



BASEL COMMITTEE ON BANKING SUPERVISION
FINANCIAL STABILITY INSTITUTE
BANK FOR INTERNATIONAL SETTLEMENTS



ALIGNING DESIGN FEATURES WITH POLICY OBJECTIVES

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ALIGNING THE OBJECTIVES: MEMBERSHIP, COVERAGE AND TRANSITIONING

- **The Basic Policy Objectives**
- **Central Design Features**
 - Mandates and Powers
 - Membership
 - Coverage
 - Funding
- **Principle 8 – Compulsory Membership**
- **Principle 9 – Coverage**
- **Principle 10 – Transitioning from a Blanket Guarantee to a Deposit Insurance System**



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International Association
of Deposit Insurers

The Basic Objectives

- Protecting Depositors
- Maintaining Financial Stability



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International Association
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Central Design Features

- Mandates and Powers
- **Membership**
- **Coverage**
- Funding



Membership

Principle 8 – Compulsory Membership:

“Membership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (eg. retail and small business depositors) to avoid adverse selection”.

Objectives: Protecting Depositors and Maintaining Financial Stability

- Ensure all deposit taking institutions
- Subject to prudential regulations
- Avoid adverse selection
- Ensure level playing field

Compulsory membership exists in the vast majority of deposit insurance systems



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Membership

Additional Advantages

- Diversifying the exposure of the deposit insurer and minimizing the risk;
- Ensuring a stringent controlling system and supervisory standard for all member institutions (banks and non banks);
- Ensuring that all institutions benefiting from the insurance system contribute to the cost of insurance; and
- Providing additional controlling and supervisory instrument while studying the membership application.



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Coverage

Principle 9 – Coverage:

“Policymakers should define clearly in law, prudential regulations or by-laws what is an insurable deposit.

The level of coverage should be limited but credible and be capable of being quickly determined.

It should cover adequately the large majority of depositors to meet the public-policy objectives of the system.

Be internally consistent with other deposit insurance system design features”.



Coverage

The level of coverage can be set through an examination of relevant data.

- Multiples of per capita GDP and multiples of average deposit value provide reasonable benchmarks
- Deposit distribution among depositors (value of average deposit, insured accounts, insured deposits etc)
- Deposit distribution among insured institutions (loss given default)
- Fund sufficiency and premium rate
- Optimal coverage limit, beyond which the marginal benefit becomes negligible and immaterial

