THE ROLE OF DEPOSIT INSURANCE IN PROMOTING FINANCIAL INCLUSION

Introduction

Financial exclusion plays a key part in the creation and amplification of poverty via limitation of the extent to which the poor and/or marginalized communities access to financial services. Broadly, a person is considered financially excluded when he/she is not able to access some or all the services offered by mainstream financial institutions in his/her country of residence due to problems associated with access, conditions, prices, marketing or self-exclusion.

Banking institutions have often argued that it is too expensive to invest in traditional infrastructure in the form of brick and mortar branches, which are required to reach the underserved population segments due to high transaction costs and huge set up costs. In most cases, the physical infrastructure in form of the road network, electricity, and telephone services is often sparse, dilapidated if not dysfunctional. The advancement in technology especially mobile telephones and electronic money has allowed the development of branchless banking as it helps people to have access to financial services at lower cost.

What is Financial Inclusion?

Financial inclusion or inclusive financing is the delivery of financial services at affordable costs to sections of disadvantaged and low-income segments of society. The main goal of financial inclusion is to improve the range, quality and availability of financial services and products to the unserved/under-served and financially excluded. It can also be defined as the ability of an individual, household, or group to access appropriate financial services or products.

Deposit Protection and Financial Inclusion

Deposit protection schemes promote financial inclusion via protecting a majority of the depositors, leveling the playing field, promoting confidence in formal financial institutions and by affording broad access to safe and affordable small savings accounts, and complementing other financial safety net players as discussed hereunder:

1. Protecting the Majority of Depositors

A Deposit Protection Scheme (DPS) provides assurance or a guarantee to depositors that they will receive their deposits in part or in full in the event of a bank failure. A key measurement of the effectiveness of a DPS, as articulated in most deposit insurers' public policy objectives, is the percentage of depositors fully covered by the Scheme, that is, those with deposits equal or below the protection limit.

Acceptable benchmarks on the international arena provide for covering 90% of the deposits by number. Operationally, this means that, depositors with deposits less than the coverage limit will be paid in full. Excess balances over and above the coverage limit are recoverable via the liquidation process on a pro-rata basis

In practice, the coverage limit, by design, takes care of interests of the unsophisticated depositors, who are frequently incapable of knowing the true nature of the condition and performance of a banking institution due to lack of skills and resources as well as opaqueness of the information.

As a matter of principle, establishment of a Deposit Protection Scheme catering for both individual and well to do corporate clients, as opposed to a Scheme for small depositors alone, also reduces incidences of deliberate financial exclusion.

2. Building Confidence in Financial Institutions

Deposit protection promotes financial inclusion by fostering confidence in financial institutions and potentially leading to greater savings among the poor provided they are informed about safe places to store their money.

A Deposit Protection Scheme provides peace of mind and security to depositors in knowing that their deposits will be reimbursed in the event that their contributory institution becomes illiquid or insolvent.

Deposit protection reduces financial uncertainty, thereby building confidence in the financial system and enhances financial intermediation on a nationwide basis, thereby promoting financial inclusion.

3. Promotes Competition in Financial Sector

Traditionally, larger banks because of their size, track record and brand visibility have an edge over smaller banks in attracting deposits at lower interest rates.

Deposit protection makes depositors of smaller banks feel safe and protected hence neutralize the advantages that accrue to big banks.

Potential depositors may have greater trust in banks if they believe their savings are insured and this may lead to more individuals to open bank accounts.

4. Financial Literacy and Public Awareness

Most deposit protection systems carry out financial literacy and public awareness campaigns to raise awareness among the banked and unbanked public on the merits and limitations of deposit protection, deposits which are protected, coverage limits, types of providers and products are covered (or not), and safe methods of storing their money thereby promoting the use of the main stream banking.

Such campaigns are conducted through a variety of media channels, including internet, print, electronic, point of purchase, roadshows and billboards.

5. Compulsory Coverage of Financial Intermediaries

Membership to DPS is compulsory to any registered deposit-taking institution. Any depositor who banks with an insured deposit-taking institution is automatically covered, notwithstanding whether the depositor is sophisticated or not.

In some jurisdictions, deposit protection was extended to cover such financial intermediaries as credit unions, mutual funds, and informal and formal microfinance institutions and microfinance banks.

Extending protection to these institutions affords broad access to safe and affordable financial services and products to the marginalized and the unbanked public, thereby promoting financial inclusion.

6. Providing Protection to a wide range of Financial Products

Deposit insurers do insure financial innovations provided by members, as long as the financial innovation meets the definition of a covered deposit.

Extending protection to these financial institutions and products offers depositors peace of mind knowing that their money is protected and may allow the marginalized to have access to basic financial service especially through microfinance institutions.