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# Public awareness of deposit insurance and investor compensation schemes in Bulgaria

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**Abstract**

The purpose of deposit insurance and investor compensation schemes is to protect the clients of banks and investment intermediaries by providing compensation in the case of unavailability of clients' deposits or assets. Generally, knowledge about the activities of both schemes is rather limited by the public. This is observed not only in developing countries, but also in the developed ones. This problem is called public awareness.

The paper investigates the public awareness of the main components of the financial safety net in Bulgaria – the deposit insurance scheme and investor compensation scheme - based on a random distribution of a questionnaire among 232 people. The investigation is not considered as being representative but it indicates tendencies in the public awareness of both schemes in Bulgaria. The analysis in the paper is focused on the questions regarding the main activities of the deposit insurance and investor compensation schemes as well as the amount of guarantee, scope of both schemes, compensations payments events, the behavior of depositors and investors in cases of trouble events, etc.

The survey shows that in terms of the deposit insurance the awareness of participants is above average, while regarding investor compensation, the results are well below average, one could even say that such awareness is lacking at all. The results of the survey provide information that the efforts of the regulators and financial safety net schemes should be directed to increasing the awareness of depositors and investors in Bulgaria about the benefits and limitations of both schemes.

**Key words:**

Deposit guarantee scheme, Investor compensation scheme, Public awareness, deposits, banks, investment intermediaries, capital market

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## 1. Introduction

The optimal protection for the consumers of financial services is a key factor influencing the stability of the financial system. The more adequate this protection is, the higher the trust of consumers of financial services, and respectively the financial system becomes more stable. This strong interrelation between the trust and stability of the financial system is predetermined by the specifics of the activities of the financial intermediaries. Every financial crisis is a proof for the existence of this interrelation. It is impossible to have a stable financial system without the trust of the users of financial services.

A good regulatory framework is a key factor for ensuring adequate protection for the consumers of financial services, but it is not a single prerequisite. It is more evident in the recent years, considering the regulatory measures which have been established that their effectiveness regarding the protection of financial services' consumers depends largely on the consumers' financial awareness and financial literacy.

Generally, the protection of consumers of financial services has its peculiarities and it is related to the subject matter of these services, which are mainly in monetary form and therefore, consumers are largely more vulnerable than those of non-financial services. In general, money can more easily and in larger amounts be subject to loss, misuse, etc. In addition, financial markets place the financial wealth of the nation, and their state always has a great public resonance. This is also explained by the greater risks in the financial markets, where crises occur more quickly and unexpectedly, and, accordingly, the damage is greater.

Due to these specific risks associated with the management of money and financial instruments banking and investment services are among the most heavily regulated in the economy. Regulation, in turn, covers a wide range of requirements and rules that institutions providing banking and investment services must comply with - for example, in terms of capital requirements, professional qualifications of the management, obligations to disclose information about financial condition and conflicts of interest, etc. In addition, banks and non-bank financial intermediaries are subject to licensing and constant monitoring by the regulatory authorities. The purpose of licensing and permitting regimes, rules and requirements is to provide adequate protection to investors and depositors and to ensure the efficient functioning of the financial markets, as they in turn make financial markets more stable and inclusive.

The need for better protection of depositors and investors on the capital market also led to the creation first of deposit guarantee schemes and subsequently of investor compensation schemes. The main purpose of these institutions is to financially protect depositors and investors on the capital market, increase confidence in the banking sector and the capital market and reduce the negative consequences of shocks in the financial sector. Schrich (2008) points out that the elements of the financial safety nets are the prudential regulation and supervision, lender of last resort, failure resolution and deposit insurance. The current paper concentrates only on deposit insurance and investor guarantee schemes. Historically, deposit guarantee schemes emerged first, due to the leading role of banks as financial intermediaries, and the schemes for the protection of consumers of non-bank financial services were subsequently created. Deposit guarantee schemes are the most recognizable element of the financial safety net, with their primary purpose of protecting customers' deposits in the banks against losses caused by bank failures and insolvency. In most countries the banks are main financial intermediaries; therefore, the deposit guarantee schemes are a key element of the financial safety net. Mladenov (2015) states that an economic reason for the need for the existence of deposit insurance is primarily the risk of bank insolvency, which in turn stems from the predominantly short-term nature of bank liabilities and, at the same time, the long-term nature of their assets, which is where the specific liquidity requirements of banks originate. The main purpose of the deposit guarantee schemes is to protect not only the individual bank depositors, but also to contribute to the stability of the banking sector.

The first modern deposit guarantee scheme was established in USA in response to the banking crisis, that erupted during the Great Depression /1929-1933/. During this period, many banks failed and went

bankrupt, leading to bank panics and massive withdrawals of deposits. The US President at that time Franklin Roosevelt closed all banks for 6 days and the country passed the Banking Act /June 16, 1933 /, which created the Federal Deposit Insurance Corporation /FDIC/. Initially, the FDIC provided a guarantee of $2 500. Subsequently this amount has been increased several times, and since 2008 the guaranteed limit has been established at $250 000.

After the creation of the Federal Deposit Insurance Corporation /FDIC/ in the USA, such schemes were gradually created in large, developed countries, and in the countries of Central and Eastern Europe - after the beginning of the changes in the 90s. In the USA, as in most countries, deposit guarantee schemes were created because of banking crises. Today, most countries have deposit insurance systems, and according to IADI (International Association of Deposit Insurers) data, as of mid-2014, there are 120 countries with existing deposit guarantee schemes (Pruski, 2014). In most of the other countries, where there are no explicit deposit guarantee schemes, similar protection is provided, but it is implicit, and it is most often expressed in the silent commitment of the state to pay the deposits in case of bank failure. Explicit deposit guarantee schemes are mainly observed in high-income countries (84% of high-income countries have explicit deposit guarantee schemes) (Demirguc, Kane&Laeven, 2014). The global financial crisis revealed some major problems related with the functionalities of deposit insurance schemes as inadequate level of coverage, co-insurance, lack of protection for some financial sectors, etc (IADI, 2015).

Schemes to compensate the investor in the capital market appeared later than deposit guarantee schemes, and historically the first scheme was established in 1970 in USA under the name Securities Investor Protection Corporation – that is 37 years later than the establishment of the first deposit guarantee scheme. Among the EU member states, such a scheme was created first in Great Britain - in 1988, followed by Italy - in 1992. In all other EU member states, such schemes were created only after the adoption of the European directive on investor compensation schemes, according to which each member country must necessarily have at least one scheme in this area. According to IADI report as of the end of 2014 out of 61 studied jurisdictions 17 have integrated protection scheme where in a single agency pre-existing deposit insurance scheme provides a guarantee or protection to investors in securities firms.