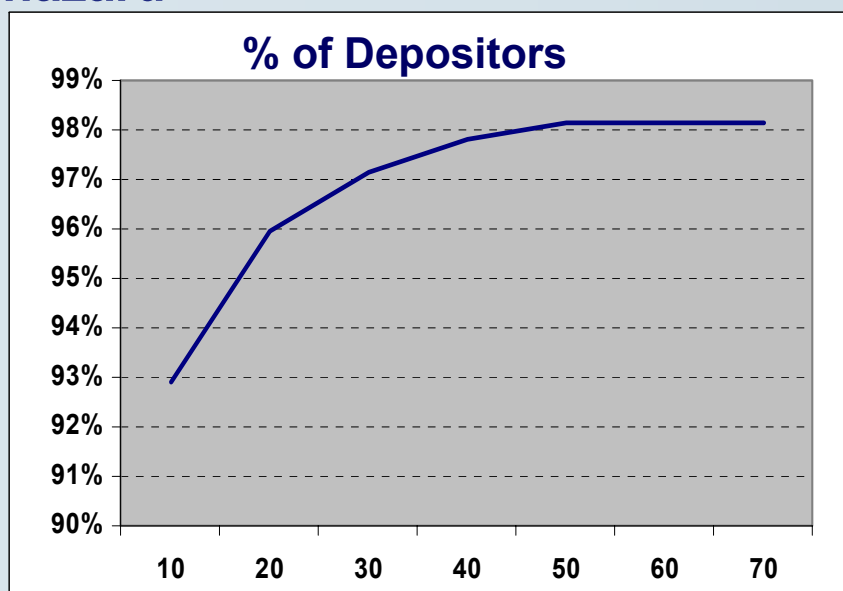


Coverage

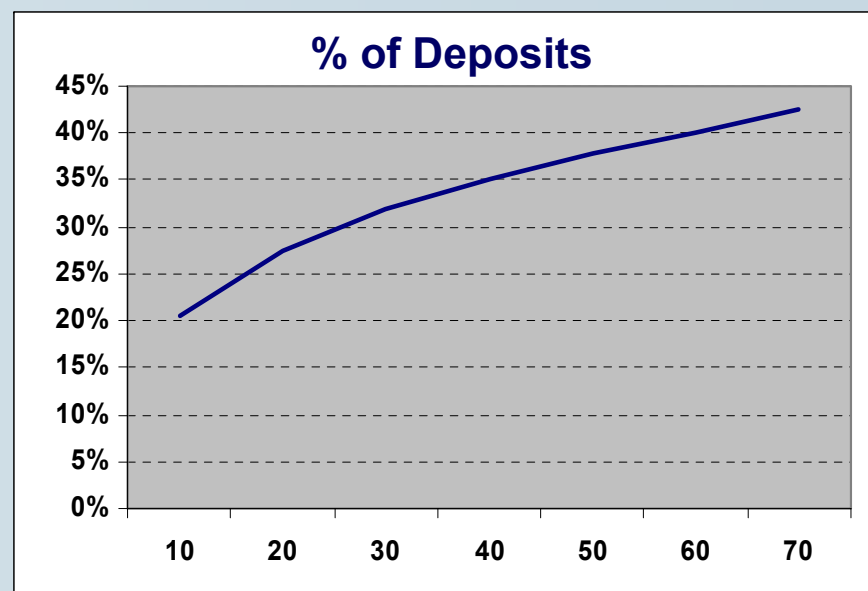
Objectives: Protecting Depositors and Maintaining Financial Stability

Large majority of **depositors** not large majority of **deposits**:

High enough to insure **system stability**, and low enough to mitigate **moral hazard**



Coverage Limit

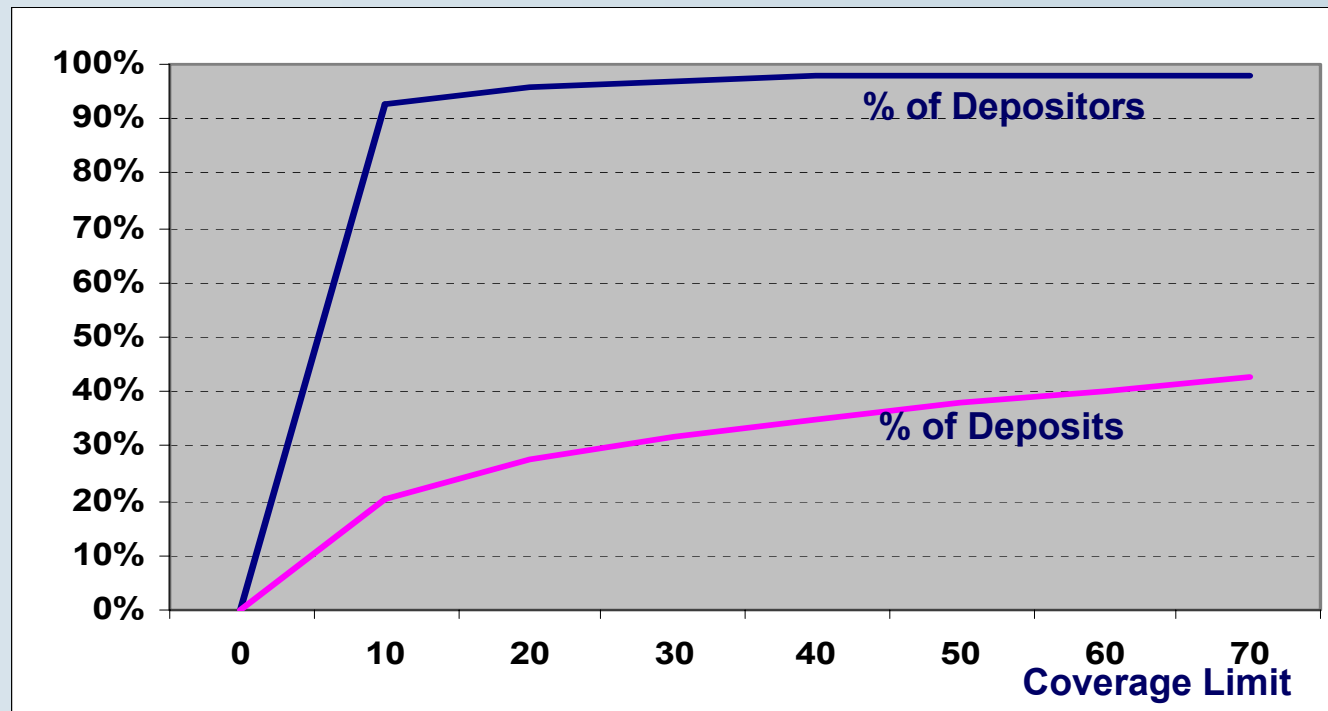


Coverage Limit



Coverage

Cover adequately the large majority of depositors in order to meet the **public-policy objectives**: Protecting Depositors and Maintaining Financial Stability





Coverage

The law of diminishing marginal return (benefits) is clearly applicable.

