IN-DEPTH ANALYSIS

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# Institutional Protection Schemes – What are their differences, strengths, weaknesses, and track records?

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# Institutional Protection Schemes

## What are their differences, strengths, weaknesses, and track records?

**Abstract**

This paper documents the relevance of Institutional Protection Schemes (IPSs) in the European banking market, and it discusses some drawbacks of the current practice of recognizing some IPSs as a deposit guarantee scheme as well as possible options for regulatory reform.

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# LIST OF ABBREVIATIONS

| | |
|---|---|
| **BVR** | Bundesverband der Deutschen Volksbanken und Raiffeisenbanken |
| **CEPS** | Center for European Policy Studies |
| **CRR** | Capital Requirements Regulation |
| **EBA** | European Banking Authority |
| **ECB** | European Central Bank |
| **EDIS** | European Deposit Insurance Scheme |
| **IMF** | International Monetary Fund |
| **IPS** | Institutional Protection Scheme |
| **ISG** | Institutssicherung |
| **DGS** | Deposit Guarantee Scheme |
| **DGSD** | Deposit Guarantee Scheme Directive |

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# EXECUTIVE SUMMARY

The Capital Requirements Regulation of 2013 provides for the possibility that a support mechanism among banks is recognized as an Institutional Protection Scheme (IPS). An IPS among a group of banks is defined as *'a contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency to avoid bankruptcy where necessary'* (Article 113(7)). Banks have the incentive to gain IPS status, as this allows them to apply zero risk weights to exposures to counterparties within the IPS. The CRR lists a set of requirements that banks need to fulfil to be recognized as an IPS, among them that *'the arrangements ensure that the institutional protection scheme is able to grant support necessary under its commitment from funds readily available to it.'* In the euro area, the European Central Bank (ECB) has determined that an IPS needs to establish an ex ante fund to meet this requirement.

The Deposit Guarantee Schemes Directive (DGSD) of 2014 stipulates that an IPS may be recognized as a Deposit Guarantee Scheme (DGS) if it complies with this directive. In practice, one IPS in Austria, and two IPSs in Germany have been recognized as DGSs. This entails that the ex ante fund of the IPS takes on the dual roles of ensuring the liquidity and solvency of member institutions and of guaranteeing member institution deposits. This paper documents the relevance of IPSs in the European banking market, and it discusses some drawbacks of the current practice of recognizing some IPSs as a DGS as well as possible options for regulatory reform.

In Europe, IPSs are active in Austria, Germany, Italy, Poland, and Spain. In Austria and Germany, IPSs held dominant shares of covered deposits of 62.7% and 67.2% in 2019, respectively. In the euro area and the EU as a whole, the IPS shares of covered deposits are significant at 23.3% and 21.3%, respectively.

The resources of the ex ante fund of a joint IPS-DGS are conceptually equal to bank capital to the extent that they are available to ensure member institution solvency, even if these resources do not contribute to regulatory capital. This provides member institutions of a joint IPS-DGS with an unfair competitive advantage, as the use of unrelated DGS funds to enable distressed banks to continue as going concerns may in practice be more restricted.

At present the European Commission is reviewing the DGSD pursuant to this directive's review clause, and thus this is an appropriate time to consider reforming the current treatment of IPSs in the DGSD. Obviating the possibility of an IPS to act as a DGS brings two advantages. First, this could strengthen deposit insurance, as an unrelated DGS has a clearer mandate to safeguard deposits and, second, it could level the playing field as the use of DGS resources to maintain member institution solvency will be more restricted. Similar advantages materialize if IPS member institutions are required to join any future European Deposit Insurance Scheme.

# 1. INTRODUCTION

Savings and cooperative banks in Europe have typically formed national networks with central institutions that perform tasks that individual banks cannot perform well themselves. For instance, central institutions may perform tasks such as securities trading or financing of exporter customers. In addition, networks enable banks to adopt a common brand name, and to realize scale economies carrying out back-office functions. Importantly, networks of bank may also conclude a mutual support mechanism to assist a network member in financial distress.

The Capital Requirements Regulation (CRR, European Parliament and European Council (2013)) provides for the possibility that a support mechanism among banks is recognized as an Institutional Protection Scheme (IPS). An IPS among a group of banks is defined as '*a contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency to avoid bankruptcy where necessary*' (Article 113(7)). Banks have the incentive to gain IPS status, as this allows them to apply zero risk weights to exposures to counterparties within the IPS. The CRR lists a set of requirements that banks need to fulfil to be recognized as an IPS, among them that *'the arrangements ensure that the institutional protection scheme is able to grant support necessary under its commitment from funds readily available to it.'* In the euro area, the European Central Bank (ECB) has determined that an IPS needs to establish an ex ante fund to meet this requirement.

