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WORKING DOCUMENT

From:	Commission services
To:	Working Party on Financial Services and the Banking Union (CMDI) Financial Services Attachés
N° Cion doc.:	ST 8483 2023 INIT
Subject:	CMDI Review: DGSD - Item 3: Presentation by Commission services, survey on DGS recoveries and recent pay-outs



PUBLIC

DGS recoveries in liquidation after a payout event

Outcome of targeted survey

CWP 7 July 2023

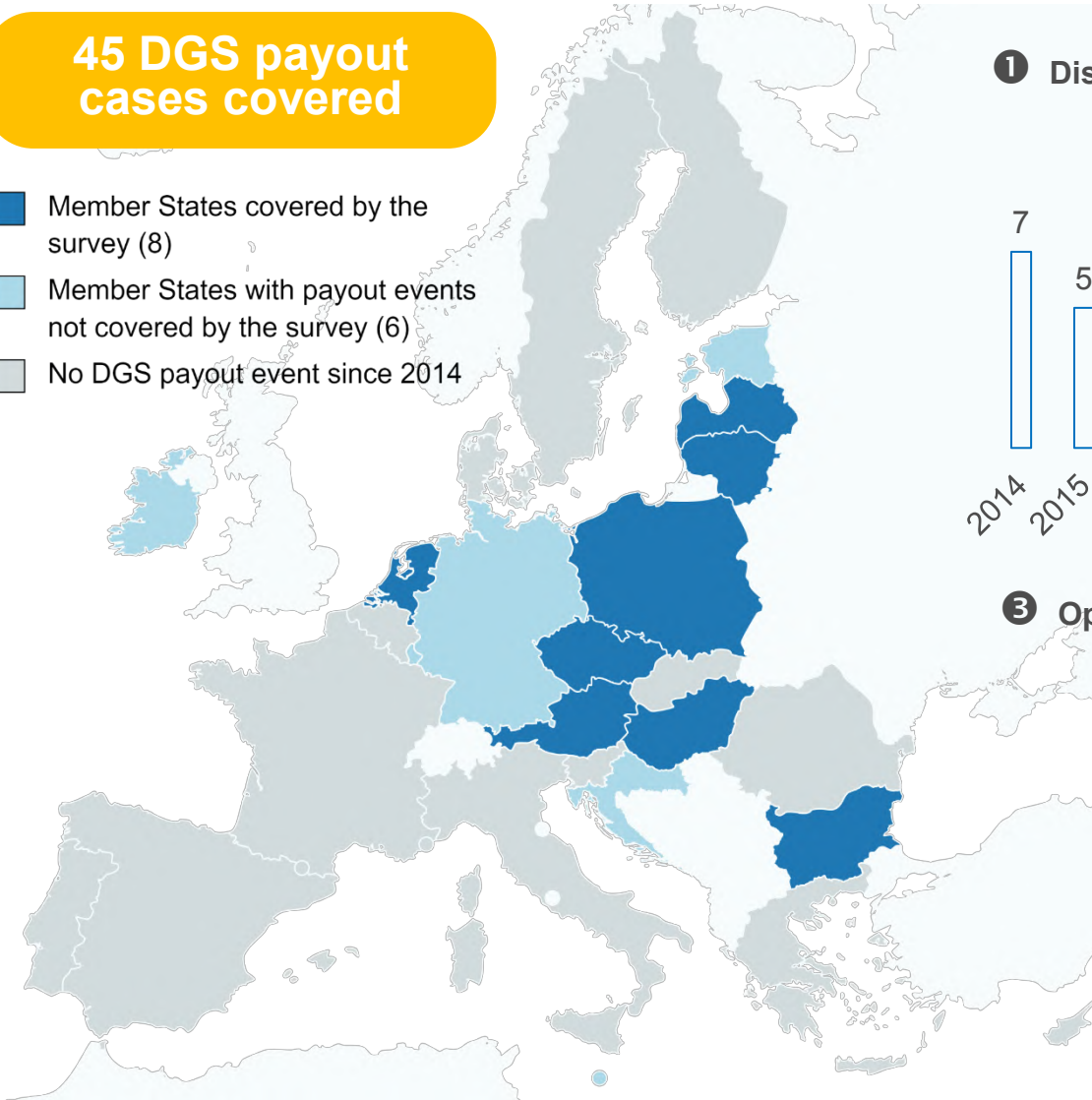
Objective, scope, approach and methodology

Objective of exercise	<ul style="list-style-type: none">• Collection of factual and informative data on DGS recoveries in past payout cases• Inform the policy debate in the co-legislation
Scope of exercise	<ul style="list-style-type: none">• 8 Member States (AT, BG, CZ, HU, LT, LV, NL, PL) with payout events in the period 2014 – today• Factual data gathered on 45 payout cases
Approach and methodology	<ul style="list-style-type: none">• Means of collecting data: ad-hoc survey• Questions covering:<ul style="list-style-type: none">• type, nature and triggers of insolvency proceedings• timing (start and end date of proceeding)• amounts of covered, preferred non-covered, non-preferred non-covered deposits, % of deposits in TLOF• DGS target level and available financial means at start of the payout proceedings• amount disbursed by DGS for the payout, amounts of funds recovered as of today, expected recoveries by DGS at end of insolvency proceedings, overall amount of liquidation proceeds from sale of assets, ranking of deposits at time of payout proceeding, years it took to recover 50% of DGS payout costs• amounts of ex-post extraordinary contributions raised, amounts of public money used as liquidation aid• overall loss on assets in the insolvency proceedings
Data limitations	<ul style="list-style-type: none">• Absence of certain indicators/metrics, especially in case of open procedures (e.g. overall loss on assets, overall liquidation proceeds)• Unavailability of data at Member State level (e.g. covered deposits out of total deposits, amount of non-covered deposits, DGS target level amount at the moment of the liquidation)

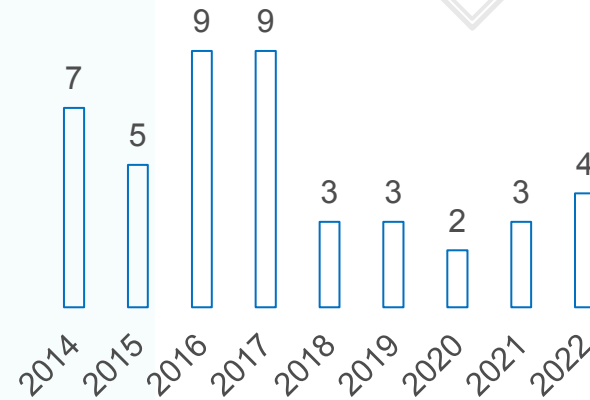
Overview of the survey sample

45 DGS payout cases covered

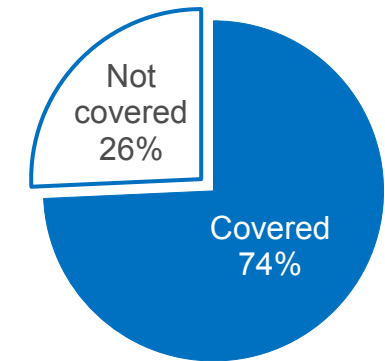
- Member States covered by the survey (8)
- Member States with payout events not covered by the survey (6)
- No DGS payout event since 2014



