Recent trends in protectionism

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Economic booms, financial crises and the effects of globalisation have resulted in many countries adopting deposit protection schemes with others changing the role of their respective deposit protection schemes.

The Financial Stability Board report (2012) noted that after the global financial crisis there were calls for, and greater convergence in deposit protection practices in most jurisdictions.

Substantial enhancements were made to deposit protection design features such as the elimination of coinsurance, introducing higher coverage limits, improvements in pay-out processes, adoption of ex-ante funding, greater depositor awareness, and strengthening of information sharing and co-ordination with other safety net participants.

Higher coverage levels

The financial crises of 1970s, 1980s and most recently the GFC of 2007/8 resulted in the insolvency of many financial institutions, and ultimately set in motion fundamental changes in the role of deposit protection.

The first major developments were on the coverage limit. The developed world, mainly European countries and United States of America, increased their coverage limit by 4,8 and 5,6 times of Gross Domestic Product per capita respectively.

In Asia the increase was around 26 times of GDP per capita. The overall increases in coverage limit were different across countries ranging from 75 percent to 400 percent. European coverage limit currently stands at 100 000 euros per individual while in USA is at US$250 000. These developments were mainly done to move away from the notion of protecting unsophisticated depositors to that of achieving financial stability taking into account the magnitude of the financial crisis.

Hoelscher (2011) indicated that the 100 000 euros and US$250 000 coverage limit for European countries and USA will cover 98 percent and 99,8 percent of depositors respectively by number and covers 60 percent and 78 percent respectively in terms of value, against the 80/20 scenario before the crisis. In theory, a higher coverage reduces the incentive for arbitrary depositor runs but should not be done at the expense of market discipline.

According to Choi (2004), Argentina abolished deposit protection in 1992 in favour of giving preference to the claims of small depositors to the assets of a bank in liquidation, but bank runs during the Mexican crisis forced it to announce a new system of deposit protection in April 1995 in order to include a financial stability mandate. The objective of only protecting small depositors is not effective during financial crisis as low coverage limit levels are normally inadequate to stabilise depositor expectations.

Elimination of co-insurance

Most jurisdictions have moved away from the concept of coinsurance where in the insurer and the insured depositor will apportion between them any loss covered by the policy according to a fixed percentage of the insured deposit. From a survey that was done during the GFC, it was noted that the presence of coinsurance was one of the factors that led depositors of Northern Rock, for instance, to indulge in pre-emptive runs. In practice, depositors are more likely to be risk averse during periods of systemic crisis.

Integrated Deposit Protection Scheme

Far reaching deregulation of financial markets over time have resulted in shifts from distinct banking, insurance and securities business to more integrated financial services offering many types of complicated financial products. Most jurisdictions in Europe, Africa and Asia have introduced Integrated Protection Schemes in response to such changes in the financial landscapes.

This has resulted in most deposit insures being given broader mandates to provide protection to insurance policyholders, depositors and investors in banks and non-bank financial institutions like asset managers and stockbrokers.

The Malaysia Deposit Insurance Scheme was extended to protect insurance policyholders and depositors effective 31 December 2010.

Following the Asian financial crisis in 1997, the Korea Deposit Insurance Corporation was also transformed into an integrated deposit insurer covering depositors, investors and policyholders. UK operates a scheme covering Insurance companies, Depositors and Investment companies.

From Paybox to Risk Minimisation Mandate

Traditionally, most deposit protection schemes were established as paybox functions with narrow mandates mainly to reimburse depositors in the event of bank failure. In recent times, several deposit insurers have had their mandates widened from paybox to loss minimiser, or paybox plus, or risk minimiser thereby, in the latter role, assuming an explicit financial stability mandate involving on-site and off-site prudential oversight responsibilities as well as assuming a full suite of resolution powers.

In Africa, Kenya, Zimbabwe, and Nigeria have their mandates widened to risk minimisation. Tanzania is waiting for the law to be passed.

Flat Premium Rate versus Risk Based Premium Rate

In recent years, the number of jurisdictions adopting risk-based premium regimes has been increasing. The overall objective of risk-based premium rate is to foster discipline among contributory institutions. A flat rate premium does not reflect the true level of risk-taking and in some instances encourages poor decision-making and moral hazard.

It should be noted that while not all bank failures are a result of moral hazard, risk-based deposit insurance provide better incentives to deter bank failures. This is because contributory institutions with higher risk levels are subjected to pay higher insurance premiums as they are likely to fail compared to sound banks.

Single Customer View Concept

One of the key deliverables of a deposit protection scheme is to ensure that depositors access their insured deposits promptly in the event of a bank failure. Historically, most deposit protection schemes faced the following challenges when making reimbursements: lack of access to depositor records in advance of a failure; poor quality of depositor records at banks; and inability of banks to provide depositor records within the desired time frames.

Given these limitations, some jurisdictions have pro-actively introduced new and faster payout systems and instituted mandatory reconfiguration of banking institutions' IT infrastructure to provide a single customer view perspective.

A Single Customer View is generally defined as an aggregated, consistent and holistic representation of data known by an organisation for a single depositor using unique identifiers.

An effective SCV intuitively provides for ready access to a reliable and consistent view of aggregate deposits for each eligible depositor per deposit-taking institution to facilitate faster payout in the event of a bank failure.

In the UK, for example, the Financial Services Compensation Scheme embarked on a mandatory program where all its members produce aggregated balance of a customer’s accounts across the bank within a period of 72 hours upon request.

In Mexico they developed a system that validates data layouts and content using the Depositor ID number (Unique Depositor Key Code) that picks all accounts that belong to one individual depositor.

In Malaysia and Hong Kong they rely on national identity documents and numbers of individuals and companies to aggregate deposits belonging to one individual depositor. From a deposit insurance system perspective, Single Customer View is defined as a holistic view of all deposit accounts eligible for deposit insurance coverage for a single depositor using unique identifiers.

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