The Deposit Guarantee Schemes Directive (DGSD, European Parliament and European Council (2014)) stipulates that an IPS may be recognized as a Deposit Guarantee Scheme (DGS) if it complies with this directive. In practice, one IPS in Austria, and two IPSs in Germany have been recognized as DGSs. This entails that the ex ante fund of the IPS takes on the dual roles of ensuring the liquidity and solvency of member institutions and of guaranteeing member institution deposits. In this paper, we document the relevance of IPSs in the European banking market, and we discuss some drawbacks of the current practice of recognizing some IPSs as DGSs as well as possible options for regulatory reform.

Section 2 reviews the regulatory treatment of IPSs in the CRR and the DGSD. In section 3, we present some data on the importance of IPSs in national and European banking markets. In Europe, IPSs are active in Austria, Germany, Italy, Poland, and Spain. In Austria and Germany, IPSs held dominant shares of deposits that are covered by deposit insurance, of 62.7% and 67.2% in 2019, respectively. Shares of covered deposits of IPSs are smaller in Italy, Poland, and Spain at 1.0%, 11.3%, and 5.6%, respectively. In the euro area and the EU as a whole, the IPS shares of covered deposits are significant at 23.3% and 21.3%.

The resources of the ex ante fund of a joint IPS-DGS are conceptually equal to bank capital to the extent that they are available to ensure member institution solvency, even if these resources do not contribute to regulatory capital. This provides member institutions of a joint IPS-DGS with an unfair competitive advantage, as the use of unrelated DGS funds to enable distressed banks to continue as going concerns may in practice be more restricted. Section 4 presents some data on the importance of the ex ante fund of the three joint IPS-DGSs in Austria and Germany relative to their reported bank capital to illustrate the potential importance of this issue.

At present, the European Commission is reviewing the DGSD pursuant to this directive's review clause, and thus this is an appropriate time to consider reforming the current treatment of IPSs in the DGSD. Section 5 discusses two advantages of obviating the possibility of an IPS to act as a DGS. First, this could strengthen deposit insurance as an arm's-length DGS has a clearer mandate to safeguard deposits and, second, it could level the playing field as the use of DGS resources to maintain member institution solvency will be more restricted. Similar advantages materialize if IPS member institutions are required to join any future European Deposit Insurance Scheme (EDIS). Section 6 concludes.

# 2. IPSs IN THE REGULATORY FRAMEWORK

## 2.1. IPSs in the CRR

According to Article 113(7) of the CRR, financial institutions may apply a risk weight of 0% to exposures to counterparties with which the institution has entered into an IPS. Such a scheme is defined as *'a contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency to avoid bankruptcy when necessary'*. The article sets out a number of conditions that a group of credit institutions has to satisfy to be recognized as an IPS by the competent authority. The main conditions can be summarized as follows:

- Member institutions need to be established in the same Member State.
- The arrangement should ensure that the IPS is able to grant support necessary under its commitment from funds readily available to it.
- There needs to be a uniform system for the monitoring and classification of risk that covers all individual members and the IPS as a whole.
- The IPS has to draw up and publish consolidated reports or alternatively aggregated reports for the IPS as a whole.
- The IPS shall be based on a broad membership of credit institutions of a predominantly homogeneous business nature.
- IPS members have to give advance notice of at least 24 months if they wish to exit the scheme.

For the euro area, the ECB (2016) has published a set of guidelines on how it will interpret the various IPS requirements set out in Article 113(7). Specifically, to satisfy the requirement to be able to grant the necessary support from readily available funds, the IPS needs to have created an ex ante fund (ECB, 2016, p. 6). Furthermore, contributions to this fund should follow a clearly defined framework, and an adequate floor/minimum amount for the ex-ante fund has to be determined to ensure prompt availability of the funds.

