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Implementing Deposit Insurance in Cambodia

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Leveraging the Bank Sector to promote the Riel

In Asean, Cambodia is the only country without a Deposit Insurance Scheme (DIS), with the exception of Myanmar, which has a financial system that barely functions. An appropriately designed DIS would not only enhance confidence in the banking system, it could also build confidence in the Khmer Riel (KHR) and increase the level of savings in KHR.

Background

Money has three principal functions:

1. As a means of exchange (eg to purchase things)
2. As a store of value (eg savings in a bank)
3. As a unit of account, or measure of value (eg for accounting purposes)

Our paper is focused on promoting the Riel as a **store of value**, by implementing a Deposit Insurance Scheme (DIS) specifically for Riel deposits. Increasing the use of KHR as a store of value is likely to have flow on effects to increase its use as a means of exchange.

Typically, the main purpose of a DIS is to support confidence in deposit taking banks, and to minimize the risks of a bank run. Demonstrating the success of such schemes, during the GFC the world did not experience bank runs on insured deposits (Kane, Demirgüç-Kunt, and Laeven).

However in the case of Cambodia, a DIS will also have as a clear goal supporting confidence in KHR Deposits specifically, in turn contributing to greater use of the Riel. This was envisaged in a 2010 IMF Report on de-dollarisation in Cambodia, which specifically noted that Deposit Insurance was a tool that could be used to support confidence in the Riel, and in turn support de-dollarisation (Duma).

How widespread is Deposit Insurance Globally?

Deposit insurance is the norm rather than exception. Globally, 112 countries have an explicit Deposit Insurance Scheme (Kane, Demirgüç-Kunt, and Laeven).

Within ASEAN, deposit insurance is particularly widespread, with only Cambodia & Myanmar not having a scheme. As noted above, Myanmar's financial system barely functions, leaving Cambodia as the only country in the region with a functioning financial system to not have a DIS.

<table>
<tr><th>Has Deposit Insurance</th><th>Does not have Deposit Insurance</th></tr>
<tr><td>Indonesia</td><td rowspan="4">Cambodia</td></tr>
<tr><td>Singapore</td></tr>
<tr><td>Thailand</td></tr>
<tr><td>Laos</td></tr>
<tr><td>Vietnam</td><td rowspan="4">Myanmar</td></tr>
<tr><td>Malaysia</td></tr>
<tr><td>Brunei</td></tr>
<tr><td>Philippines</td></tr>
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Design of a DIS

Based on the key design features of a DIS outlined by Kane, Demirgüç-Kunt, and Laeven, we have outlined the most appropriate elements for a Cambodian DIS.

Feature	Recommendation	Rationale
Type of Scheme		
Administration	Legally Separate within NBC	In some countries, the DIS is legally separate and managed privately, and in others it sits within the relevant ministry. We believe the most appropriate model, and the most common model internationally, is that it sits within the central bank as a legally separate entity. Globally, 86% of schemes are legally separate from their host institution.
Role	Paybox only	Internationally, 43% of DIS have a paybox only role, whereby they simply reimburse depositors in the event of the bank's insolvency. Other models include a supervisory and/or resolution role. We believe Cambodia's DIS should be limited to a paybox function only (ie pay out depositors in the event of a bank collapse). It should not replicate or usurp the supervisory function undertaken by the NBC.
Participation and Coverage		
Participation	All Commercial Banks, MDIs, and Specialised Banks authorised to take deposits.	In a practical sense, there is no operational distinction between local and foreign banks in Cambodia, and therefore the DIS should apply to all licensed Commercial Banks. With MDIs and Deposit Taking Specialised Banks also taking KHR deposits, we believe that they should also be covered by the DIS.
Types of Deposits	KHR customer deposits only	This is a key feature of the design of the Cambodian DIS, which is that it only covers KHR deposits. This is in line with one of the key drivers of implementing a DIS which is to build confidence in KHR as a means of savings, and to de-emphasise USD deposits. Furthermore, this is in line with IMF recommendations that USD either has lower cover, or none at all.