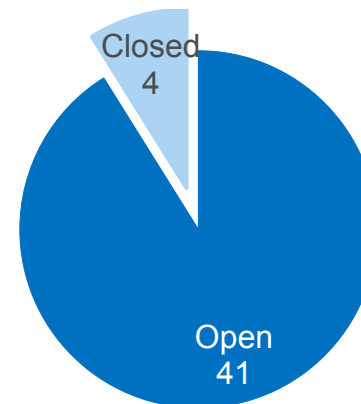
1 Distribution of cases by payout date



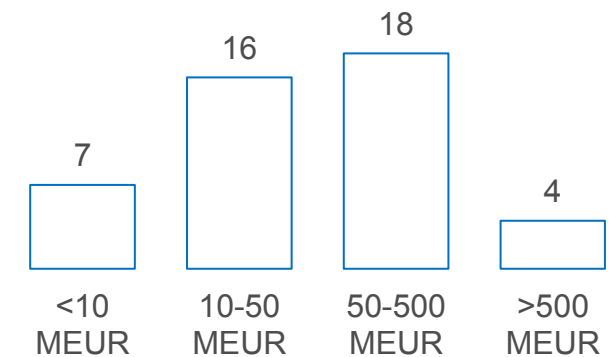
2 Coverage of liquidation cases with DGS payouts compiled by EBA ([link](#))



