

DEPOSIT PROTECTION FUND AND THE PAYMENT OF COMPENSATION FOR INACCESSIBLE DEPOSITS

Ing. Rudolf Šujan, Chairman of the Presidium of the Deposit Protection Fund

The Deposit Protection Fund (hereinafter the "Fund"), pursuant to Act of the National Council of Slovak Republic No 118/1996 Coll. on deposit protection and amending certain acts in the wording of subsequent legislation performs the payment of compensation for protected deposits in the case that they have become inaccessible in some banks. Over the period 1999 to 2004 it performed the payment of compensation to depositors at AG Banka, a. s., Nitra, Slovenská kreditná banka, a. s., Bratislava, Dopravná banka, a. s., Banská Bystrica and Devín banka, a. s., Bratislava. Since payment has already been completed in all four cases, we shall in this article deal in more detail with information and knowledge gained from the preparation and realisation of compensation disbursement.

The existence of a market economy is unthinkable without the existence of money, where banks fulfil an indispensable role in the economy and financial system of every country. The banking sector in Slovakia has been undergoing historic development, influenced in each period by political, social and economic conditions. Slovakia, since its founding in 1993 and the establishment of the National Bank of Slovakia, has seen cardinal changes and great progress towards a modern commercial banking system. The hallmarks of the new banking system in Slovakia have become openness and a competitive orientation, where these nevertheless also create the possibility for bank failure, this regardless of whether the economy is in a state of financial crisis. For this reason the necessity of regulation and protection in the banking system is becoming increasingly important. Several directives have been issued by the European Union, governing the framework and conditions for performing banking activity, where Directive 94/19/EC of 30 May 1994 on deposit protection systems forms the legislative basis for building deposit protection systems. In Slovakia bank deposit protection is provided through the Deposit Protection Fund (DPF), established by Act of the National Council of the SR No 118/1996 Coll. of 20 March 1996 on deposit protection and the amendment of certain acts, effective since 1 July 1996. The purpose of this act is to regulate the protection of deposits at banks and foreign banks (hereinafter simply "banks") and the provision of compensation for these deposits, should they become inaccessible..

Beginnings of building the Deposit Protection Fund

Over the past nine years or more the Deposit Protection Fund has passed several milestones and stages,

during which time it has become a significant element of stability and confidence in the Slovak banking sector.

In the period up to 1997 the institutional bases of the Fund were established, while at the same time development of the information system for compensation disbursement was underway. This system was completed at the close of 1999 and as the following period showed, the Deposit Fund Protection system for paying out compensation for inaccessible deposits (hereinafter the "compensation disbursement system") became a significant technical resource in fulfilling one of the Fund's basic tasks, in paying out compensation to the depositors of the four banks that gradually over the years 1999 to 2001 were declared insolvent to pay out deposits. In the following stage the DPF became a participant in the bankruptcy proceedings for the assets of these four banks, where in all cases, as the largest creditor, it is exercising claims under the title of inaccessible deposit compensations paid to the depositors of the four banks. Throughout its operation the DPF has at the same time become involved in a broad range of international cooperation in the field of deposit protection.

Since its outset the Deposit Protection Fund has created its own financial resources for paying out compensation by gathering and administering contributions from banks. The Fund, pursuant to Article 12(3) of the Deposit Protection Act, has also issued the internal legal standard "General Conditions for Disbursement of Compensation for Natural Persons' Inaccessible Deposits at Banks" (hereinafter "General Compensation Disbursement Conditions") and prepared the procedure for paying out compensation for inaccessible deposits. All conditions set by this and other legislative standards and the possibility to use information technology formed the starting point for building the compensation disbursement system.



At the start of 1999 an analysis was made in cooperation with selected banks of the possibility for banks to generate data on deposits and depositors in the format and structure necessary for realising disbursement. Subsequently, over the course of the year the compensation disbursement system was built up in its software and hardware parts. In November 1999 the DPF tested the system. On 3 December 1999 the National Bank of Slovakia declared AG Banka, a.s., Nitra insolvent to pay out deposits and thus on this day the DPF began the preparation to pay out compensation for inaccessible deposits at this bank.

