



DEPOSIT INSURANCE AND ITS IMPLICATIONS FOR FINANCIAL CONSUMER PROTECTION

FINANCIAL CONSUMER PROTECTION AND FINANCIAL LITERACY

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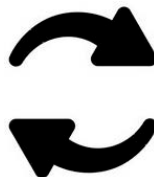
- Deposit insurance and wider perspective on consumer protection in financial markets**
- Reasons for protecting and informing consumers and possible obstacles within these processes**
- Global and local examples of risks associated with consumer protection**
- The approach to consumer protection in the EU (new Deposit Guarantee Scheme Directive)**
- IADI research programs on consumer protection and Core Principles for Effective Deposit Insurance Systems**

The deposit insurance fund is only one of the elements of a complex **consumer protection** scheme in financial markets



Consumer protection is an attribute of not only deposit insurers but also of other financial safety-net players as well as policymakers

Because of the complexity of financial markets, **consumer protection** and the **policy of informing consumers** always need to be considered from a broad perspective



Protection needs to be linked with the large variety of products available in financial markets such as capital investments or credit

The financial system should be equipped with a properly designed consumer protection scheme, comprising various entities with different responsibilities

The whole mechanism contributes to the financial stability of the economy

CONSUMERS OF FINANCIAL SERVICES

- Often have lack of basic market knowledge
- Sometimes buy complicated products designed for professionals
- Do not understand the risk associated with financial products nor the intent behind their design
- Have a strong tendency for confirmation bias and wishful thinking – especially dangerous in financial markets
- See only „one side” of the market
- Are susceptible to herd instincts

SELLERS & DESIGNERS OF FINANCIAL PRODUCTS

- Offer complicated products whose construction is unclear even for their sellers
- Do not sufficiently inform about the undertaken risk
- Transfer a large part of the risk to counterparties (consumers)
- Create uneven distribution of rights and obligations between counterparties involved in the product (in favour of the seller)



In recent years more consumers and retail investors have become active in financial markets and are being offered a more complex and wide-ranging set of financial services and instruments



This directly translates into a greater volume and value of transactions taking place in financial markets

Consumers and retail investors need to be fully protected and supplied with extensive information about products and services, investments, and especially the risk associated with their actions

Why is informing and protecting consumers in financial markets crucial?



Because consumers need to:

- **understand what they are doing**
- **understand the potential consequences of their decisions**
- **understand and accept the risk of an investment or financial transaction**



MARKET IMPERFECTIONS IN THESE AREAS CAN HAVE SERIOUS RAMIFICATIONS IN THE FORM OF CREATION OF MARKET BUBBLES AND CAUSING DIFFERENT TYPES OF CRISES

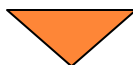
CURRENCY RATE PLN / EUR 2007-2009



- ❑ A steady trend of PLN appreciation encouraged Polish exporters to purchase currency options with banks, hedging the value of their revenues from abroad
- ❑ In 2008 Poland was hit by an economic crisis, which triggered the process of rapid depreciation of PLN

MECHANICS OF THE PROBLEM

- ❑ Companies that had purchased options were obliged to sell PLN to banks at a fixed price stipulated in contracts (e.g. PLN 3.5), also when the market price was PLN 4.8
- ❑ This was in a large part a **speculation game** because the contracted amounts were much higher than the expected export revenues from particular companies



LOSSES OF POLISH COMPANIES

- ❑ Negative valuation of currency derivatives issued by Polish companies amounted to PLN 16 billion
- ❑ Negative valuation of currency options amounted in total to PLN 9 billion
- ❑ 99 public listed companies were affected by losses on options

NAME OF COMPANY	CURRENCY OPTION LOSS IN MILLIONS PLN
Krosno	300
Ciech	300
Zakłady Police	124
Cersanit	53
Rudniki	13