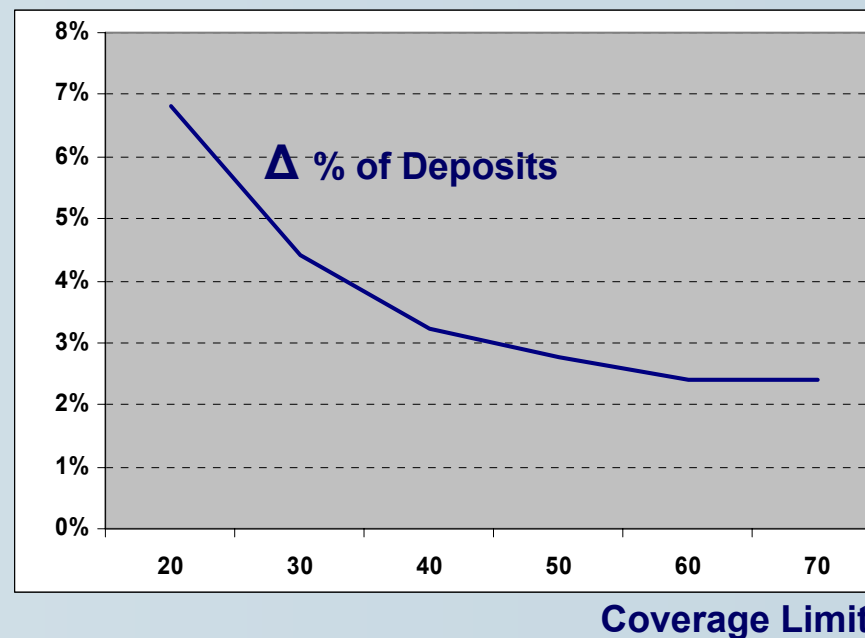
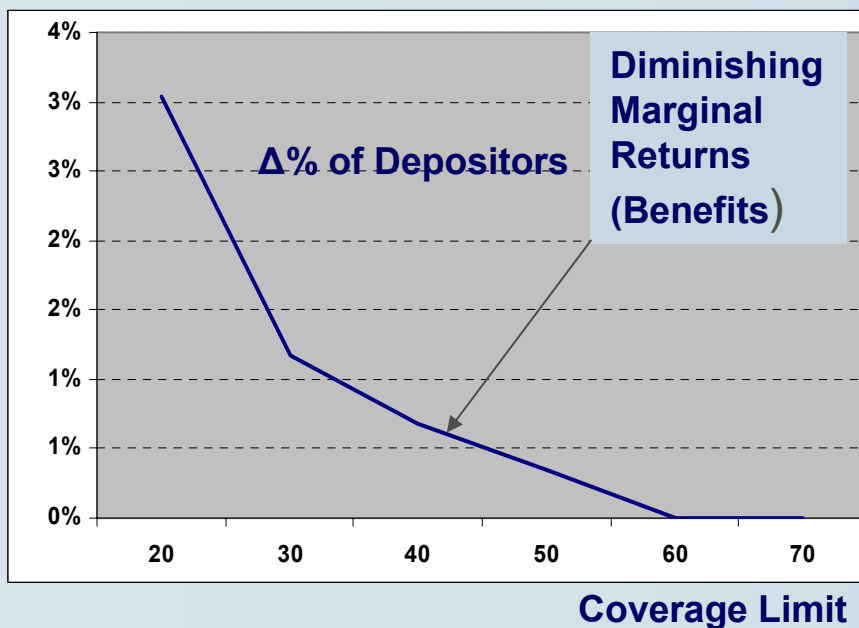
As coverage limit increases:

- Number of fully insured depositors increases at a decreasing rate; declining (diminishing) benefits;
- Additional benefits almost disappear after certain coverage limit;
- Value of insured deposits continue to increase at a less decreasing rate;
- Cost continue to increase; and
- After certain coverage limit, continuous increase in cost with no additional benefit in terms of insured depositors.



