

Economic Analysis of Banking Regulation

Chapter 11 of Mishkin

8 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 protections
8. Restriction on competition

1. Government Safety Net: Deposit Insurance (1)

- Asymmetric information on banks
 - Depositors cannot observe the quality of private loans
- The problem of asymmetric information leads to 2 problems in banking system:
 - Bank failure: People don't put money in banks
 - Bank panics: People run to withdraw money
- Deposit insurance can (1) protect depositors (2) reduce problem caused by asymmetric info.

1. Government Safety Net: Deposit Insurance (2)

- However, deposit insurance may lead to other problems:
 - 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
- A good design of deposit insurance is needed!

1. Government Safety Net: Deposit Insurance (3)

- Explicit or implicit system?
 - Explicit system : transparent, but involve some costs
 - Implicit system : depends on the authorities' decision, but less costly during normal time
 - Implicit system : costly anyway, during crises
- Level of protection?
 - Full protection leads to moral hazard
 - Partial protection is needed

สถาบันคุ้มครองเงินฝาก (สคฝ.)

Deposit Protection Agency (DPA)

The Coverage of insured deposits according to The Royal Decree on an extension of deposit coverage, is as follows:

Period	Coverage
11 Aug 2012 – 10 Aug 2015	Baht 50 million
11 Aug 2015 – 10 Aug 2016	Baht 25 million
11 Aug 2016 – Onwards	Baht 1 million

Coverage of insured deposits

Deposits exceeding the coverage amount could be claimed from the liquidation process.

Source: www.dpa.or.th

1. Government Safety Net: Deposit Insurance (4)

- Partial protection:
 - 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?

1. Government Safety Net: Deposit Insurance (5)

- Why 1 million baht?

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

2. Restrictions on bank asset holdings

- Even without government safety net, banks still have incentives to take too much risk: Moral hazard
- Moreover, acquiring information about banks' activities is costly
- These restrictions will help reduce the problem of moral hazard and promote diversification

3. Capital Requirements

- Reduces moral hazard: banks have more to lose when have higher capital
- Can be regulated in 2 ways:
 - Based on leverage ratio or EM
 - Does not concern risks and off-balance-sheet activities
 - Basel Accord: Risk-based capital requirement
 - Hold capital at least 8% of risk-weighted assets
- New regulations are still to come.

4. Chartering and bank examination

- Reduces adverse selection problem of risk takers owning banks: They will not be chartered
- Reduces moral hazard by preventing risky activities: Once a bank is chartered, it is required to file some reports every period.

5. Assessment of risk management

- Assessment of the quality of the bank's balance sheet at a point in time is not enough anymore
- With financial innovations, a bank that is quite healthy at a point in time can become insolvent rapidly from trading losses
- At the present time, focus more on risky activities, management processes and systemic risk

6. Disclosure requirements

Regulators require banks to adhere to certain standard accounting principles and disclose a wide range of information

7. Consumer Protection

Banks must provide information about the cost of borrowing, including interest rates and fees correctly

8. Restrictions on Competition

- Increased competition may increase moral hazard problem in banking sector
- However, we have to think about the disadvantages of higher charges and decreased efficiency as well

The Bank of Thailand

- There are 4 acts associated with the BOT
 - Bank of Thailand Act
 - Financial Institutions Businesses Act
 - Currency Act
 - Exchange Control Act

Financial Institutions Businesses Act

- The objective of this act is to enhance the risk management measures of the financial institutions, to ensure the prudential and protect the damage which may result from the financial institutions undertaking.
- It also has the aim to maintain economic stability and entrust the depositors and the public by prescribing the good governance rules for any person who perform the duty of a director, a manager, an officer or a person with power of management of financial institutions.

Other Related Authorities

- The Securities and Exchange Commission:
www.sec.or.th
- The Office of The Consumer Protection Board:
http://www.ocpb.go.th/list_law.asp
- The Credit Information Protection Committee:
<http://www.creditinfocommittee.or.th/en/default.php>