Source: KNF

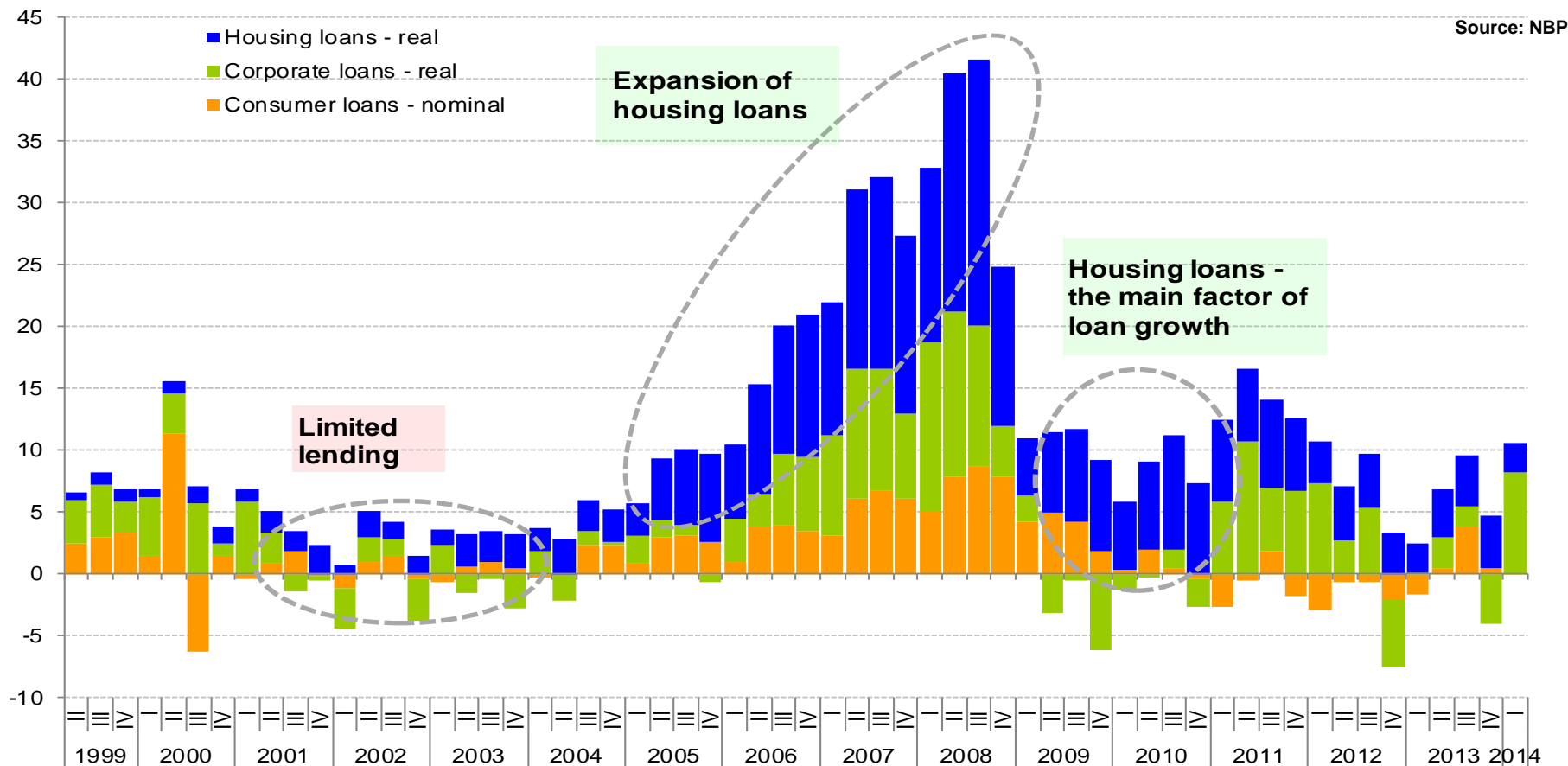
EXAMPLES OF MARKET BUBBLE CREATION**GLOBAL CHARACTER**

- „Dotcom” bubble
- Credit boom during times of low interest rate levels
