the European Union (EU) in 2004. Less than 10 years earlier, the Bank Guarantee Fund Act (1994) had been enacted. Even then, although Poland was not covered by EU directives, there was a desire to comply with them. Directive 94/19/EC on deposit guarantee schemes (1994) is worth mentioning. The Act on the BFG came into being less than six months later and, importantly, was not a simple calque of the European Communities' regulations, although its main assumptions were taken into account (Szambelańczyk, 2020,

[1] ECU (European Currency), European Currency Unit, a non-cash unit of account used between 1979 and 1998 in the countries of the European Communities. It was used in intergovernmental debt settlements and in European Monetary System operations. Its value was calculated on the basis of a weighted average of a basket of the currencies of the Member States of the Communities, taking into account their economic importance. 1 January 1999. The ECU was replaced by the euro.

p. 6). In the years following the entry into force of the Act, the limits of the underwriting amounts were raised up to EUR 22,500 in 2003, so that Poland met all the requirements for entry into the Community. Directive 94/19/EC (1994) stipulated a minimum guarantee limit of EUR 20,000. In addition, it gave the possibility to apply 10% co-insurance, i.e. a guarantee of only 90% of the funds. There was therefore ambiguity as to whether the two provisions could be applied together, in which case the maximum indemnity would be EUR 18 000 (Pawlikowski, 2005, p. 16). In Poland, the limit was set at EUR 22,500 from 2003, of which EUR 1,000 was guaranteed at 100% and the amount between EUR 1,000 and EUR 22,500 at 90%. The depositor could therefore count on a maximum of EUR 20 350 in compensation. In the following years, the limits stabilised until 15 September 2008, when the US bank Lehman Brothers collapsed. This caused panic among the public as well as the entire interbank market. New safeguards had to be swiftly implemented in the form of an increase in the guarantee limit. The Act amending the Bank Guarantee Fund Act and amending other acts (2008) set it at the equivalent of EUR 50,000. This amount was a compromise because the limit could not be set too low so that the public would not remain concerned about the guarantee of their deposits and be inclined to run on the banks. A much higher limit above EUR 50,000 was not immediately introduced, for the reason that the public might see the previous amounts as unreliable and the banking sector as a whole as not very stable. Under Directive 2009/14/EC (2009), a limit of EUR 50,000 was proposed, and by the end of 2010 EUR 100,000. In line with these guidelines, after 2 years of the amount in force, the Act on amending the Bank Guarantee Fund Act and certain other acts (2010) implemented a guarantee level up to the equivalent in EUR 100,000. It is worth noting that the 2008 and 2010 Acts, in accordance with the directive, abolished co-insurance, which affected the 100% guarantee level.

2.2. Guarantee scheme collateral ratio and BFG balance sheet structure

Under the two action formulas mentioned in the Introduction, the BGF operates several funds, which can be divided into two groups. The first one serves the pay box formula and comes down to guaranteed disbursements, and the second one, the risk minimiser, to restructure guaranteed entities. Banks and credit unions contribute quarterly to these funds in the amount indicated by the Resolutions of the BFG Council. In the first six years of the BFG's operation, a fund for the protection of guaranteed funds and an assistance fund were maintained. In addition, under the Act on the functioning of cooperative banks, their affiliation and affiliating banks (2000), a cooperative bank restructuring fund was established (BFG, 2002).

The Fund's balance sheet at the end of 2021 showed the following on the liabilities side: banks' guarantee fund, banks' forced restructuring fund, cash guarantee fund, cash forced restructuring fund and cooperative banks' restructuring fund. On at the balance sheet date, i.e. 31.12.2021, the balance of the banks' guarantee fund was approximately PLN 18.7 billion, while the funds in banks eligible for guarantees were PLN 1 022.6 billion (BFG, 2022c). Thus, the coverage ratio of the deposit guarantee scheme in banks was 1.83%, which is in line with Directive 2014/49/EU on deposit guarantee schemes (2014), setting a minimum ratio of 0.8%. Fund measures are only absolute measures, only ratios describe the relative level of security of the banking system. Between 2016 and 2021, the security ratio in banks was on an upward trend reaching in 2016 1.65%, up to 1.83% at the end of 2021. (BFG, 2022c). At the end of 2022, the level of the ratio decreased reaching 1.77% (EBA, 2023). It is worth mentioning that on 26 October 2022. The Board of the BFG adopted a resolution, according to which it reduced the above-mentioned ratio from 2.6% (such it had set earlier) to a target level of 1.6%. Consequently, since the level was reached in 2022, the Board also issued a resolution not to collect contributions to the banks' guarantee fund in 2023 (Resolution, 2023).