The paper investigates the public awareness of the financial safety net in Bulgaria /the two components - deposit insurance scheme and investor compensation scheme/ based on a distribution of a questionnaire among 232 people. The investigation is not representative as such an investigation requires significant resources which cannot be provided within a scientific project, sponsored by UNWE. The idea is to collect some information about the attitude of Bulgarian citizens to the awareness of the existing financial safety net in the country, which could also be used as a reason for analysis for the project[1]. However, some interesting observations emerged during this study, and they are outlined in the paper. The investigation is first of its type as there are previously done which are concentrated on the activities of the deposit insurance scheme[2] but the public awareness of both major components of financial safety net in Bulgaria – deposit insurance and investor compensation – are not examined. The questions included in the questionnaire refer to the main activities of the deposit insurance and investor compensation schemes as amount of guarantee, scope, and time for paying out compensation as there are some other questions that refer to the market confidence and the behaviour of participants regarding banks and the capital market. The questionnaire was distributed online to different types of respondents based on their education, age and sex on a random basis thus aiming to cover different types of

[1] This paper is created as a part of a project UNWE project НИД НИ-10/2022/А “Investigation on the Development of the Financial Safety Net in Bulgaria”, 2022-2024.

[2] There is investigation on the public awareness of the Deposit Insurance Fund held in 2002. Additionally, in her dissertation The Evolution of the Financial Safety Net, 2015, Elena Ralinska also handled research dedicated on the public awareness of the deposit insurance schemes. The results of this research showed that except the limit of protection most of the respondents are not acquainted with the activity of the deposit insurance scheme.

opinions and perceptions. The aim of the investigation is not to cover any dependencies in the schemes' perception based on age, sex and education but to detect general trends in the public awareness of the deposit insurance and investor compensation schemes in Bulgaria. The current investigation may serve as an initial basis for future studies that elaborate on specific features in both schemes and as well as on dependencies regarding age, sex and education in schemes' perception. The deposit insurance and investor compensation legislation follow strictly the European one and for that reason we do not aim to provide recommendations for its improvement. However, the research may be a good starting point to set specific areas for improvement of financial literacy which has been a country's priority in the recent years (since 2021 Bulgaria has a National Strategy for Financial Literacy as well as an Action Plan for the period 2021-2025 which shows the strong aim of the state to put adequate resources and efforts in the field. Deposit insurance and investor protection should be a part of the national policy in the field).

The paper does not contain recommendations about improving the components of the financial safety net in Bulgaria. The results prove that retail clients are better acquainted with practical issues as the level of protection provided by the deposit insurance scheme and obligations of the banks to provide information about deposit protection, but they lack knowledge about the structure of the deposit insurance scheme, deadlines for payments and currency for payments. The respondents entirely lack knowledge about the investor compensation scheme in Bulgaria despite its existence since 2005, e.g. they are not familiar with the existence of the scheme, its purpose and amount of compensation and compensation cases. These results can be used as a basis for information campaigns for raising public awareness for the financial safety net in the country and points out the real need for knowledge among consumers about the activities of the investor compensation scheme in Bulgaria.

## 2. Public awareness

In general, the activity of deposit guarantee and investor compensation schemes is poorly known, with a large proportion of consumers of these services not even knowing that such protection exists. This problem is observed not only in developing countries, but also in the developed ones, which is an indicator that there is no dependence on this point of view. In the research and documentation of the relevant professional organizations (International Association of Deposit Insurers, European Forum of Deposit Insurers), this problem is called *public awareness* and it is considered mainly from the point of view of the deposit guarantee schemes, but it is also fully relevant to investor compensation schemes (IADI, 2014, IADI, 2012).

According to the International Association of Deposit Insurers Guidelines on Public awareness, for a deposit guarantee scheme to be effective, it is essential the public to be informed constantly about its benefits and limitations. Another point of view, it is the familiar question of trust in banks and money, without which their existence is impossible in the modern form.

Since its creation in 2001, International Association of Deposit Insurers (IADI) has been systematically dealing with the issues of public awareness. One of the activities of the IADI includes the preparation and distribution of the so-called "Guidelines", referring to various areas and representing a kind of standards for the members of the association. In the field of public awareness, "Guidelines" were published in 2009 and a revision of this document was prepared in 2012.

The "Guidelines" are based on the "Basic Principles for effective deposit guarantee systems". One of these principles (Principle № 10) refers to the public awareness and states: "In order for the deposit guarantee system to protect the depositor and contribute to financial stability, it is essential that the public is continuously informed about its benefits and limitations."

The content of principle 10 is set out in 8 points, which describe the responsibilities and the necessary actions of deposit guarantee schemes regarding public awareness, so that the deposit guarantee system is effective.

Below we will focus on the main points of the IADI document: Enhanced Guidance for effective deposit

insurance systems: Public Awareness of deposit insurance systems, Guidance Paper, November 2012. The document is called "New /enhanced/ guidance", unlike only the "Guidelines" of 2009, and represents an update and development of the issues in this area, incl. based on the experience of the global financial crisis.

The "Guidelines" first provide an overview of the importance of public awareness of deposit guarantee schemes. Familiar arguments are made for the importance of these systems in building confidence in deposit insurance and hence in banking system, which is linked to the more general question of consumer protection because like customers of other consumer services, the bank customer, the depositor, has the right to be informed and familiar with the status of his accounts - the guaranteed and, accordingly, the non-guaranteed part of them. From this point of view, there is a shift in the focus of public awareness campaigns from protected deposits in the narrow sense to the assistance in creating and maintaining a sound banking practice for the protection of depositors.

More specifically, the "Guidelines" deal in detail with the organization of an effective public awareness campaign, which is understood not as a one-time act, but as an ongoing important activity of deposit guarantee schemes. Again, the strong argument of this approach can be pointed out, namely the drive for prevention, where payments by the schemes would be saved if the public knew and responded adequately to the functioning of the financial safety net.

According to the “Guidelines” the main points of an effective public awareness campaign should include development of a long-term strategy and plan to reach a certain level of public awareness; target audience; participating parties; content; communication tools; frequency and time selection for the campaign; budget and resources and evaluation of the effectiveness of the campaign. According to the "Guidelines" only 9 of all Financial stability board member countries stick to these main points as these countries are Canada, Hong Kong, Indonesia, Japan, South Korea, Russia, the UK and the US. A key issue is the necessity of specific communication plans for different scenarios, e.g. change of limit of coverage, change in legislation, failures, cross-border issues (South African Reserve Bank, 2022).