The consolidated or aggregated reports that an IPS has to draw up according to Article 113(7) are intended for risk assessment purposes by the IPS itself and the supervisor. Thus, the construction of these reports does not imply that the IPS as a whole needs to satisfy any minimum capital requirements. However, if the IPS does meet minimum own funds requirements at the IPS level, then the CRR potentially provides for an additional concession – beyond the zero risk weights applied to counterparty exposures mentioned before. In particular, if the IPS meets IPS-level minimum own funds requirements, then according to Article 49(3) competent authorities may, for the purposes of calculating own funds on an individual or sub-consolidated basis, permit institutions not to deduct holdings of own funds in the case of holdings in another institution that falls within the same IPS. In the absence of this permission, generally some deduction applies. Specifically, if an IPS member institution has holdings in another 'financial sector entity' (as defined in Article 4(27) of the CRR), it generally has to deduct part of these holdings from Tier 1 capital (see Articles 45-47 of the CRR).[1] A failure to deduct part of holdings in related financial institutions increases effective leverage at the individual IPS member institution level, potentially reducing financial stability.[2]

[1] In addition, as a further possible derogation in case an IPS publishes consolidated reports and has adopted a cross-guarantee scheme in the meaning of Article 4(127), consolidated common equity Tier 1 capital can fully recognize any minority interest arising within the cross-guarantee scheme (Article 84(6)).

[2] Gong, Huizinga and Laeven (2018) provide empirical evidence that the non-deduction of equity ownership in some affiliated financial institutions from own equity provided small Bank Holding Companies in the US with an avenue to take on additional risk before regulatory reform, implementing Basel III, in 2014.

## 2.2. IPSs in the DGSD

According to the DGSD, all credit institutions join a national DGS, providing statutory deposit guarantees up to a coverage level of Euro 100,000 for the aggregate deposits of each depositor. DGSs have to establish an ex ante fund. In particular, Member States shall ensure that, by 3 July 2024, the available financial means of a DGS shall at least reach the level of 0,8% of the covered deposits of its members. Among its sources of funds, DGSs shall raise the available financial means by contributions to be paid by their members.

The DGSD contains the following two articles related to IPSs:

- An IPS may be recognized as a DGS if it fulfils the criteria laid down in Article 113(7) of the CRR and complies with the DGSD (Article 4(2)).
- Member States may decide that members of an IPS pay lower contributions to the DGS (Article 13(1)).

Importantly, the DGSD does not require an IPS that is recognized as a DGS to build a larger ex ante fund than other DGSs, even though such an IPS has the dual tasks of ensuring the liquidity and solvency of its member institutions and of providing statutory deposit insurance. This could imply that a joint IPS-DGS effectively offers weaker deposit insurance, as its ex ante fund is less clearly earmarked to guarantee deposits.

National authorities have the option to lower contributions of IPS member institutions to a non-IPS DGS, presumably because credit institutions that are member institutions of an IPS are deemed to be safer, which could justify lower risk-based contributions. However, an IPS and its member institutions may in practice not be safer, and this surely does not follow if size is taken to be an index of safety, as the size distributions of IPSs and non-IPS banks and banking groups tend to overlap. Thus, the option to reduce contributions for IPS member institutions, if exercised, could well provide these institutions with an unfair competitive advantage.

# 3. THE SHARE OF IPSs IN EUROPEAN BANKING MARKETS

In this section, we provide some data on the importance of IPSs in European banking markets, and we provide short descriptions of individual IPSs. Institutional protection schemes exist in Austria, Germany, Italy, Poland, and Spain. Table 1 provides the names of individual IPSs, and it gives information on the number of affiliated banks, the number of customers, and the amount of covered deposits for each IPS in 2019, as recently provided by be IPSs themselves (IPS, 2021). The IPSs are seen to differ considerably in absolute size. The two German IPSs (Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR) Institutssicherung (ISG) for cooperative banks, and Sicherungssystem der Sparkassen-Finanzgruppe for savings banks) are particularly large with covered deposits of Euro 534.6 billion and Euro 742.3 respectively. The two IPSs in Austria (Austrian Savings Banks Group and Raiffeisen Banking Group) are also relatively large, with covered deposits of Euro 55 billion and Euro 88 billion.

Table 1: Individual IPSs in Europe: measures of size and whether they are recognized as a DGS

| Country | IPS | Affiliated banks | Customers in millions | Covered deposits in billions | DGS |
|---|---|---|---|---|---|
| Austria | Austrian Savings Banks Group | 49 | 3.8 | 55 | Y |
| Austria | Raiffeisen Banking Group | 360 | 4 | 88 | N |
| Germany | BVR-ISG | 841 | 30 | 534.6 | Y |
| Germany | Sicherungssystem der Sparkassen-Finanzgruppe | 395 | 50 | 742.3 | Y |
| Italy | Raiffeisen Südtirol IPS | 40 | 0.3 | 7 | N |
| Poland | IPS - SGB | 193 | 2.2 | 8.7 | N |
| Poland | SOZ BPS | 326 | 2.8 | 14.3 | N |
| Spain | Grupo Caja Rural | 30 | 4.5 | 42.86 | N |
| Total | | 2234 | 97.6 | 1492.8 | |

Data are for 2019. Data source apart from last column: IPS (2021)

