



# Romania's Deposit Guarantee Fund in the Banking System

## Status Report

Convergence Group Meeting

Warsaw, November 15 2005

CONFIDENTIAL

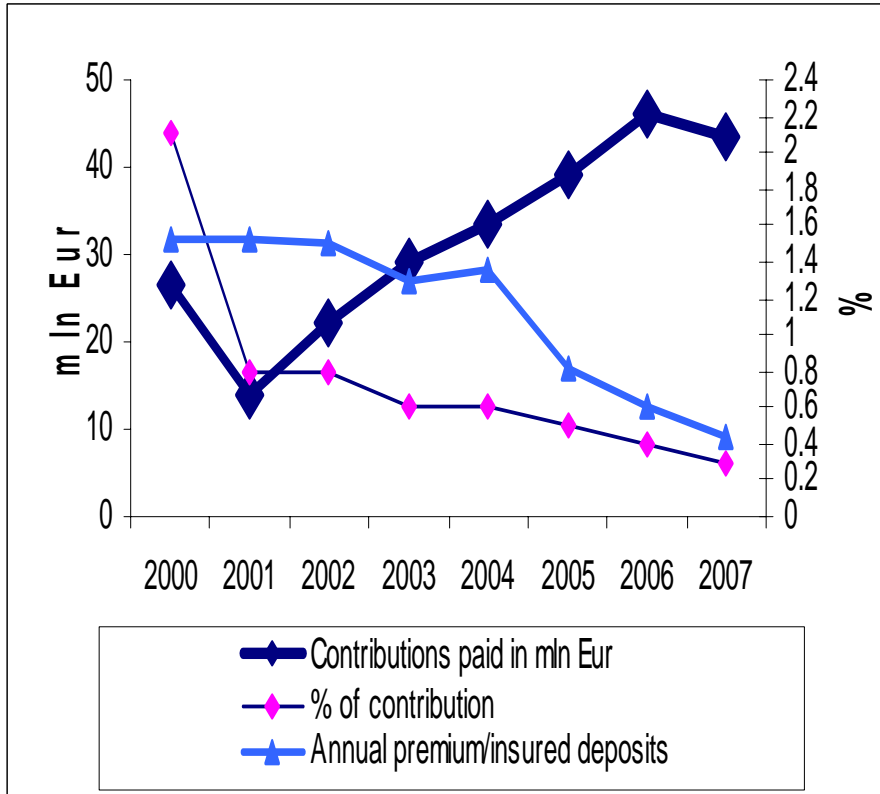
# The Assignment

- Romanian authorities wish to make an updated assessment of the level of banks' contributions to the Deposit Guarantee Fund (DGF)
  - *“This assessment should take into consideration the latest developments in the Romanian banking sector, the international practice, as well as the need to maintain a well-funded guarantee scheme to preserve the confidence of depositors.”*
    - » DGF Letter to Convergence, May 2005
- “Convergence” works with the Italian Deposit Guarantee Fund (FITD)