In addition to the liabilities side, it is worth looking at the opposite side — the assets, i.e. the assets of the BFG. This side answers the question of what the BFG uses banks' and credit unions' contributions and own profits for. The balance sheet total in 2021 was approximately PLN 28.7 billion. The largest item on the asset side was securities and other financial assets amounting to approximately PLN 25.8 billion, which accounted for around 90% of total assets. These were detailed to debt securities of banks (PLN 8.5 billion), which accounted for approximately 33% of securities, and of the State Treasury (PLN 17.3 billion). This corresponded to approximately 67% of securities (BFG, 2022a, p. 76). Under the Bank Guarantee Fund Act (2016), the Fund may mainly purchase securities issued by the Treasury, the NBP and the governments or central banks of EU or OECD member states. In addition, the Fund may make deposits with the NBP and the Minister of Finance (BFG Act, 2016). In 2021. BFG invested in NBP money bills (approximately PLN 6.8 billion) and bonds (approximately PLN 19 billion) (BFG, 2022a, p. 74). It is worth noting that the total of the debt securities portfolio was higher by approximately PLN 77 million compared to the amount of debt securities reported in the balance sheet. This was most likely due to the complicated accounting policy of the BFG. In contrast, it can be estimated that other central bank instruments (compliant with the BFG Act, 2016) amount to approximately PLN 1.7 billion and bonds of other governments to approximately PLN 1.8 billion.

2.3. Development of the guaranteed payment procedure: analysis of legal changes and computerisation

Section 2.1 presents the history of changes in the guaranteed amounts and the structure of the BFG funds. Section 2.3 describes the manner in which guaranteed disbursements were made using the example of Bank Spółdzielczy (BS) in Grębów in 2019 and Bank Staropolski SA in Poznań in 2000. The choice of these institutions was based on the desire to show the differences in the manner of guarantee disbursements against the background of legal changes and the progress of the BFG's computerisation. In view of the fact that there have been no major legal changes since the collapse of BS Grębów, this example is also a depiction of the current legal situation. It must be reiterated that Bank Staropolski was a commercial bank and the bank in Grębów was a cooperative bank. The collapse of Bank Staropolski was the largest since the establishment of the BFG (BFG, 2001, p. 7). Both of these forms of business were guaranteed by the BFG. It should also be noted that these two different moments are separated by 19 years. During this time, there was a major development in computerisation.

Bank Staropolski suspended its operations on 13 January 2000. The District Court in Poznań issued a decision declaring Bank Staropolski bankrupt on 11 February 2000, so 29 days passed between the suspension of operations and the declaration of bankruptcy. In the case of Bank Spółdzielczy w Grębowie, the Financial Supervision Commission (KNF, 2019) suspended the bank's activities on 12 July 2019 and 3 days later, i.e. on 15 July, the court declared it bankrupt. The number of customers of the commercial bank was 147,300 and of the cooperative bank 2,365. The guarantee amount in 2000 was set at EUR 11,000 with co-insurance, i.e. up to EUR 1,000 at 100% and between EUR 1,000 and EUR 11,000 at 90%. 19 years later, the amount was EUR 100,000 at 100%. Since the first BFG Act (1994), the provision stating that guaranteed amounts expressed in euros are converted into the Polish currency at the exchange rate quoted by the National Bank of Poland on the day the court declared bankruptcy has not changed. On 11 February 2000, the euro exchange rate was PLN 4.078, while on 15 July 2019 it was PLN 4.2673. Bank Staropolski's client could therefore count on a maximum payout from the BGF of PLN 40,780, while for BS Grębów's client the payout was PLN