Within the EU, attention is paid to several of the already discussed problems of public awareness, but also from the point of view of the global internal market of the community. In addition to the main questions concerning the operation of deposit guarantee schemes, the Impact Assessment document of the proposal for a directive on deposit guarantee schemes (Impact assessment) gives examples of the unsatisfactory level of public awareness of the schemes. The unsatisfactory level of public awareness results in depositors that are not informed about the provided degree of protection, which is very dangerous in crisis situations as it may cause bank panic.

The Impact Assessment document (2010) cites an interesting case study of public awareness in the UK. According to the data of the survey, very few of the respondents knew the name of the deposit guarantee scheme in the country - FSCS (Financial Services Compensation Scheme), and few of the richer respondents indicated the amount of the guarantee to 30-35 thousand pounds. All Northern Rock bank customers knew the guarantee was £35,000 but did not know the name of the FSCS. None of the respondents knew anything more about the scheme, e.g. how it works and how it is funded. Most assumed that the scheme was government or some form of private insurance.

Public awareness is a key factor in the effectiveness of the financial safety net. One possible interpretation of the term "DGS efficiency" is that the system is configured and operated in such a way as to create peace of mind and confidence among depositors, so that they do not succumb to bank panic and withdraw their deposits unnecessarily, this leading to bankruptcies and blocked payments by the system. From a public point of view, it is the cheapest approach, because it saves the indirect financial burden on those same depositors, on whom the banks ultimately transfer the contributions paid by them in the deposit guarantee scheme.

The interpretation of the problem of "Public awareness" intersects with behavioural finance, which is of

an interdisciplinary character. Behavioural economic theory, of which behavioural finance is a part, studies the influence of psychological, social, cognitive, and emotional factors on the economic decisions of individuals and institutions, as well as their consequences for market prices, incomes, and the allocation of resources. Behavioural theory is mainly concerned with the limits of rationality of economic agents.

Contrary to the banks, non-bank investment intermediaries do not have maturity mismatch short-term liabilities and long-term and illiquid assets (Baran et al., 2012). Non-bank investment intermediaries can liquidate their assets quickly and at fair market value. Clients of non-bank investment intermediaries have in fact proprietary claims (attached to specific property) in case of investment intermediary failure contrary to the bank clients who have personal claims (his/her own deposit). That peculiarity is a key feature that differentiates the functioning of the deposit insurance and investor compensation schemes.

### 3. Questionnaire results

The investigation on the public awareness is based on a questionnaire developed by the authors of the paper. The questionnaire was distributed online and offline in the period from May 2023 till July 2023 among randomly chosen people. The results of the survey are given in number of respondents in the figures. The questions are in the following main areas: scope of the guarantee and guaranteed limits provided by the deposit insurance and investor compensation schemes, institutional organization of both schemes, payment deadlines in case of deposit insurance and investor compensation events, actions undertaken by the depositors in case of possibility for scheme activation, public perception of the capital market. The analysis of the results of the questionnaire will be presented in two parts: part one – analysis of the results related to the deposit insurance scheme and part two – analysis of the results related to the investor compensation scheme.

**Deposit insurance scheme.** The deposit insurance scheme in Bulgaria was established earlier (in 1999) compared with the investor compensation scheme (in 2005). Since its creation the deposit insurance scheme has paid deposits to the clients of four banks – Credit Bank in 1999, Bulgarian Universal Bank (2001), International Bank for Trade and Development (2005) and Corporate Commercial Bank (2014). In 1996-1997 there was a huge bank crisis that led to the failure of one third of the Bulgarian banks. Nevertheless, since its creation the scheme paid the deposits of Credit Bank and Bulgarian Universal Bank because of this huge bank crisis. Paying out of the guaranteed deposits started at the beginning of March 1999 and finished in the end of December 2004 as a total amount of guaranteed deposits of 8,942 mln. BGN were paid to 9 839 depositors. Paying out of deposits of Bulgarian Universal Bank started at the end of June 2000 and it finished at the end of June 2005. The total amount of deposits paid out to the clients of BUB was 190,135 thousand BGN to 137 depositors. Paying to depositors of International Bank for Trade and Development started at the end of September 2005 and it ended at the end of September 2010 as a total amount of deposits at the value of 24,751 mln. BGN were paid to 4010 depositors. A significant challenge in the activities of the deposit insurance fund was the failure of Corporate Commercial Bank, the fourth biggest bank in the country until its bankruptcy in 2014. Payment of the guaranteed deposits started at the beginning of December 2014 and ended at the beginning of December 2019. The total amount of the guaranteed deposits paid was 3,687 bln. BGN to 112 021 depositors. When the insolvency of Corporate Commercial Bank was announced we witnessed a mini bank panic in the country leading to massive deposit withdrawal from that bank and from other banks with Bulgarian ownership despite the existence of the deposit insurance scheme in the country and higher limit of coverage equaling to 196 thousand BGN. Deposit payments as a result of Corporate Commercial bank insolvency were performed under the provisions of the old Law on Deposit Insurance (since 2014 a new Law on Deposit Insurance was adopted implementing the regulations of Directive 2014/49 on deposit insurance schemes). Under the previous Law deposits with preferential interest rates fell under the exclusions from deposit insurance payments. As the deposits of many physical and legal persons were negotiated under preferential interest rate conditions and for that reason were not subject to deposit payments this topic was widely discussed in the media and the general public was made aware of it. After the adoption of the new Law on Deposit Insurance in 2014 and in conformity with the requirements of Directive 2014/49 on deposit insurance schemes,

the deposits under preferential interest rate conditions were included in scope of the deposit protection. The main reason for including these deposits in the scope of protection is that if they are excluded, it takes time to identify the holders of such accounts to verify their eligibility, which in turn creates conditions for delaying the payment of guaranteed deposits.

Considering the activities and establishment of both schemes the Bulgarian public is much more aware of the activities of the deposit insurance scheme, also taking into consideration the higher familiarity of the Bulgarians with deposit products rather than with the investment products. The failure of Corporate Commercial Bank was also a good lesson regarding the financial safety net as the huge number of depositors were affected by that bank failure and the deposit insurance scheme paid out deposits to 112 021 depositors at the amount 3,687 bln. BGN.