# Are DGF Resources Too High or Too Low?

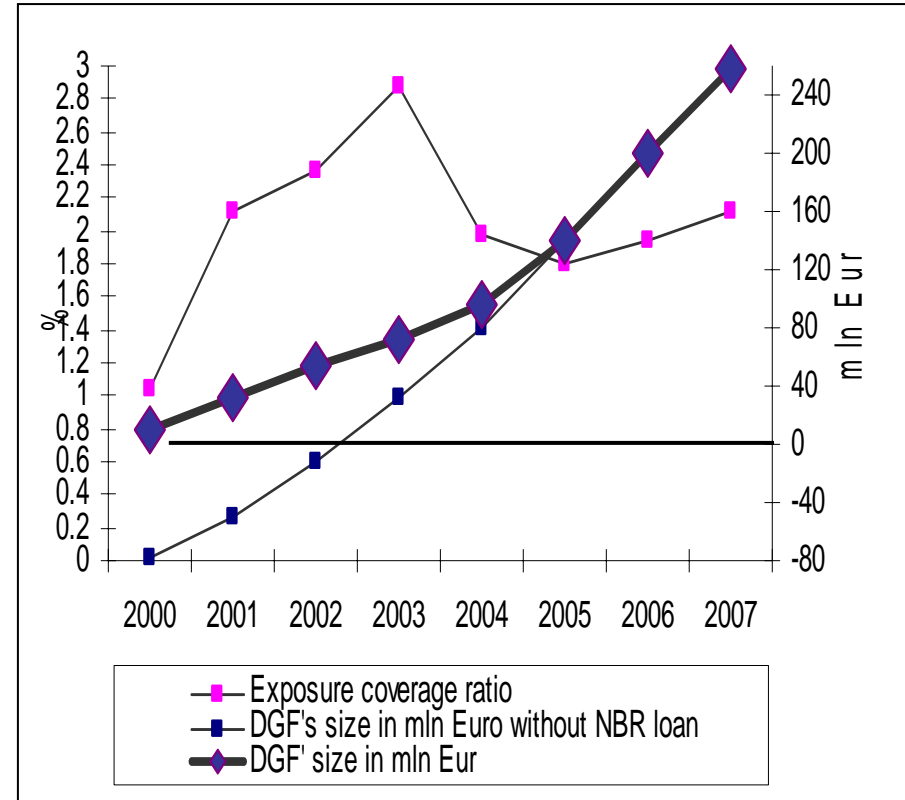
## Annual Premium

Premium is dropping