Deposit Insurance Systems in the MENA Region: Recent Developments

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Deposit Insurance Systems in the MENA Region: Recent Developments

- Background
- Explicit vs. Implicit Systems in the MENA Region
- Basic Design Features of Existing Explicit Systems
  - Public Policy Objectives
  - Mandates and Powers
  - Membership, Funding and Coverage Limits
  - Governance
- Deposit Insurance and Financial Crisis: Policy Responses
- The Way Ahead

Deposit Insurance Systems in the MENA Region: Background

- Nine deposit insurance systems:

  Lebanon, Bahrain, Oman, Morocco, Sudan, Algeria, Jordan, Turkey and Yemen.

- Six independent deposit insurance systems; (Lebanon, Sudan, Algeria, Jordan, Turkey and Yemen).

- The Lebanese system was the earliest deposit insurance systems in the MENA region; (1967).

- The Yemen's Deposit Insurance System is the most recent system in the region; established in 2008.

Implicit Deposit Insurance in the MENA Region

In general, MENA countries that do not adopt an explicit limited-coverage deposit insurance system provide explicit unlimited coverage

Justifications:

•Financial stability enhancement

•Sufficient budgetary resources, particularly in the Gulf oil producing countries

•Government dominance in banking sector, direct participation or sole ownership

•Stringent regulations beyond the conventional prudential regulations, direct controls on capital movements, foreign exchange transactions and investments.

Implicit Deposit Insurance in the MENA Region

In general, MENA countries that do not adopt an explicit limited-coverage deposit insurance system provide explicit unlimited coverage

Implications:

- Resistance to the introduction of explicit systems
- Increased Moral Hazard and deteriorated efficiencies
- Explicit systems, when established, face challenges in whipping out long standing public beliefs
- Forbearance and continuous government support through open bank assistance by monetary authority or the Treasury

Why Explicit Deposit Insurance

- Long term stability of the financial system when avoiding moral hazard
- Promoting sound financial practices and fair competition among Banks
- Enforcement of market discipline by providing protection only to less-financially-sophisticated depositors
- Encouraging banks to better manage their risks
- Containing, reducing and redistributing the cost of bank failures
- Avoiding the contagion effect of financial Crises
- Providing formal mechanisms for resolving failed institutions
- Enhancing the confidence in the system at large to encourage national savings and promoting economic growth.

Increased Moral Hazard and Deteriorated Efficiencies

The Current Blanket Coverage increases moral hazard

- Protected depositors have less incentive to monitor banks.
- Banks have more incentive to take excessive risks when depositors are protected.
- Deposit Insurance may increase Moral Hazard if poorly designed.
- Recent Experience reveals significant increase in the number of countries adopting deposit insurance schemes.
- There is a need then to design and adopt an effective deposit insurance scheme that promotes financial stability but contains Moral Hazard.
- Different countries have different protection schemes before the adoption of an explicit limited deposit insurance system; so that the newly adopted systems must have different implication on Moral Hazard

Moral Hazard in Deposit Insurance

Explicit Blanket Guarantee

Limited Explicit Deposit Insurance

Deposit Insurance contains Moral Hazard

Implicit Blanket Guarantee

Limited Explicit Deposit Insurance

Different Outcomes for Incentive Structure
Increase/ Decrease Moral Hazard in the Banking System

Deposit Insurance contains Moral Hazard

Absences of Guarantee (No Deposit Insurance)

Limited Explicit Deposit Insurance

Deposit Insurance may create incentive incompatibilities and thus moral hazard if the scheme is poorly designed

Basic Design Features of Existing Explicit Deposit Insurance Systems in the MENA Region

Public Policy Objectives:

- State and structure of the banking system beside public attitude and expectations were important determinants of the adopted policy objectives.

- All existing deposit insurance systems in the (MENA) region share the same public-policy objectives:

- To contribute to the stability of the financial system and
- To protect less-financially- sophisticated depositors.

Clearly stated by the relevant legislation

Basic Design Features of Existing Explicit Deposit Insurance Systems in the MENA Region

Mandates and Powers:

- Existing deposit insurers in the (MENA) region have mandates ranging from narrow "pay-box systems", 4 systems, to pay-box systems with extended powers and responsibilities, but there are actually no risk minimizing systems in the region with clear powers related to supervision and risk assessment.
- Liquidation responsibility but limited resolution authority.

Basic Design Features of Existing Explicit Deposit Insurance Systems in the MENA Region

Coverage:

- Prevailing coverage limits vary significantly across countries in the region, given the significant variations in income levels and per capita GDP.
- Ranges from 8.4 multiples of per capita GDP in Yemen to 0.5 in Lebanon
- In general, they cover adequately the large majority of depositors with minimal moral hazard implications

Currency covered:

- Local currency deposits: Sudan, Lebanon, Jordan, Yemen
- Both local and foreign currency deposit with identical coverage limits : Bahrain, Algeria, Morocco, Turkey and Oman.