The compensation disbursement system is composed of application modules created in the Oracle Forms environment, working under an Oracle database. The system ensures the automation of individual activities and software support for data access, data processing, control mechanisms and monitoring the level of disbursement. The compensation disbursement system enables the DPF to effectively perform its activity in paying out compensation for inaccessible deposits, minimising requirements for manual intervention in the data processing and thereby also the possibility of error occurrence in calculating the level of compensation. It provides a real-time overview of the level of compensation disbursed, where the priority is to ensure a non-stop, guaranteed operating regime and robustness against failure and equipment error.

The compensation disbursement system guarantees immediate preparedness for the commencement of activity and enables concurrent disbursements for multiple insolvent banks by means of one or several banks performing the disbursement.

Basic legal framework underlying compensation disbursement

Under the Deposit Protection Act, if a bank is unable to pay out deposits for a period of 48 hours, it is to notify this at latest the following working day to the National Bank of Slovakia and the DPF.

The National Bank of Slovakia within three days of receiving the bank's notification, if the liquidity shortage proves permanent, or if no other possibilities are found for removing it, the NBS declares the bank insolvent to pay out deposits.

The DPF, following receipt of a notification from the National Bank of Slovakia on the bank's insolvency to pay out deposits, announces the commencement, term, place and procedure for disbursing compensation, this within five days of notification.

The procedure would be similar in the case of a suspension of deposits handling on the basis of an executable court judgement under the Bankruptcy and Settlement Act.

Compensation disbursement must end within three months of the bank being declared insolvent to pay out deposits, though in justified cases the DPF may request the National Bank of Slovakia for an extension of this deadline by another three months (and repeatedly so). Disbursement must however be terminated within one year of the bank being declared insolvent to pay out deposits; should however a depositor be unable to exercise his/her right to compensation within this period, in exceptional cases he/she may do so within three years of the start of the compensation disbursement.

Besides these organisational conditions, the Act also contains other conditions that must be taken account of in the compensation disbursement system, in particular those conditions concerning the range of deposits protected, the method of calculation and the level of compensation, the conditions temporarily and definitively limiting the disbursement of compensation, the manner of proving and verifying the depositor's identity and the manner of proving and verifying the deposit relationship of the depositor to individual deposits.

The activity of the DPF in preparing and ensuring the disbursement of compensation ensued from the respective decisions of the Board and Presidium of the DPF, where this activity was managed and organised so that the disbursement of compensation, using the deposit disbursement system, operated smoothly and in accordance with the Deposit Protection Act.

The DPF evaluated data on the total level and development of deposits subject to protection at banks declared insolvent to pay out deposits (hereinafter an "insolvent bank") and presented to the statutory representatives of these banks the requirements and measures for the overall arrangement of disbursing compensation. It checked the manner for recording and administering data on depositors and their deposits in primary documentation and in the bank's information system, stipulated the form for their generation and the manner of their presentation.

The Board of the DPF, after assessing the selection criteria, chose the paying-out bank, with which the Fund agreed the method of information exchange, the method of remittance and debiting of funds and other activities for the overall realisation of the procedure for disbursing compensation in accordance with the Deposit Protection Act.

The Fund explained the basic information concerning the compensation disbursement to the Slovak National Clearing Centre and the Slovak Authorisation Centre, in connection with ensuring the suspension of deposit handling in the insolvent bank via payment cards in the ATM network and at POS terminals. It obtained official information from the Statistics Office of the Slovak Republic for calculating the maximum level of compen-



sation for inaccessible deposits. It also informed the public as to the preparation, method and dates for the disbursement of compensation.

The Fund provided the financial resources for compensation from its own resources, these having created by contributions from banks, and totalling in December 1999 SKK 2.26 billion. These resources were fully sufficient for paying out compensation to the depositors of AG Banka, further resources were obtained in the form of an extraordinary contribution from banks in the year 2000 of SKK 795 000 000. The largest part of the financial resources was obtained in the form of loans from the National Bank of Slovakia, this gradually in the form of SKK 2.97 billion (in the case of Slovenská kreditná banka), SKK 2.3 billion (in the case of Dopravná banka) and SKK 11.651 billion (in the case of Devín banka).

Basic information on the payment of compensation for inaccessible deposits is shown in the following tables.