The questions that were included in the questionnaire regarding the deposit insurance scheme include guaranteed amount, deadline for payments, deposit insurance fund, information that should be provided to the banks' clients regarding deposit insurance, as well as the behaviour of the depositors. The questionnaire is held in a period where no deposit insurance or investor compensation events are carried out. The questionnaire is presented in Appendix 1. The results of the questionnaire show the following:

More than half of the respondents are familiar with the maximum amount of guarantee provided by the deposit insurance scheme (59%) - equal to 100 000 EUR. The minimum level of protection that was provided by Directive 94/19 / EC on deposit guarantee schemes provided a minimum level of protection up to 20 000 EUR. This level of protection has been implemented since the beginning of 2007 when the country joined the EU and it was valid until 2008 when the level of protection was unified for the EU, equaling to 50 000 EUR. The current maximum level of protection up to 100 000 EUR has been in force since 2010. Regarding the level of protection, the Bulgarian deposit insurance scheme follows the EU legal framework on deposit insurance schemes. The previous minimum level of protection of 20 000 EUR was pointed as provided guarantee only by 6% of the respondents and 26% of the respondents pointed out as a maximum level of protection 50 000 EUR – that level of protection has been effective only for one year in the period 2008-2009.

57% of the respondents answered correctly that the deposit protection provided refers to the total amount of the client's deposits in a certain bank. The majority of the respondents provided wrong answer to the questions regarding the deadline for deposits' payments by the deposit insurance scheme in case of bank's insolvency – 40% of the respondents answer that the deadline for deposits' payments is 30 days. Only 26% provided the correct answer, that is 7 days. Before the implementation of the new deposit insurance directive in 2014 - Directive 2014/49/EU – the deadline for payments was 30 days.

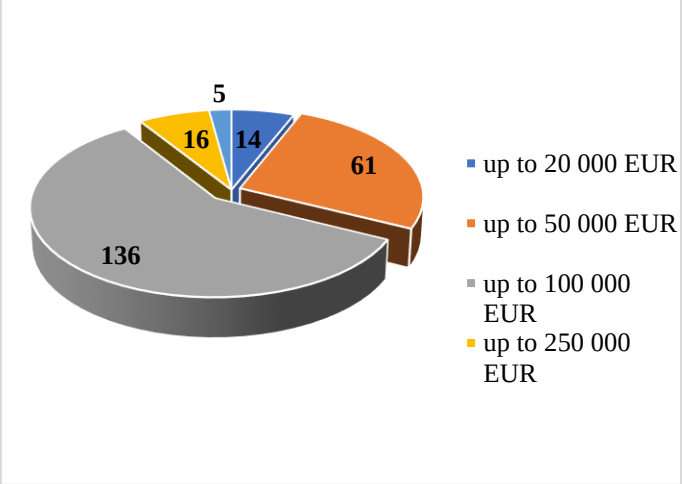



**Fig. 1 Structure of respondents according to their view on the amount of the deposit guarantee provided by the Bank Deposit Guarantee Fund (Q1 of the questionnaire in Appendix 1) (count)**

*Source: Compiled data by the authors based on the questionnaire in Appendix 1.*

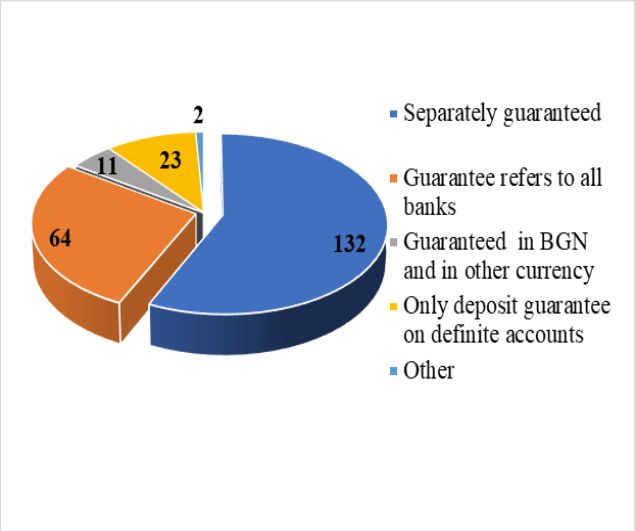



**Fig. 2 Structure of respondents according to their view on how the deposits in different banks are guaranteed (Q2 of questionnaire in Appendix 1) (count)**

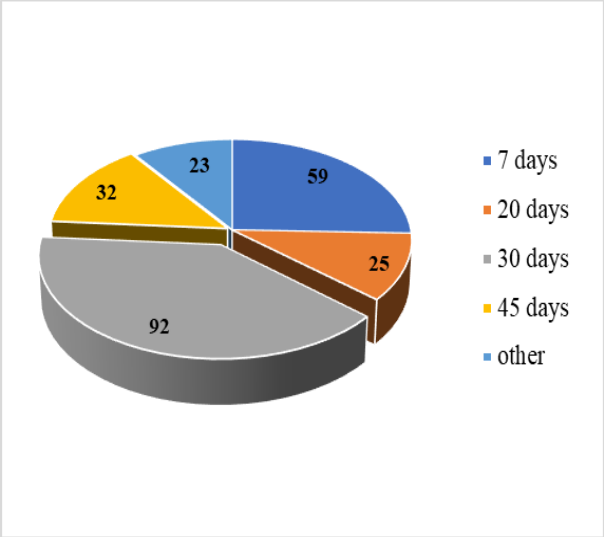
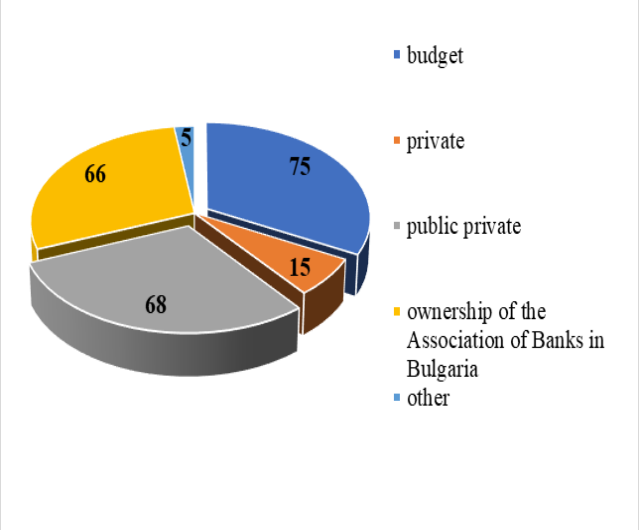



**Fig. 3 Structure of respondents according to their view on what is the deadline for payments of guaranteed deposits by the deposit guarantee scheme in Bulgaria (Q3 of questionnaire in Appendix 1) (count)**

*Source: Compiled data by the authors based on the questionnaire in Appendix 1.*

A small number of respondents knew what type of organization the Deposit insurance fund is – 33% of the respondents answered that the Fund is a budget organization, 30% answered correctly that the fund is a public private organization and 29% responded that DIF is an organization that is owned by the Association of Banks in Bulgaria. These results are somehow expected due to the wrong references in publications and in the media regarding the comments with the situation of Corporate Commercial Bank where it was stated that the guaranteed deposits affected directly the state budget.