426,730. The value of all accumulated deposits of Bank Staropolski amounted to PLN 770 million (Michalewska & Werbolewski, 2010). The value of guaranteed deposits was lower and amounted to PLN 625.1 million. The relative measure of coverage of guaranteed deposits in relation to total deposits corresponded in the case of Bank Staropolski to 81%. The disbursement of the guaranteed amounts is made in the first instance by the bank-agent appointed by the BFG. In view of the fact that Bank Staropolski was the first commercial bank of medium size, the disbursements were made at two branches of this bank and also at: Bank Przemysłowo-Handlowy SA, Bank Śląski SA, Kredyt Bank SA and Powszechny Bank Kredytowy SA. The Co-operative Bank in Grębów was a small bank and the role of agent bank was assumed by Santander Bank Polska SA. In order not to cause additional banking panic when the bank was suspended, customers wanted to withdraw their funds as soon as possible. Unfortunately, in 2000, depositors had to wait as long as 119 days after the bank's suspension for their money. The situation was different in 2019. The total waiting time was only 10 days from the day the FSC suspended operations.

The background of the computerisation of the payout procedure is particularly evident in the waiting period for money. The BFG now has a Guarantee Realisation System (SRG) in place, which allows it to effectively control the lists of depositors, verify disbursement amounts and draw up lists of disbursements of guaranteed funds. In 2000, the biggest problem was the "manual" writing out of the lists. Persons appointed by the BFG had to verify and calculate the value of the disbursements for each of the approximately 147,300 people, and then there was still the need to carefully supervise the disbursements. This was a huge challenge at a time when the BFG's IT system was not well developed.

2.4. Information activities of the BFG

The main pillar of stability in banking is first and foremost the trust of customers in the institutions to which they entrust their funds. When one bank collapses, customers of another bank may panic and start withdrawing their deposits en masse. Such a phenomenon is referred to as a "run on the bank". The existence of a guarantee system is not enough to prevent this. Educational activities are also necessary. The BFG does not have any department and office operating in this area, but, in accordance with the BFG Act (2016), it conducts indirect information activities. It is worth noting that other financial market support institutions have organisational units responsible for education. These include, for example, the Financial Ombudsman, the NBP and the Insurance Guarantee Fund. According to the Act on the BFG (2016, Article 318), banks and credit unions belonging to the guarantee scheme are obliged to inform their customers about the basic principles of the guarantee before concluding an account agreement and at least once a year thereafter. This obligation is implemented by the bank, inter alia, through SMS notifications or in the bank app, less frequently in written form. Other forms of information are placards located in prominent places in the operating room of the bank or cash desk. On a grey background, a blue logo of the BFG is placed in the centre. Above and below it there is information shown "deposits in this bank are guaranteed by the Bank Guarantee Fund to the extent provided for in the Bank Guarantee Fund Act". Less significant forms of information include the information provided verbally to the bank's customer by the clerk. On the other hand, a provision on the BFG in the document concluding the bank account opening agreement is mandatory.

3. Materials and methods

The research tasks were made possible through the use of descriptive analysis, financial analysis, a case study and a survey. Information from academic articles, BFG annual reports and the BFG Acts was used.

A survey was conducted with a sample of 100 people online in May 2023. The survey questionnaire consisted of 6 questions on: (1) age, (2) education, (3) recoverability, (4) institution responsible for the payment of guaranteed funds, (5) amount of guaranteed deposits, (6) knowledge of the guarantee scheme.

4. Results

The increasing level of guaranteed amounts gave bank customers a sense of security. They were raised, rightly so, due to the increasing average amount of deposits held by customers and also by subsequent EU requirements. The limit has been the same for 13 years. The results of the analysis of the BFG (2018–2022b; 2023) reports show that the volume of customer deposits has grown faster than the sum of guaranteed deposits in banks and credit unions (Table 1). The phenomenon of inflation and the economic development of the country also contribute to this difference.

The analysis also shows that the coverage ratio of guaranteed amounts to total deposits is low. On the other hand, its level is relatively high compared to other European countries (Table 2) and meets EU standards. Analysing the BFG's balance sheet on the asset side, as well as the Fund's investment portfolio, it can be concluded that the State Treasury is an indirect guarantor of deposits, as most debt securities are Treasury bonds or NBP money bills.