The Deposit Protection Fund in the case of AG Banka paid out in the first week compensation totalling SKK 1.331 billion (71.07%), at the end of the second the total compensation paid out was SKK 1.491 billion (86.18%). At 3 March 2000 compensation totalling SKK 1 718 285 756.16 had been paid out to 23 797 depositors (98.0%). In percentage terms the payment of compensation in the case of other three banks followed a similar course.

In accordance with Article 10(2) of the Deposit Protection Act the DPF in the case of each bank terminated the payment of compensation for inaccessible deposits at three months, where payment was continued in accordance with Article 10(9) of the Deposit Protection Act for up to three years in cases where depositors for serious reasons could not take over the compensation, and in which cases the depositors requested payment in writing.

Lessons learnt from paying out compensation

The Deposit Protection Fund began preparation for disbursing compensation practically from its very beginnings. It created the organisational and technical conditions for compensation disbursement. In the framework of these conditions it coordinated all the elements of the

AG Banka Nitra	
Date of deposits insolvency declaration	3 December 1999
Paying-out bank	Slovenská sporiteľňa, a.s.
Compensation disbursement period	10 January 2000 – 10 January 2003
Maximum compensation per depositor	SKK 310 500
Number of clients compensated	24 145
Total compensation paid out	SKK 1 742 515 387.48

Slovenská kreditná banka Bratislava	
Date of forced administration declaration	19 April 2000
Date of deposits insolvency declaration	19 May 2000
Paying-out bank	Všeobecná úverová banka, a. s.
Compensation disbursement period	19 June 2000 – 19 June 2003
Maximum compensation per depositor	SKK 322 000.00
Number of clients compensated	33 142
Total compensation paid out	SKK 4 317 676 058.08

Dopravná banka Banská Bystrica	
Date of forced administration declaration	1 July 2000
Date of deposits insolvency declaration	18 July 2000
Paying-out bank	Slovenská sporiteľňa, a. s.
Compensation disbursement period	14 August 2000 – 14 August 2003
Maximum compensation per depositor	SKK 328 200.00
Number of clients compensated	24 375
Total compensation paid out	SKK 2 222 817 428.95

Devín banka Bratislava	
Date of forced administration declaration	24 August 2001
Date of deposits insolvency declaration	21 September 2001
Paying-out bank	Slovenská sporiteľňa, a. s.
Compensation disbursement period	5 Nov. 2001 – 5 Nov. 2004
Maximum compensation per depositor	SKK 355 000.00
Number of clients compensated	103 314
Total compensation paid out	SKK 11 612 670 362.92

Summary data on disbursement of compensation for all four banks	
Number of clients compensated	184 976
Total compensation paid out	SKK 19 895 679 237.43

parties involved into the disbursement process so that disbursement to depositors for their inaccessible deposits occurs smoothly, and mainly so that it is realised in full extent according to the Deposit Protection Act.

From the data on compensation disbursement it ensues that the substantial majority of the compensation was paid out without problem and quickly. The primary goal however was not speed in payment but full accordance with the Deposit Protection Act. Concurrently it may be said that in paying out compensation no critical moments occurred that could have brought about doubts or a lack of confidence among depositors as to the payment of compensation and the deposit protection system.



However, in the process of preparation and compensation disbursement itself the DPF did resolve individual cases in which deviations had occurred in satisfying the conditions for payment of the compensation set by the Deposit Protection Act.

Knowledge gained in disbursing compensation, in performing ex-ante and ex-post control activities, as well as in handling complaints and claims was influenced by factors that may be divided into the following fields:

1. The legal status of the insolvent bank prior to its declaration as insolvent to pay out deposits, and following this declaration.
2. The bank's organisational arrangement and commercial policy.
3. The quality and completeness of data records on deposits and their depositors in the bank's primary documentation and information system.
4. The level of informedness of depositors on deposit protection from the side of the insolvent bank.
5. The organisation of the compensation disbursement.

Legal status of the insolvent bank prior to its declaration as insolvent to pay out deposits, and following this declaration

In commencing proceedings in the matter of revoking a permit to operate as a bank and in introducing forced administration in a bank (besides AG Banka, a.s., forced administration was introduced in all other three insolvent banks) the National Bank of Slovakia adopted measures securing the bank's management or appointing an administrator for performing the forced administration. These measures were directed at, in particular, restricting settlements, prohibiting deposit handling, and effecting asset and liability trades. On the basis of the measures of the National Bank of Slovakia the appointed administrators for forced administration also adopted measures towards the bank's organisational components.