3 Open vs. closed liquidation cases



4 Distribution of cases by DGS payout amount



Content

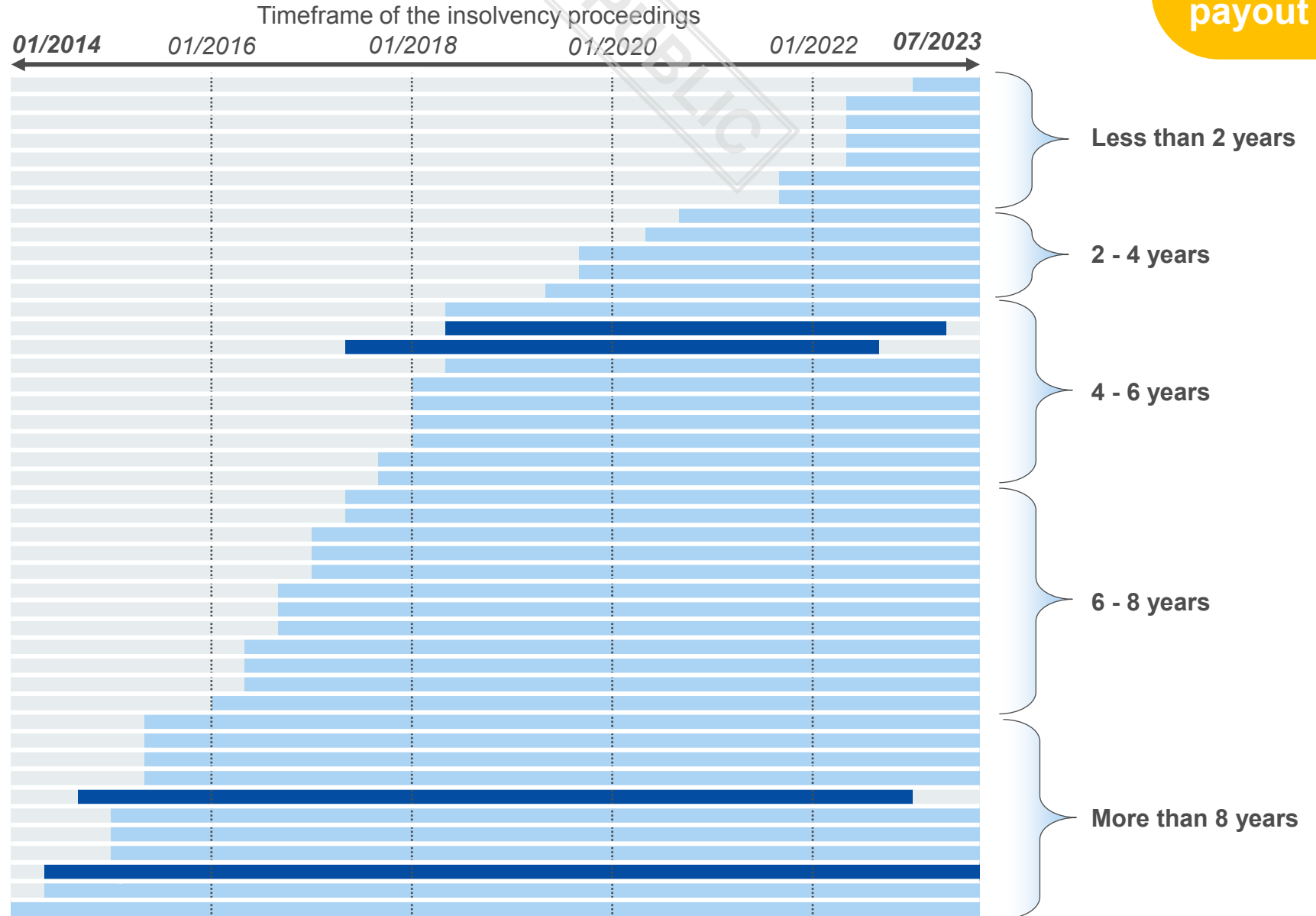


1. Approach and objectives
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5. Main takeaways

Timing of liquidation proceedings

1 bar = 1 DGS payout event

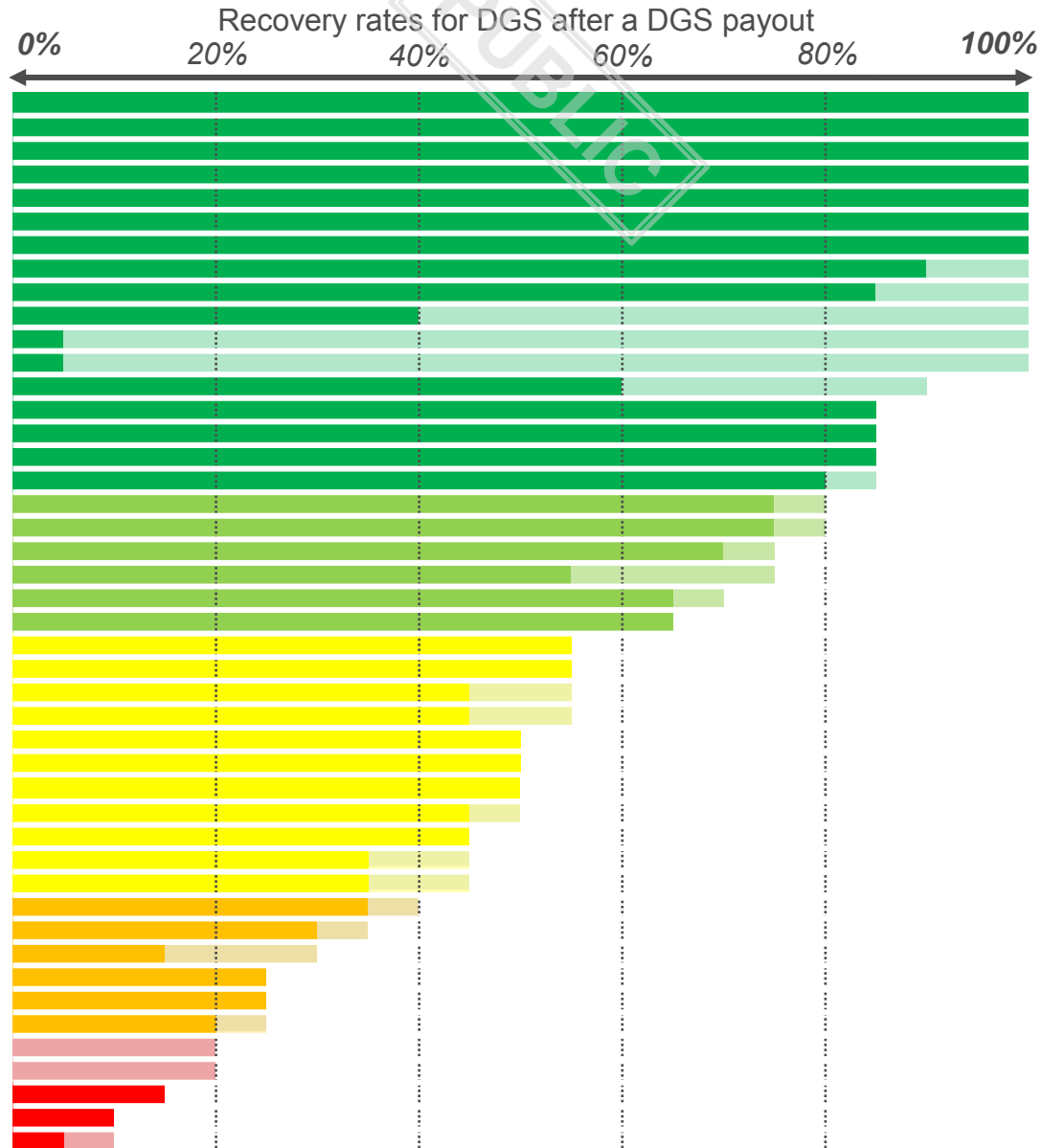
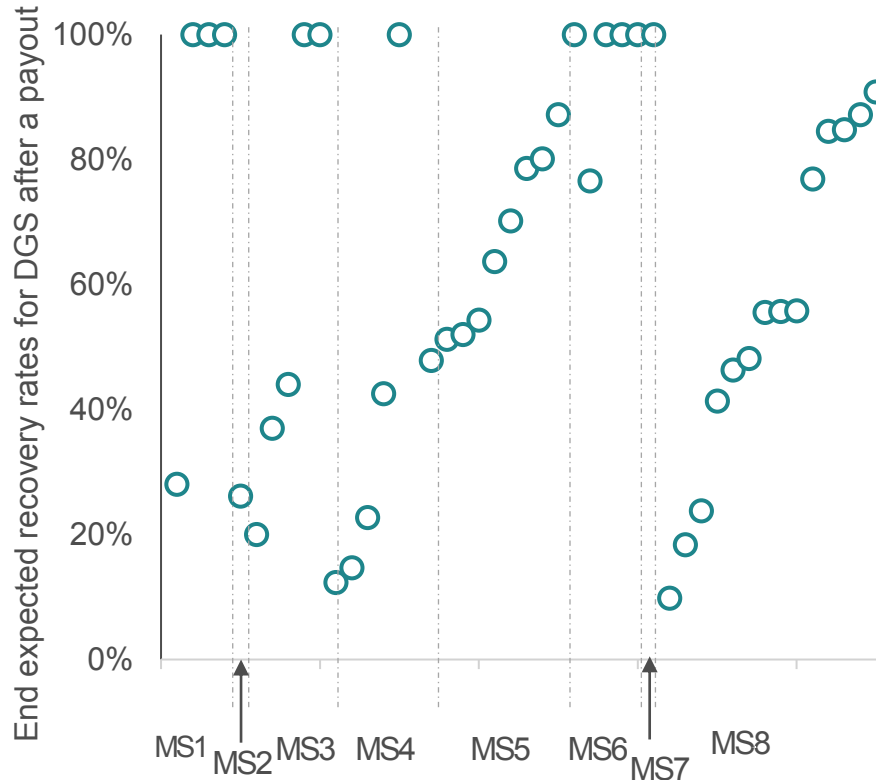
① Liquidation proceedings usually take many years to complete



Recoveries rates for DGSs

- 1 Liquidation proceedings usually take many years to complete
- 2 The recovery rate of DGSs after a payout event varies highly across Member States and it is highly case-specific

1 dot = 1 DGS payout event



Reading note: the lighter part of the bar represents expected DGS recoveries while actual DGS recoveries are depicted in darker colour.

DGS total expected recoveries between 80 and 100%
17 cases (38%)

DGS total expected recoveries between 60 and 80%
6 cases (13%)

DGS total expected recoveries between 40 and 60%
11 cases (24%)

DGS total expected recoveries between 20 and 40% - 6 cases (13%)

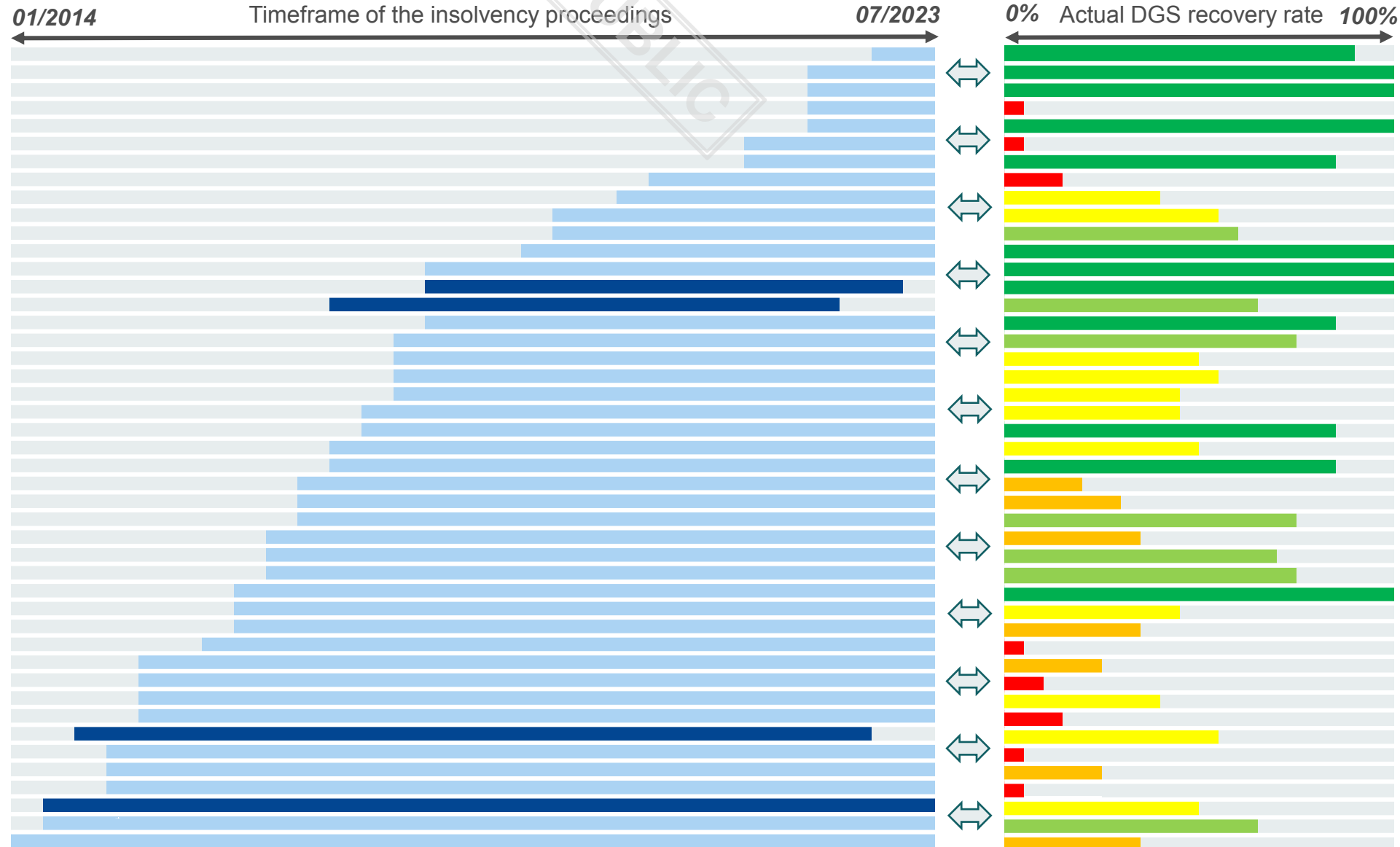
DGS total expected recoveries between 0 and 20% - 5 cases (11%)

DGS recovery rates and rapidity of recoveries

- ❶ Liquidation proceedings usually take many years to complete
- ❷ The recovery rate of DGSs after a payout event varies highly across Member States and it is highly case-specific
- ❸ The amount of DGS recoveries is not necessarily correlated with the duration of the liquidation proceedings

Liquidation procedure closed
 Liquidation procedure open

Reading note: each blue bar represents the starting date (and, where applicable, ending date) of the liquidation procedure related to a DGS payout event.