Thanks to the development of computerisation, the BFG has significantly reduced the waiting time for guaranteed funds. It is important to note that, in the event of a bank failure, the total sum of customer deposits is not equal to the sum of BFG payouts. The ratio of these amounts is negligible in large banks, or higher in medium and small banks. This is influenced by a number of factors. The most important of these is that most of the banks and credit unions that failed were small (to a lesser extent medium) in size, i.e. they held less than 1% of the customer deposits of all banks. The second element is, of course, the guarantee limit, which, expressed in national currency, is now more than PLN 450,000. This is relatively high, but as we can see, the group of people with the most funds is the most affected in the event of a bank failure. Besides, the use of diversification of funds, i.e. depositing them in different banks up to the guarantee limit, gives a sense of almost absolute security in the event of bankruptcy (not necessarily if the account is hacked). All disbursements that the BFG has dealt with so far have been successful — the guaranteed funds have indeed been paid out to customers.

In order to prevent bank panics, the BFG conducts indirect information activities. In order to test the effectiveness of this activity, a survey was conducted, the results of which confirmed research conducted in earlier years (Kurowski & Górski, 2021, p. 89). As many as 46% of the respondents found out about the existence of the guarantee scheme by completing the survey, as they indicated that they had no knowledge of the guarantee scheme (Chart 1). Although the rest of the respondents knew about the existence of the guarantee scheme from other sources, only 35% of these people were able to answer questions about the entity responsible for the payment of the guaranteed funds and the amount of the guarantee without mistakes. Among these persons, all had a secondary or higher education and almost half in the financial field. The majority of respondents (56%) correctly answered that the BFG was responsible for deposit guarantees (Chart 2). When asked about the guarantee limit, almost half of all respondents indicated PLN 100 000 (Chart 3), including 50% of those who indicated the BFG as the deposit guarantee institution. Thus, the indication of the BFG as the institution responsible for the payment of guaranteed funds among half of this group was not based on reliable knowledge, but on conjecture. Question 3 was designed to test respondents' confidence in the system for protecting their deposits. More than half of the respondents (57%) answered that they would not get their deposits back in the event of bankruptcy, or that they had no opinion on the matter (Chart 4). One in four survey participants responded that deposits are guaranteed to the equivalent of €100,000. Of these people (38%) had an economic and financial background.

5. Conclusion

Based on the analysis of the history of changes in the guaranteed amounts, it can be concluded that the possibility of introducing a higher limit corresponding to the security and stability of the banking sector should be considered. The main investment item of the BFG from the contributions of banks and loan associations is debt securities of the State Treasury and the NBP. Thus, indirectly, it is the existence (not the bankruptcy) of the state that guarantees the deposits of bank customers, including those with foreign capital. Paradoxically, it is the small banks that are the safest, as the collapse of one of the ten largest banks in Poland could result in a domino effect, while the collapse of a small one would not. However, the banking sector made up of the largest banks has to look after its own interests, as most of the largest enterprises have their accounts with the largest banks and the guarantee limit is the amount that enterprises trade in on a daily basis.

The following conclusions can be drawn from the survey. The degree of public awareness of the basic principles of bank deposit guarantee is very low. The indirect information activities of the BFG and the direct information activities of banks are not effective. In the future, it would be advisable to strive for greater awareness through better education, e.g. TV advertising spots to reach a wide audience or radio advertisements, which are an effective way to reach the audience. The BFG should establish partnerships and cooperation with other community organisations and co-organise or patronise conferences in the area of banking and business.

The most significant challenges encountered in the research process were the need to obtain up-to-date information on the functioning of the BFG and the difficulties associated with obtaining a representative sample in the survey. The first difficulty was the limited availability of up-to-date data to reflect the day-to-day operations of the BFG. Delays in the publication of annual reports were a significant factor in the difficulty of obtaining the most up-to-date information. Another obstacle was the challenge of representative sampling in the survey.

