DPS Promotes Financial Inclusion

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Financial exclusion plays a key part in the creation and amplification of poverty via limitation of the extent to which the poor and/or marginalised 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 under-served population segments due to high transaction costs and huge set-up costs.

In most cases the physical infrastructure in the form of the road network, electricity and telephone services is often sparse and dilapidated if not dysfunctional.

The advancement in technology especially mobile telephones and electronic money has thus allowed the development of branchless banking as it helps people to have access to financial services at lower cost.

A consumer survey conducted by Finscope for Zimbabwe in 2009 revealed that 36 percent of the adults are formally served including both banked, and other formal bank products or services.

About a quarter of the adult population (24 percent) are banked that is, they use financial products provided by a commercial bank regulated by the Reserve Bank whilst 22 percent of the adults have or use other informal banking institutions which are not regulated such as money lenders, cooperatives and savings clubs.

At least 41 percent of Zimbabweans have or use informal mechanisms for managing their finances. This means that about 41 percent of adults in Zimbabwe are financially excluded.

International Association of Deposit Insurers 2013 indicated that most of the unbanked public reside in Africa, Asia, Latin America and Middle East.

The Group of 20 in 2009 formally committed to focus on improving accessibility of basic financial services by the marginalised or poor as over 2 billion adults' world over do not have access to the formal financial services.

Accordingly, regulators and governments in most countries are addressing this problem through new channels and technology, including micro-finance institutions, branchless banking and electronic money.

Through these and other developments, increasing numbers of small depositors and low-income earners are gaining access to financial services in emerging economies.

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, levelling 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.

Protecting the Majority of Depositors

A deposit protection scheme provides assurance or a guarantee to depositors that they will receive their deposits in part or in full in the vent 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, i.e. those with deposits equal or below the protection limit.

Acceptable benchmarks on the international arena provide for covering 80 percent to 90 percent of the deposits by number and 20 percent by value.

Operationally, this means that, depositors with deposits less than the coverage limit will be paid in full and those with amounts above the limit will be under some sort of coinsurance whereby depositors are insured for a portion less than 100 percent of their deposits.

Excess balances over and above the coverage limit are recoverable via the liquidation process. 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.

Building Confidence in Financial Institutions

Deposit insurance 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 enhance financial intermediation on a nationwide basis, thereby promoting financial inclusion.

In some jurisdictions deposit insurers have a mandate to assist banks with liquidity or capital when the need arises.

Promotes Competition in Financial Sector

Deposit insurance contributes to financial stability and can promote competition in the 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 neutralise 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.

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 benefits 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, and billboards.

A study by Kendall et. al (2010) to measure financial access in 139 countries confirmed a positive relationship between deposit insurance and deposit account penetration.

Compulsory Coverage of Financial Intermediaries

Membership to DPS is usually compulsory to any registered banking institution. Any depositor who banks with an insured deposit taking institution 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 micro-finance institutions and micro-finance banks.

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

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.

For example, financial innovations such as mobile banking, agent banking, branchless banking, e-money, and pre-paid cards are covered by the deposit insurance system, provided these services are offered by members.

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

Complementary Financial Safety Nets and Regulatory Discipline

Establishment of deposit protection agencies with wide mandates such as risk minimisation or loss minimisation compliments the supervisory and regulatory framework via carrying out on-site, off-site and special examinations at contributory institutions.

While some may view such arrangements as duplication of effort, there is demonstrable evidence in some jurisdiction that such developments enhance alertness of the safety net players in several ways including: allowing safety net players to complement each other; enhanced regulatory objectivity, accountability and transparency; reduced opportunities for regulatory arbitrage, failure or capture and allows deposit insurers to mitigate risks on the protection front.

Conclusion

In conclusion, a DPS promotes financial inclusion. Financial exclusion carries risks and costs, including: risks to financial integrity, given that the cash-based world of the financially excluded is not transparent; and risks of social, political, and therefore ultimately financial instability.

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