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Second-round effects on non-covered deposits (1/2)

Data limitation: 4 payout cases from LV are out of scope due to data unavailability.

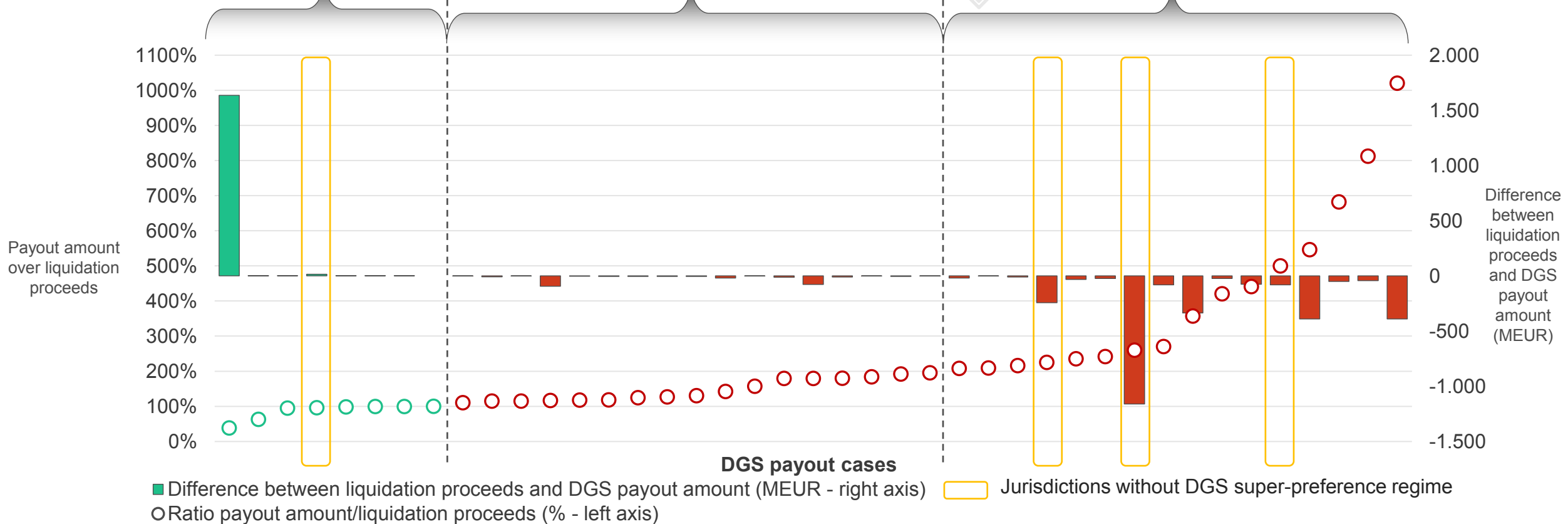
1 Partial recoveries for non-covered depositors (payout amount under amount of liquidation proceeds)



2 Small losses for the DGS but losses incurred by other creditors (payout amount above the amount of liquidation proceeds)



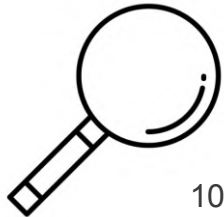
3 Major losses incurred by other creditors and the DGS (payout amount more than twice the amount of liquidation proceeds)



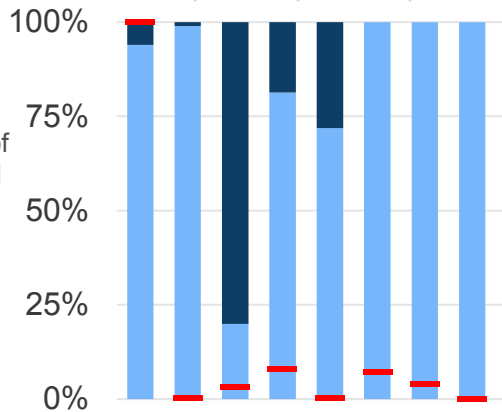
Reading note: liquidation proceeds correspond to all proceeds collected as part of the liquidation of the bank in failure, for the benefit of not only the DGS but also other creditors.

Second-round effects on non-covered deposits (2/2)

Data limitation: 4 payout cases from LV are out of scope due to data unavailability.



Breakdown of non-covered deposits



- Preferred non covered deposits
- Non preferred non covered deposits
- Coverage of deposits by remaining liquidation proceeds after DGS reimbursement

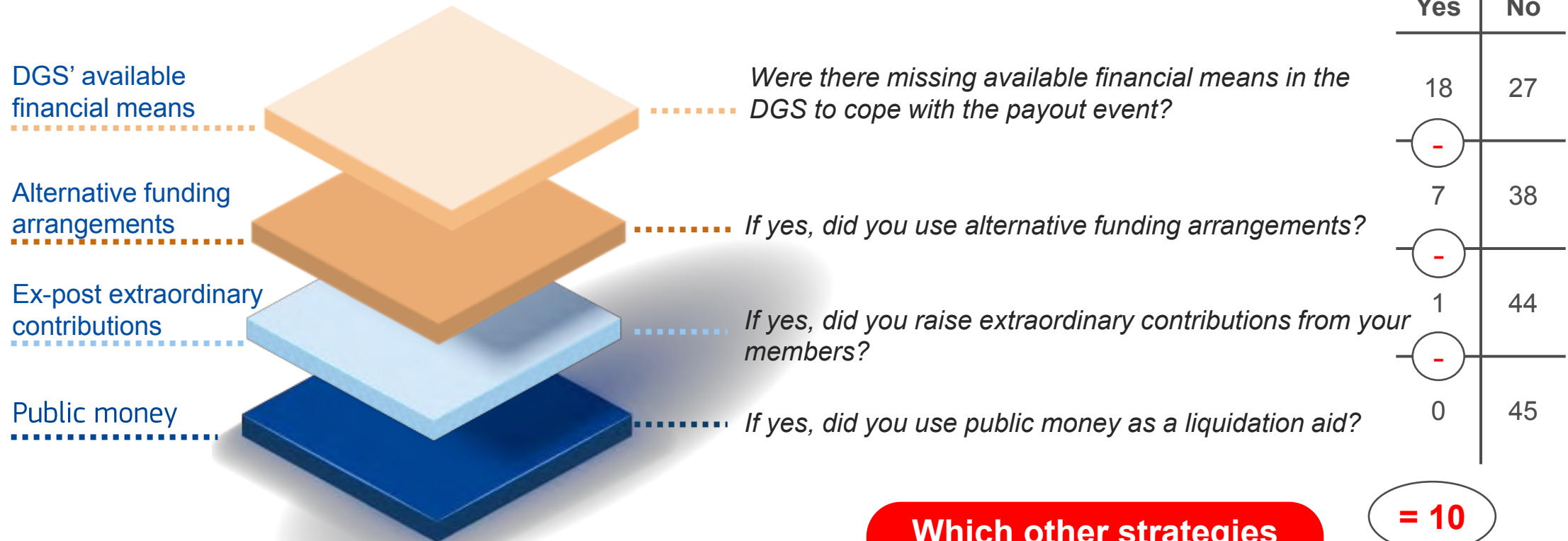
1 Preferred deposits incur significant losses during liquidation proceedings following a DGS payout event

