South African Reserve Bank

Opening remarks by Francois Groepe,
Deputy Governor of the South African Reserve Bank,
at the public workshop on proposals to establish
a deposit insurance scheme for South Africa

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Introduction

Good afternoon, distinguished guests, ladies and gentlemen.

It gives me great pleasure to welcome you to this workshop on a possible deposit insurance scheme for South Africa. We are privileged to have present here today fellow central bankers, commercial bankers, financial market participants, regulators, public sector representatives, academics, members of the media fraternity, and other staff members of the South African Reserve Bank (SARB). In particular, I would like to extend a very warm welcome to the representatives from the World Bank, which has been very supportive over the past two to three years in the formulation of the proposals that will be discussed today, as well as to the representatives from other central banks in the Common Monetary Area that are present. We hope that this workshop will be the first step in expanding our fruitful cooperation in the area of managing bank failures.

The SARB and National Treasury are currently developing new legislation to put in place a framework that will facilitate the resolution of failing financial institutions in an orderly and transparent way, one which seeks to minimise the use of government funding to bail out such institutions. This new resolution framework is an important pillar of the SARB's expanded and explicit financial stability mandate, as contained in the Financial Sector Regulation Bill. A key component of such a resolution framework is the establishment of an explicit deposit insurance scheme to ensure that the depositors who are most exposed to an asymmetry of information and thus least able to hedge themselves against financial loss in the event of a bank failure are protected against any losses and hardship that may stem from a bank failure. This framework is expected to enhance the public's trust in the banking sector, which is an important aspect of financial stability.

The implementation of a prefunded deposit insurance scheme will bring about closer adherence to the Key Attributes of Effective Resolution Regimes and to the Core Principles of Effective Deposit Insurance Systems issued by the Financial Stability Board and the International Association of Deposit Insurers respectively.

South Africa has a well regulated and stable banking sector, but one that is also quite concentrated. Where one tends to find relatively regular failures of small banks in some other countries, bank failures in South Africa are rare – although when they do occur, they are typically more disrupting.

Because bank failures in South Africa do not occur often and because, in the past, these failures involved relatively small banks or banks with limited retail funding (like African Bank), it was possible for government to compensate at least the retail depositors. Over time, this practice has led many South Africans to believe that their bank deposits are fully insured. However, this type of deposit protection is implicit rather than explicit, with compensation being largely dependent on the size of the failing bank and the fiscal strength of government at the time of such failure. There is unfortunately no clear, upfront guarantee of deposits in place, which creates uncertainty in the event of a payout about the deposits that will be compensated and to what amounts. Such decisions are often arbitrary, depending on the circumstances at the time.

Furthermore, even if deposits are paid out, it can be a lengthy process to actually execute the payments in the absence of readily available depositor information and payout mechanisms. This can cause prolonged periods of hardship for depositors who do not have access to their bank accounts.

Another important disadvantage of an implicit deposit guarantee system is that it relies on government funding and tends to be procyclical; as such, support is usually required at a time when the economy and the financial system may already be vulnerable as a result of wider-spread bank failures.

In principle, it is not desirable that public funds are used to pay for private failures.

The main advantage of the implicit deposit insurance arrangements that South Africa has had in place to date, and probably the reason why we have lived with them for such a long time, is that the current framework does not put a direct cost on the banking sector – and it hardly costs the government anything unless there is actually a bank failure. However, we regard such arrangements as risky and acknowledge that they create a significant contingent liability for government.

It is for all these reasons that South Africa is moving away from government-funded, implicit deposit insurance scheme to a privately-funded, explicit deposit insurance scheme. An explicit deposit insurance scheme sets out payment arrangements in law and ensures there is always adequate funding available. This funding is built up by the private banking sector in good times rather than at the point of failure. And although the proposed deposit insurance scheme will be prefunded, we will endeavour to ensure that we avoid placing an excessive cost on the banking system, distorting the competitiveness in the banking sector, or causing moral hazard to the extent that it may become a threat to financial stability.

