

Deposit Insurance

MacDonald (1996)

8 Basic Aspects of Banking Regulation

1. Government safety net
2. Restrictions on bank asset holdings
3. Capital requirements
4. Chartering and bank examination
5. Assessment of risk management
6. Disclosure requirements
7. Consumer protection
8. Restrictions on competition
- (+) Prompt corrective actions

Introduction

- In most cases, a deposit insurance scheme is viewed as a supplement to other measures designed to protect depositors
- Other forms of the government safety net include
 - Lending from the central bank to troubled institutions (“Lender of last resort” role of the central bank)
 - Government may provide funds directly to troubled institutions
 - Government can take over troubled institutions and guarantee that all creditors will be repaid in full

Introduction

- Deposit insurance schemes can also be viewed as an alternative to various ad hoc arrangements that government or central bank put in place in order to protect bank depositors (Implicit deposit insurance)
- Government or the central bank can put temporary arrangement in place to protect depositors

The Rationale for Deposit Insurance

- Asymmetric information on banks
 - Depositors cannot observe the quality of private loans
- Direct rationale: protect depositors
- Indirect rationale: reduce problems in banking system caused by asymmetric information
 - Bank failure (a bank is unable to meet its obligations and must go out of business): people don't put money in banks
 - Bank panics: people run to withdraw money

Moral Hazard

- However, deposit insurance may lead to moral hazard problem:
 - Banks' moral hazard:
 - Encourage risk-taking behaviors
 - Too big to fail: Regulators are reluctant to allow a big bank to fail. Increases moral hazard for big banks
 - Depositor side:
 - No incentive to assess banks' credit risks
 - They will choose banks solely from the interest rates
- A good design of deposit insurance is needed!

Explicit or Implicit System

- Explicit system:
 - the operation of a deposit insurance scheme is largely pre-determined
 - transparent
 - but involve some administrative costs to operate the scheme
- Implicit system:
 - depends on the authorities' decision
 - more flexible and less costly during normal time
 - however, it is very costly during crises, because it involves full insurance in most of the cases

Private Insurance

- In theory, private insurance is possible
 - Banks buy insurances from private companies
 - Insurance companies assess level of riskiness of each bank, and charge accordingly
- However, private insurance is unlikely to be feasible in practice
 - The insurance industry in many countries is less developed than the banking industry and does not have sufficient resources
 - Bank failures tend not to be isolated event, and insurer does not want to cover a widespread run
 - It is difficult to assess the probability of bank failures

Types of Deposit Insurance Scheme

- Governments may provide unconditional deposit guarantees (close to implicit one, but it is stated formally)
 - Simple, but may cause moral hazard problem
- Publicly owned deposit insurance corporation, financed at least in part by the commercial banks
- Public scheme administered jointly by the central bank and commercial banks, funded by the latter
- Private scheme organized by commercial banks alone without government involvement
- Options 3 and 4 are mainly to be found in western European countries

Amount of Insurance Coverage

- Unlimited protection is attractive for depositors. However, it maximizes moral hazard problem and costs
- Most schemes set a ceiling on the amount of compensation which can be given to a single depositor
- With compensation ceiling:
 - Small depositors need not to worry about their deposits
 - Corporate and big depositors have incentives to monitor banks' credit risks
 - Costs involved in monitoring activities can be covered by the benefits

Amount of Insurance Coverage

- Setting such a limit is a matter of judgement and depends on circumstances prevailing in a particular country
- Countries may wish to consider practicing “co-insurance” (depositors always bear a share of losses)

Other Related Issues

- Triggering of compensation payments to depositors
- Limitation on categories of deposits protected
- Financing deposit insurance
- Administrative arrangements

สถาบันคุ้มครองเงินฝาก (สคฟ.)