Coverage

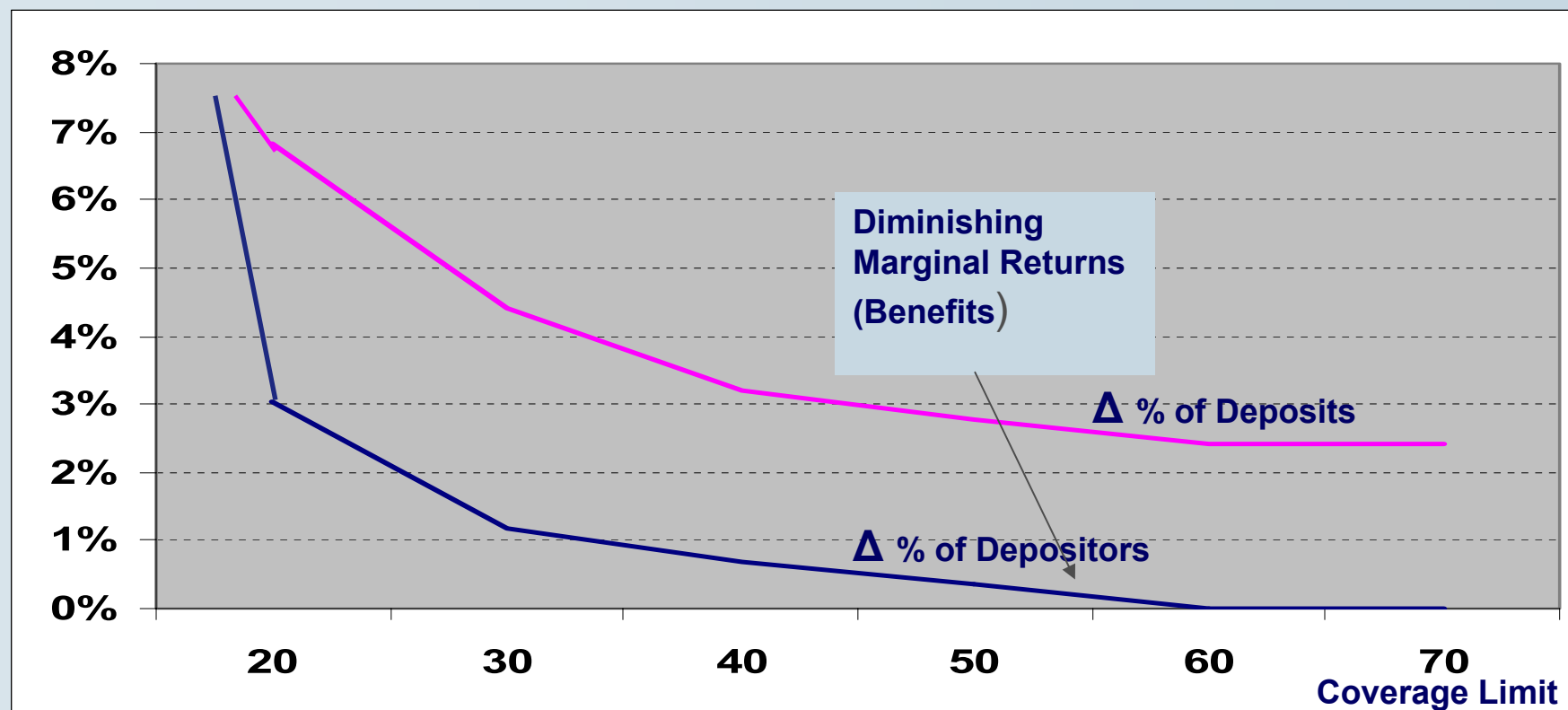
The Marginal Analysis provides additional useful tool to understand the behavior of insured depositors / insured deposits with increases in coverage limits:





Coverage

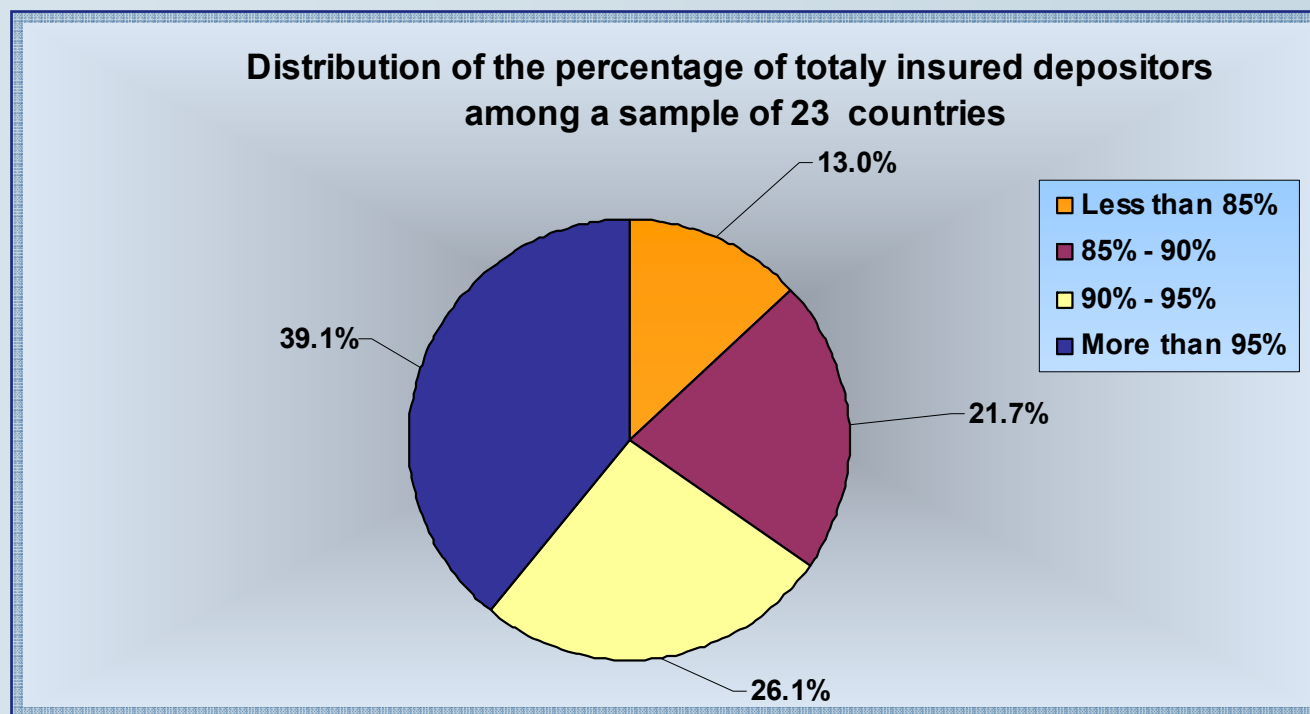
Objectives: Protecting Depositors and Maintaining Financial Stability





Coverage

Two thirds of deposit insurance systems provide full coverage for more than 90% of depositors (sample of 23 countries).

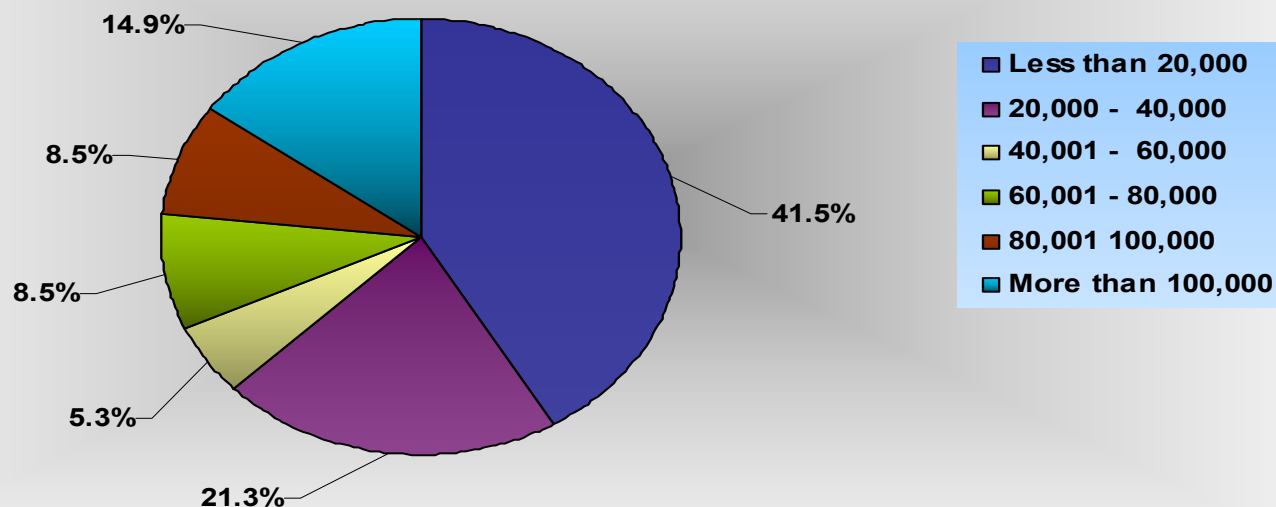




Coverage

Around 62% of deposit insurance corporations set a coverage limit less than \$40,000 (sample of 94 countries)