fast; annual payment up



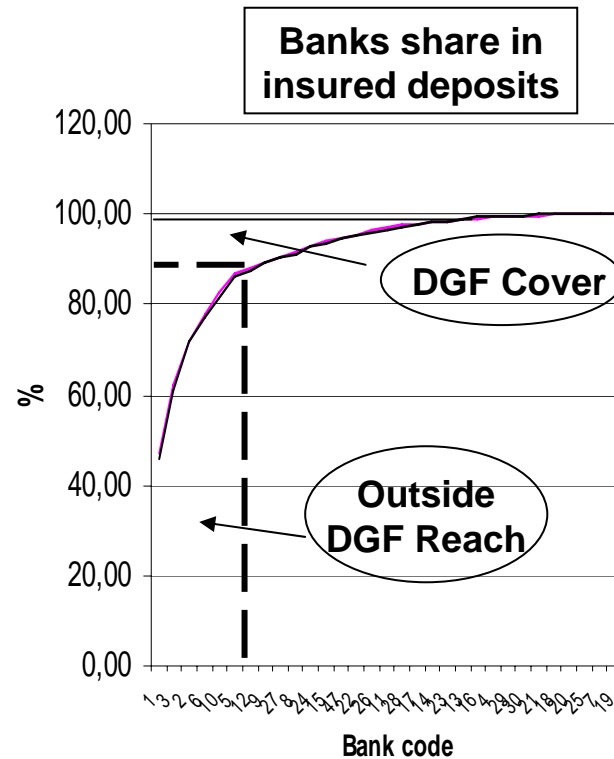
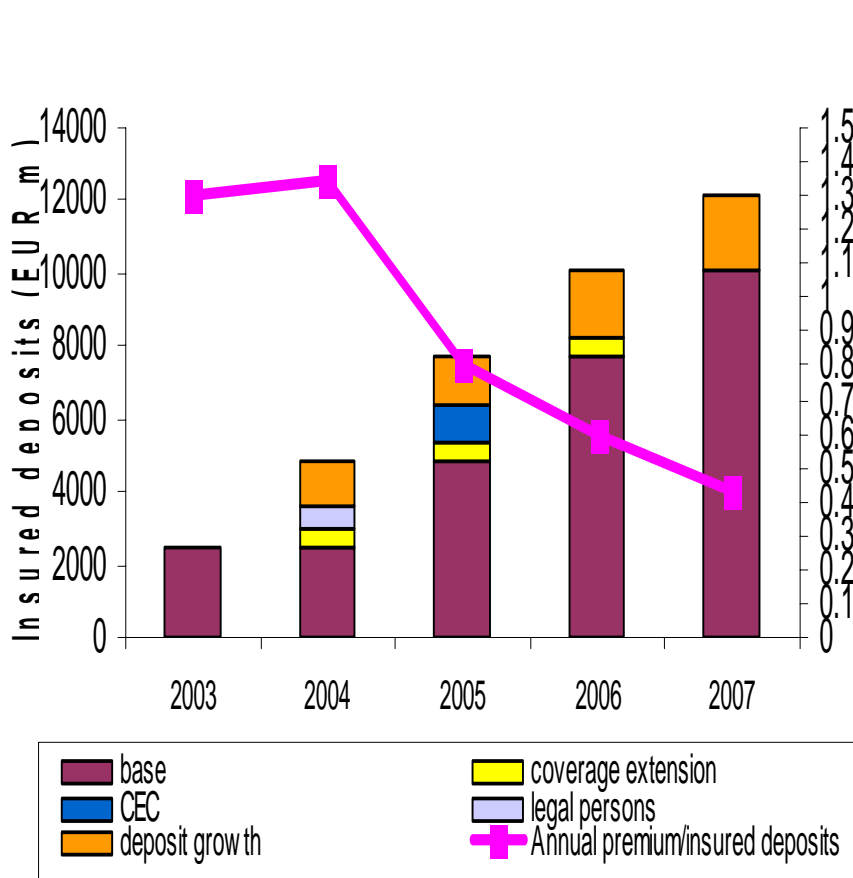
## DGF Size