	Total (Loss on non-covered deposits)		Loss on non-covered preferred deposits		Loss on non-covered non-preferred deposits	
	MEUR	%	MEUR	%	MEUR	%
Case 1	0	0%	0	0%	0	0%
Case 2	344	99%	340	100%	4	100%
Case 3	13	96%	2	84%	11	100%
Case 4	168	92%	134	90%	34	100%
Case 5	1.303	99%	936	100%	367	100%
Case 6	3	92%	3	93%	0	NA
Case 7	1	95%	1	96%	0	NA
Case 8	2	100%	2	100%	0	NA

Second-round effects on the DGS members and the wider economy (2/2)

① Besides the destruction of franchise value of the failing bank (that have proven to be difficult to quantify in the absence of data from Member States on loss on assets), a DGS payout event leads to a need for replenishment of the DGS, that can entail ex post extraordinary contributions from the banking sector or recourse to alternative funding arrangements

DGS' financial layers to cope with a payout event



Which other strategies for replenishment?

= 10

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Simplification approach

- 1 There are two key dimensions to estimate DGS recovery performance

Amount recovered by the DGS



Relevant metric

End recovery rate of the DGS (based on MS estimate, in case the procedure is still open)

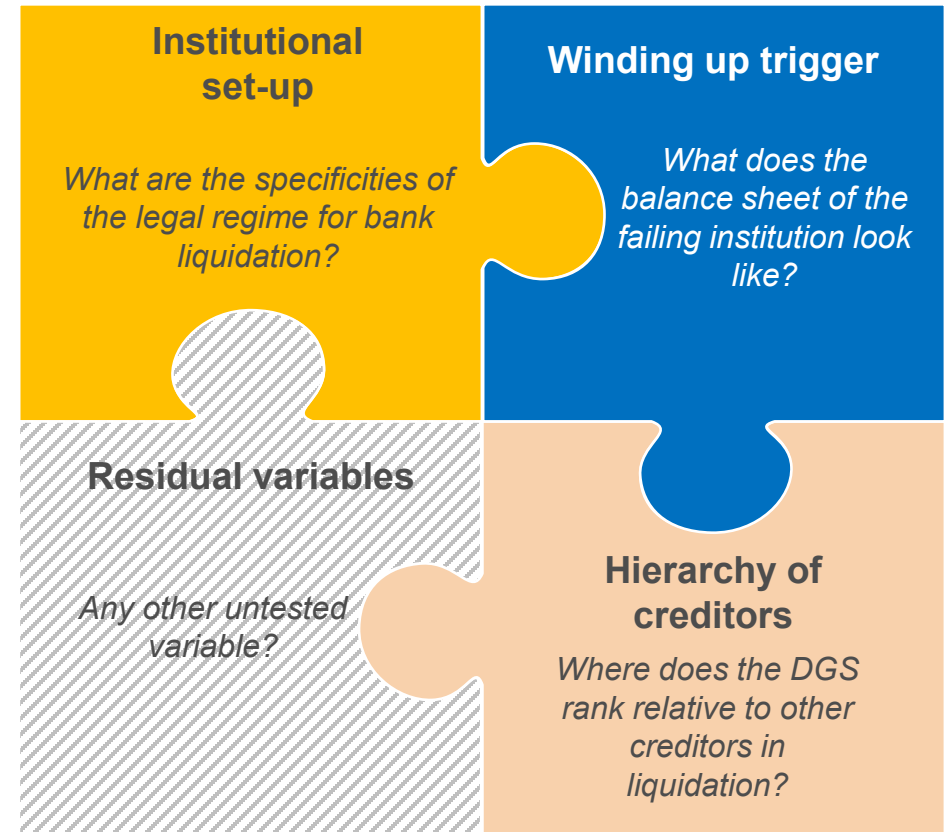
Rapidity of the DGS recoveries



Relevant metric

Portion of actual funds recovered by a DGS over a calendar year (linear)

- 2 Some drivers (non-exhaustive list) of such DGS recovery performance metrics can be tentatively narrowed down to a closed set of variables



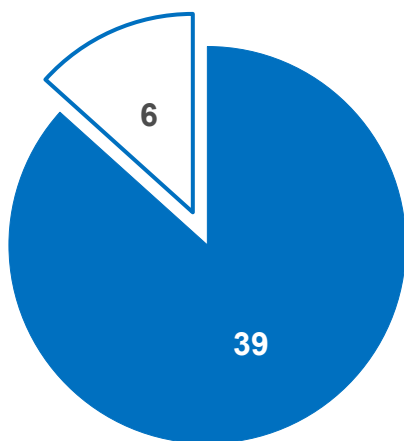
DGS recovery performance drivers

Institutional set-up

① Member States have diverse institutional set-ups framing the insolvency proceedings applicable to banks

	General corporate insolvency regime	Modified or self-standing bank insolvency regime	
Co-existence of administrative winding-up and court-based insolvency proceedings	15	1	16
Court-based bank insolvency proceedings	28	1	29
	43	2	45

② National liquidation proceedings give an unequally prevalent role to DGSs



- The deposit insurer manages a fund and plays no role in liquidation other than as a creditor by virtue of subrogation
- The deposit guarantee scheme is required by law to cooperate with liquidators in achieving an explicit insolvency objective of prompt repayment of insured depositors

③ Several Member States have developed legal mechanisms to strengthen the DGS position after/during a payout event

Zoom on national legislation arrangements to protect the DGS in case of a payout...

...through incentives for a quick reimbursement of the DGS in liquidation after a payout event

⇒ **Statutory interest mechanism (3 Member States)**



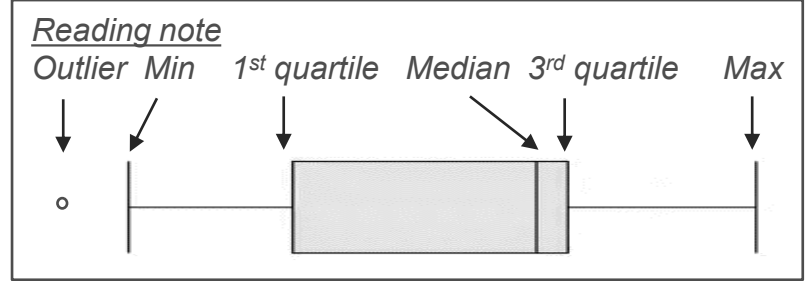
...through lower exposure of DGS available financial means in case of a payout event

⇒ **Direct repayment of depositors through liquid assets of the failed institution (2 Member States)**