Deposit Protection Agency (DPA)

- Deposit Protection Agency is a government organization established in B.E. 2551 under the Deposit Protection Agency Act B.E. 2551 in order to provide protection for depositors of Financial Institutions, especially small depositors, the majority of depositors, who may not have access to sufficient financial information.
- In case a particular insured financial institution fails, reimbursement shall be made to insured depositors under the stipulated amount of coverage within a certain period of time.
- Deposits exceeding the coverage amount shall be claimed from the liquidation process.

DPA Thailand

- Insured financial institutions cover
 - 30 commercial banks
 - 2 finance companies
 - 3 credit foncier companies
- SFIs are not insured by this scheme

DPA Thailand

5. What is the source of funds used to reimburse depositors?

The money comes from the “Deposit Protection Fund”, which every financial institution contributes to under the DPA Act. The fund is managed by the Deposit Protection Agency, and is invested in highly secure and liquid securities with reasonable returns such as government bonds, Treasury bills, Ministry of Finance guaranteed bonds, and bank deposits at the Bank of Thailand, etc.

8. Are non-standard accounts such as accounts without a passbook, or savings accounts with life insurance policies protected under the deposit protection scheme?

These types of deposits are eligible for protection even without a passbook.

For savings accounts with life insurance policies, only the savings account is protected but the life insurance policy is not eligible for protection because it is not a deposit.

DPA Thailand

11. What does ‘the coverage amount per a depositor per financial institution’ mean?

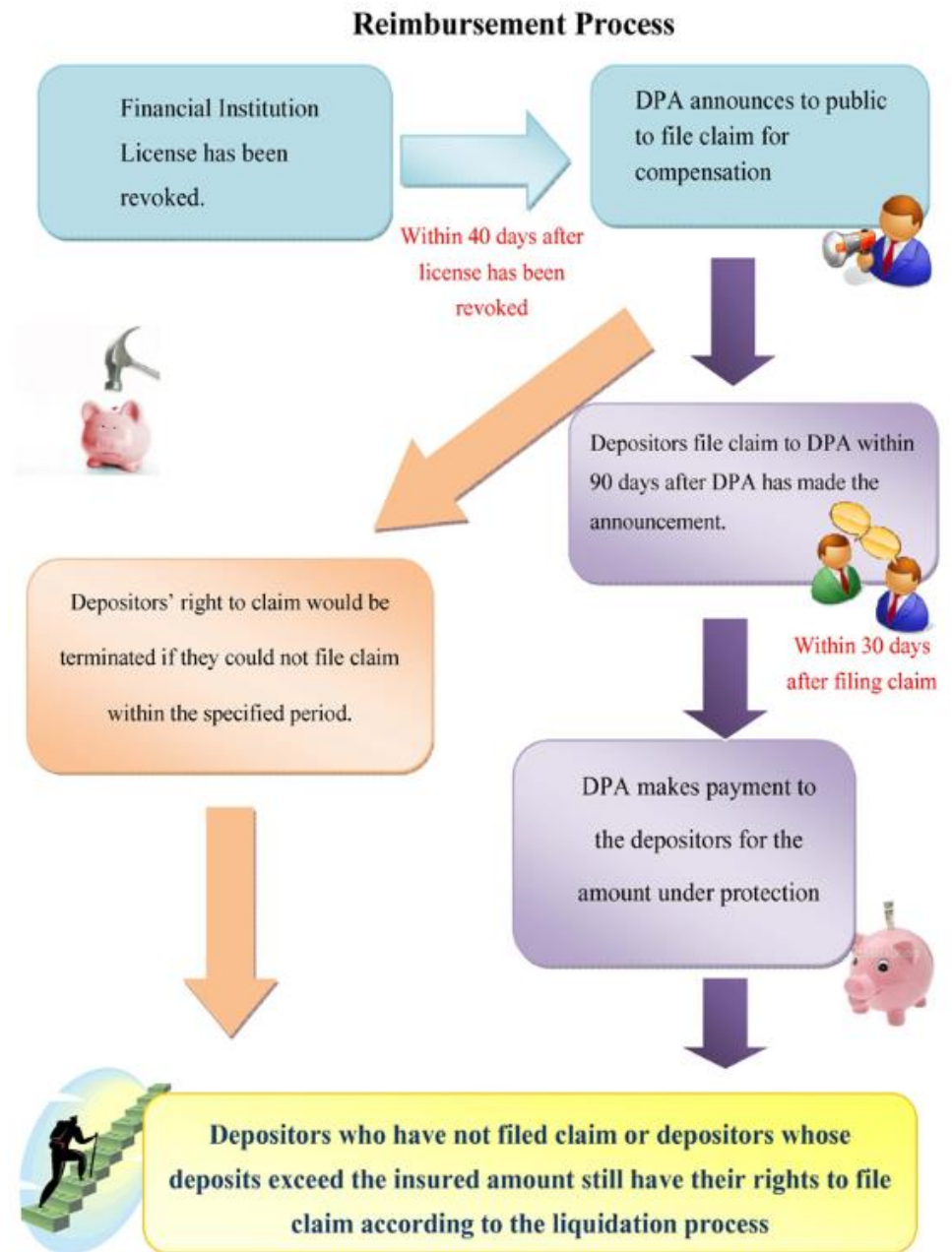
The coverage amount which will be reimbursed to an individual is calculated by accumulating every deposit account from every branch of a financial institution that belongs to one person’s name.