- Mortgage-backed securities (global financial crisis)

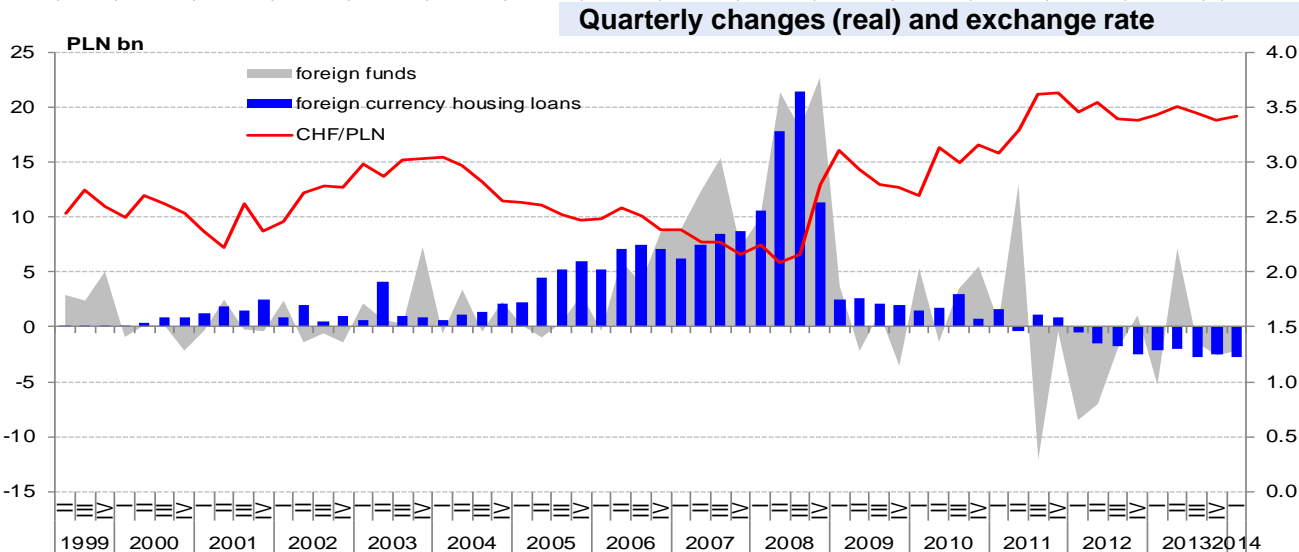
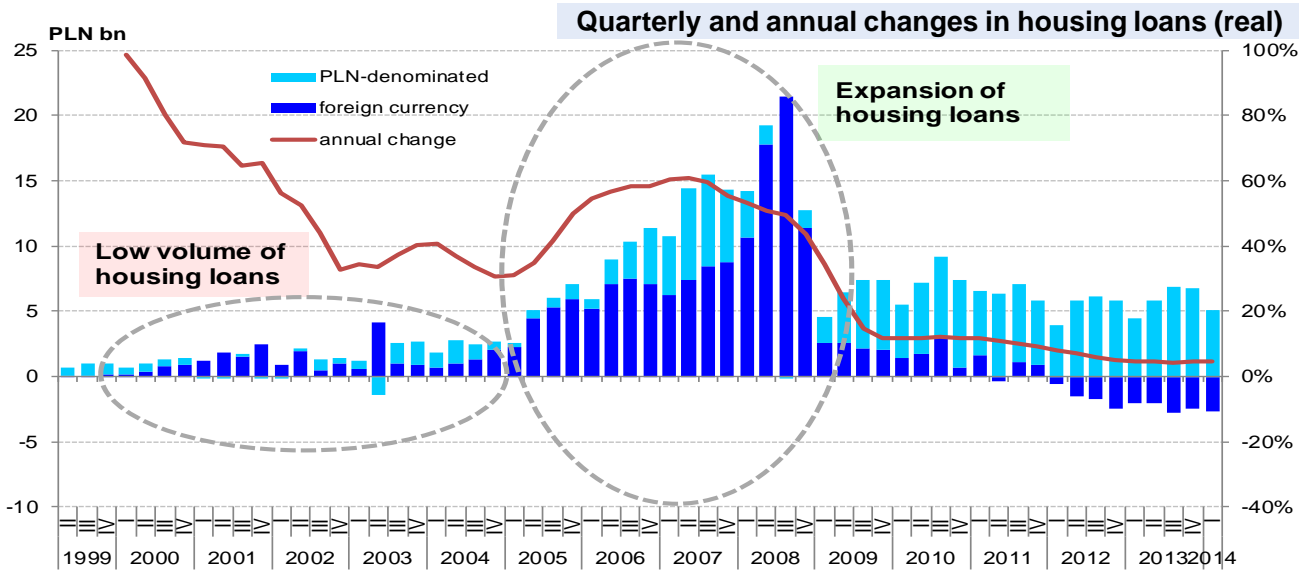
**LOCAL CHARACTER
(EXAMPLES FROM POLAND)**

