
Asian Banking, Depositor Preference, and Deposit Insurance

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Summary

- Asian banking integration requires close attention to depositor preference and insurance arrangements
 - Both cross - border and national aspects
 - Depositor preference becoming common globally
 - Nature of preference arrangements can substantially reduce risk to insurance fund
 - “fair value” premium – may be zero
 - Rationale for *ex ante* fees reduced
 - But, dependent on funding structure, and
 - growth of secured funding, netting arrangements complicate matters
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Conclusions

- Coordinated discussions on structure of deposit insurance schemes and (domestic and national) depositor preference arrangements needed
 - Have implications for bank funding, structure and financial stability
- Current arrangements not adequate for successful Asian banking integration such as proposed by ASEAN ABIF framework
 - Particularly if to eventually be ASEAN+3

Depositor Preference

- Refers to priority of claims of all bank creditors in event of bank failure
 - Some jurisdictions place (some/all) depositors ahead of unsecured creditors, others don't
 - Perhaps behind unpaid employees, taxes, amounts owed to Central Bank etc.
 - Behind “encumbered” assets (secured (repo) funding, covered bonds, netting/set-off arrangements)
 - Either/or banking/general insolvency law provisions
 - Deposit insurance fund may or may not assume priority of insured depositors it has paid out

(Domestic) Depositor Preference Types

- *Tiered Depositor Preference*
 - Insured deposits $\overset{S}{>}$ Uninsured Deposits $\overset{S}{>}$ Other Creditors
 - Deposit insurer may inherit insured deposit seniority
 - *General Depositor Preference*
 - Insured deposits $\overset{S}{=}$ Uninsured Deposits $\overset{S}{>}$ Other Creditors
 - Deposit insurer may inherit depositor seniority
 - *Insured Depositor Preference*
 - Insured deposits $\overset{S}{>}$ Uninsured Deposits $\overset{S}{=}$ Other Creditors
 - Deposit Insurer may inherit insured deposit seniority
 - *No Depositor Preference*
 - Insured deposits $\overset{S}{=}$ Uninsured Deposits $\overset{S}{=}$ Other Creditors
 - Deposit insurer may have no seniority
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Alternative Depositor Preference Types

		Tiered Depositor Preference	General Depositor Preference	Insured Depositor Preference	No Depositor Preference
Ranking	Senior	Insured Deposits	Insured & Uninsured Deposits	Insured Deposits	Insured & Uninsured Deposits & Unsecured Creditors
		Uninsured Deposits		Uninsured Deposits & Unsecured Creditors	
Junior		Unsecured Creditors	Unsecured Creditors	Unsecured Creditors	
		Equity	Equity	Equity	Equity

National Depositor Preference

- Depositors in home jurisdiction have priority over depositors in a foreign branch if bank fails
 - Eg, US, Australia, Singapore
 - UK FSA proposals 2012
 - Ensure local depositors in bank branches of banks from outside EEA have equal priority with home country depositors
 - If not, require subsidiarisation, ring-fencing of UK branch assets etc
 - US complication: Equal preference may make foreign branch deposits insured under home country scheme
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Depositor Preference World-wide

- IADI (Dec 2013) survey
 - 62 respondents had depositor preference
 - 37 did not
 - UK and EU jurisdictions – introduction 2015
 - 31 had preference arrangements determined under banking law, 25 under insolvency law, others a mix or regulation
- Examples: Argentina, Australia, China, France, India, Indonesia, Mexico, Russia, Switzerland, Turkey, US
- IMF has recommended introduction in recent FSAPs of Brazil and Canada