The BFG has continued to operate without interruption for 28 years. During this period, it has successfully carried out its tasks without showing shocks in the face of financial market crises. Nevertheless, the biggest aspect of securing the banking system is the trust (and its construction) of bank customers. The Fund is able to cope with guaranteed payouts in small banks or loan associations. Unfortunately, it would not be able to cope with the failure of a large commercial bank institution.

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Appendix

Table 1.
Values of customer deposits and guaranteed funds in banks and credit unions in Poland between 2017 and 2022 (PLN billion)

Year	Customer deposits in banks and cash offices	Guaranteed funds in banks and cash registers	Difference
XII 2017	1143.8	720.3	423.5
XII 2018	1230.8	779.7	451.1
XII 2019	1319.9	860.1	459.8
XII 2020	1463.6	963.5	500.1
XII 2021	1605.9	1022.6	583.3
XII 2022	1711.3	1068.1	643.2

Source: Own preparation based on BFG (2018–2022b; 2023).

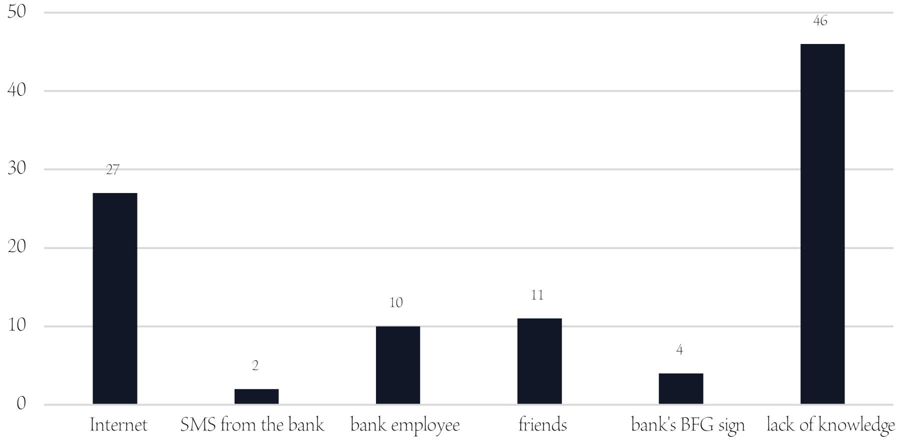
Table 2.
Deposit guarantee scheme coverage ratio in selected European countries in 2022 (%)

Country	Indicator
Romania	2.68
Sweden	1.98
Bulgaria	1.88
Poland	1.77
Latvia	1.66
Iceland	1.57
Belgium	1.45
Estonia	1.44
Norway	1.31
Greece	1.25
Luxemburg	1.19
Lithuania	1.06
Denmark	1.00
Croatia	1.00
Portugal	0.94
Finland	0.93
Malta	0.82
Slovakia	0.81
Hungary	0.78
Spain	0.75
Cyprus	0.69
Austria	0.66
Ireland	0.64
Germany	0.63
Netherlands	0.62
Slovenia	0.59
France	0.45
Italy	0.44

Country	Indicator
Czech Republic	0.42
Liechtenstein	0.19

Source: Own preparation based on EBA (2023).

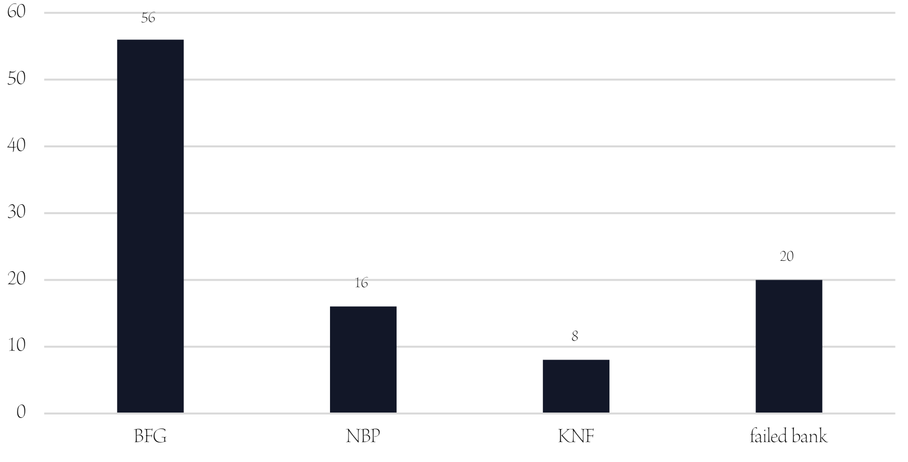
Chart 1.
Sources of knowledge about the deposit guarantee scheme (%)



Note:
Question from the survey: If deposits are guaranteed, how do you know this?