The information on covered deposits in Table 1 can be used to illustrate how important IPSs are in national and European banking markets. To do this, we compute the share of IPS covered deposits in total covered deposits in a particular banking market (these total covered deposits are the sum of covered deposits for all DGSs that are active in a particular banking market). Table 2 shows that the two Austrian IPSs together represent a dominant share of 62.7 % of covered deposits in Austria in 2019. In Germany, the two IPSs represent a similarly large share of 67.2% of covered deposits. Shares of IPS covered deposits are smaller in Italy, Poland, and Spain at 1.0%, 11.3%, and 5.6%, respectively. In the euro area and the EU as a whole, the IPS shares of covered deposits are sizeable at 23.3% and 21.3%.

Table 2: Shares of covered deposits of IPSs in Europe

| | Share of covered deposits (%) |
|---|---|
| Austria | 62.7 |
| Germany | 67.2 |
| Italy | 1.0 |
| Poland | 11.3 |
| Spain | 5.6 |
| Euro area | 23.3 |
| EU | 21.3 |

Data are for 2019. Data sources: EBA (2022) and IPS (2021)

Next, we provide short descriptions of the IPSs listed in Table 1. In Austria, the Austrian Savings Banks Group is a banking group and an IPS, consisting of a central institution, Erste Group Bank AG, and 48 savings banks (see International Monetary Fund (IMF), 2020b, p. 12). Five of these are controlled through majority ownership by Erste Group Bank AG, while 43 savings banks are controlled through a common cross-guarantee scheme. This banking group has been recognized as a DGS.

In Austria, the Raiffeisen sector is also organized as an IPS. According to IMF (2020a, pp. 8-9, and 2020b, pp. 12-13), the Raiffeisen sector has a three-layer structure. There are a large number of first-tier banks, that hold shares in one of the eight second-tier regional banks. First-tier banks and their associated second-tier banks form liquidity associations in which the second-tier banks are central institutions that provide liquidity management and payment facilities to pertinent first-tier banks. The eight second-tier banks in turn form a liquidity association with a third-tier central institution, RBI, which is a listed bank that is partly owned by the second-tier banks[3]. The federal Raiffeisen Banking Group IPS connects RBI with the second-tier banks. In addition, there are six regional IPSs that connect second-tier banks to local banks.

In Germany, there are two IPSs. First, BVR-ISG includes two major banks, DZ HYP and the Münchener Hypothekenbank, and a set of smaller cooperative banks that are partly subsidiaries and partly independent legal entities. The members of this IPS operate a supplementary voluntary bank-protection scheme, called BVR protection scheme (BVR-SE), as an additional subsidiary. Second, the IPS of the German saving banks, organized in the Deutscher Sparkassen- und Giroverband, consists of a set of major banks, among them Bayersiche Landesbank, DekaBank Deutsche Girozentrale, Landesbank Berlin, Landesbank BW, and Norddeutsche Landesbank, and smaller savings banks. Both German IPSs have been recognized as DGSs.

In Italy, the Raiffaisen Südtirol IPS, founded in November 2020, consists of the Raiffeisen Landesbank Südtirol, RK Leasing, and a set of individual Raiffeisenkassen.[4]

In Poland, there is the IPS of the cooperative banks, called BPS Association Protection Scheme, consisting of the Bank of Polish Cooperatives, which is a commercial bank, and individual cooperative banks. A second IPS, called the SGP network of cooperative banks, consists of a set of cooperative banks linked to the commercial bank SGB. According to the IMF (2019), the two central commercial banks of these IPSs provide financial and non-financial services to their participating cooperative banks that include general management support, liquidity management, and branding.

In Spain, the IPS of the Caja Rural Group, which was formed in 2018, is a group of savings banks and other affiliated entities (among them Banco Cooperativo Español, RGA, and RSI). According to the group website, some affiliated companies, including the Rural Computer Services Company, provide member institutions with support for developing their activities.[5]

[3] RBI has been particularly affected by the war in the Ukraine, as it generated a significant portion of its profits from operations in Russia and the Ukraine in 2021. This led Moody's to downgrade the bank's stand-alone bank credit assessment rating on March 4, 2022, while keeping its adjusted (support) rating stable given that its IPS membership ensures financial support in case of need.

[4] See the website of Raiffeisen Südtirol IPS at https://www.ipsraiffeisen.it.