Asia: Deposit Insurance & Preference

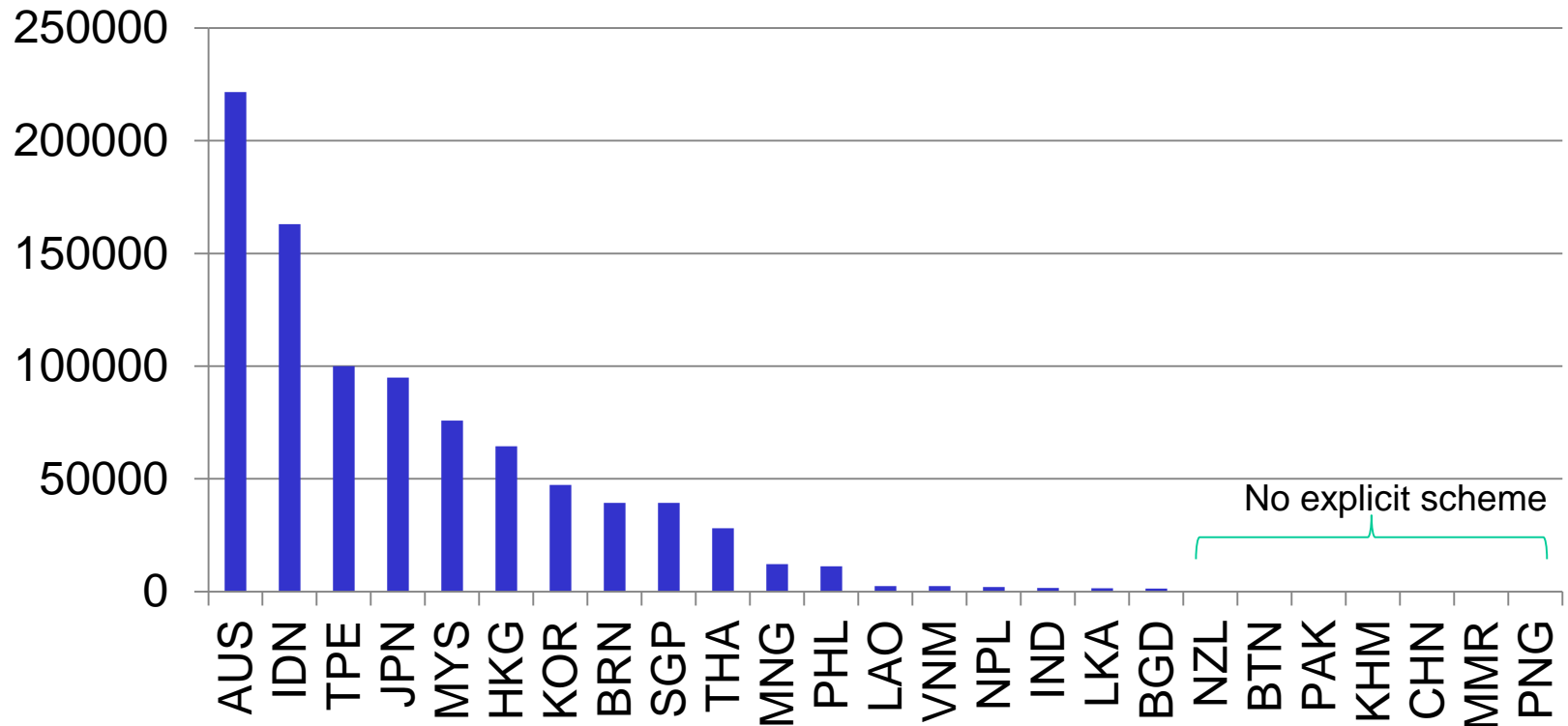
Explicit deposit insurance	From	Depositor Preference
Afghanistan	2009	Yes
Australia	2008	Yes (Tiered)
Bangladesh	1984	No
Brunei Darussalam	2011	Yes
Hong Kong	2004	Yes (Tiered)
India	1961	Yes (General) from 2014
Indonesia	2004	Yes
Japan	1971	No
Korea, Rep.	1996	No
Lao PDR	1999	?
Malaysia	2005	Yes (General)
Mongolia	2013	Yes
Nepal	2010	?
Philippines	1963	No
Singapore	2006	Yes (Tiered)
Sri Lanka	2012	?
Taiwan	1985	Yes
Thailand	2008	No
Vietnam	2000	Yes (insured only)