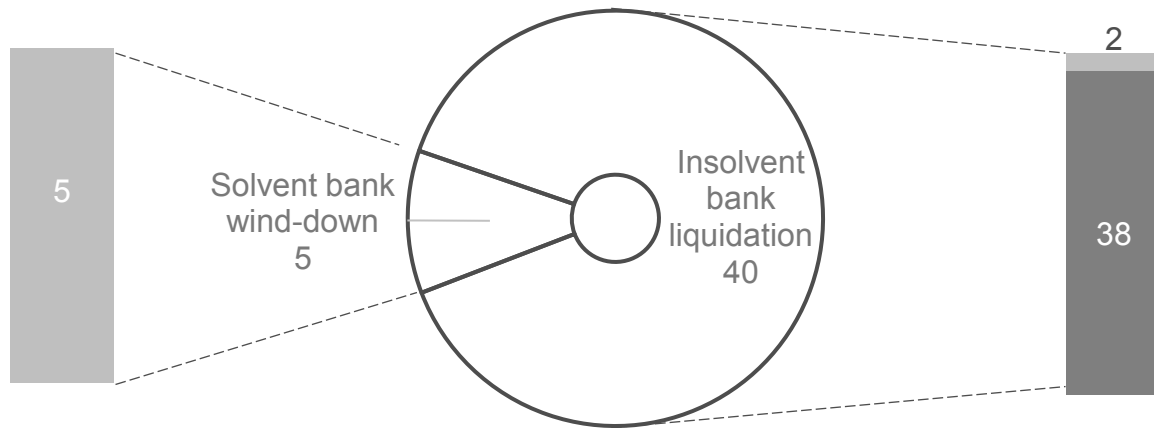


DGS recovery performance drivers

Winding up trigger



1 Most DGS payout cases follow failures of banks which are insolvent

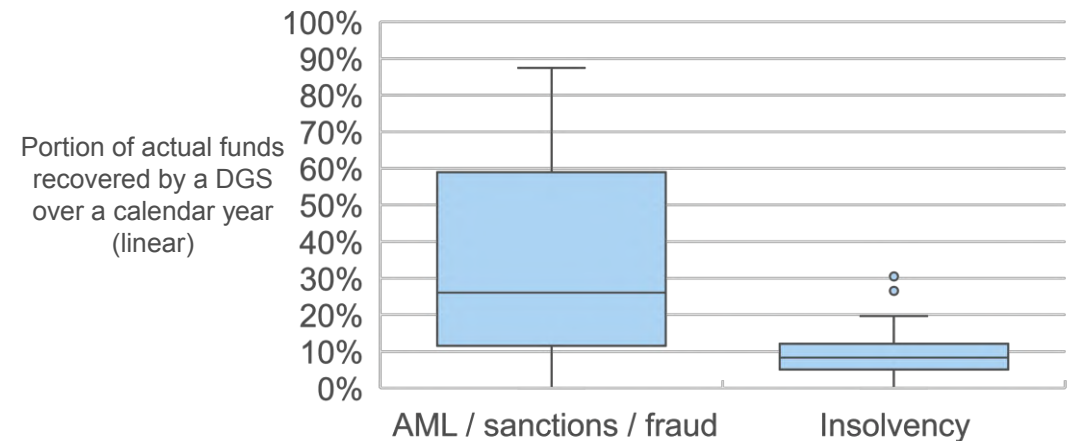


- Root causes of bank failures: AML, sanctions or fraud
- Root causes of bank failures: balance sheet insolvency or licence revocation

Zoom on some recent failures due to non-insolvency motives

MS	Payout year	Payout amount	Description
	2022	1,017 MEUR	Russian ownership of the bank caused a bank run at the beginning of Russian invasion in Ukraine
	2022	670 MEUR	Operational problems, mainly related to IT services and availability of (key) personnel, caused by sanctions against Russia, made the bank unable to provide its banking services.
	2022	36 MEUR	The bank was closed for its lax financial crime controls, as the bank intended to accept a financial injection from shareholders who failed to explain the origin of their money.

2 DGSs' recovery metrics for DGSs after a bank failure linked to AML/sanctions largely outperform those applicable to payout events due to bank insolvency



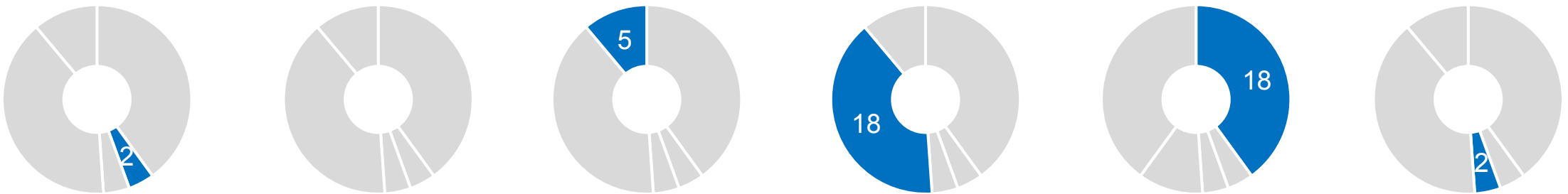
DGS recovery performance drivers

Ranking of the DGS (1/2)

General depositor preference	Tiered depositor preference			Insured depositor preference	No depositor preference
	Type 1	Type 2	Type 3		
BG*, HU	None	HU	AT, CZ, LV, NL, PL**	PL, LT	CZ
Secured liabilities					
Insured deposits and uninsured deposits	Insured deposits	Insured deposits	Insured deposits	Insured deposits	Insured and uninsured depositors rank pari passu with other unsecured creditors
	Uninsured deposits	Uninsured deposits of individuals and SMEs	Uninsured deposits of individuals and SMEs	Uninsured (non-preferred) depositors and other unsecured creditors	
Other uninsured deposits (larg corp. and FI)		Insured deposits of large corp. and FI and other unsecured creditors			
Other unsecured creditors	Other unsecured creditors	Other unsecured creditors			
Subordinated liabilities, equity					

Creditor hierarchy

Share of sample



* BG had not in place a « pure » general depositor preference as it kept a hierarchy between eligible and non-eligible deposits.

** Due to the entry into force of changes in the law in May 2022, PL has a “tiered depositor preference - type 2, although its recent payout cases were made in accordance with a “tiered depositor preference - type 3”.

DGS recovery performance drivers

Ranking of the DGS (2/2)

- ① Benefitting from the super-preference in the hierarchy of claims did not protect DGSs from incurring above-average losses and experiences slower-than-average recoveries in liquidation proceedings

TOTAL	General depositor preference	Tiered depositor preference			Insured depositor preference	No depositor preference
		Type 1	Type 2	Type 3		
45 cases	No super-preference of the DGS	Super-preference of the DGS	Super-preference of the DGS	Super-preference of the DGS	Super-preference of the DGS	No super-preference of the DGS
	2 cases	0 case	11 cases	12 cases	18 cases	2 cases

End recovery rate of the DGS (based on estimate, in case the procedure is still open)

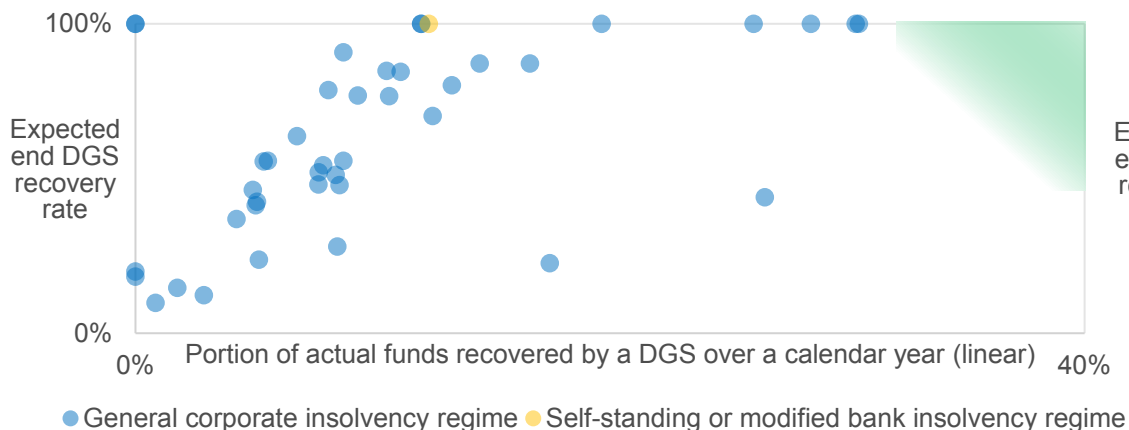
Average	Comparison to average					
64%	↓ 1pt	NA	↓ 26pts	↑ 16pts	↓ 5pts	↓ 32pts
Average	Comparison to average					
16%	↓ 8pts	NA	↓ 8pts	↑ 11pts	↓ 7pts	↓ 3pts

**Reading note:* On average, at the end of liquidation proceedings subsequent to a DGS payout, the recovery rate of the DGSs in jurisdictions applying a general deposit preference regime is 1 pt smaller (i.e. 63%) than the average for our entire cases sample (i.e. 64%).

