Deposit insurance and crisis management: the current landscape and the way forward

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Ladies and gentlemen, good morning.

It is a great honour to be here at such a prestigious international event to share some thoughts about the role of deposit guarantee schemes (DGSs) in crisis management, also in the light of changes in the regulatory, operational and technological environment.[1]

This occasion presents a meaningful opportunity to exchange reflections, experiences and insights from different standpoints, on the milestones reached and possible improvements to the safety net, as well as to promote fruitful dialogue among stakeholders.

1. Main features and the role of DGSs

DGSs play a crucial role in the management of bank crises. Robust bank supervision remains the best line of defence against a banking crisis, but a properly designed resolution and an efficient deposit insurance system are important components of a functioning financial safety net.

DGSs are essential to curb the likelihood of banking panics and are therefore a key policy feature for ensuring financial stability. Moreover, by collecting funds from the banking industry they help to shift the cost of insurance from the public finances to the banking industry itself.

DGS funds are primarily used to prevent bank runs by ensuring that depositors have immediate access to their insured funds in the event of a bank failure, thus acting as an *ex ante* safe device for depositors (the 'paybox mandate').

1 With thanks to Gianluca Aloia, Federico Signore and Marilena Iannicola for their valuable contributions.

DGSs may also be called upon to perform one or more additional functions, as they are designed to work as part of a balanced dynamic system and should not be regarded as a static pool of funds.

Many DGSs have progressively expanded their mandates to include additional tasks, such as financial support in resolution (the 'paybox plus mandate') and have implemented loss and risk minimization strategies.[2] Broader mandates enable DGSs to be more committed in banking crisis management.

2. Changes in the crisis management framework

As we all know, the framework for dealing with non-viable banks has advanced significantly in the decade following the global financial crisis of 2007-08 and, for the European countries, the subsequent sovereign debt crisis.

At the international level, the Financial Stability Board (FSB) focused on systemically important banks and identified best practices for managing their crises. Largely following the international standards set out in the FSB's 'Key Attributes of Effective Resolution Regimes' – which also provide for interaction and cooperation between the resolution authority and DGSs – EU regulators adopted the Bank Recovery and Resolution Directive (BRRD), which introduced a new crisis management regime with a higher degree of harmonization.

The aim of the directive was to overcome the too-big-to-fail problem and eliminate the need for bailouts with public funds in the event of bank failures.[3] Through the participation of investors and creditors in the failed banks' losses, the framework also aimed to reduce moral hazard and restore the level playing field for larger and smaller banks.

In Europe, the establishment of the Single Resolution Mechanism (SRM), tasked with improving the resolvability standards of significant banks, ensured a consistent approach to crisis prevention and management for the largest banks across the Banking Union.

The centralization of duties and responsibilities for bank crisis management at the European level was an essential step towards the completion of the Banking Union and resulted, among other things, in intensive data collection, coordination between authorities and advance planning.

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2 For instance, the Deposit Insurance Corporation of Japan (DICJ) has a loss minimization mandate, while the Federal Deposit Insurance Committee (FDIC) in the US adopts a risk minimization model. See IADI, 2022 Annual Survey.

3 Ignazio Visco, introductory remarks at Banca d'Italia's Workshop 'The crisis management framework for banks in the EU. How can we deal with the crisis of small and medium-sized banks?', May 2021.

Important progress has been made in improving the willingness of banks to tap capital market in order to issue MREL instruments, in removing obstacles to resolvability, and in implementing tools to intervene early and quickly in an unsound or failing institution.

In this environment, DGSs have had a major role to play, as they have been enabled to intervene in the resolution process to preserve the access of covered depositors to their funds, notably in the event of a 'virtual bail-in'.

However, there is still room to improve the regulation of crisis management in small and medium-sized banks – assuming they do not raise concerns for financial stability – which is an important missing piece in the European crisis management framework.

3. The DGSD and DGSs' interventions beyond payout

In addition, in line with the best practices issued by the international standard setters, the Deposit Guarantee Schemes Directive (DGSD) recognized DGSs as fully-fledged participants of the safety net.

Under the DGSD, Member States may allow DGSs to perform more than a reimbursement function and use the available financial means to prevent the failure of a credit institution (preventive interventions) and to finance measures in the context of national insolvency proceedings (alternative interventions), subject to certain conditions and limitations (notably the least cost criterion).[4]

The use of measures other than payout has significant advantages. Not only are they less costly than payout, but from a system-wide perspective they also help to safeguard depositors' confidence and overall financial stability, mitigating the disruptive effects of piecemeal liquidation.[5]

Italy's longstanding experience confirms the central role of DGSs in crisis management. Since the establishment of the two Italian DGSs, 90 interventions out of 93 have been preventive or alternative and only 3 have been payouts.[6] Alternative measures proved to be paramount to solve banking crises and a real strategic partnership can be identified among Banca d'Italia and the two Italian DGSs.

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4 See Article 11(3) and 11(6) of the DGSD.