The application of these measures in the bank's practical activity, for example the opening of new accounts in respect of deposits subject to protection in the first days of forced administration, the realisation of a client's orders in setting up a term deposit, its change, cancellation or transfer, created situations which the DPF had to deal with in a special manner. Since the DPF, pursuant to the Deposit Protection Act, can act against a bank only from the date of the declaration of the bank's insolvency to pay out deposits, it could not influence the manner in which these measures were realised by the bank's staff, it did however in several cases have to arrange and take into consideration the measures' application in practice within the limits of the Deposit Protection Act.

In the regime of revoking a banking permit and in the

forced administration regime of a bank depositors' claims were set off, whereby the value of the bank's assets was reduced, consequently reducing the level of the bank's assets' monetisation in bankruptcy proceedings as well as the ensuing satisfaction of the DPF's receivables towards the bank.

Following the declaration of bankruptcy proceedings on the bank's assets, the set-offs were subject to examination from the aspect of their satisfying the legal conditions for their legal validity. This and other activities were performed by the administrator of the bankrupt estate. In the case of the declaration of bankruptcy proceedings the DPF did not have the possibility to express its opinion on the administrator's appointment.

Organisational arrangement and commercial policy of the bank

The preparation and realisation of the compensation disbursement was influenced by the bank's organisational structure, this mainly in the case of AG Banka and Dopravná banka. These banks were in the stage of undergoing some development in which formerly independent banks had been merged. Each merger meant also taking over individual deposits and a change in the development plan and in the administration of retail products. Differences were also seen in the administration of deposits and even in the framework of branches of the same bank.

The branches of the original banks administered their portfolio of deposit products and at the same time were taking over the new products of the merged bank. In the conversion and importing of data on deposits and loans from the original banks' information system into the information system of the merged banks differences arose between primary documents in respect of deposit products and data in the information system.

A typical feature of all three banks were deposits with high interest rates and various types of premiums upon the multi-year duration of a deposit relationship. The result of this commercial policy by the banks was that numerous depositors received compensation payments for deposits in all three banks.

Quality and completeness of data records on protected deposits and their depositors in primary documentation and in the bank's information system

The Deposit Protection Act lays down the conditions that must be fulfilled for payment of compensation. Pursuant to Article 3(5) of the Deposit Protection Act (in the wording applicable for compensation disbursement) protected deposits must be drawn on the first name, surname, address and date of birth (birth ID no.) of a natural person.



In paying out compensation, data from the information system and data in depositors' documents were compared at the pay-out point, where in the case of a discordance in the data the compensation was not paid out.

The DPF was detecting incorrect data in launching control mechanisms of the compensation disbursement system, in performing controls at an insolvent bank and also in resolving claims and disputed cases.

Different and incorrect data occurred also in the bank's information system and in depositors' documents, and concerned all conditions for the payment of compensation, i.e. the name, surname, birth ID no., date of birth, account balance or the account number relating to the deposit subject to protection. The differences were seen in cases where data in some sources was missing completely, was stated incompletely, incorrectly or in duplicate.

The differences had arisen due to various causes and in various ways, for example:

- in converting data from the information system of the merged bank,
- in creating a new information system in the bank and converting the data from the old into the new information system,
- the bank incorrectly recorded the data on the depositor into the information system and the respective documents in converting an anonymous deposit into non-anonymous,
- in the information system the account for a protected deposit was administered as an unprotected, and conversely an account in respect of an unprotected deposit was administered as protected,
- some data on the depositor in the information system, where the depositor had accounts at several branches, was different and was recorded in duplicate in the database,
- some deposits of natural persons – free traders, deposits of non-profit organisations, societies, associations, foundations, etc., were administered in the information system as protected deposits,
- the bank had not recorded data on the birth ID no., or on the date of birth of a depositor – non-resident,
- in the incorrect inputting of data into the information system or into primary documents through the human failure factor, which was a common denominator in all differences.

Level of informedness among depositors on deposit protection from the side of the insolvent bank

As seen from the course of compensation disbursement for inaccessible deposits at all the four banks and mainly from knowledge gained in control activity and in

solving disputed cases it may be said that the level of informedness among depositors on deposit protection from the side of these insolvent banks was not at a sufficient level.