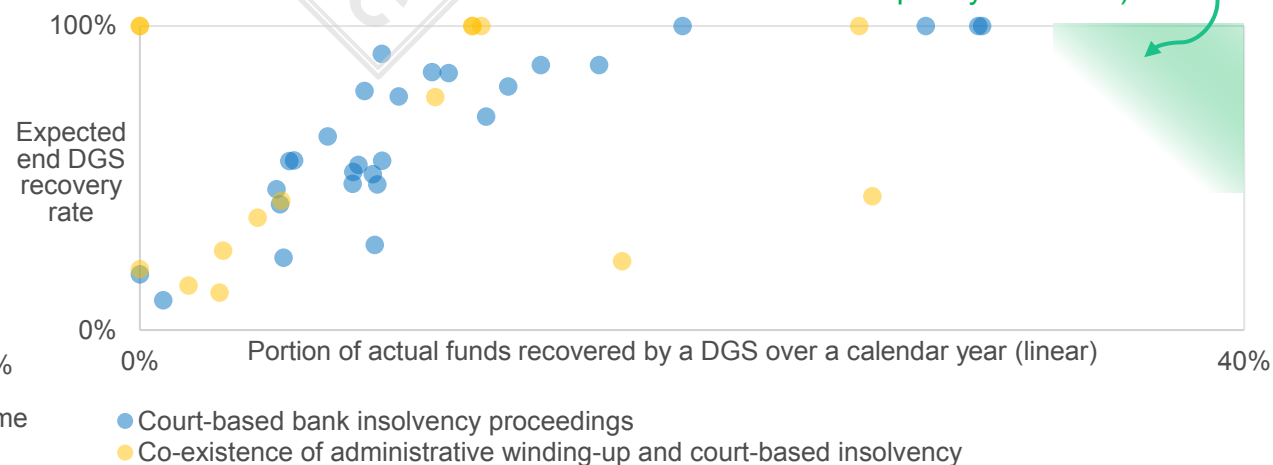
Overview of recovery process

Significance of DGS recoveries drivers (1/3)

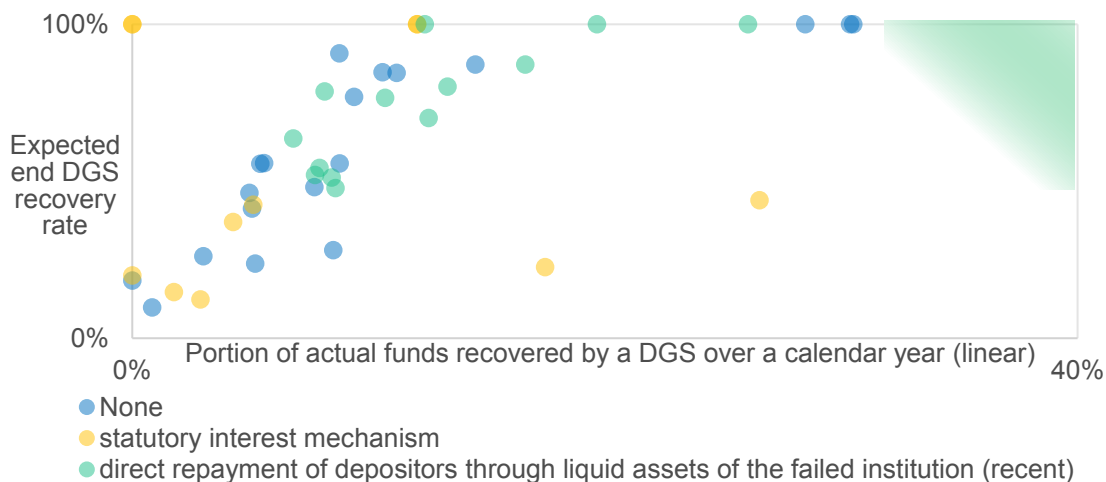
1 Institutional set-up (1/3): nature of bank winding up procedures



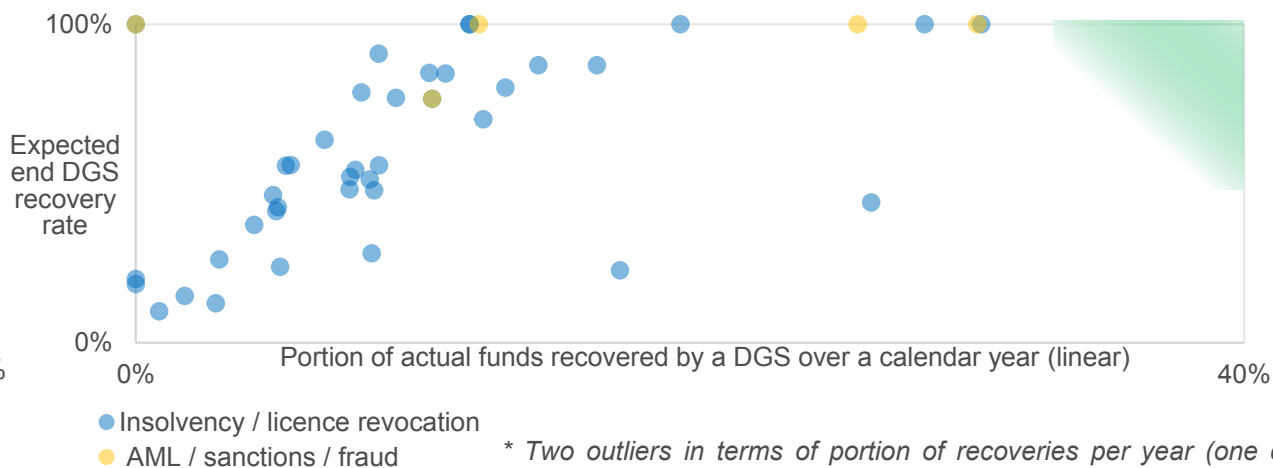
1 Institutional set-up (2/3): legal framework