No insurance	Depositor Preference
Bhutan	?
Cambodia	?
China	Yes
Myanmar	?
Pakistan	?
PNG	?
New Zealand	No

Asean

Sources:
IADI, World
Bank

Deposit Insurance Caps (2013*)



■ Coverage limit in US dollars in 2013 (statutory limit, converted in US dollars)

*Thailand: 2016 proposed new (much lower) cap

ASEAN Banking Integration Framework (ABIF)

- Endorsed by ASEAN Central Bank Governors in December 2014
 - Qualified ASEAN Banks (QABs) concept
 - Reciprocal bilateral agreements among ASEAN-5 enabling operation as if domestic bank in host country
 - Requires home-host regulatory / supervisory cooperation
 - Ultimate objective of multilateral agreement on ASEAN banking sector integration by 2020
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Banking Integration: Some Requirements

- Supervision and Regulatory cooperation
- Resolution arrangements
- Legal structure (branches, subsidiaries etc)
- Deposit Insurance
 - “it may be necessary to put in place a single resolution mechanism that includes a single resolution agency, and a common deposit guarantee scheme” (Almekinders et al, IMF, 2015)
- Depositor Preference

Banking Integration Complications: Lessons from Iceland

- Icesave (UK Dutch branches of Landsbanki), failure Oct 2008
 - UK/Dutch deposit insurance schemes paid out amounts covered (according to Icelandic scheme) -anticipating reimbursement
 - UK/Dutch governments paid out rest of retail deposits
 - Also similar issues with Kaupthing Edge failure
 - (branches in Finland, Norway, Germany, Austria)
 - European Union directive 94/19/EC – national deposit insurance schemes to provide protection for their banks' depositors anywhere in EU (but Iceland cap less than UK)
 - Subsequent drawn out political and legal disputes
 - September 2015 settlement – leaves UK scheme out of pocket, but around 85% of GBP 4.5 bill deposits reimbursed by UK authorities recouped from Landsbanki liquidation
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Malaysia-Indonesia ABIF Agreement

- Heads of agreement signed December 2014

	Indonesia	Malaysia
Insurance Cap USD '000 equiv (2013)	163	76
Foreign Bank Branches	Covered	Not covered
Local Incorporation required	??*	Yes
Foreign currency deposits covered	Yes	Yes
Depositor Preference	Tiered	General

* Historically some foreign banks operate as branches.
Legislation under consideration to require incorporation and limit on foreign ownership

Preference and Deposit Insurance Cost

- Depositor Preference dramatically affects net payouts by insurer in event of failure
 - Tiered preference may make probability infinitesimal (if robust supervision)
 - Fall in asset values required to lead to insurer losses is extremely large
 - Dependent on financial structure