- Popularity of derivative products (currency options)
- Mortgage loans in foreign currencies for households
- Structured investment products as a way of ordinary saving
- Offering aggressive-strategy investment funds for those types of consumers that particularly need to be protected (e.g. the elderly)

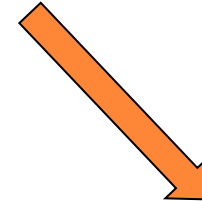
LOANS BY CATEGORIES – QUARTERLY CHANGES (IN BILLIONS PLN)



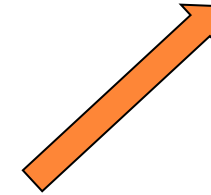
Availability of cheap financing allowed banks to create an attractive housing loan offer, which in combination with a high demand of households for flats/houses allowed dynamic development of lending

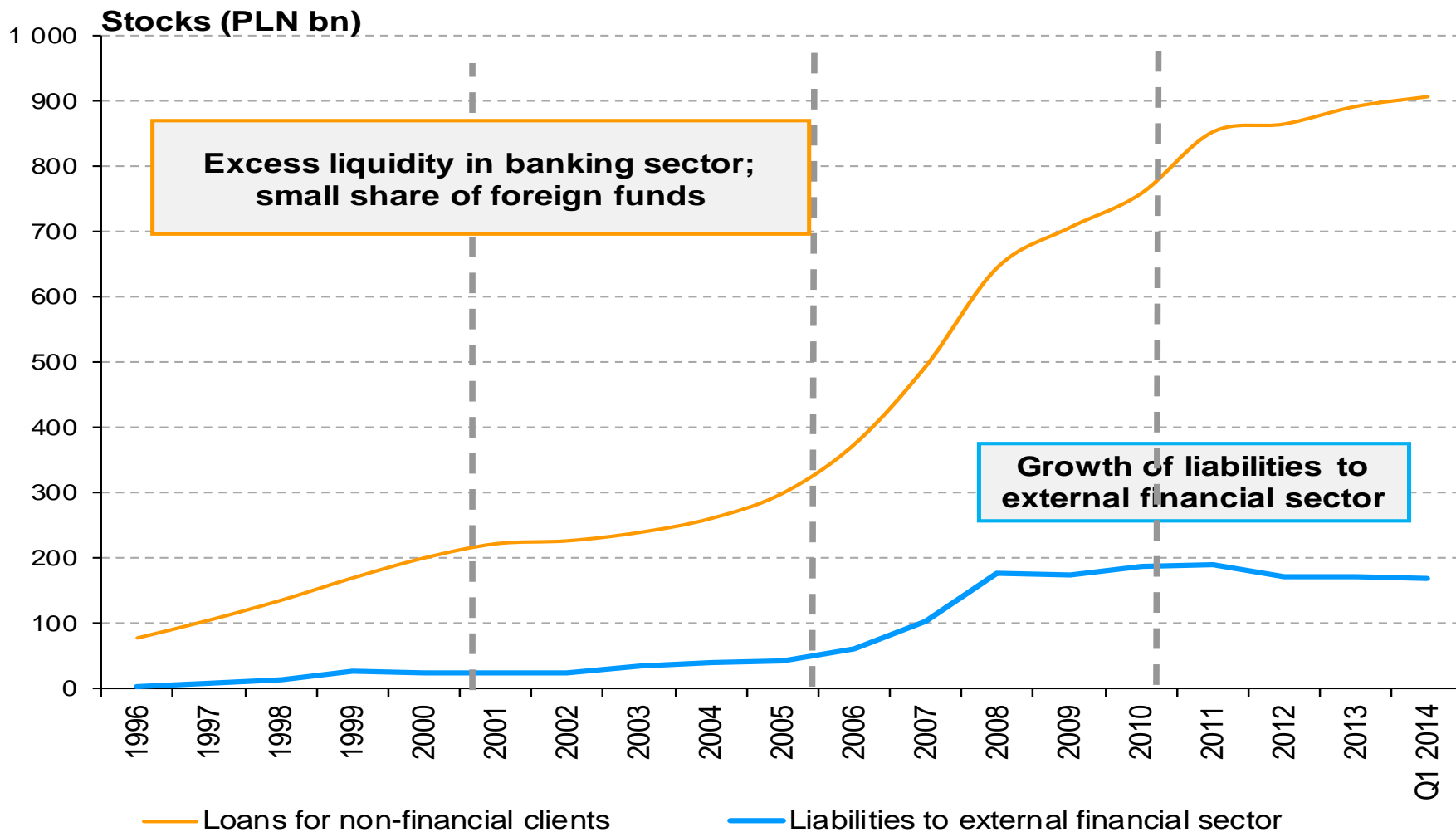


Source: NBP



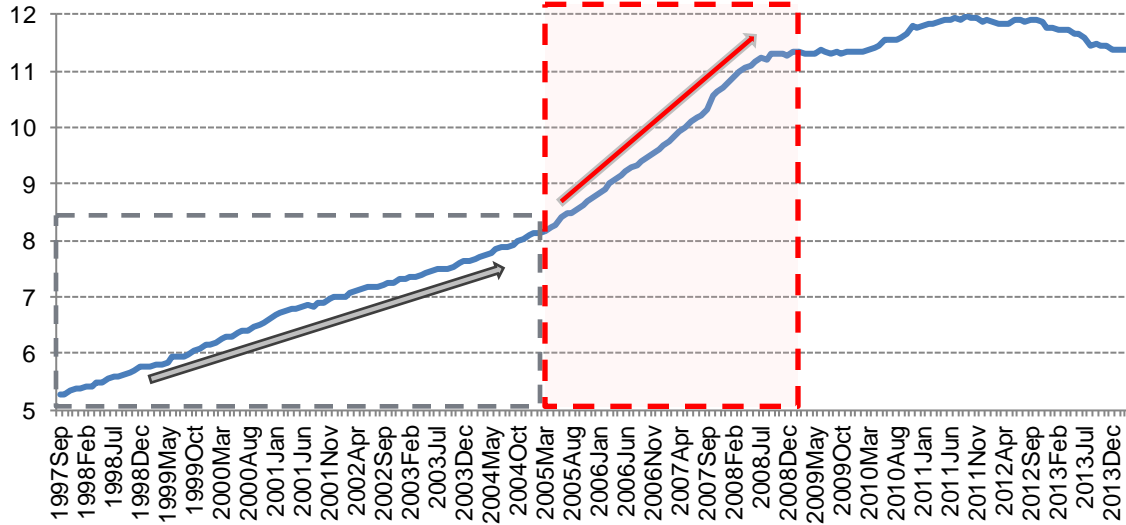
The dynamic growth of housing loans was possible mainly due to the growth in foreign currency loans, which were cheaper than PLN-denominated loans because of banks' access to foreign funding





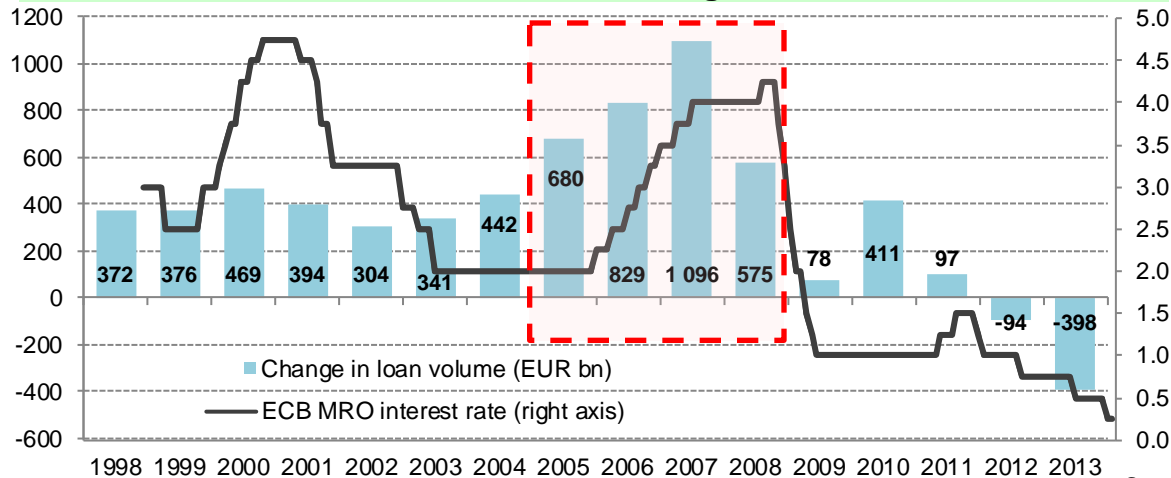
Years 2005 - 2008 – a period of increased inflow of foreign funding

Loans for Non-MFIs (EUR trillions)