The requirement for the banks to provide information to depositors about the deposit insurance was realized by 57% of the respondents. Only 4% considered that banks are not required to provide any information about deposit insurance to the depositors and 21% thought that such information should be provided by the banks in case the depositor asked for such information.



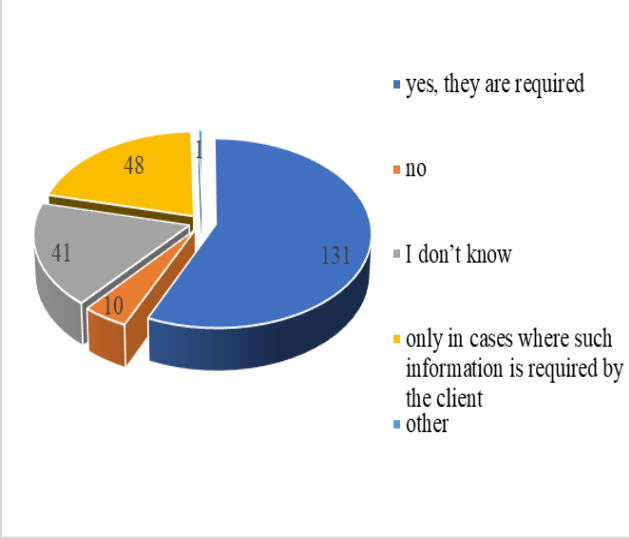
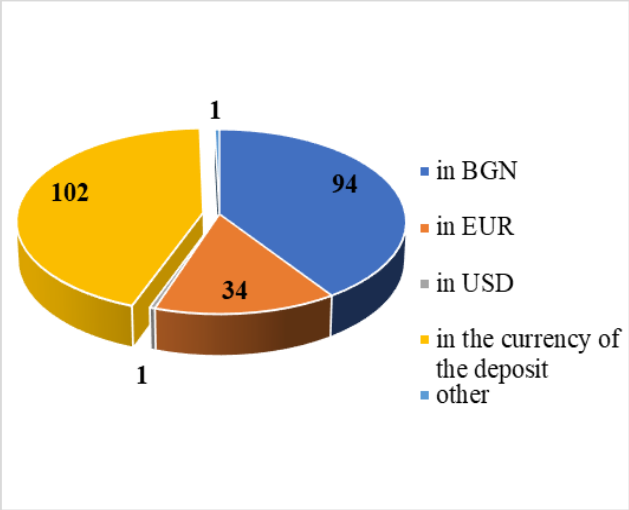



**Fig. 4 Structure of respondents according to their view on what type of organization is the deposit insurance scheme in Bulgaria (Q4 of questionnaire in Appendix 1) (count)**

**Fig. 5 Structure of respondents according to their view on whether the banks are required to provide depositors with information on deposit insurance (Q5 of questionnaire in Appendix 1) (count)**

*Source: Compiled data by the authors based on the questionnaire in Appendix 1.*

Many of the respondents – 44% answered that in case of a deposit insurance event the deposit insurance scheme pays out deposits in the currency they are made, e.g. BGN, EUR, USD, etc. Smaller number of respondents – 41% provide the correct answer, which is that in case of a deposit insurance event the deposits are paid in BGN as deposits in foreign currency are denominated in BGN by applying the official exchange rate announced by the BNB at the day the credit institution is declared insolvent. 15% of the respondents answered that deposits are paid in EUR. Both deposits to physical persons and legal entities are guaranteed by the deposit insurance scheme and this correct answer is provided by 62% of the respondents. Only 29% of the respondents answered that the protection is provided only to legal persons, which is probably due to announcements that the financial safety net is mainly directed to retail depositors and investors.



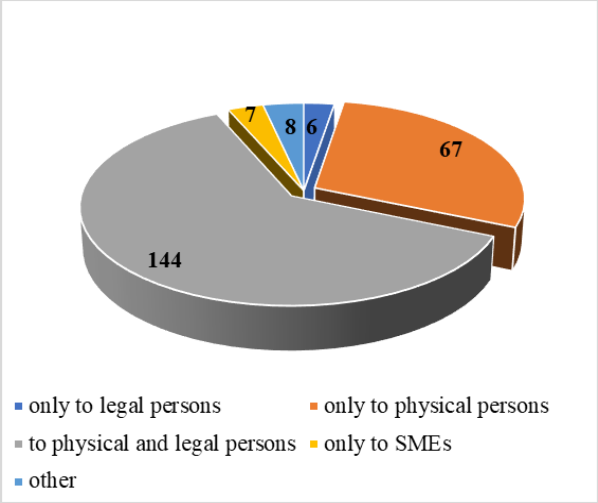




**Fig. 6 Structure of respondents according to their view on the currency in which the guaranteed deposits are paid out (Q6 of questionnaire in Appendix 1) (count)**

**Fig. 7 Structure of respondents according to their view on the types of deposits guaranteed by the Bulgarian deposit insurance scheme (Q7 of questionnaire in Appendix 1) (count)**

*Source: Compiled data by the authors based on the questionnaire in Appendix 1.*

There are two questions investigating depositors' behavior regarding the perception of the deposit insurance scheme. One of these questions refers to the possible activities to be undertaken by depositors in case they hear rumours that their bank is going to fail. 42% of the respondents answer that they are going to withdraw their deposits from the bank despite the existence of a deposit guarantee scheme and only 7% answer that they are going to leave their deposits at the bank. This answer indicates mistrust in the scheme which is probably related to the experience with Corporate Commercial Bank where the depositors had to wait more than six months to have their deposits paid due to the period of a special conservatorship that was applied by the Central Bank before the activation of the deposit insurance scheme. This was a special provision in the Law on Deposit Insurance Fund before the current amendments and it was not related to the activation of the deposit insurance scheme and timing of deposits payments. To avoid such a behavior of deposits withdrawals more campaigns are necessary pointing out the provided protection, limit of guarantee and timeline for paying out in case of events of bank failures. The time for deposits paying has been shortened to 7 working days – compared to the previous version in the Deposit Insurance Directive where the deadline for payments was 45

days. In the last years the financial safety net evolved intensively taking into consideration the development of a framework for resolution and restructuring and the concept that systemically important banks are going to be resolved rather than bankrupted. That concept in case it is properly conducted to the general public can also affect the behavior of the depositors, e.g. in case of disturbances with a systemically important bank it would be believed that the bank is going to be bailed out rather than bankrupted and retail depositors are going to have their money safe up to the guaranteed minimum of 100 000 EUR. 11% of the respondents answered that they are going to wait in cases of rumors for bank's failure and 38% are going to act wisely and withdraw the amount above the guaranteed limit.