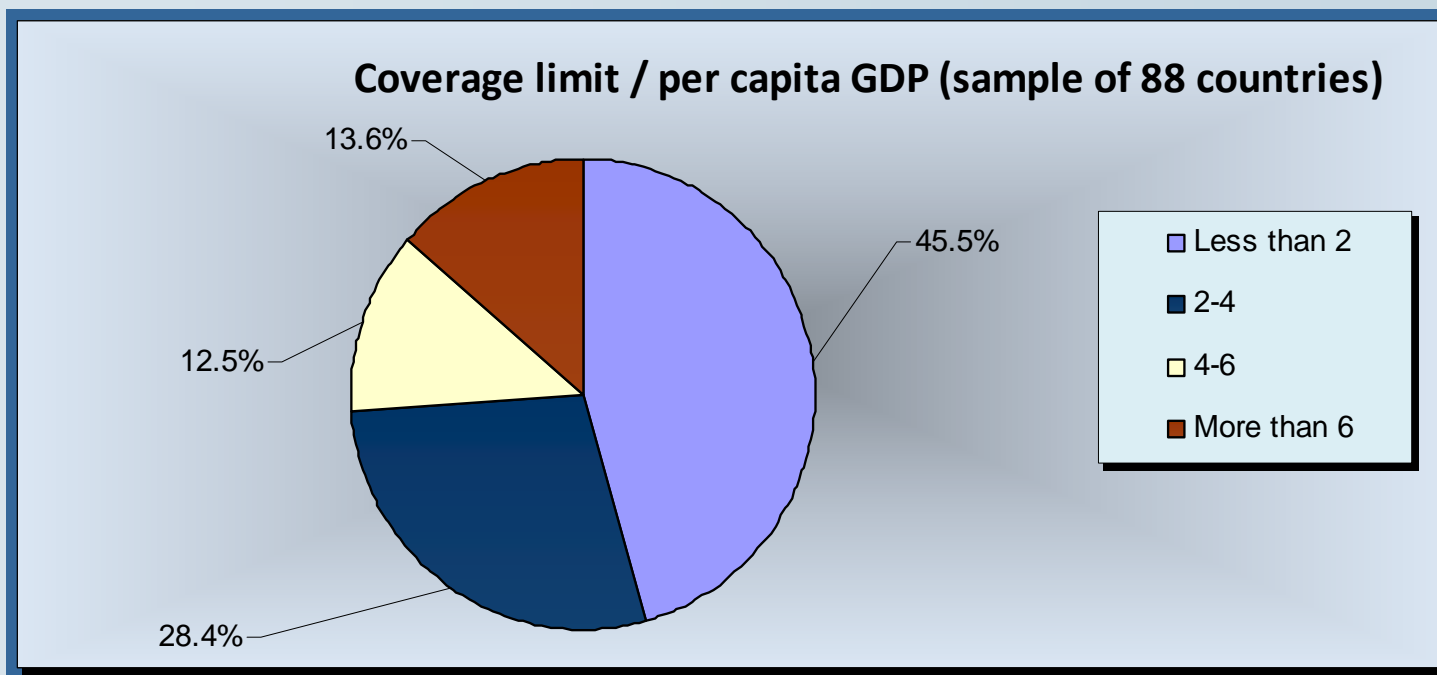
Distribution of coverage limits among a sample of 94 countries