Intensive growth of bank lending to Non-MFIs in pre-crisis period

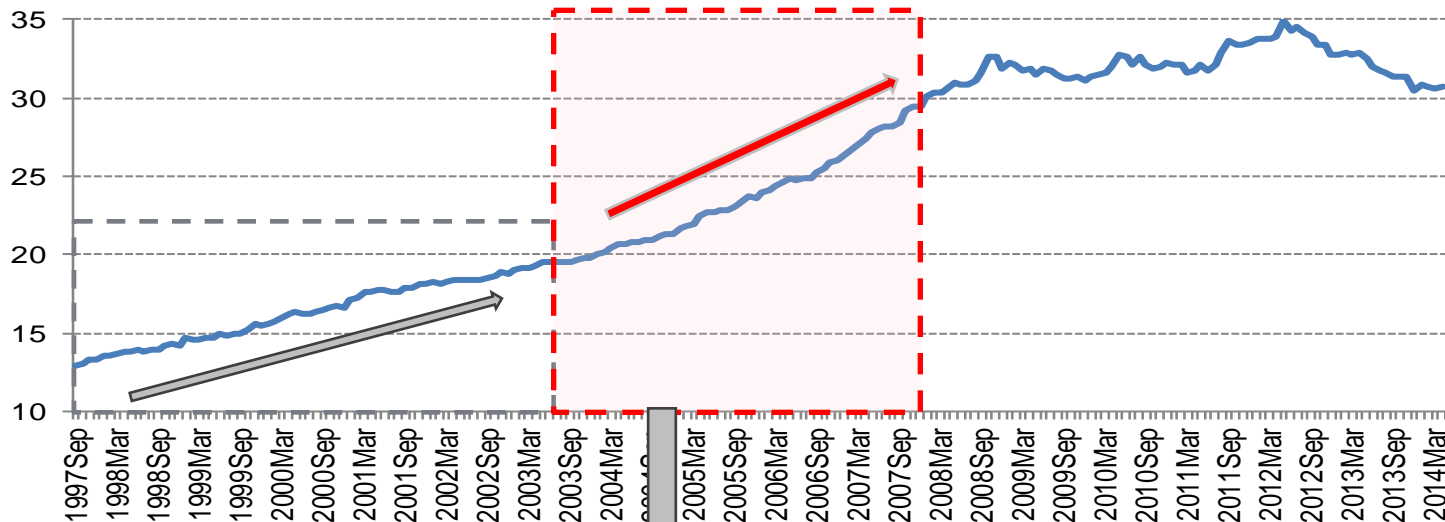
Loans for Non-MFIs – change in volume



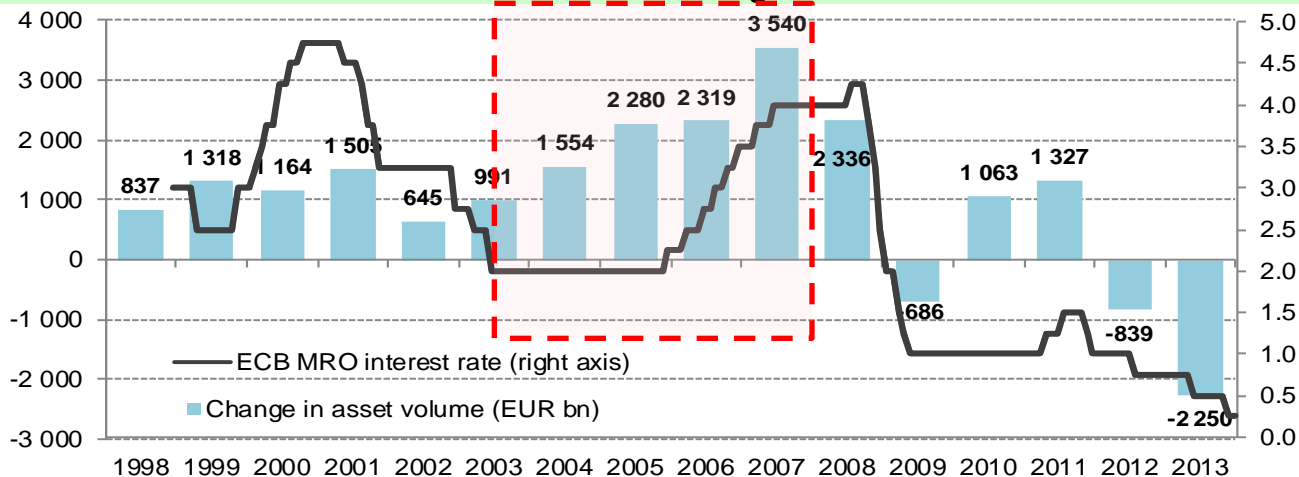
In 2005-2008 annual change in volume between 0.6-1.1 EUR bn, in comparison to 0.3-0.4 EUR bn in 1998-2004

Source: ECB

Total assets (EUR trillions)