Basic Design Features of Existing Explicit Deposit Insurance Systems in the MENA Region: Coverage

DI System	Lebanon	Turkey	Bahrain	Morocco	Oman	Sudan	Algeria	Jordan	Yemen
Maximum protection level (in the currency of origin)	5.000.000	50.000	20.000	80.000	20.000	Investment - 4000 for deposits - 3000 for Current deposits.	600.000	10.000	2.000.000
Maximum protection level (in USA dollars)	3.310	30.000	39.790	9.411	51.950	- 2000 for Investment deposits - 1500 for Current deposits	8.440	14.160	9.990
Maximum protection level/ GDP per capita	0.5	2.7	1.5	3.7	3.4	2 (Investment deposits) 1.5 (Current deposits)	1.7	4.6	8.4

Basic Design Features of Existing Explicit Deposit Insurance Systems in the MENA Region

- **Funding:**
- **Ex-ante funding is preferred over ex-post funding with respect to insuring prompt reimbursement, maintaining public confidence and avoiding pro-cyclical effects of deposit insurance assessment.**
- **With the exception of Oman and Bahrain, all systems in the MENA region adopt Ex-ante funding and build gradually financial reserves to meet their probable future obligations.**
- **Premiums are flat (with the exception of Turkey that applies a risk based system) and their levels ranges from 10-50 basis points.**
- **Bahrain: Ex-post bank funding (funds obtained once a bank has failed)**
- **Oman: Ex-post funding beside the ex-ante funding**
- **Reserves are supplemented by annual contributions from either the Treasury or Central Bank in some cases:**

Lebanon: 100% of annual premiums is paid by the Treasury

Oman: 50% of total value of premiums collected is provided by the Central Bank

Sudan and Yemen: 10% of the annual premium collected is paid by the Treasury and the Central Bank; 5% from each.

Bahrain: The system is fully funded by annual contributions by the Treasury (25 m .Dirham)

- **To ensure prompt reimbursement of depositors claims, systems have direct access either to Treasury funds or capital markets in case of fund shortage**

Basic Design Features of Existing Explicit Deposit Insurance Systems in the MENA Region: Funding

DI System	Lebanon	Turkey	Bahrain	Morocco	Oman	Sudan	Algeria	Jordan	Yemen
Premium Ratio (Basis Points)	15	11-19	------	20 with a maximum of 25	10-50*	25	25	25	20
Funding	Ex- ante	Ex- ante	Ex- post	Ex- ante	Ex- ante Ex- post	Ex- ante	Ex- ante	Ex- ante	Ex- ante

* Board of Governors may apply different rates on different banks

Basic Design Features of Existing Explicit Deposit Insurance Systems in the MENA Region

<u>Membership:</u>

Membership of banks is compulsory in all exiting deposit insurance system in (MENA) and all banks are subject to prudential regulation and supervision by the respective central banks.

- Membership is confined to banks.

Basic Design Features of Existing Explicit Deposit Insurance Systems in the MENA Region

Relationships with other safety net members:

- Although a deposit insurer's interrelationship varies according to its mandate and powers, the need for close coordination and information sharing among financial safety-net participants is highly important as the majority of deposit insurance systems in the MENA region have narrow mandate with no direct access to banks' records.
- Liquidation responsibility requires clear formal institutional arrangements for information-sharing and policy-coordination.

Deposit Insurance and Financial Crisis: Policy Responses

- Kuwait and Saudi Arabia declared blanket guarantee to all bank deposits with no further details.
- Jordan guarantees all bank deposit through the end of 2009.
- UAE adopted a blanket guarantee for three year.
- Turkey guarantees all bank deposit through the end of 2010.
- Bahrain raised its guarantee on bank deposits to a maximum of BHD 20.000 from the previous ceiling of BHD 15.000.
- Egypt has announced plans to set up a deposit insurance fund in the future.
- Remaining countries in the MENA have not initiated any change in their deposit insurance system .

Deposit Insurance and Financial Crisis: Policy Responses

Country	Initiating temporary blanket deposit insurance coverage	Increasing deposit insurance coverage limit	No action
Saudi Arabia	✓ (no term length)		
Kuwait	✓ (no term length)		
United Arab Emirates	✓ (three years)		
Jordan	✓ (end of 2009)		
Bahrain		✓ (from BHD 15.000 to BHD 20.000)	
Lebanon			✓
Oman			✓
Turkey	✓ (end of 2010)		

The Way Forward

- Transitioning from a blanket guarantee to an explicit limited –coverage systems: most of the countries adopted temporary blanket guarantee
- Transition should be as rapid as a country's circumstances permit
- 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 (some of the already existing system need to be improved)
  - Sufficiency of system resources
  - Detailed communicated timeline
  - Public awareness campaign
  - Coordination with safety net members
  - Cross boarder coordination

Thank you for your kind attention

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