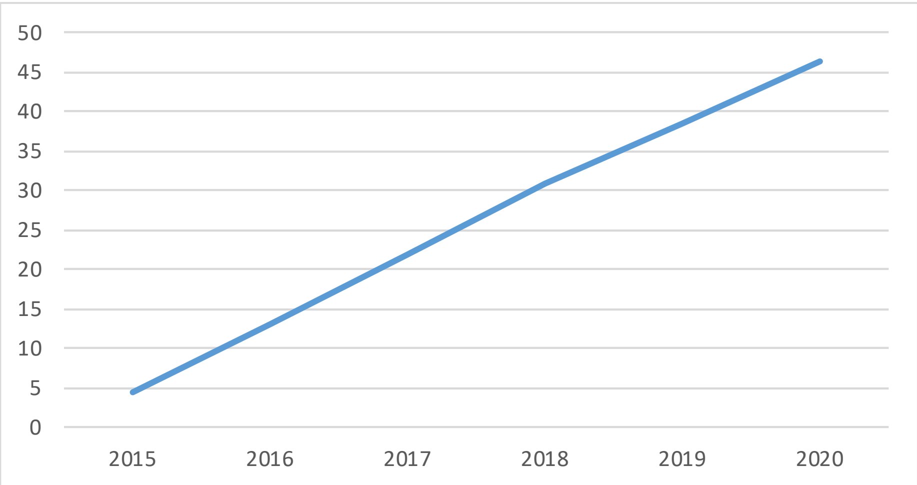
[5] See the website of Caja Rural Group at https://www.grupocajarural.es/en.

# 4. THE DUAL ROLES OF THE EX ANTE FUNDS OF IPSs THAT ARE RECOGNIZED AS DGSs

An IPS that is recognized as a DGS has the combined tasks of ensuring the liquidity and solvency of its member institutions and of guaranteeing deposits. The ECB (2016) requires an IPS to have an ex ante fund to be able to grant the necessary support to member institutions from available funds, while the DGSD requires a DGS to build an ex ante fund to guarantee deposits. In practice, the ex ante fund of a combined IPS-DGS thus has the dual objectives of supporting member institutions and guaranteeing deposits. The resources of the ex ante fund of a joint IPS-DGS are conceptually equal to bank capital to the extent that they are available to ensure member institution solvency, even if these resources do not contribute to regulatory capital. This provides member institutions of a joint IPS-DGS with an unwarranted competitive advantage, as the use of DGS funds to enable distressed bank to continue as going concerns may in practice be more restricted (see Article 11(3) of the DGSD for a formal list of restrictions that apply to all DGSs). In this section, we present some data on the size of the ex ante fund of the three dual IPS-DGSs in Austria and Germany relative to their reported IPS-level equity to illustrate the potential importance of this issue.

To start, we consider whether the joint IPS-DGSs in Austria and Germany have accumulated relatively large available financial means, as reported by the DGS to the European Banking Authority (EBA), in recognition of their dual missions. In Austria, there are two DGSs: the IPS-DGS for the Austrian savings banks and the non-IPS DGS Austria. Figure 1 shows that the deposits coverage ratio, defined as DGS available financial means relative to covered deposits, of the IPS-DGS of the Austria savings banks reached 0.463% in 2020, which exceeds the coverage ratio of DGS Austria of 0.227% in 2020 (data for DGS Austria are available only for the years 2019 and 2020).

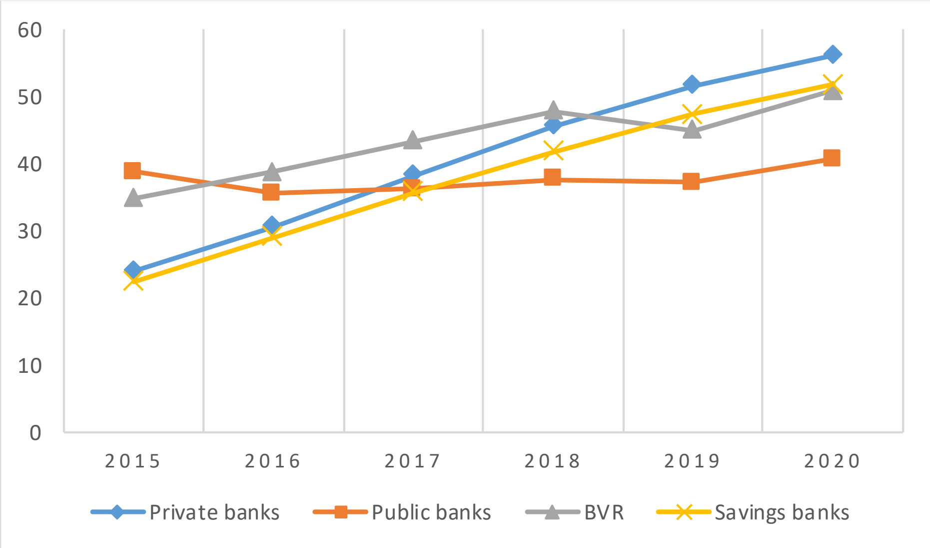
Figure 1: Deposits coverage ratio of the Austrian Savings Bank Group, 2015-2020




This figure displays covered deposits as a share of available financial means for the DGS of the Austrian Savings Group in basis points. Data source: EBA (2022).