Size will be doubling over next 2 years; but relative size stabilizing at 2%



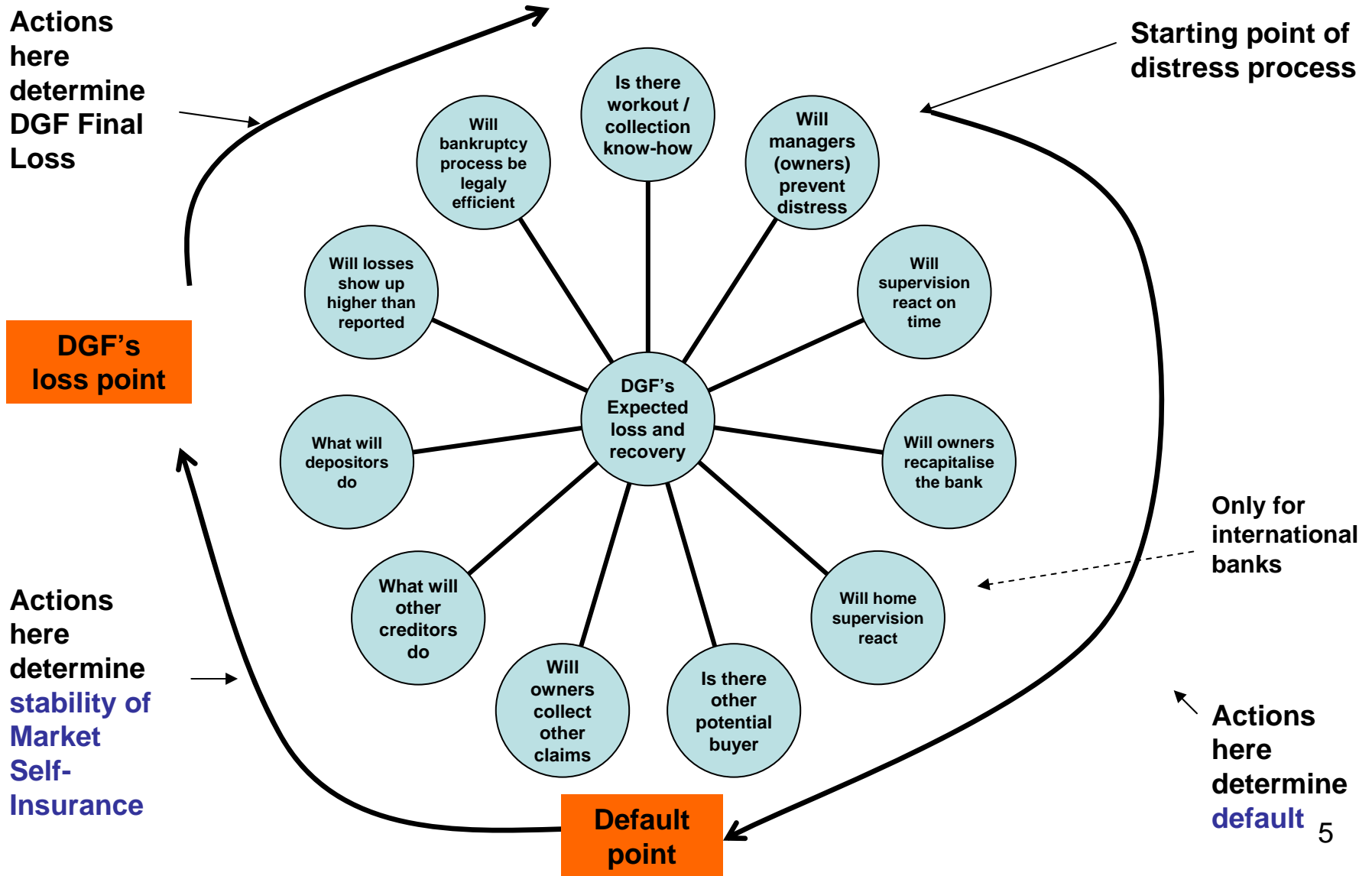
2005 DGF Size Only 30% Higher Than 2000 Pay-③ut