The last question investigates the different options for depositors what to do with the money that has been withdrawn from the bank. More than half of the respondents – 58% answered that they are going to keep the money in a safe and 30% answered that they are going to deposit their money at another bank. Only 7% answered that they are going to invest their money in the capital market. Those answers are not surprising considering the Bulgarian market. The most preferred option is in fact to keep the withdrawn funds in cash which can be perceived as an indication for mistrust in the banking and financial system. The second option that is chosen – depositing in another bank – indicates that Bulgarians do not see alternatives to the products and services provided by the banks. Investments on the capital market are hardly perceived as an alternative to bank deposits. The issue of mistrust and moral hazard is also a key in the creation of European Deposit Insurance Scheme (EDIS) that aims to complete the Banking Union. The creation of EDIS has been put for discussion since 2015 but currently there is no development on its creation and strong opposition by Germany and the Netherlands. Germany opposes the creation of EDIS because it does not see any guarantees that stable banks are not going to support the weak ones and it will support EDIS only when adequate measures for decreasing public debt are being undertaken as the banks usually invest in sovereign bonds of the local governments.

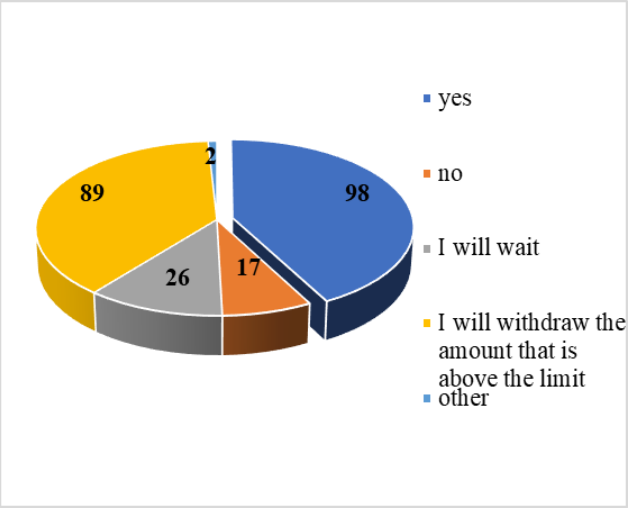



**Fig. 8 Structure of respondents according to their view on whether they will withdraw their deposits, if they hear rumors that their bank is going to fail despite the existence of a Deposit Guarantee Fund (Q8 of questionnaire in Appendix 1) (count)**

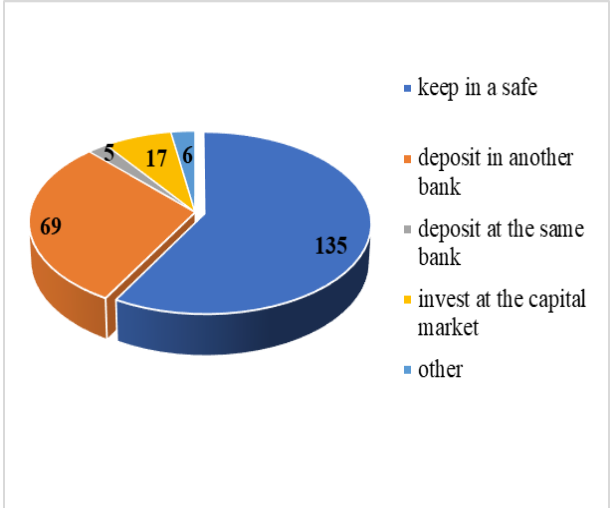



**Fig. 9 Structure of respondents according to their view on what the Bulgarians will do if they do decide to withdraw their money from the bank? (Q9 of questionnaire in Appendix 1) (count)**

*Source: Compiled data by the authors based on the questionnaire in Appendix 1.*

**Investor compensation fund.** The Bulgarian investor compensation scheme, i. e. the Investor compensation fund (ICF, Fund) was established with the adoption in May 2005 of the Law on Amendments and Supplements to the Public Offering of Securities Act as a protection scheme on the capital market. The activity of the Fund is fully synchronized with the requirements of Directive 97/9 of European Commission

on the investor compensation schemes. The Bulgarian legislation regarding the instruments, activities and participants on the capital market strictly follows the EU requirements as they are set in Markets in Financial Instruments Directive II (MiFID II) and Markets in Financial Instruments Regulation (MiFIR) which also contains provisions aiming to enhance the investor protection. Since the end of 2022 MiFID and MiFIR have been under review as new drafts of MiFID III and MiFIR II have been created. Investor protection is also in the scope of MiFID III where more detailed provisions for enhanced retail investor protection have been developed, e.g. requirements for investment companies to provide retail investors with comprehensive information about the risks associated with complex products and services. Despite these provisions in the relevant capital market legislation the existence of investor compensation scheme boosts to the capital market confidence and stability and makes it more attractive for the retail investors.

The main function of the Investor compensation fund is to provide protection to the clients of investment intermediaries by paying compensation in cases where the investment intermediary is unable to fulfil its obligations to clients due to reasons related to its financial condition. This refers to the cases in which the intermediary is bankrupt, or the Financial Supervision Commission has revoked its license. The limit of compensation provided by the Fund has been changed several times, and since 2010 it has been BGN 40 000 up to 90% of the value of client assets. Limiting the coverage to 90% of the amount of the claim means that part of the risk is borne by the client and in case of bankruptcy of an investment intermediary, the Fund will pay 90% of the claim.

The Fund does not protect the clients of investment firms from the risk associated with an unfavorable movement in the prices of financial instruments. This scheme only indirectly helps to maintain confidence in the capital market, as clients know that their assets held by investment firms will be returned to them by the scheme. However, the scheme is not responsible for the current value of the assets – in a market crash they can turn out in the extreme case to be titled with zero value.

Since the establishment of the Fund, there have been only four cases of triggering the compensation payment procedure, and only in two of the cases the Fund paid compensations in the total amount of EUR 142 000. In the remaining two cases, the Fund did not pay compensation due to the fact that the relevant investment intermediaries were able to recover the client's assets (Investor compensation Fund, Annual report 2020).

