



Deposit Protection as an Instrument for Financial Sector Development

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Outline of presentation

Introduction of GBDS

Role of KfW in establishing Deposit Protection schemes

Key information

Objectives

Best practice

Necessary framework

Main design features

Specifics when considering MFIs



GBDS is a consultation firm specialized in financial sector development

- founded in 2001 in Berlin
 - specialized in projects in the field of financial sector regulation and supervision as well as deposit insurance and credit bureaus
 - regional focus in Eastern Europe; also active in Africa and Asia
 - roughly 40 projects related to deposit insurance; involved in the implementation/development of DI in 10 countries
 - Managing Partner is Vice-Chairman of the European Forum of Deposit Insurers (EFDI)
 - working on behalf of the Kreditanstalt für Wiederaufbau (KfW), as well as other donors and governmental institutions
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The German KfW is involved with the implementation and further development of DI Schemes

KfW's Contribution to the Creation of Deposit Insurance Funds.



Deposit Insurance Systems

- Bosnia and Herzegovina
- Armenia
- Azerbaijan
- Montenegro
- ...

KfW's contribution

- Financial contribution (initial capitalisation)
- Technical Assistance (TA)

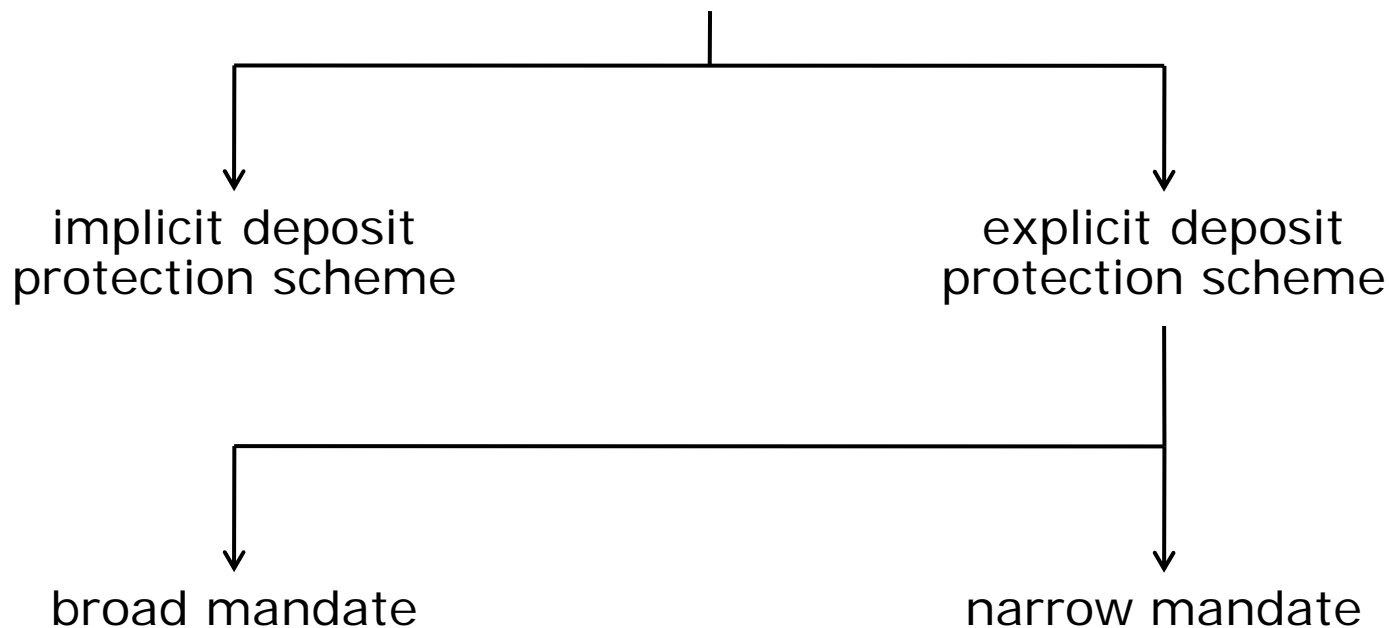
Decision Making Process:

- Formal Request
- Pre Feasibility Study
- Intergovernmental Negotiations
- Setting the Legal Framework
- Feasibility Study / Project Appraisal
- Loan & Financing Agreement
- Disbursement
- Monitoring / Final Evaluation



“Deposit Insurance/Protection” is a general term applied for various mechanisms or institutions

“The protection offered under a system of deposit insurance is a guarantee that all or a limited amount of the principal and the interest accrued on protected accounts will be paid¹”





It is essential to be familiar with core definitions used in this field¹

Deposit: to be defined according to bank law, in Europe according to Directive 94/19/EC

Protected/Insured/Eligible deposit : deposits repayable by the guarantee scheme under national law

Guaranteed/Covered/Reimbursable deposits: deposits obtained from eligible deposits when applying the level of coverage provided

Level of Coverage: level of protection granted in the event of deposits being unavailable under national law

Coinsurance: percentage of eligible deposits not covered

Premium: amount of money collected by the protection scheme among its members, in advance or in case of interventions to cover its administrative expenses and its interventions

Ex-post/ex-ante funding mechanism: type of funding mechanism, how money is collected among DGS members

1) Definitions according to European Commission Joint Research Centre



DP objectives are oriented according to depositor protection and financial market stability

main goals

- protecting the funds of small depositors
- contributing to the stability of the financial system

other goals

- foster competition between banks
- avoiding chain reactions in financial crisis
- strengthening banking supervision
- providing mechanisms for resolving failed banks



Best practices have emerged with the increased utilization of DP Schemes

1. explicit DP recommended over implicit DP
2. authority objectives in establishing DP have to be clear
3. coverage level consistent with objectives
4. commitments to depositors backed by adequate funding
5. specific design features can reduce moral hazard
6. legal power as well as human and financial resources of a scheme in accordance with mandate
7. actions well coordinated with other safety net players
8. efficiency and effectiveness enhanced i.e. by laying down functions and powers and ensuring public awareness
9. advantages of DP best realized when preconditions are met



Preconditions for the introduction of a Deposit Protection Scheme have to be met

macroeconomic situation

stable macroeconomic environment, i.e.:

- GDP/growth rate
- inflation
- balance of payments
- budgetary behaviour
- ...

state of development of the banking system

- economic situation of banking sector as a whole and important banks in particular (profit/loss, equity ...)
- market size and structure, need for consolidation
- role and efficiency of central bank (supervision)
- ownership/corporate governance
- specific bank risks (credit, liquidity, market, solvency)
- soundness

legal and regulatory environment

- law on central bank
- law on banks
- insolvency law
- civil law
- all other statutory provisions relating to the money and credit system of a country



A DP Scheme is adjusted to suit local circumstances by changing specific design features

legal basics

legal form of scheme (public/private); DP-law; statute/by-law, regulations;

membership

number of schemes; obligatory or voluntary; who is member; obligations; termination of membership

scope and level of protection

protected-/non protected deposits; level of protection (protection ceiling, coinsurance)

funding/financial issues

initial funds; collection of premiums; investment of funds

organization of scheme

agency bodies; supervisory board; selection of managing director

compensation procedure

preconditions of insurance event; modalities of making claims by depositor; cooperation with receiver



DP is be recommendable for MFIs, while specific- ations particular to MFIs are to be considered

- DP can lead to distortion of the market when only the deposits of commercial banks are protected
- Runs at non-insured institutions may spill over to insured institutions
- A precondition for considering a DP-Scheme for deposit-taking MFI is a minimum level of regulation and supervision
- When establishing a DPS for MFIs the consideration of regional/local circumstances is particularly important
- MFIs can be protected by an existing fund or by a separate DPF only intended for MFIs
- The level of protection can be equal for all depositors or differentiated by institutions
- Premiums can be uniform or differentiated by institutions/ level of protection



Examples

- Philippines
- Indonesia
- Mexico
- Peru
- Uganda



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