# Can Premium Be Decreased Further While Coverage Is Doubling Over 3 Years?



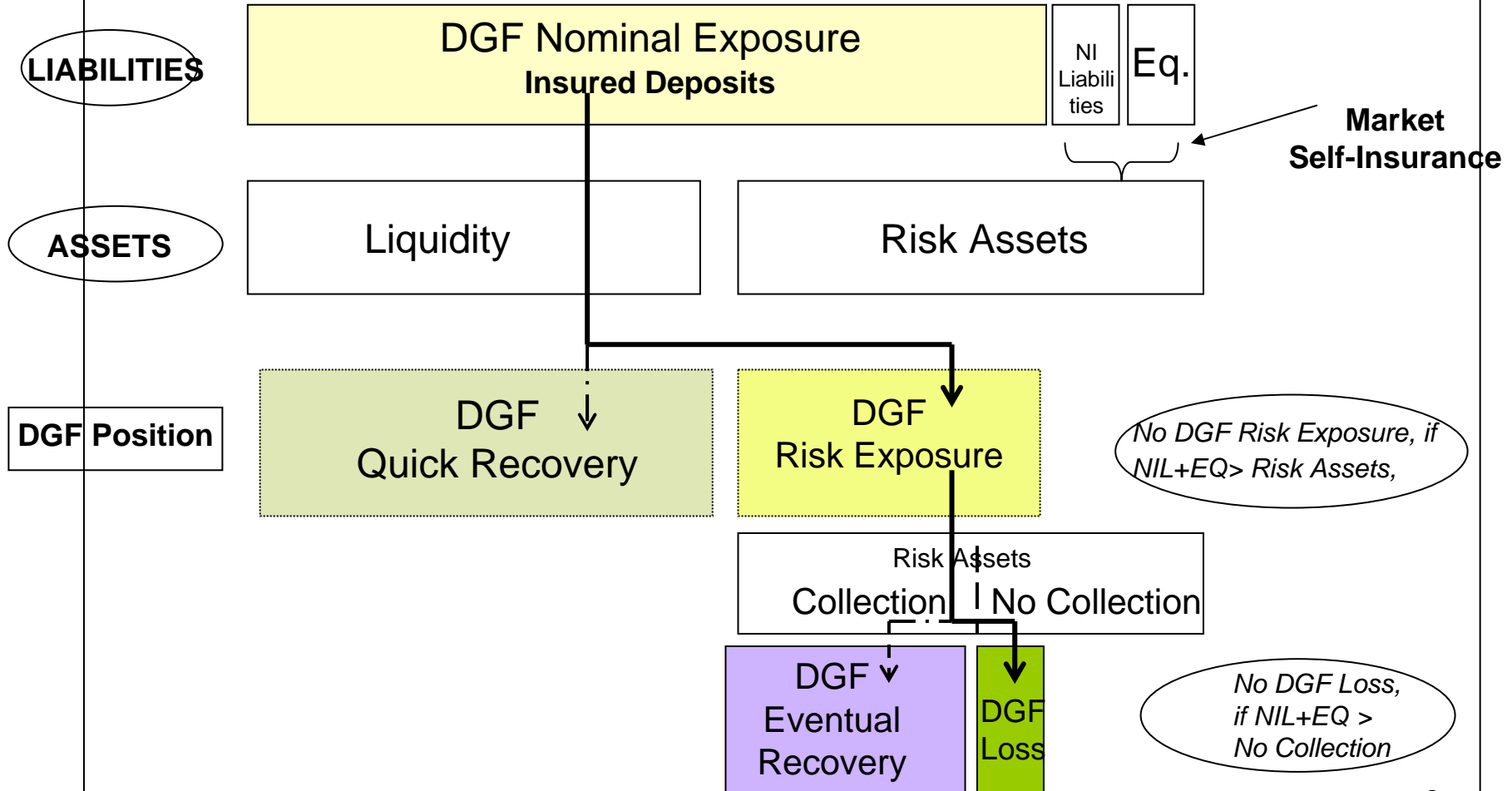
And DGF Can Cover Only Bottom 15% of the Market?

# DGF Loss: After A Long Distress Path



# DGF: From Nominal Exposure To Loss

## Conceptual Illustration



# DGF Policy Focus Shift Possible?

## “Pay-Out” Focus

- DGF able to absorb joint distress only in smallest banks (bottom 2%)
- Inability to handle 7+ large banks (85% of sector)
  - Constraining NBR intervention powers
  - Moral hazard
- Pre-emptive monitoring through close cooperation with NBR not a priority
- Weak incentive to pursue post-bankruptcy collection
- Strong incentive to maximize Fund’s size
  - To play “safe”



## “Final Loss” Focus

- DGF able to absorb joint distress of a larger sub-set of the banking system
- Builds on strengthened NBR capabilities and new shareholder incentives
- Focus on speedy bankruptcy procedures
- Run to minimize net cost to banking system
- Requires careful assessment of financial structures
  - Allows use of early warning signals
- Makes banking system a co-monitoring party