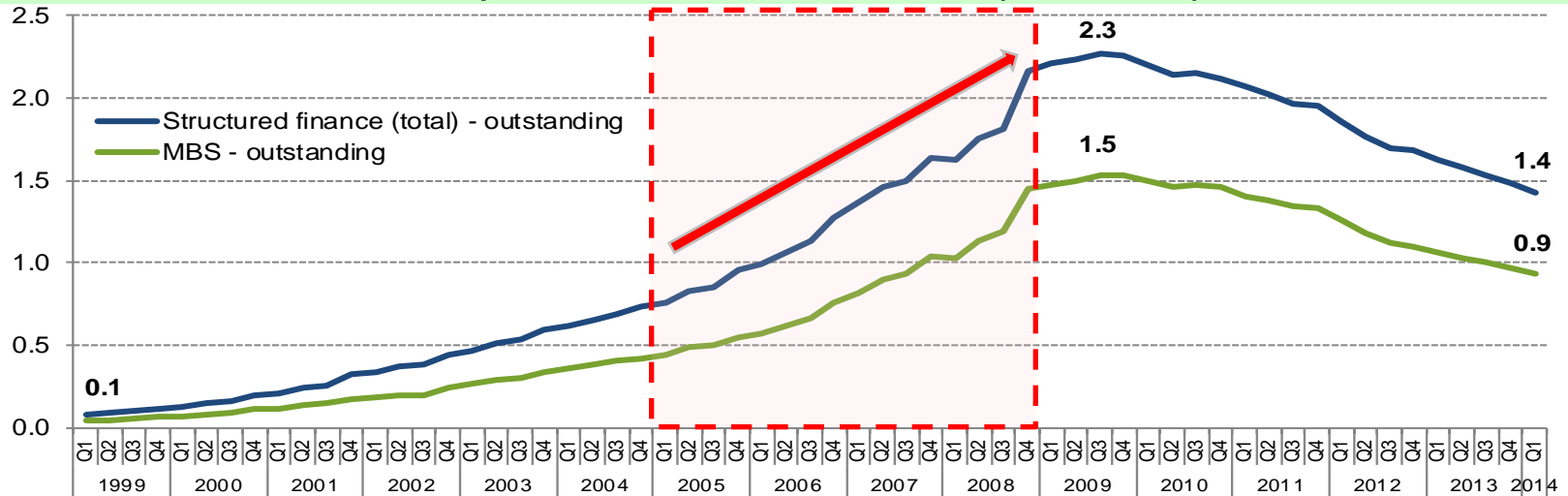
Total assets – change in volume



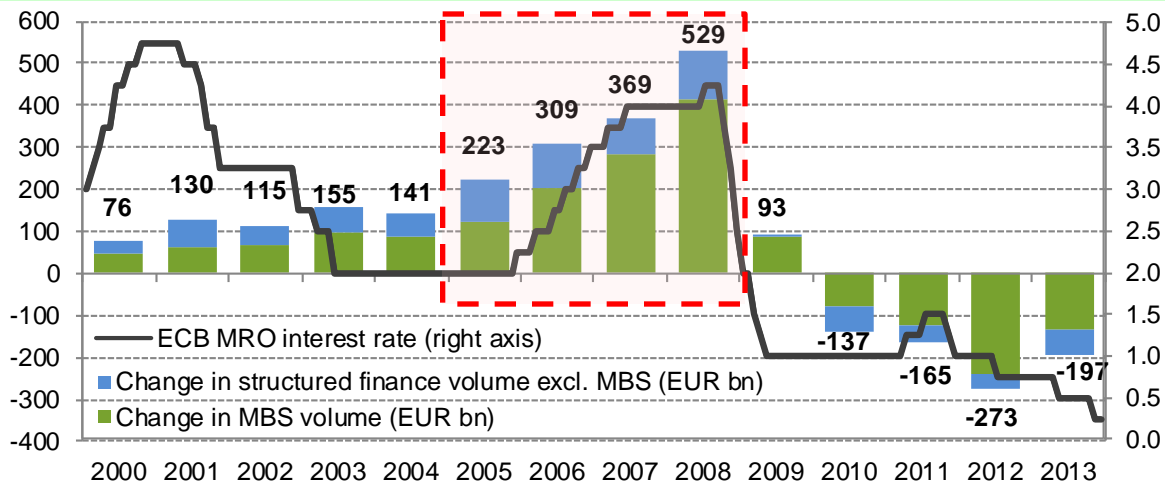
Intensive growth of total euro area bank assets in pre-crisis period

Source: ECB

European structured finance 1999-2014 (EUR trillions)



European structured finance – change in volume

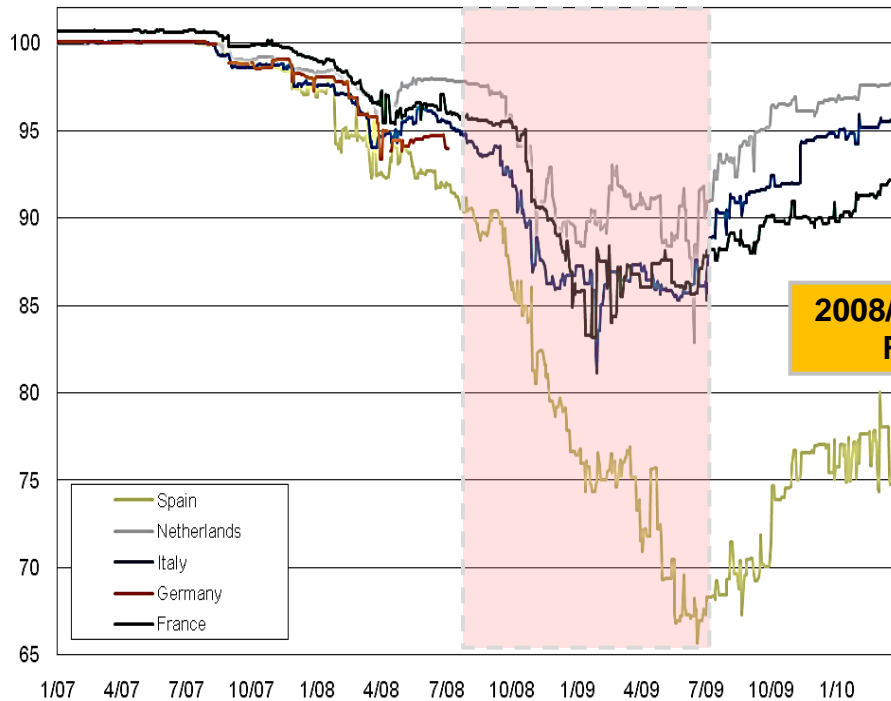


2005-2008 – dynamic growth of outstanding balance of European securitized products (including mortgage-backed securities)