Germany has four DGSs: the IPS-DGSs for the cooperative and savings banks, and two separate DGSs for the private and public banks. The IPS-DGSs for the cooperative and savings banks attained coverage ratios of 0.518% and 0.509% in 2020, while the two other DGSs had coverage ratios of 0.561% and 0.407% (Figure 2). Thus, the four German DGSs had comparable deposits coverage ratios in 2020, suggesting that the two joint IPS-DGSs did not accumulate materially larger ex ante funds in recognition of their more comprehensive roles.

Figure 2: Deposits coverage ratios of German DGSs, 2015-2020




This figure displays covered deposits as a share of available financial means for the four German DGSs in basis points. Data source: EBA (2022).

Next, we consider the issue of how important the ex ante funds of the three combined IPS-DGSs are relative to the capitalization of these three IPSs. As a measure of reported capitalization, we consider the leverage ratio, defined as the ratio of equity (in column 1 of Table 3) to assets (column 2). The reported leverage ratio is inclusive of the ex ante fund, given that the consolidated financial statements (in the cases of the Austrian savings banks and the German cooperative banks), and the aggregated financial statements (in the case of the German savings banks) incorporate the ex ante fund. The IPS of the Austrian savings banks had a leverage ratio of 8.07% in 2020, while the IPSs of the German cooperative and savings banks had leverage ratios of 8.25% and 7.46%, respectively (column 3).

To ascertain the relevance of the ex ante funds for IPS capitalization, we consider the counterfactual IPS leverage ratio that arises, if the ex ante fund is removed from the IPS balance sheet. For this purpose, the size of the IPS ex ante fund is proxied by the available financial means that the joint IPS-DGS reports to the EBA as given in column 4. Specifically, the counterfactual leverage ratio is computed as the ratio of actual equity net of these resources to actual assets net of these resources (column 5). The percentage change in the adjusted leverage ratio in column 5 relative to the actual leverage ratio in column 3 is provided in column 6. The leverage ratio of the IPS of the Austrian savings banks would be reduced by 1.05%, while the German cooperative and savings banks would see their IPS leverage ratios go down by 2.24% and 2.10%, respectively.

By 2024, the three IPS-DGSs need to have expanded their available financial means to at least 0.8% of covered deposits. Assuming constant covered deposits, we can compute the required available financial means of the DGS in 2024 to be equal to 0.8% of covered deposits in 2020 (column 7). Using these hypothetical larger available financial means, we can alternatively compute counterfactual leverage ratios after we deduct the pertinent available financial means from both assets and equity (column 8) as well as the relative change in the leverage ratio compared to the actual leverage ratio (column 9). In this scenario, the leverage ratio of the Austrian savings banks would decline by 1.81%, while for the two German IPSs it would decline by 3.47% and 3.31% (column 9). Overall, Table 3 shows that the IPS ex ante fund represents a material share of IPS-level capitalization for the three dual IPS-DGSs, providing member institutions with a material advantage relative to other financial institution to the extent that the ex ante fund is available to support them as going concerns.

Table 3: Leverage ratio adjustments if available financial means of the DGS are removed from the IPS balance sheet

| | Actual | | | Deducting available financial means | | | Deducting 0.8% of covered deposits | | |
|---|---|---|---|---|---|---|---|---|---|
| | Equity in billions | Assets in billions | Leverage ratio (%) | Deduction in billions | Leverage ratio (%) | (5)-(3) as % of (3) | Deduction in billions | Leverage ratio (%) | (8)-(3) as % of (3) |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) |
| Austrian savings banks | 22.4 | 277.4 | 8.07 | 0.26 | 7.99 | -1.05 | 0.44 | 7.93 | -1.81 |
| German cooperative banks | 121.8 | 1475.9 | 8.25 | 2.97 | 8.07 | -2.24 | 4.59 | 7.97 | -3.47 |
| German savings banks group | 177.9 | 2383.3 | 7.46 | 4.04 | 7.31 | -2.10 | 6.35 | 7.22 | -3.31 |