Coverage

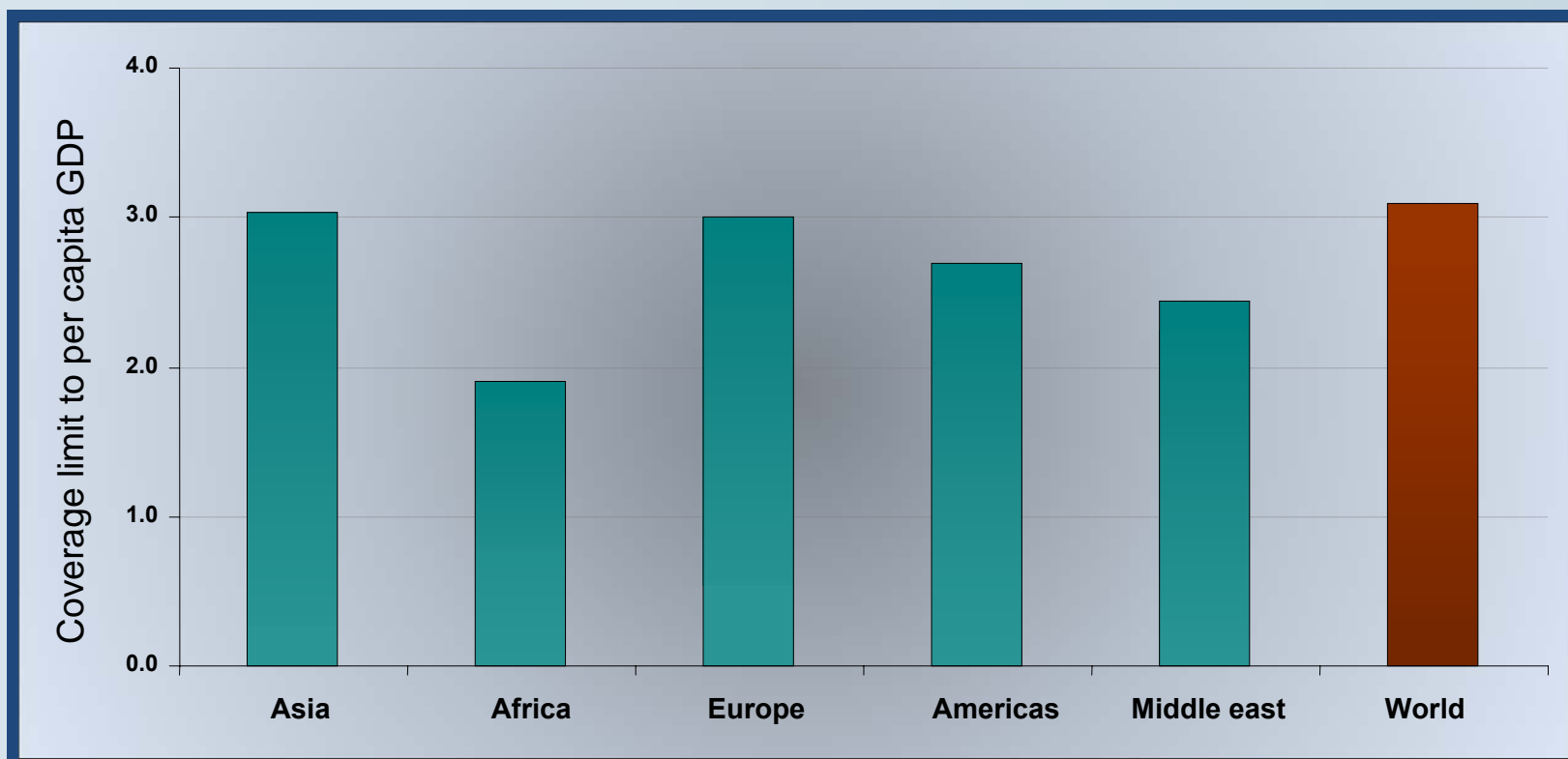
Around 75% of deposit insurance systems have a coverage limit to per capita GDP less than four multiples (sample of 88 countries)





Coverage

Distribution of coverage limit to per capita GDP





Coverage

Scope of Coverage:

Objectives: Protecting Depositors and Maintaining Financial Stability

- Insure all depositary institution;
- Cover all kind of retail deposits;
- Include foreign currency deposits if material and if there is a risk of capital flight;
- Set it right from the first place with the future in mind; frequent adjustments are disruptive; and
- Keep real value of the coverage limit in inflationary environment.



Coverage

Policy Objectives

Protecting Depositors
Maintaining Stability

% Insured Depositors

% Insured Deposits

Design Features

Membership

Premium Level /Structure

Targeted Fund Level

Deposits Distribution

Probability of Default

Loss Given Default

Access to Borrowing

Benchmarks

Multiples of Per Capita GDP

Multiples of Average Deposit

CL in Neighboring Countries



Transitioning to Limited Coverage

Principle 10 – Transitioning from a Blanket Guarantee to a Limited Coverage Deposit Insurance System:

“When a country decides to transition from a blanket guarantee to a limited coverage deposit insurance system, or to change a given blanket guarantee, the transition should be as rapid as a country's circumstances permit.

Blanket guarantees can have a number of adverse effects if retained too long, notably moral hazard.

Policymakers should pay particular attention to public attitudes and expectations during the transition period“.



