



Protecting Your Deposits

# Deposit Protection Scheme

## Highlights

### ATTRIBUTES OF A DESIRABLE DEPOSIT INSURANCE SYSTEM

The advances in financial liberalization and globalization demand an appropriate deposit protection scheme that takes into account the new economic and financial environment, more so, since it will become increasingly more difficult for the government to operate an implicit deposit protection scheme (DIS) in the changing environment.

#### Desirable Deposit Insurance System

DIS systems must therefore also evolve to stay in touch with these new trends and developments to strengthen the competitiveness of the financial industry and make financial intermediation more efficient. Following the global financial crisis of 2007-2009, the "too big to fail" policy was viewed as counterproductive and that large banks should be left to fail if their risk management is not effective. Some effort was made to minimize their failure by improving individual components of the new regulation for systemically important banks (additional capital requirements, enhanced supervision and resolution regimes). In the event that a big bank fails, a DIS must be designed to minimize the social costs involved.

The DIS must be able to minimize the moral hazard of financial institutions pursuing high-risk, high-return investments. Some believe that DIS actually create moral hazard and result in the insolvency of financial institutions and the instability of the financial system. The task is to design a deposit protection scheme that can minimize this problem.

The DIS must gain the confidence of depositors to reduce the social costs arising from lack of confidence. Without a DIS, depositors would have to protect their deposits themselves.

DIS should allow depositors to transact freely with financial institutions, reducing the social costs involved. Losses arising from the insolvency of a financial institution must be shared equally by financial institutions, depositors, the government and the general public, according to the size of their deposits and the level of prudence exercised by each financial institution.

#### Status and Functions of a Desirable Deposit Insurance System

The establishment and maintenance of public DIS also seem justified in view of the forces of financial market liberalization, globalization, integration and privatization that have taken place in the world. DIS must be given powers and rights to resolve financial institution insolvencies swiftly, professionally and at the least cost. The financial burden on depositors, financial institutions and taxpayers is thus minimized.

In the absence of seed capital, the deposit insurance system could get initial funding to operate the scheme from government or borrow from the market or central bank. The deposit protection agency will repay loans after a certain period from contributions made by contributory institutions.

For more information on the Deposit Protection Scheme contact:

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