Data are for 2020. Data sources: EBA (2022), and the three IPS annual reports for 2020 as listed.
Austrian savings banks: https://www.erstegroup.com/en/investors/reports/financial-reports
German cooperative banks: https://www.bvr.de/p.nsf/0/866AAE60A88B0A54C125872F002ADF7F/%24FILE/200909_BVR_KJA_EN_Download_ES.pdf
German savings banks group: https://www.dsgv.de/en/facts/financial-report.html#financial-report-2020

The dual objective of the ex ante fund of joint IPS-DGSs also raises the question of whether the ownership of this ex ante fund is recognized as own funds by the overall IPS and by individual member institutions. On this issue, the annual report of the IPS of the Austrian savings banks for 2020 provides clarity as follows:

*"…. starting in 2014 an IPS ex-ante fund was established and endowed for the following 10 years. The payments of the individual members are recognized in the balance sheet as a share in IPS GesbR, which manages the ex-ante fund and are accounted for as revenue reserve. Due to the contractual terms, this revenue reserve represents a blocked reserve. The writing off of this blocked reserve may only take place as a result of the mobilisation of the ex-ante fund due to a claim. This reserve can therefore not be utilised internally to cover losses and on member level does not qualify as capital according to the CRR; on a consolidated level, the ex-ante fund does quality, however."*

Thus, the individual Austrian savings bank cannot recognize their ownership of the ex ante fund as own funds. No similar statement was found in the annual reports of the two German IPS-DGSs for the cooperative and savings banks, and also not in the annual reports of several member institutions of these two IPSs that were reviewed. However, Landesbank BW (a member institution of the IPS for the German savings banks) explicitly accounts for its contributions to the deposit insurance fund as an expense in its income statement for 2020, which would be inconsistent with capitalizing such contributions as bank capital. The failure of individual member institutions to recognize their ownership stake in the IPS ex ante fund as own funds nonetheless does not gainsay the economic advantage stemming from the fact that the ex ante fund could be deployed to ensure member institution liquidity and solvency.

All three IPS-DGSs in Austria and Germany collectively meet capital requirements, which implies that according to Article 49(3) of the CRR, the competent authority could grant member institutions of these IPSs permission not to deduct holdings of own funds in the case of holdings in another institution that falls within the same IPS. All three IPS-DGSs include at least one significant institution that is directly supervised by the ECB, suggesting a key role for the ECB in determining whether this permission is granted. In particular, in the case of the IPS for the Austrian savings banks, Erste Bank Group AG is a significant institution. Furthermore, the IPS of the German savings banks includes DZ HYP and Münchener Hypothekenbank as significant institutions, while the IPS of the German savings banks has Bayerische Landesbank, DekaBank Deutsche Girozentrale, Landesbank Berlin, Landesbank BW, and Norddeutsche Landesbank as significant member institutions. A review of the annual reports of the three overall IPS-DGSs did not yield any information on whether this permission has been granted. Choulet (2017, p.13), however, asserts that the IPS of the German cooperative banks has this permission, and that it is probable that the IPS of the German savings banks has this permission as well, without providing pertinent documentation or references. If so, the standard deductions from Tier 1 capital in case of the ownership of financial institutions do not apply to internal IPS ownership, and the member institutions of these IPSs will be able to become effectively more leveraged than otherwise would be possible.

# 5. SHOULD THE REGULATORY TREATMENT OF IPSs BE REFORMED?

Currently the European Commission is in the process of reviewing the DGSD pursuant to this directive's review clause, which makes this an appropriate time to evaluate the treatment of IPSs in the DGSD.[6] The treatment of IPSs in the DGSD and the CRR raises three particular concerns regarding the strength of deposit insurance and fair competition that are discussed in this section, along with possible options for reform.

*Issue 1: A joint IPS-DGS could entail weaker deposit insurance.*

An IPS that is recognized as a DGS has the dual tasks of ensuring member institution liquidity and solvency and of providing deposit insurance. Such a dual mission potentially weakens deposit insurance, as some of the resources of the IPS ex ante fund could be spent in vain to stabilize a distressed IPS member institution, leaving less money to provide deposit insurance.[7] As a related point, IPS resources that are deployed to stabilize a member institution can in part be used to pay off non-deposit liability holders, making the IPS into a guarantee scheme for all liabilities rather than only for covered deposits.

Reform that takes away the possibility that an IPS is recognized as a DGS would eliminate the potential for such a DGS to offer weaker deposit insurance.[8] Alternatively, reform can weaken this risk by requiring a joint IPS-DGS to build a larger ex ante fund than the currently uniform norm of 0.8% of covered deposits by 2024, depending on the perceived risk of weaker deposit insurance. [9]

*Issue 2: The ex ante fund of a joint IPS-DGS is potentially used to ensure member institution solvency, implying an unfair competitive advantage.*

This issue can also be ameliorated by disallowing joint IPS-DGSs or by requiring a joint IPS-DGS to build a relatively large ex ante fund.