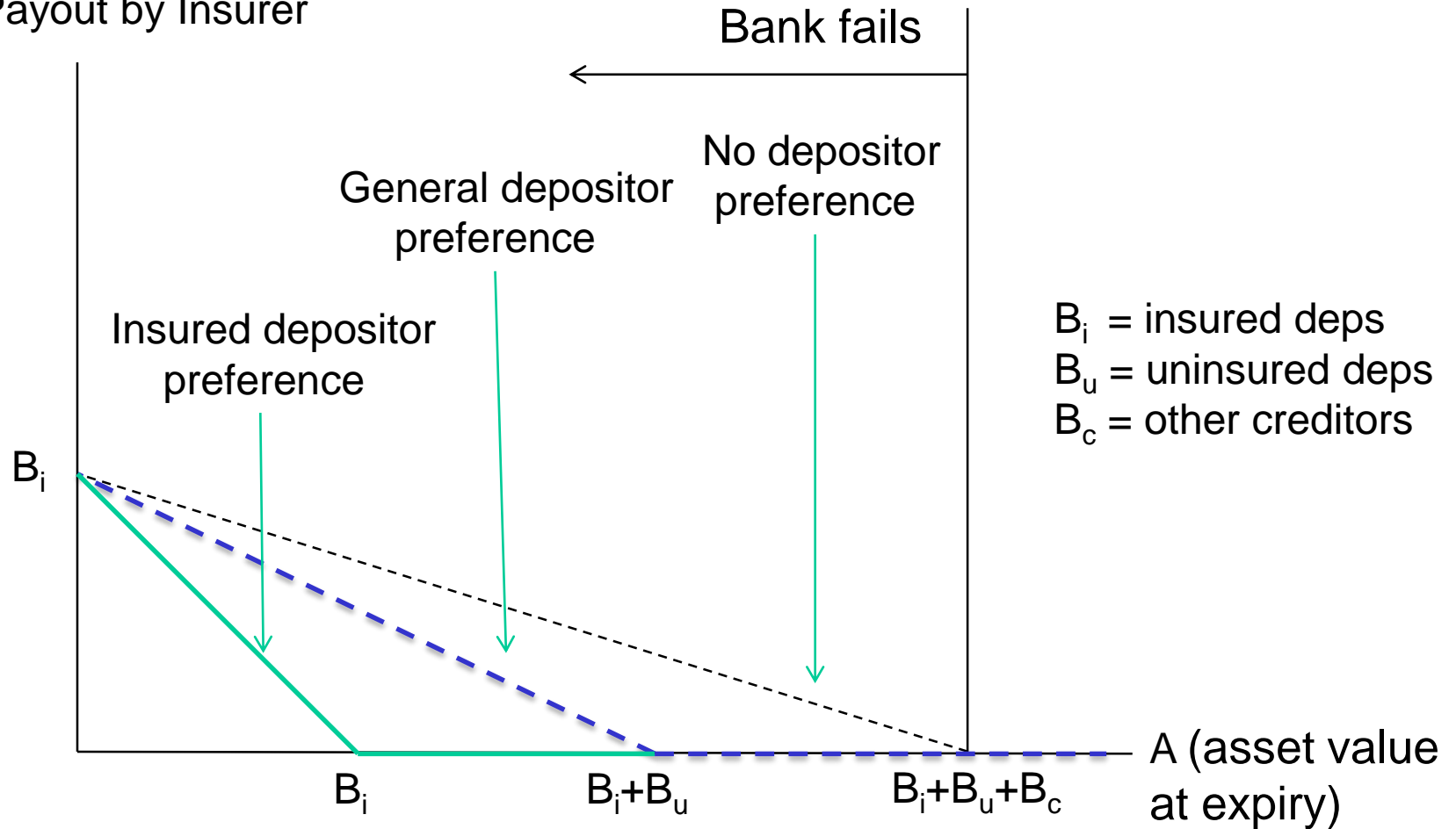
- *Example:*

With tiered preference, assets have to fall in value by over \$70 before insurer makes loss

Assets	Liabilities
Loans etc 100	Insured Deposits 30
	Uninsured Deposits 30
	Bonds 30
	Equity 10

Deposit Insurer Payouts under Different Preference Arrangements

Net Payout by Insurer



Secured Funding and Encumbered Assets

- Increased use of collateralised funding by banks and encumbered assets
 - Encumbrance via: covered bonds, repo financing, netting of derivatives, central bank liquidity support
 - Does that affect deposit insurance pricing
 - Less assets available, but possibly
 - Less deposit funding
 - Fair value needs to be calculated by reference to unencumbered assets relative to insured deposits
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Depositor Preference: Possible Consequences

- Reduces “fair” price of Deposit Insurance
- Bank Funding and Structure
 - More use of deposits v other debt
 - Shift some activities out of bank
 - Increased use of secured /collateralised funding /asset encumbrance
 - Holding company structures
 - Reduced incentive to leverage
- Financial Stability
 - Relative propensity to “run” and price v liquidity effects

Conclusions

- Depositor preference arrangements critical for resolution arrangements, design and pricing of deposit insurance
 - Increased global focus on preference arrangements
 - Coordinated discussions on structure of deposit insurance schemes and (domestic and national) depositor preference arrangements needed for banking integration
 - Current arrangements not adequate for successful Asian banking integration such as proposed by ASEAN ABIF framework
 - Particularly if to eventually be ASEAN+3
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