5 Piecemeal liquidation is therefore the worst crisis management option, with negative impacts on public confidence and on overall financial stability, while interventions other than payout ensure the continuity of the bank's borrowing relationships and the preservation of the enterprise value and of the employment level, and a high degree of depositor protection. See 'The banking crises of 2023: some initial reflection', speech by Paolo Angelini, Deputy Governor of Banca d'Italia, at the event 'Promoting Accountability in Times of Crisis', November 2023; A. De Aldisio, G. Aloia et al., 'Towards a framework for orderly liquidation of banks in the EU', Notes on Financial Stability, 15, August 2019; and 'Protecting depositors and saving money', Occasional Paper Series, ECB, Frankfurt am Main, June 2023.

6 More specifically, the Interbank Deposit Protection Fund (FITD) has managed 16 interventions since 1987, of which 9 were alternative interventions, 2 were depositor payouts and the remaining 5 were preventive interventions. The Deposit Guarantee Scheme for Cooperative Banks (FGDCC) has carried out 77 interventions since 1997: only one case involved a depositor payout, while the remaining 76 were interventions other than payout (24 alternative interventions and 52 preventive interventions).

4. International experience

The key role of DGSs in crisis management is also confirmed in some major non-EU jurisdictions.

In the US, for instance, the DGS's support for the transfer strategies is a pillar in the framework and was successfully used for almost a century, including recently in the early 2023 crises. Between March and May 2023, three large regional banks were closed and resolved with a purchase and assumption (P&A) transaction and with sizeable support from the Federal Deposit Insurance Corporation (FDIC).[7] To facilitate the resolution of financial institutions, the Deposit Insurance Corporation of Japan (DICJ) has provided financial assistance in 182 cases and injected capital into 34 financial institutions so far.[8]

5. Changes in the banking environment

The banking environment has changed in recent years. Technological innovation is perhaps the main driver of change.

On the one hand, it is leading credit institutions to adapt their business models and rethink the ways they provide banking services, both in response to customers' new expectations and to changes in product customization and customer service. It is also creating new opportunities in terms of profitability, thanks to efficiency gains and cost reductions.[9]

On the other hand, it poses challenges. Corporate governance systems should be strengthened in order to increase the digital literacy of management and supervisory bodies. Moreover, technology increases the use of outsourcing (and the associated risks) as well as competition between intermediaries.[10]

Finally, financial stability concerns may arise. Indeed, the digitalization and internationalization of finance, while providing access to fast payments (including instant bank transfers) and mobile banking, may also lead to the amplification of concerns through social media, causing considerable and unexpected deposit withdrawals and risks of bank runs.

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7 Specifically, the FDIC intervened to support the transactions, with a total cost of more than $40 billion (estimated as of 31 December 2023). While one intervention (First Republic Bank) was carried out under the least cost requirement, the systemic risk exception was invoked in the other two cases (Silicon Valley Bank and Signature Bank), so the FDIC could deviate from the least cost principle.

8 See DICJ, Annual Report 2022/2023.

9 Many banks are using technology to replace traditional channels. The resulting efficiency gains are bringing benefits to both banks and their customers. Banks with a greater ability to operate online have higher profitability on average, show improved revenue diversification and increased their share of the lending market. Customers benefit from lower service costs – with charges on online accounts being 60 per cent of what they are for traditional accounts – as well as from easier access to banking services. 'The Governor's Concluding Remarks', Banca d'Italia, May 2024.

10 See also 'The Governor's Concluding Remarks', Banca d'Italia, May 2024.

In the new digital world, close cooperation between supervisory and resolution authorities and effective deposit insurance are even more crucial to avoid systemic crises and protect financial stability.

The recent turmoil that occurred in the banking sector in the first quarter of 2023 in the US and in Switzerland showed how quickly a risk of contagion can materialize in a digital world and how commercial banks are heavily dependent on a fickle base of depositors.

The concentration of large deposits held by firms and individuals connected in virtual communities may contribute to synchronised deposit outflows and cause a massive flight of depositors.

Recent crisis episodes have tested assumptions about the appropriateness of the coverage threshold, stimulating discussions on a possible revision of the existing framework with a view to adapting it to changes in the social and economic systems and financial markets.

One possible way forward could therefore be to raise the coverage threshold, also in line with the recent international debate.[11]

In fact, observers with a say on these issues, including IADI, have pointed out the virtuous cycle between increasing the level of depositor protection and reducing the likelihood of bank runs.

In our view, a higher insurance threshold would help to stabilize banks' funding, which tends to be more volatile in the new environment.

The possible increase in contributions for the banking system would be more than offset by the increase in its stability and by the perception of greater safety among depositors and other creditors.

6. The EU's three milestones: CMDI, EDIS and the digital euro

Coming back to the EU, let me underline three points.

The review of the crisis management and deposit insurance (CMDI) framework in Europe is underway. This project is a unique opportunity to address the shortcomings of the current regulatory landscape.

The proposal published by the European Commission in April 2023 introduces improvements but also contains weaknesses.[12] It is key that the prominent role of the DGSs in the financial safety net be further strengthened; the effectiveness of the revised framework will depend on two aspects, both related to DGSs.