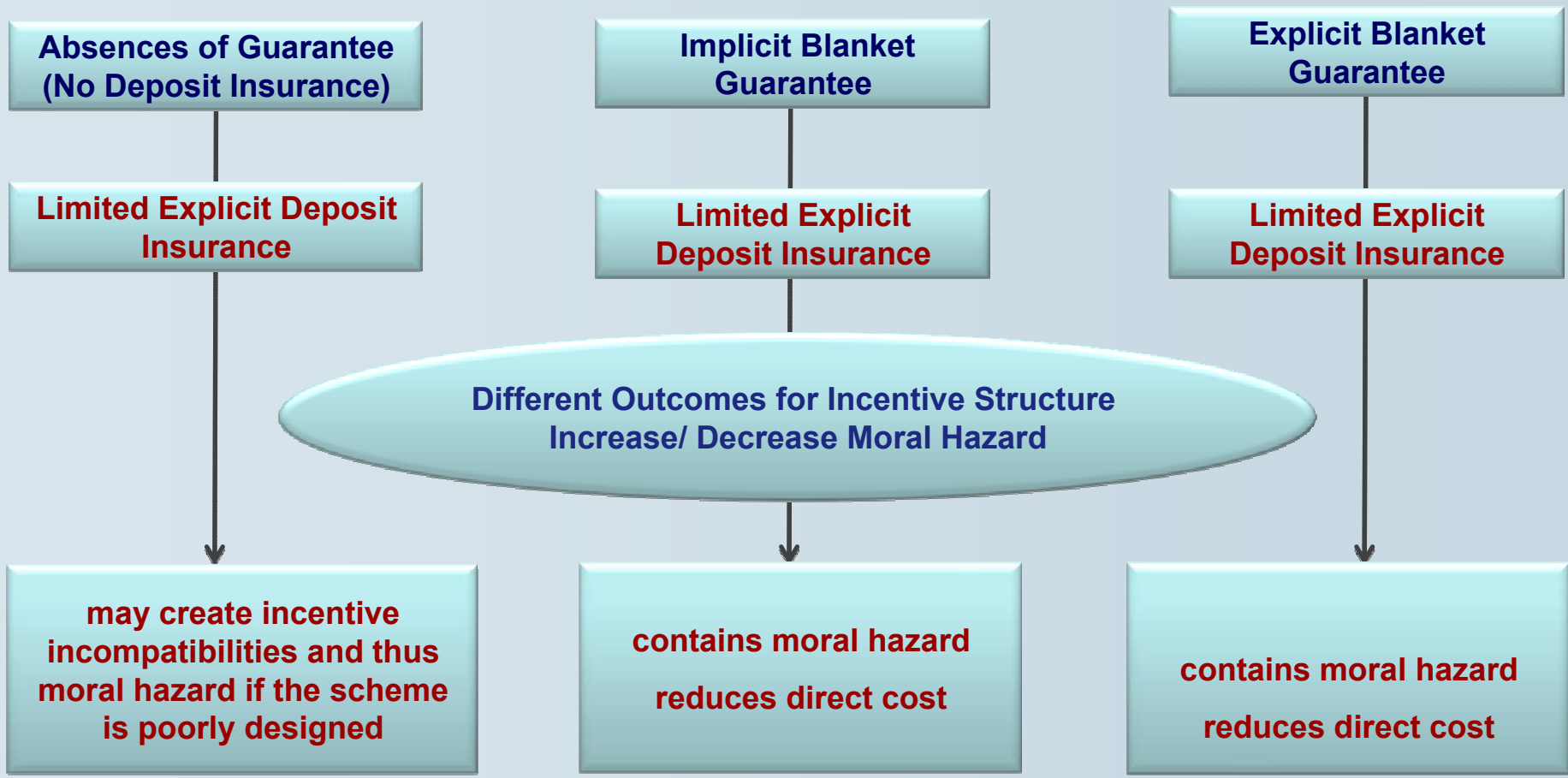
Transitioning to Limited Coverage

- Significant Number of countries still lack explicit limited coverage deposit insurance system;
- The majority believed to be providing implicit blanket coverage;
- Many countries adopted temporary blanket guarantee in response to the recent global financial crisis, most of them temporary.

- **Blanket converge is costly:**
 - Increase the direct cost: increases loss given default cost when probability of default is higher than normal times**
 - leads to moral hazard if retained too long:**
 - Protected depositors have less incentive to monitor banks.
 - Banks have more incentive to take excessive risks when depositors are protected.
- **Transition should be as rapid as a country's circumstances permit**



Transitioning to Limited Coverage





Transitioning to Limited Coverage

- **Plans are needed to orderly transition to limited coverage**
- **Preconditions should be met to minimize the risk of instability during the transition period:**
 - Economic and financial stability
 - Sound banking system
 - Strong prudential regulations and supervision
 - Properly designed deposit insurance system (revise the system)
 - Sufficiency of system resources
 - Detailed communicated timeline
 - Public awareness campaign
 - Coordination with safety net members
 - Cross border coordination



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Thank You