



# **Moral Hazard**

## **Experience of the Czech Deposit Insurance Fund**

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**Istanbul, June 26, 2007**



## Moral Hazard Risks

- Incentives to monitor risky behavior differ under different deposit insurance systems
- Level and extent of coverage important public policy objective limiting moral hazard
- Various methods available to curtail moral hazard



## **Methods of reducing Moral Hazard**

- (1) Good corporate governance and management
- (2) Market discipline exercised by depositors and creditors
- (3) Regulatory discipline exercised by supervisory or deposit insurance authorities



# Introduction of deposit insurance in the Czech Republic

- Established late 1994
  - Coverage CZK 100 000, 20% coinsurance
  - Only CZK deposits of physical persons insured
- Since September 2001
  - Coverage € 25 000, 10% coinsurance
  - CZK + other currency deposits of physical as well as legal persons insured



## Changes to the deposit insurance

	1.1.1995	1.7.1995	6.2.1998	1.9.1998	7.9.2001	1.5.2002	1.4.2006
Limit of Coverage							
- CZK	<b>100 000</b>		<b>300 000</b>	<b>400 000</b>	<i>800 000</i>		
- EUR	<i>3 182</i>		<i>9 275</i>	<i>12 367</i>	<b>25 000</b>		
- USD	<i>3 890</i>		<i>11 670</i>	<i>15 565</i>	<i>31 130</i>		
Coinsurance	20%			10%			
Premiums							
- banks	0,50%				0,30%	0,10%	
- bank building societies		0,10%				0,05%	
- credit cooperatives							0,10%



## **Where is the problem?**

### **Three Amendments to the Banking Act**

- retroactive, ad hoc changes to the parameters of deposit insurance
- introduction of extra-standard compensation for uninsured types of deposits



# Financial impact on DIF

CZK million

Amendment to the Banking Act (Year)	Bankrupt bank	Bankruptcy Year	Standard Compensation	Extra-standard Compensation	Total
1998	Česká banka, a.s.	1995	518,6	443,1	961,7
2001	Pragobanka, a.s.	1999	344,1	70,0	414,1
2001	Universal banka, a.s.	1999	1 857,2	442,5	2 299,7
2001	Moravia banka, a.s.	1999	4 754,6	1 684,4	6 439,0
2006	Kreditní banka Plzeň, a.s. *)	1998	580,3	1 648,0	2 228,3
2006	Union banka, a.s. *)	2003	12 356,7	2 586,2	14 942,9
2006	Plzeňská banka, a.s. *)	2003	135,7	16,8	152,5
	<b>TOTAL</b>		<b>20 547,2</b>	<b>6 891,0</b>	<b>27 438,2</b>

\*) Extra-standard compensations have not been paid



## Latest Development

- Complaint to the Czech Constitutional Court
- 15 February 2007 – decision
  - The amendment set aside for procedural reasons
  - No investigation to the merits of the case
- 23 May 2007 - new proposal of Senators



## Conclusions

- Freely granted licenses in early 90's
- No analyses and systemic solution when establishing the Fund
- Correlation of legal changes with election campaign
- Hard to fight a precedent