Source: Own preparation.

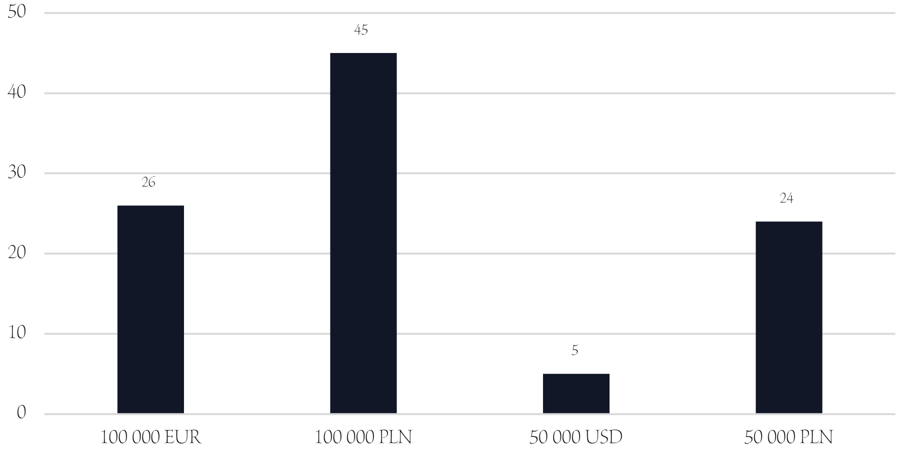
Chart 2.
Institution responsible for payment of the guaranteed funds (%)



Note:
Question from the survey: Which institution is responsible for disbursing your funds in case of a bank failure?

Source: Own preparation.

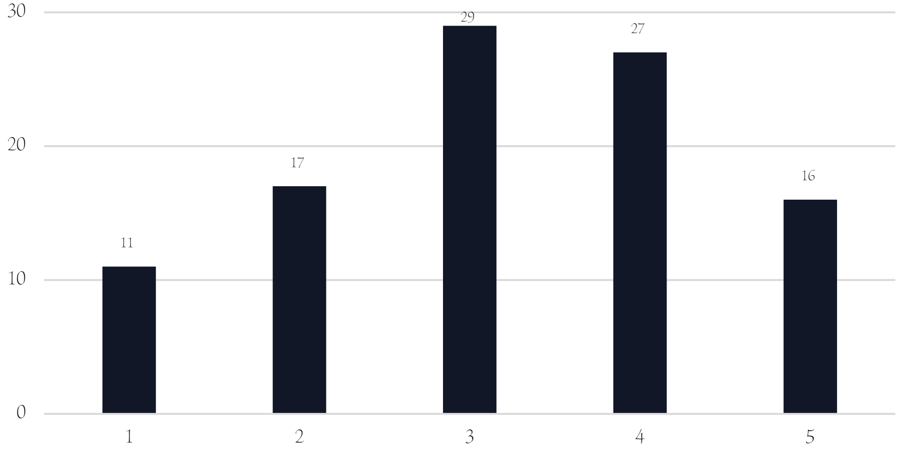
Chart 3.
Value of guaranteed funds



Note:
Question from the survey: What will happen to your funds deposited with the bank in case of its bankruptcy? Answers: You will get them back, but no more than (...).

Source: Own preparation.

Chart 4.
Confidence in the deposit protection scheme



Note:
Question from the survey: Do you think you will recover your funds held in your bank account in the event of bank failure? Answers on a scale of 1–5, where 1 means "you will not get your money back at all" and 5 means "you will get your money back in full."

Source: Own preparation.