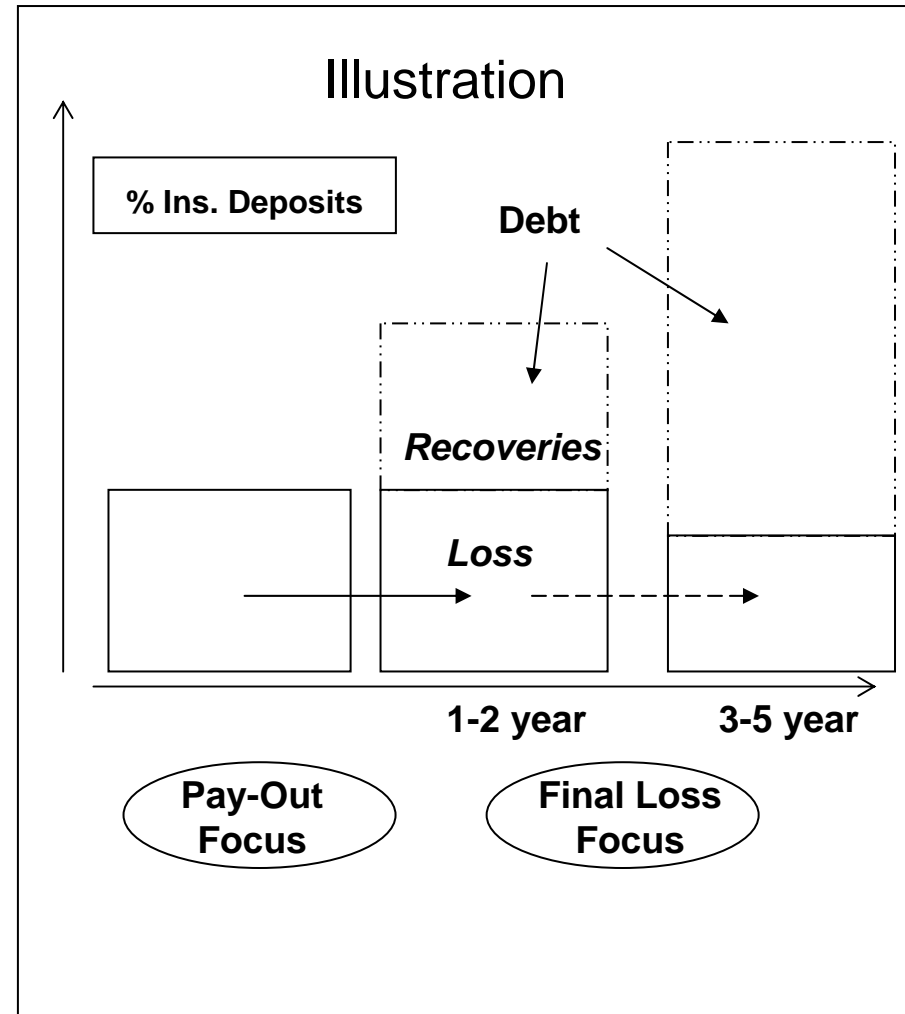
# Implications for Annual Premium

- Short-term

- As liquidity back-stop line is raised from banks, premium could be calculated to keep DGF's size constant relative to insured deposits
  - To cover shortfall for deposit growth unmet by investment income
  - Actual level depends on deposit growth

- Long-term

- Under appropriate conditions in absence of defaults and foreseeable risks, premium could be calculated to allow DGF's relative size to shrink
  - Premium could even be suspended once aggregate liquidity back-stop lines exceed a certain level relative to insured deposits



# Present Focus: Three Issues

- What is a prudent DGF “equity” size?
- What is a desirable DGF debt-equity ratio?
- How to determine the annual premium policy?

# New Findings

- Exposure Coverage Ratio (ECR) is relevant DGF policy indicator
- If debt-enhanced, ECR would enable DGF to withstand multiple IMF credit shock scenario
- ECR “equity” portion may stay constant
- “Premium instrument, not target”

# Next Steps

- More technical discussions with National Bank of Romania
- Final findings to DGF Board
- If accepted, DGF-RBA discussions for stand-by credit line
- In parallel, design of new annual premium policy
- Timeline: H1 2006

# Value For Banking System

- More detailed consideration by authorities of costs incurred by banking system
- Make DGF operate with modern financial policy
- With stand-by credit line, banking system becomes stronger DGF stakeholder
- Reduced cash contributions (next slide)

# Estimated Banking Sector P/L Impact

# This Is A “Convergence” Review

**“Convergence”**<sup>1/</sup> is a financial sector development program for South-East Europe focused on:

- Undertaking, as an “honest broker”, analytical tasks of micro-institutional issues
- Taking EU integration as a strategic perspective
- Involving market participants in the search of market-building solutions -- and fostering their dialogue with authorities
- Using the experience of regional former policy makers and local experts whenever possible
- Working in partnership with other institutions