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11 FDIC, 'Options for deposit insurance reform'; IADI, 'Uninsured Deposits: Relevance and Evolution Over Time', Policy Brief No. 8.

12 'The banking crises of 2023: some initial reflection', address by Paolo Angelini, Deputy Governor of Banca d'Italia, at the event 'Promoting Accountability in Times of Crisis', Rome, November 2023.

Firstly, the use of DGSs to support transfer strategies (both in resolution and in liquidation) should be facilitated, including through a wide and strengthened least cost test.

Secondly, the DGSs should be allowed to fill the funding gap efficiently and easily, in order to unlock the resources of the Single Resolution Fund.

The wider role of DGSs in resolution and liquidation may raise concerns about the adequacy of their resources and the resulting increased costs for the banking system.[13] In this respect, interventions beyond payout typically minimize the cost of banking crises for all the stakeholders involved, arguably including the DGS itself;[14] moreover, a wider use of DGS funds would improve the positive outcomes mentioned earlier (in terms of public confidence and financial stability) and may consequently lead to a reduction in banks' funding costs.

Increasing the involvement of DGSs would be even more important with a view to completing the Banking Union through the establishment of the European Deposit Insurance Scheme (EDIS).

The creation of a European Fund with the power to support the management of bank failures would mark the transition from a European network of national DGSs to an integrated European mechanism to protect depositors.

Indeed, in a broad-based system where responsibilities for supervision and resolution are centralized, depositor insurance should also be mutualized.

Only a fully mutualized EDIS that also covers alternative interventions would ensure depositor protection without producing cross-subsidization effects.[15]

Less ambitious solutions would not deliver the beneficial effects of a fully-fledged mutualization and would transfer the management of crises to the central level while leaving the costs at the national level. From our point of view, it is therefore crucial to ensure consistency between the responsibility of the decision-making process and the funding mechanism.

Looking ahead, concerns may arise around the introduction of central bank digital currencies (CBDCs), such as the digital euro.

Some observers fear that a digital euro could create instability by potentially challenging the traditional banking business. In this regard, it is crucial to adjust some features of the CBDCs, such as their holding limits, in order to avoid any negative impact on financial stability and to maintain a balance between private money and central bank money.

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13 Increased costs may arise from a potential increase in the target level of DGS and from higher contributions paid by banks to replenish the financial resources used.

14 The banking crises of 2023: some initial reflection', address by Paolo Angelini, Deputy Governor of Banca d'Italia, at the event 'Promoting Accountability in Times of Crisis', Rome, November 2023.

15 J. Carmassi, S. Dobkowitz, J. Evrard, L. Parisi, A. Silva and M. Wedow, 'Completing the Banking Union with a European Deposit Insurance Scheme: who is afraid of cross-subsidisation?', Occasional Paper Series, ECB, Frankfurt am Main, April 2018.

Moreover, a gradual adoption of the digital euro would reduce the risk of cliff-edge effects on bank deposits.

It bears repeating that depositors do not need digital central bank money to run on banks. They can already withdraw their funds and move deposits quickly, including through instant bank transfers.

On the contrary, CBDCs might even help to mitigate the risk of bank runs. A digital euro could provide real-time information on the outflow of bank deposits, allowing the authorities to react more quickly, which in turn would increase depositors' confidence.[16]

7. Conclusion

To conclude, recent trends in the banking sector and upcoming changes in regulation could be given due consideration in the ongoing review of the IADI Core Principles, focusing on a well-balanced partnership between stakeholders.[17]

Developments in the financial sector and technological innovation pose important challenges for authorities and deposit insurers. When market and depositor confidence is lost, they must act in a predictable manner to minimize the risk of bank runs, thus preventing contagion and preserving public confidence.

To this end, it is extremely important to learn from past experience and to adapt flexibly to changes in the environment by looking ahead and working closely together.

So far, enhancing cooperation in crisis management has been a very ambitious undertaking but many significant milestones have been achieved in a relatively short time span through joint efforts aimed at converging different regulatory traditions and at incorporating the best national practices into a unified approach.

Cooperation is key. Banca d'Italia is firmly committed to promoting developments in the field of depositor protection and cooperation. I encourage all of us, regulators, DGSs and supervisors, to stay connected, work together and continue our dialogue, here and in all the appropriate international fora and networks.

Today's meeting provides a great opportunity to discuss all these issues and to explore views and suggestions that will contribute in a constructive way to the debate on how to improve depositor protection and foster a safer financial system. So let me once again thank the organizers for the honour of opening this event, which I am sure will provide us all with inspiring ideas and useful takeaways.

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16 'The cost of not issuing a digital euro', address by Fabio Panetta, Governor of Banca d'Italia, at the conference 'The macroeconomic implications of central bank digital currencies', Frankfurt am Main, November 2023.

17 The IADI Core Principles for Effective Deposit Insurance Systems were published in 2009 and revised in 2014.

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