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Deposit protection scheme

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The State Bank of Pakistan has finally launched Deposit Protection Scheme (DPS) to provide protection to small depositors in the event of a bank failure. This scheme will be managed by Deposit Protection Corporation (DPC), which will be a wholly-owned subsidiary of the SBP to arrange a deposit protection mechanism for the depositors. The protected amount has been determined at Rs 250,000 per depositor per bank as envisaged in the DPC Act, 2016. All commercial banks will be members of DPS and required to pay the prescribed premium. While establishing a DPC, international standards have been followed as described in the “Core Principles for Effective Deposit Insurance Systems” issued by International Association of Deposit Insurers (IADI) and the design features of deposit protection mechanism in Pakistan are mostly in line with these principles. According to the SBP, “the objective of DPC is to compensate the small and financially unsophisticated depositors to the extent of protected deposits in the unlikely event of a bank failure.”

It may be mentioned here that the stability of financial systems is of paramount importance for policymakers around the world and DPS is one of the instruments to achieve this objective. Pakistan is of course late in catching up with the idea perhaps due to the fact that depositors have not lost money and public confidence in the financial system has always remained strong due to the SBP’s effective regulatory and supervisory regime. The idea of deposit insurance was introduced as late as November, 2008 through an IMF facility that Pakistan signed at that time and it has been work in progress since then. Keeping in view its importance, the establishment of DPC was envisaged in SBP’s strategic plan 2016-2020 under the strategic goal titled “strengthen the financial system stability” to ensure safety and soundness of the banking system of Pakistan. While strong banking laws and regulations and effective supervision have been in place for a long time and depositors never lost the money, the implementation of deposit protection scheme will further strengthen the confidence of depositors in the regulatory architecture of the SBP and in the safety of their deposits. Needless to add, that DPS will not be a burden on the national exchequer as enough funds will be mobilised through premium payments from the banks which can be used to provide immediate liquidity to small depositors in the case of a bank failure.

Although there could be hardly any argument against the launch of the DPS, there are at least three factors which need to be considered by the SBP. Firstly, the quantum of protection (only Rs 250,000) the DPS will provide seems to be small and needs to be raised so that a vast number of depositors are covered and feel satisfied with the safety of their funds. Secondly, no mention has been made about the foreign currency deposits which will probably remain outside the scope of the scheme. Since there was a real example of freezing foreign currency accounts, the holders of these accounts are also needed to be reassured about the safety of their funds. And thirdly, it is not clear who has to finally pick up the burden of insurance premium. We are raising this question because banks will try to shift the burden to various categories of depositors and the consequences in each case will be different.