The activity of the Investor compensation fund has its specifics compared to the activity of the deposit guarantee scheme. First, the nature of the risk is different compared to the risk for bank depositors. Second, the scope of the protection scheme in the capital market is smaller than in banks, where the population holds most of its savings. This dependence applies not only to Bulgaria, but also to all other countries. According to the BNB data, the assets of the banking system at the end of March 2024 are about BGN 176.3 billion or about 81,8% of the assets of the financial sector in our country (FSC, 2023, Association of Banks in Bulgaria, 2024). Third, unlike the banking system, there is no lender of last resort in the capital market, except the state by exception, which would intervene in some extreme circumstances. Fourth, in principle, deposit guarantee schemes in banks are built and operate more simply and transparently, as they guarantee clearly and precisely certain amounts owed by banks to customers, which are paid out in the event of bankruptcy of the respective bank. In case of bank failure, deposits are paid by the deposit guarantee scheme in the same denomination, there is no risk of losing their value (for the moment we are abstracting from the possible inflation for the term of the deposit, and it could also compensate - fully or partially - with the received interest). This is not the case with the investor compensation scheme, where the investment is not paid out at face value, but at the market value of the assets at the relevant date. That means that the Investor compensation fund assesses the client's assets, which also predetermines the significantly longer period for receiving compensation from the Investor compensation scheme.

And while in terms of the deposit insurance the awareness of participants in the survey is above average, in terms of compensating investors on the capital market, things are well below average, one could even say that such awareness is lacking at all.

The questions that were included in the survey about the Investor compensation fund are a total of 4 and

they refer to basic aspects of its activity.

When asked what they know about the Investor Compensation Fund, more than half of the respondents (61%) said they did not know such a Fund existed or they had only heard of its existence. Not a small percentage of the respondents (46%) do not know what the purpose of this Fund is, and it is quite debatable whether the remaining 54% know for sure (see Fig. 11).

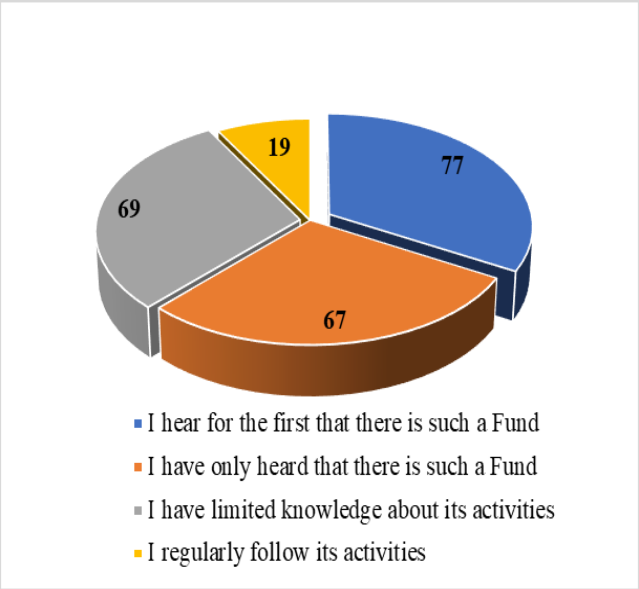



**Fig. 10 Structure of respondents according to their knowledge about the Investor compensation fund (Q10 of questionnaire in Appendix 1) (count)**

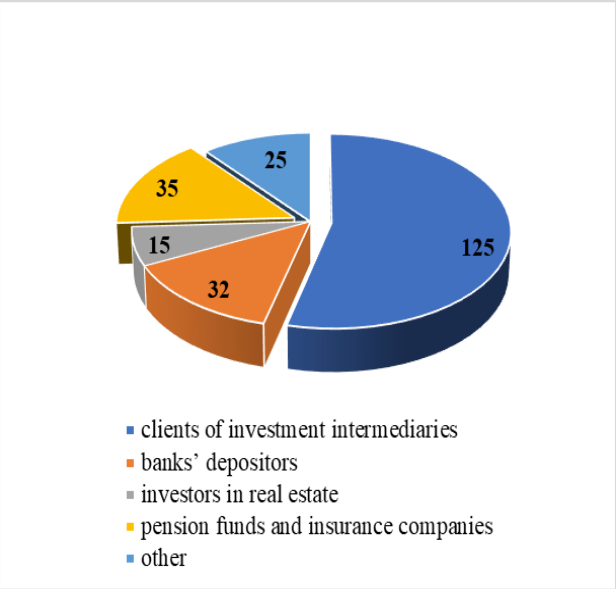



**Fig. 11 Structure of respondents according to their knowledge on the protection provided by the Investor Compensation Fund (Q11 of questionnaire in Appendix 1) (count)**

*Source: Compiled data by the authors based on the questionnaire in Appendix 1.*

A very small percentage of respondents (15%) know what the amount of compensation provided by the Investor compensation fund is, and it is noted that 52% directly answered that they do not know. More than 50% do not know when they have the right to receive compensation from the Fund, as 22% of them believe that the Fund covers the risk of losses from the investment itself (see Fig. 13).

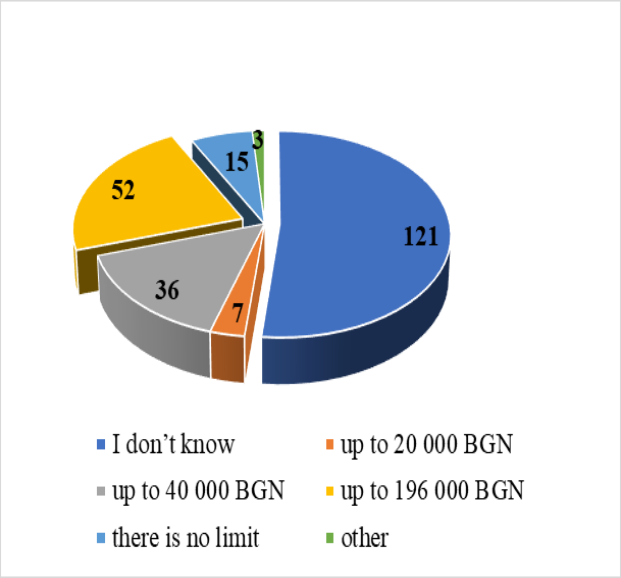



**Fig. 12 Structure of respondents according to their view on the amount of compensation provided by the Investor Compensation Fund (Q12 of questionnaire in Appendix 1) (count)**