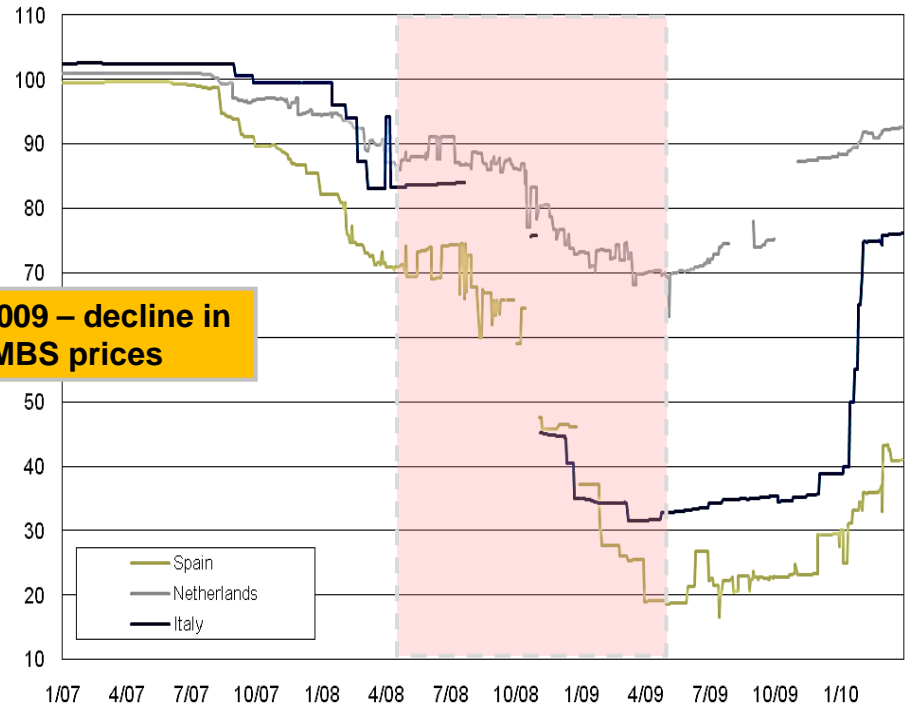
In 2008 the annual increase in volume was 4 times higher than in 2004

Source: Sifma

European 3-5 Yr AAA RMBS Prices



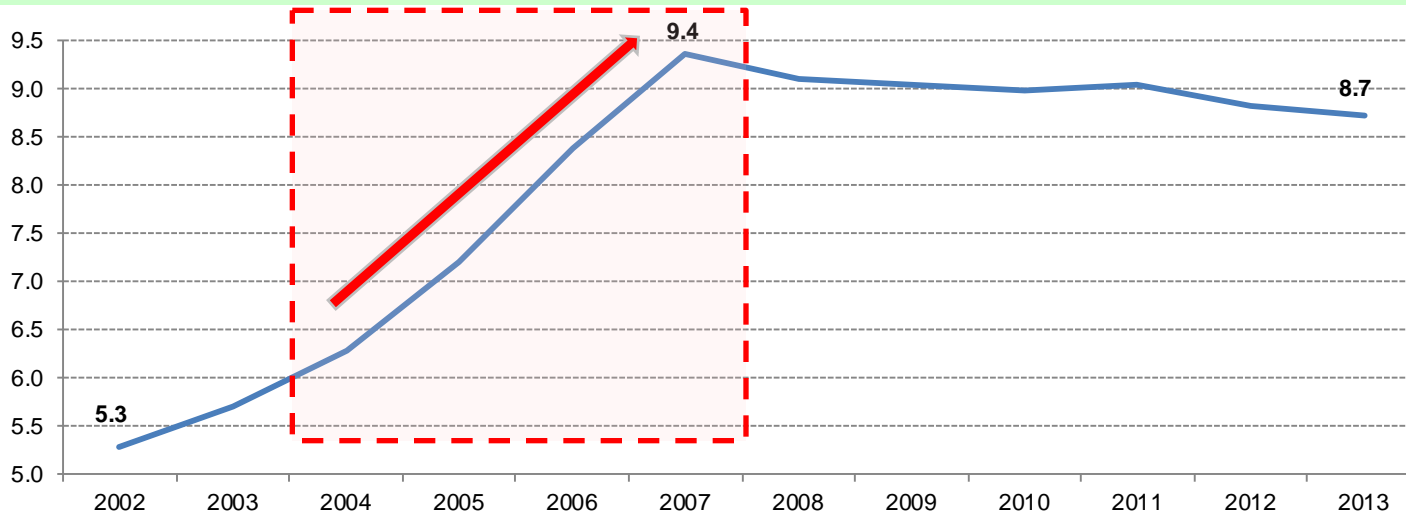
European 3-5 Yr BBB RMBS Prices



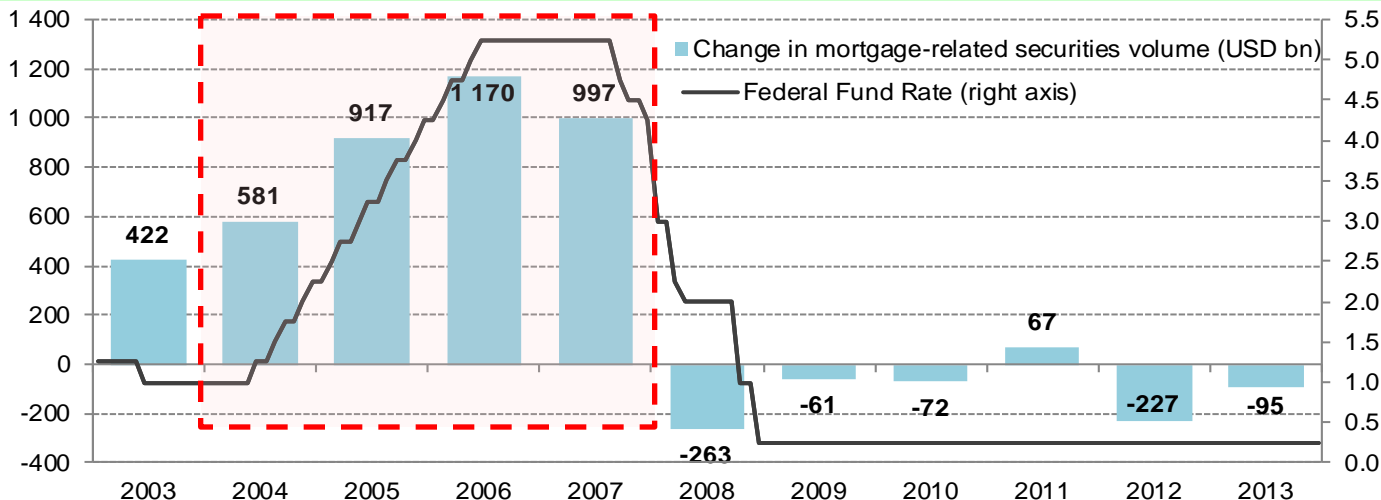
Source: Afme.