1 Institutional set-up (3/3): national specificities



2 Winding up trigger

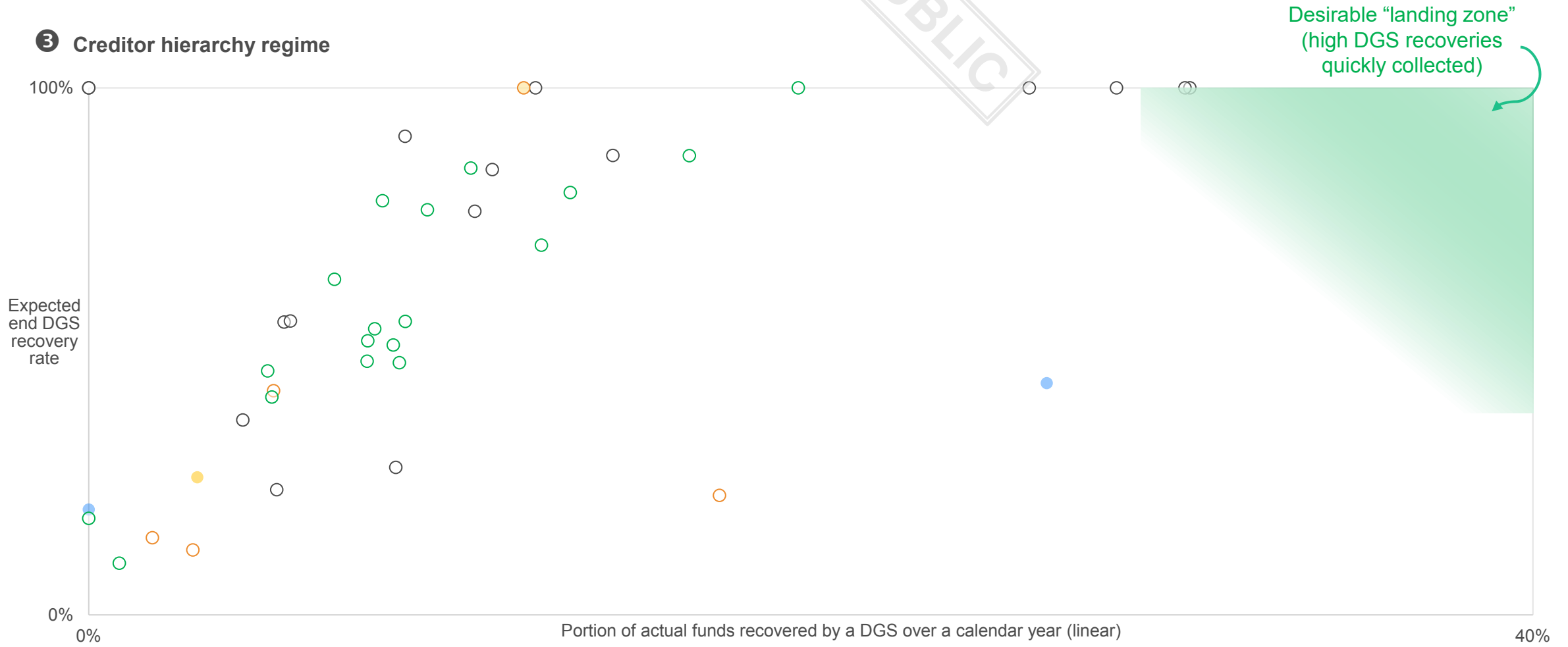


* Two outliers in terms of portion of recoveries per year (one case from LV and one from NL) could not be displayed on the above graph.

Overview of recovery process

Significance of DGS recoveries drivers (2/3)

3 Creditor hierarchy regime



Desirable "landing zone"
(high DGS recoveries
quickly collected)

○ Tiered depositor preference - Type 3 ● Single tier general depositor preference ● No Depositor preference ● Tiered depositor preference - Type 2 ● Insured depositor preference

* Two outliers in terms of portion of recoveries per year (one case from LV and one from NL) could not be displayed on the above graph.

Overview of recovery process

Significance of DGS recoveries drivers (3/3)

	End recovery rate of the DGS (based on estimate, in case the procedure is still open)			Portion of actual funds recovered by a DGS over a calendar year (linear)			
	Cases	Min	Average	Max	Min	Average	Max
Institutional set-up							
Administrative & court-based + General insolvency regime	2	77%	88%	100%	11%	12%	12%
Administrative & court-based + General insolvency regime + use of failed institution's assets	2	100%	100%	100%	26%	114%	203%
Administrative & court-based + General insolvency regime + DGS statutory interest	11	12%	54%	100%	0%	7%	27%
Administrative & court-based + Self-standing/specific bank insolvency regime	1	26%	26%	26%	3%	3%	3%
Court-based + General insolvency regime	18	10%	61%	100%	0%	11%	31%
Court-based + General insolvency regime + use of failed institution's assets	10	48%	69%	100%	7%	11%	20%
Court-based + Self-standing/specific insolvency regime + DGS statutory interest	1	100%	100%	100%	87%	87%	87%
Winding-up trigger							
AML / sanctions / fraud	7	77%	97%	100%	0%	53%	203%
Insolvency / licence revocation / negative amount of bank's funds	38	10%	58%	100%	0%	9%	31%
Hierarchy of claims							
No Depositor preference	2	20%	32%	44%	0%	13%	27%
Single tier general depositor preference	2	26%	63%	100%	3%	8%	12%
Insured depositor preference	18	10%	59%	100%	0%	9%	20%
Tiered depositor preference - Type 2	5	12%	38%	100%	2%	8%	17%
Tiered depositor preference - Type 3	18	24%	80%	100%	0%	27%	203%

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Main takeaways

- DGS recoveries in liquidation proceedings are **heterogeneous, uncertain and, generally, they can be slow.**
- The circumstances of the winding up (insolvency or solvent wind-down) **which can be an indication of the asset quality can play an important role in** DGS recoveries in liquidation and the DGS time-to-recover.
- Apart from the DGS super-preference, **some Member States have strategies at national level to improve the position of their DGS in liquidation:** legally enshrined role of monitoring of the DGS during liquidation, statutory interest rate on DGS recoveries, use of the failing institution's assets for the repayment of deposits.
- **DGSs benefitting from super-preference in the hierarchy of claims can incur losses and slow recoveries,** sometimes to a bigger extent than DGSs ranking pari passu with other creditors.
- **No Member State appears, by nature, good or bad** at ensuring good liquidation outcomes for its DGS.
- **Liquidation proceeds are most often insufficient to cover the DGS payout amount,** which entails losses for the DGS regardless of the hierarchy of claims regime.
- In the few cases (20%) where liquidation proceeds cover the DGS payout amount, **major losses are passed on to non-covered deposits,** including preferred depositors (retail and SMEs). DGS super-preference has the potential to worsen the situation of non-covered deposits in liquidation proceedings.
- **Most payout events have severely depleted DGS' available financial means in the past,** sometimes leading to extraordinary contributions and/or higher regular contributions in the following years from the industry.

Annex on the significance of DGS recoveries drivers – regression attempt

```
. regress TRR i.instsetup i.rootcause i.depositregime
```

Source	SS	df	MS	Number of obs	=	45
Model	1.80004068	11	.163640062	F(11, 33)	=	2.38
Residual	2.26947223	33	.068771886	Prob > F	=	0.0268
Total	4.06951291	44	.09248893	R-squared	=	0.4423
				Adj R-squared	=	0.2564
				Root MSE	=	.26224

TRR	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
instsetup						
2	-.1171054	.2622439	-0.45	0.658	-.6506447 .4164339	
3	-.0958927	.2695465	-0.36	0.724	-.6442892 .4525037	
4	-.8347589	.4584747	-1.82	0.078	-1.767533 .098015	
5	.0958927	.2695465	0.36	0.724	-.4525037 .6442892	
6	.3045265	.2968653	1.03	0.312	-.2994504 .9085034	
7	-8.70e-16	.3211819	-0.00	1.000	-.6534495 .6534495	
2.rootcause						
	-.2892424	.2197627	-1.32	0.187	-.736353 .1578682	
depositregime						
2	.035257	.2419011	0.15	0.885	-.4568944 .5274084	
3	.7152934	.3047984	2.35	0.025	.0951764 1.33541	
4	.1468168	.1343797	1.09	0.283	-.1265808 .4202145	
5	.3301571	.1575952	2.09	0.044	.0095273 .650787	
_cons						
	.6698429	.2433561	2.75	0.010	.1747311 1.164955	