The insolvent banks published the information on deposit protection at their operating premises in accordance with Article 12 of the Deposit Protection Act, though in practice their staff did not in many cases provide complete and correct information to clients important for their decision making in the matter of their setting up, changing, or terminating deposit relationship with the bank.

Insufficient, sometimes also incorrect information on deposit protection was the cause of:

- the depositing of financial resources by depositors of banks to unprotected accounts,
- not making the change of anonymous deposits to non-anonymous,
- a depositor having an anonymous deposit book in which there was stated in the title his/her name and surname considered this as a protected deposit,
- a depositor considered a joint-user of an account as its joint holder (joint depositor),
- sums exceeding the compensation limit were deposited to the account.

The DPF in assessing individual cases did not take into account the insufficient level of the depositor's informedness. In many cases depositors could have avoided the non-payment of compensation quite simply by checking the information in their documents for the deposits.

The organisation of paying out compensation

The Deposit Protection Fund organised the payment of compensation in accordance with the Deposit Protection Act, where in realising the payment of compensation it used the compensation disbursement system. An important fact here was that in paying out compensation it used the services and experience of retail banks, acting as intermediaries (Slovenska sporiteľňa, a.s. and Všeobecná úverová banka, a.s.).

In connection with paying out compensation it is important to state that in the case of all four insolvent banks deposit protection at the time (1999 to 2001), pursuant to the Deposit Protection Act, related only to the non-anonymous deposits of natural persons (excluding free traders).

The smooth course of paying out compensation is borne witness to also by the fact that of the 14 cases disputed, where so far 5 have been concluded, every time the court has decided in favour of the DPF.

Conclusion

The gradual development in the banking sector in Slovakia has also been reflected in legislation. The Deposit Protection Act has so far been amended six times. The most significant changes in the sphere of protected deposits occurred through the passing of the amendment, Act No 492/2001 Coll., pursuant to which with effect as of 1 December 2001 the deposits of natural persons – free traders and non-profit juristic persons (Article 3(a) and (b)) were also declared protected. From the date of the SR's accession to the EU, on 1 May 2004, the deposits of juristic persons – commercial companies also became protected (Article 3(3)(c)) with the exceptions stated in the Act.

An interesting fact is that while in 1996 there were 28 contributors – banks in the deposit protection system, at present there are 18 banks.

The Deposit Protection Act explicitly specifies the level of the annual contribution of banks to the DPF for a period when the Fund is in a debt position. Since the balance of the loan from the NBS as at 31 December 2004 was SKK 7.36 billion, the level of the annual contribution for 2005 was set for each bank at the level of 0.75% of the volume of its protected deposits. The level of banks' contribution into the DPF, the highest in the European Union and representing a significant burden for banks in Slovakia, is nevertheless a reflection of the fact that the DPF in the years 2000 and 2001 had to fulfil its legal duty and pay out almost SKK 20 billion in compensation for inaccessible deposits to depositors of

the four insolvent banks. This volume at the time represented 5% of the total sum of protected deposits in Slovakia's banking sector.

The most important role of the DPF at present is claiming receivables in bankruptcy proceedings, declared in 2000 and 2001, on the four insolvent banks' assets (AG Banka, Slovenská kreditná banka and Devín banka), and in which the DPF is the largest creditor, this by title of the compensation paid out for inaccessible deposits, totalling SKK 19.9 billion. These bankruptcy proceedings were from the beginning influenced by various circumstances and obstructions, in consequence of which their course has been complicated, where in all cases an investigation is being carried out by bodies active in criminal proceedings. Following certain legislative changes to the Bankruptcy and Settlement Act in 2004 procedural shifts occurred in individual bankruptcy proceedings on the bankrupt banks' assets. As yet however not one proceeding has been concluded and as yet the DPF has not received financial fulfilment from the sale of the bankrupts' assets.

With regard to the fact that income from the bankruptcy proceedings will be used for repaying the loan to the DPF from the National Bank of Slovakia, where the repayment of the loan is the condition for reducing the level of banks' contributions to the DPF, the Fund is currently devoting the greatest attention to exercising its rights as creditor. We will provide information on the course, knowledge and results of the bankruptcy proceedings in future issues of the BIATEC Journal.