South Africa is currently the only G20[1] country that does not have an explicit deposit insurance scheme. In fact, about 125 countries have an explicit deposit insurance scheme, of which the Federal Deposit Insurance Corporation in the US[2] is probably the best known, having been established in the 1930s just after the Great Depression. The organisation, funding, and operations of deposit insurance schemes varies greatly between countries; while there are a number of generic characteristics, each jurisdiction

[1] Group of Twenty
[2] United States

ultimately decides on the type and structure of the deposit insurance scheme that best suits its own financial system.

However, a common denominator of all deposit insurance schemes is that they play an important role in the resolution of failed banks and the prevention of financial crises emanating from institutional failures. They also facilitate the process through which poorly managed and weak banks can leave the system in an orderly way, without causing extreme hardship, thereby making way for efficiently managed firms that can better serve the needs of the economy and of the population.

The purpose of today’s workshop is to discuss the proposals outlined in the discussion paper that was published on 30 May 2017, which contains the joint views of the SARB and National Treasury on the design features of a possible deposit insurance scheme for South Africa. The paper deals in detail with all the aspects of the envisaged deposit insurance scheme; these will also be covered in subsequent presentations today, which I do not want to front-run or repeat. Let me just highlight, briefly, the key features of the envisaged scheme.

Firstly, the deposit insurance scheme would be housed in a separate legal entity established as a subsidiary of the SARB. This organisational structure would ensure adequate independence for the deposit insurance scheme to pursue its objectives, but with the backing of the SARB for good governance and operational support.

Secondly, all deposits (except those by other financial institutions and government, listed in the paper) would be covered, irrespective of the type or term of the deposits. Deposits at all banks, small and medium and large, would be covered to the same limit of R100 000. Based on a survey of the deposits at all banks, we estimate that R100 000 would be sufficient to fully cover the deposits of about 98% of the retail depositors in South Africa. Among the other benefits that have been mentioned, we expect that this level of coverage would help the small banks to expand their funding base and, over time, contribute to the diversification of the banking sector.

Thirdly, the envisaged deposit insurance scheme would be funded by the banks themselves, and all registered banks would be obliged to contribute to the fund. The paper proposes two possible funding options that were considered at the time. However, the most cost-efficient funding mechanism is still being discussed with the banking sector, and the ultimate decision may well differ from the proposals in the paper. It is important that the deposit insurance scheme is funded in such a way that the cost to the banking sector does not exceed the financial stability benefits, and that there is sufficient funding available to make the deposit insurance scheme effective. It is also important to have emergency funding available in the event that the deposit insurance scheme experiences a funding shortfall. Emergency funding arrangements should include prearranged and guaranteed sources of liquidity funding and be legislated. This is, however, subject to the proviso that such emergency funding is subsequently recovered from the remaining banks after the failure event.

Fourthly, the build-up of a fund is but one aspect of the deposit insurance scheme. Equally important is the availability of accurate depositor information as well as IT[3] systems and mechanisms to enable the prompt payout of deposits, supported by a sound legal framework, effective operational controls, and a strong governance framework. There will be much work for both the deposit insurance scheme and the banks once the legislation is in place. In this regard, the International Association of Deposit Insurers, of which South Africa is currently an associate member, has developed a set of tried and tested Core Principles to guide us in the development of a world-class scheme. There are also some more detailed areas that will require further research and deliberation, for example how exactly pooled accounts should be treated and how the small cooperative financial institutions should fit into the deposit insurance scheme framework. These aspects are important and will receive special attention in the coming months, without delaying the legislative processes.

We appreciate your interest in this important initiative as a major part of the success of the deposit insurance scheme will depend on the public's awareness of the scheme and knowledge about how it works. Enhancing such awareness will be an ongoing task of the

[3] information technology

deposit insurance scheme, in which the media will be our close allies. The workshop today is a good start.

Finally, we would like to remind you that there is also an opportunity to submit written comments on the deposit insurance scheme paper until 31 August 2017. We encourage you to make use of this opportunity as it will assist us in making the best policy choices.

Thank you.