Example: Mr. John’s saving accounts in

Bank A		Bank B	
Bangkok branch	– 15,000,000 baht	Chiang Mai branch	– 500,000 baht
Pattaya branch	– 2,000,000 baht	Lamphun branch	– 700,000 baht
Total	– 17,000,000 baht	Total	– 1,200,000 baht

If both Bank A and Bank B’s licenses have been revoked on the 31st of December 2016 and the coverage amount is up to 15 million baht per depositor per financial institution, Mr. John would be reimbursed 15,000,000 baht from Bank A. The 2,000,000 baht which exceeds the coverage limit would require Mr. John to submit a claim to the bank’s liquidator to be reimbursed for this portion. Mr. John will be reimbursed the entire 1,200,000 baht from Bank B.

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*Depositors who fail to file claim due to force majeure could submit the request within 90 days from the date when such cause has ended. (This would be applied on a case by case basis.)

DPA Thailand



Source: www.dpa.or.th

Why 1 million baht limit?

End of Jan 14	Total Deposits - No. of Accounts			Total Deposits - Amount		
	Accounts	%	Acc. %	Baht	%	Acc. %
1 <= 50,000 baht	72,119,060	86.39%	86.39%	352,795	3.18%	3.18%
2 > 50,000-100,000 baht	3,587,509	4.30%	90.69%	254,531	2.29%	5.47%
3 > 100,000-200,000 baht	2,857,542	3.42%	94.11%	397,954	3.59%	9.06%
4 > 200,000-500,000 baht	2,485,173	2.98%	97.09%	787,546	7.10%	16.16%
5 > 500,000-1,000,000 baht	1,152,808	1.38%	98.47%	833,384	7.51%	23.67%
6 > 1-10 million baht	1,165,869	1.40%	99.87%	3,024,944	27.27%	50.94%
7 > 10-25 million baht	70,205	0.08%	99.95%	1,069,757	9.64%	60.58%
8 > 25-50 million baht	22,629	0.03%	99.98%	808,940	7.29%	67.87%
9 > 50-100 million baht	9,727	0.01%	99.99%	691,848	6.24%	74.11%
10 > 100-200 million baht	4,177	0.01%	100.00%	584,833	5.27%	79.38%
11 > 200-500 million baht	2,347	0.00%	100.00%	734,471	6.62%	86.00%
12 > 500 million baht	1,092	0.00%	100.00%	1,553,267	14.00%	100.00%
13 Total	83,478,138	100.00%	100.00%	11,094,269	100.00%	100.00%

Source: Bank of Thailand