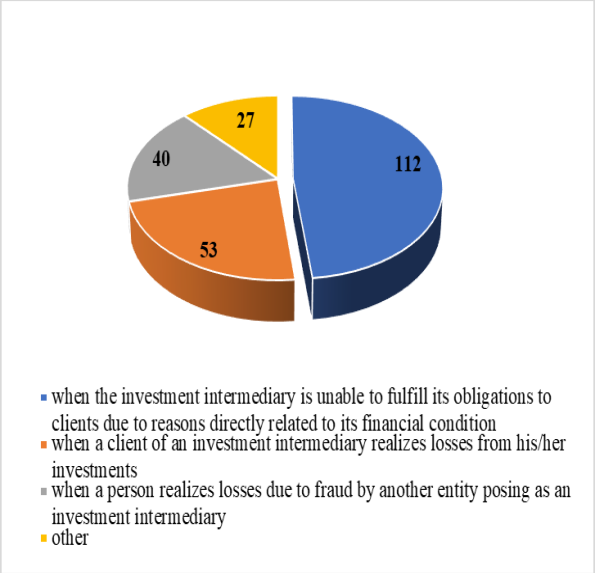



**Fig. 13 Structure of respondents according to their view on when do clients of an investment firm are eligible to receive compensation from the Investor Compensation Fund (Q13 of questionnaire in Appendix 1) (count)**

*Source: Compiled data by the authors based on the questionnaire in Appendix 1.*

In general, based on the conducted survey, it can be concluded that the public is not familiar with the activity of the Bulgarian investor compensation scheme, a trend that is observed not only in Bulgaria.

Also, the results of the conducted survey force the conclusion that it is necessary to conduct a more effective and extensive information campaign both in terms of guaranteeing deposits from the Bulgarian deposit guarantee fund and in terms of the protection of investors on the capital market.

Very often, when filling out the survey, the respondents answered that they could not know everything. Our opinion on this matter is that the awareness of depositors and investors in the capital market about the conditions and procedures in the guarantee of deposits and in the protection of investors in the capital market is of primary importance for the stability of the banking system and the capital market, since precisely awareness and trust predetermine the behaviour of depositors and investors at the smallest doubts and rumours of problems in a given bank and/or investment intermediary and in the financial system as a whole. In the summer of 2014, we witnessed a bank panic that affected several banks, two of them in particular. In the end, this "mini" bank crisis led to the failure of one bank and the provision of liquidity support to the other bank. The main reason for these events was precisely the massive withdrawal of deposits, which was caused by mistrust, lack of information and the fear of losing savings.

## Conclusion

The awareness of depositors and investors about the benefits and limitations of the deposit guarantee scheme and the investor compensation scheme is important for increasing confidence in the capital and banking market and for the effective functioning of the schemes themselves. It is awareness and trust that predetermine the behavior of consumers on the capital market and on the banking market.

Consumers have better information about the deposit insurance scheme, and they have sufficient knowledge about the level of protection provided by DIF and the information that should be provided by the banks on the clients' protection. However, consumers lack knowledge about the deadlines for deposit payments in cases of bank failures, structure of the DIF and the currency in which the deposits should be paid. These results can be explained somehow with the practical experience from the events of bank failures that were

witnessed in the country and media publications. The results of the research show that despite the mistrust in the banks in cases of banks' failures consumers do not see alternatives to deposits and do not turn to capital market. Contrary to the deposit insurance scheme consumers are rather unfamiliar with the activities and protection provided by the investor compensation scheme in the country. The respondents do not have information about the existence of the ICF, its purpose and the amount of compensation that is paid in case of compensation payments events.

The results of the research provide information that the efforts of the regulators and financial safety net schemes should be and it is to increase the awareness of depositors and investors in Bulgaria about the benefits and limitations on both investor compensation scheme and deposit guarantee scheme, to boost confidence in the capital market and to increase the level of financial literacy in the country. This knowledge can be used as a basis for future campaigns by the financial safety net as well as at policy level for increasing financial literacy in the country.

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**Appendix 1**

## QUESTIONNAIRE – PUBLIC AWARENES – FINANCIAL SAFETY NET

1. **What is the amount of the deposit guarantee provided by the Bank Deposit Guarantee Fund?**
   a/ up to 20 000 EUR
   b/ up to 50 000 EUR
   c/ up to 100 000 EUR
   d/ up to 250 000 EUR
   e/ other

2. **If a depositor has deposits in different banks, how are these deposits guaranteed?**
   a/ Deposits in each bank are guaranteed separately, e.g. up to the maximum amount for each bank
   b/ The amount of the guarantee refers to all banks
   c/ The amount of the guarantee is divided by deposits in BGN and deposits in other currency
   d/ Only deposits on definite accounts are guaranteed
   e/ Other

3. **What is the deadline for the payment of guaranteed deposits by the Bank Deposit Guarantee Fund?**
   a/ 7 days
   b/ 20 days
   c/ 30 days
   d/ 45 days
   e/ other

4. **What type of organization is the Bank Deposit Guarantee Fund?**
   a/ budget
   b/ private
   c/ public private
   d/ ownership of the Association of Banks in Bulgaria
   e/ other

5. **Are banks required to provide depositors with information on deposit insurance?**
   a/ yes, they are required
   b/ no
   c/ I don’t know
   d/ only in cases where such information is required by the client
   e/ other

6. **In what currency are guaranteed deposits paid out?**
   a/ in BGN
   b/ in EUR
   c/ in USD
   d/ in the currency in which the deposit is made
   e/ other

**7. What types of deposits does the Bank Deposit Guarantee Fund guarantee?**

a/ only to legal persons
b/ only to physical persons
c/ to physical and legal persons
d/ only to SMEs
e/ other

**8. If you hear rumors that your bank is going to fail, will you withdraw your deposits, despite the existence of a Bank Deposit Guarantee Fund?**

a/ yes
b/ no
c/ I will wait
d/ I will withdraw the amount that is above the limit
e/ other

**9. What do you think the Bulgarians will do if they do decide to withdraw their money from the bank?**

a/ They keep them at home or in a safe
b/ they deposit them in another bank
c/ they deposit them at the same bank
d/ they invest them at the capital market
e/ other

**10. What do you know about the Investor Compensation Fund?**

a/ I hear for the first that there is such a Fund
b/ I have only heard that there is such a Fund
c/ I have limited knowledge about its activities
d/ I regularly follow its activities
e/ other

**11. Who does the Investor Compensation Fund protect?**

a/ clients of investment intermediaries
b/ banks' depositors
c/ investors in real estate
d/ pension funds and insurance companies
e/ other

**12. What is the amount of compensation provided by the Investor Compensation Fund?**

a/ I don't know
b/ up to 20 000 BGN
c/ up to 40 000 BGN
d/ up to 196 000 BGN
e/ there is no limit
f/ other

**13. When do clients of an investment firm receive compensation from the Investor Compensation Fund**

a/ when the investment intermediary is unable to fulfill its obligations to clients due to reasons directly related to its financial condition

b/ when a client of an investment intermediary realizes losses from his/her investments

c/ when a person realizes losses due to fraud by another entity posing as an investment intermediary

d/ other