*Issue 3: Relatively low contributions of an IPS into a non-IPS DGS can create an unequal playing field.*

At present, the DGSD includes the national option to allow lower contribution of IPS member institutions into an arm's-length DGS. According to a Center for European Policy Studies (CEPS, 2019, p. 161) survey, five Member States (Austria, Ireland, Hungary, Germany and Poland) transposed this option into national law, while only Austria, Hungary and Poland have practical experience with this option so far. Lower contributions by IPS member institutions into an arm's-length DGS potentially offer the affected IPS members a competitive advantage compared to an equally risky individual bank or banking group that pays contributions into the same DGS. To create a more level playing field, this national option could be eliminated.

In case the EU adopts a European Deposit Insurance System, the treatment of IPSs within the deposit insurance framework can be analogously amended to obviate the above concerns. In particular, IPSs can be required to join the EDIS and to pay equal contributions compared to a similarly risky non-IPS bank or banking group.[10]

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[6] As an input into this review, the European Commission has held public and targeted consultations on the review of the crisis management and deposit insurance framework. See European Commission (2021) for a summary report on these consultations.

[7] According to Article 11(3) of the DGSD, Member States may allow a DGS (and hence an IPS that is recognized as a DGS) to prevent the failure of a member institution by implementing alternative measures. As one condition for this, the costs of the measures cannot exceed the costs of fulfilling the statutory or contractual mandate of the DGS. Whether or not this condition binds the ability of an IPS to attempt to prevent bankruptcy of a member institution at the potential expense of deposit holders depends on its interpretation. According to CEPS (2019, p. 128), the German IPS for cooperatives considers the amount that they have to inject in the failing member institution as the costs of the preventive measures, while the total covered deposits in the failing member institution are considered as the costs associated with the pay-out. Thus, the funds injected into the failing member institution need to be less than covered deposits. In this interpretation, the dual mission of the IPS appears to weaken deposit insurance. Deutsche Bundesbank (2015, p. 56) confirms that an IPS that is recognized as a DGS remains entitled to avert a going concern risk, particularly to ensure the liquidity and solvency of a member institution.

[8] Demirgüç-Kunt and Detriagiache (2002) find the adverse impact of the existence of deposit insurance on bank stability to be stronger where it is administered by the government rather than the private sector reflecting moral hazard.

[9] In the absence of regulatory reform to this effect, supervisors could nonetheless require a joint IPS-DGS to have a relatively large ex ante fund.

[10] In the current EDIS proposal, EDIS applies to all schemes that may, in principle, encounter payout events or be requested to contribute to a resolution procedure, including institutional protection schemes that have been officially recognized by a Member State as DGSs (European Commission, 2015, Section 5.1.2).

# 6. CONCLUSION

In Europe, IPSs are active in Austria, Germany, Italy, Poland, and Spain, In Austria and Germany, IPSs held very large shares of covered deposits of 62.7% and 67.2% in 2019, respectively. In the euro area and the EU as a whole, the IPS shares of covered deposits are sizeable at 23.3% and 21.3%.

The resources of the ex ante fund of a joint IPS-DGS are conceptually equal to bank capital to the extent that they are available to ensure member institution solvency, even if these resources do not contribute to regulatory capital. This provides member institutions of a joint IPS-DGS with an unwarranted competitive advantage, as the use of stand-alone DGS funds to enable distressed banks to continue as going concerns in practice could be more restricted.

At present, the European Commission is reviewing the DGSD pursuant to this directive's review clause, and thus this is an appropriate time to evaluate the current treatment of IPSs in the DGSD. Obviating the possibility of an IPS to be recognized as a DGS brings two advantages. First, this could strengthen deposit insurance, as an unrelated DGS has a clearer mandate to safeguard deposits and, second, it could level the playing field as the use of DGS resources to maintain member institution solvency will be more restricted. Similar advantages stem from requiring IPS member institutions to join any future European Deposit Insurance Scheme.

Possible questions:

Q1: Does the dual role of IPSs that are recognized as a DGS imply that potentially relatively few resources are available to guarantee deposits in a bank resolution?

Q2: Should the current practice of recognizing some IPSs as a DGS be obviated in future reform?

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This paper documents the relevance of Institutional Protection Schemes (IPSs) in the European banking market, and it discusses some drawbacks of the current practice of recognizing some IPSs as a deposit guarantee scheme as well as possible options for regulatory reform.

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