After intensive growth in the volume of securitized products, the prices of residential mortgage-backed securities (RMBS) started to decrease in 2008

U.S. Mortgage-Related Securities 2002-2013 (USD trillions)



U.S. Mortgage-Related Securities – change in volume



Intensive growth of U.S. mortgage-related securities market in the pre-crisis period

Source: Sifma, Reuters.

**DIRECTIVE 94/19/EC
ON DEPOSIT-GUARANTEE SCHEMES**

Goal

„ [...] increasing the stability of the banking system and protection for savers ”

Tools:

- protection of all depositors in the entire EU
- min. level of protection – 20 000 euro
- banks provide customers with information about the rules concerning deposit guarantee schemes

**DIRECTIVE 2009/14/EC
AMENDING DGSD**

Goal

„ [...] restore confidence and proper functioning of the financial sector”
„ [...] take all necessary measures to protect the deposits of individual savers”
„ [...] improvement of that coverage”

Tools:

- increasing level of protection to 50 000 euro and later to 100 000 euro
- faster pay-out - up to 20 working days
- eliminating the possibility of depositor co-insurance
- strengthening information rules (additionally banks inform customers if financial instrument is not covered)

**NEW DGS
DIRECTIVE
2014**



„As a result of this Directive, depositors will benefit from significantly improved access to DGSs, thanks to a broadened and clarified scope of coverage, faster repayment periods, improved information and robust funding requirements. This will improve consumer confidence in financial stability throughout the internal market.”

Basic information about the protection of deposits	
Deposits in „Example Bank” are protected by:	Bank Guarantee Fund
Limit of protection:	EUR 100 000 per depositor per credit institution
If you have more deposits at the same credit institution:	All your deposits at the same credit institution are "aggregated" and the total is subject to the limit of EUR 100 000
If you have a joint account with (an)other person(s):	The limit of EUR 100 000 applies to each depositor separately
Reimbursement period in case of a credit institution’s failure:	7 working days
Currency of reimbursement:	*
Contact:	Bank Guarantee Fund ul. ks. Ignacego Jana Skorupki 4 00-546 Warszawa
More information:	www.bfg.pl
Acknowledgement of receipt by the depositor:	



* Possible options: the currency of the Member State where the DGS is located; the currency of the Member State where the account holder is a resident; euro; the currency of the account; the currency of the Member State where the account is located

- Tools:**
- **shortening pay-out period to 7 working days**
 - **unified scope of coverage**
 - **better information for customers: e.g. information template circulated to depositors at least annually**

▶ **A high degree of compliance with the Core Principles should contribute to financial system stability and enhance depositor protection.**

▶ **The focus of protection should be on those depositors who are generally not in a position to make an informed assessment of the risk that the bank to which their funds are entrusted may fail (e.g. retail and small business depositors).**

Public awareness

▶ **In order for a deposit insurance system to be effective it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.**

- ✓ **the deposit insurer is responsible for promoting public awareness**
- ✓ **the deposit insurer works closely with member banks and other safety-net participants**
- ✓ **the deposit insurer receives or conducts a regular evaluation of the effectiveness of its public awareness program**



Enhanced Guidance for Effective Deposit Insurance Systems: Public Awareness of Deposit Insurance Systems

Bank customers, in particular depositors, have the right to be informed and educated

In order to reinforce consumer protection, some deposit insurers have already shifted the focus of their public awareness campaigns from promoting awareness of the deposit insurance system to promoting safe banking practices

A well-informed public is less susceptible to rumors, and public confidence in the safety of deposits is a powerful force in preventing bank runs

Consumers who are financially informed and know their rights can impose additional discipline on the banking system



Financial Inclusion and Deposit Insurance

Financial inclusion is enhanced by introducing or extending explicit deposit insurance protection

Access to deposit insurance should provide a measure of protection to small savers, provided they are informed about safe places to store their money

Small savers should find the protection of deposit insurance appealing, provided there is public awareness and understanding of its benefits and limitations

- ❑ Historical examples show that consumers are often not aware of the undertaken risk related to the financial products they use, which may contribute to the creation of market bubbles and, in consequence, lead to consumers bearing losses
- ❑ A clear information policy targeting consumers and investors is necessary for the protection of financial market retail clients
- ❑ Well-informed consumers and investors are important factors in maintaining stability of the financial system as a whole
- ❑ However, consumers and investors must be supported by a comprehensive network of financial safety-net institutions, which includes an infrastructure of micro- and macro-supervision as well as a highly robust deposit insurance system