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Feature	Recommendation	Rationale
Funding		
Ex Ante or Ex Post	Ex Ante	88% of countries with an explicit DIS have an ex-ante scheme. Ex post schemes exist in about one-fourth of high income countries but are altogether absent in low income and lower middle income countries which use Ex Ante schemes. In the event of a claim on the DIS, we believe it will be difficult and time consuming to raise funds from surviving banks to immediately pay out any claims. This would reflect both unwillingness on the part of surviving banks, and also the capacity of low profit banks to make a contribution.
Funding Source	Banks & MDIs	As the principal beneficiaries of a DIS, it is appropriate for the banks & MDIs to also fund it, rather than the government. Globally, 77% of DIS schemes are funded privately by the beneficiary banks, rather than the government.
Contributions and Assessment Base		
Target Coverage Ratio	DIS to target 5% of covered deposits	There is a wide dispersion of coverage ratios globally, from -0.12% in the US, 1.2% in Indonesia, up to 6.2% in Brazil and 5.4% in Turkey. Globally, the average is 3% for middle income countries. The only disclosed data for Asean countries is Indonesia and Singapore (0.13%). To maximize the confidence boosting aspect of the DIS, and given it applies only to a subset of a bank's deposits (ie KHR), a higher target of 5% should be adopted.
Premium	0.1%	This is around double the premium recently introduced in China, but in line with the current premium in the US (which is looking to rebuild the fund post GFC). It is also higher than Singapore which is 0.07% or less. While acknowledging this is slightly at the high end of global premiums, it is appropriate in the first five years of the scheme in order to achieve a 5% coverage ratio. By 2020, modeling suggests that the premium could be reduced to 0.08%.

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Feature	Recommendation	Rationale
Risk Adjusted Premiums	No	Globally, 31% of schemes adjust premiums for risk. We do not believe that is appropriate for Cambodia, given difficulties in managing risk, along with political sensitivities.
Assessment Base	Total USD Deposits	It is expected that banks will seek to pass on at least some of the cost of any premium/levy. By limiting the assessment base to USD deposits, it will make USD deposits marginally less attractive either through slightly lower deposit rates, or by increased efforts by banks to encourage KHR deposits. Over time (likely to be more than 10 years), it will necessary to consider including KHR deposits in the assessment base if they grow materially as a share of total deposits.
Payouts to Depositors		
Coverage	50m KHR (USD12.5k) (potentially increasing to 100m KHR)	For lower middle income countries, the global average is around 12x per capita GDP, although this falls to just 5x for low income countries. A level of 50m KHR would represent just under 12x GDP per capita. This would be broadly in line with the Philippines (~$11.5k), well below Thailand (~$1.5m), but above Vietnam (~$2.5k).
Payouts	Per Depositor, per Institution	Coverage should be based on total customer level exposure, rather than on account level exposure. That is, if a customer has two deposits of KHR40m for a total of KHR80k, then they would only be eligible for KHR50m as an insurance payout. Given the difficulties in determining exposures across banks, we believe it would be unrealistic to apply this cap across multiple institutions, and thus there will be some customers who will benefit by more than KHR50m by having accounts at two or more banks. This model is the prevalent model globally.

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Response of the banks and MDIs

Article 40.3.m of the Law on Banking & Finance requires the NBC to consult with the Association of Banks Cambodia prior to establishing rules for a DIS.

A deposit insurance scheme will likely be seen by covered entities as a tax on deposits, which may lead to some resistance as the banks focus on self interest.

However we estimate the negative financial impact on the bank sector will be modest, and that over the long term the bank sector will benefit from greater public confidence in KHR deposits.

In terms of direct financial impact, we estimate that the cost of the levy will amount to approximately 1% of revenue per annum in the first five years, and just over 2% of profits, making the unlikely assumption that the banks do not pass any of this on to customers.

In 2008 the NBC appropriately increased Reserve Requirements despite significant pushback from the bank sector. The public good once again justifies the NBC taking a step that may not be popular with the bank sector, but is the right thing to do.

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References

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E. Kane, A. Demirgüç-Kunt, and L. Laeven, 2014, Deposit Insurance Database, IMF Working Paper, (Washington: International Monetary Fund).

Financial Stability Board, 2012, Thematic Review on Deposit Insurance Systems, http://www.financialstabilityboard.org/publications/r_120208.pdf