SOUTH AFRICAN RESERVE BANK

An address by Lesetja Kganyago,
Governor of the South African Reserve Bank,
at the launch of the Corporation for Deposit Insurance (CODI),
Sandton, Johannesburg, 25 April 2024

Introducing deposit insurance in South Africa

Thank you for joining us today, to mark the launch of South Africa’s deposit insurance scheme.

The big picture is that South Africa is joining a very common practice, globally, of offering deposit insurance. It is a universal business model of banks to fund their assets with borrowed money, and so depositors are actually investors in banks. Usually, we say investors must accept the risks of making investments. But deposits are special, and most governments protect them.

One reason they are special is that hardly any depositors think of themselves as investors in banks. I’m sure more than a few people think their money goes into a vault, and is locked up there until they want it back. But this is not how banking works. And this is one of those rare cases where a naïve view is so widely held that policymakers have ended up shaping the world so that the naïve view is effectively true, and depositors are protected as if their money really were locked up in vaults.

Another reason deposits are special is that they usually have zero maturity, meaning they can be called at any time, and they always retain their face value, meaning if you put R1,000 in you expect to get R1,000 out.

This is different from other investment products, like bonds or equities, which have longer maturities and prices that can go up or down.

For example, if you own bonds, you lock your money in, and you expect the value of your bond to fluctuate, such that a R1,000 investment can easily be worth R900 on one day or R1,100 on another day. But this is not true of bank deposits. You get a predictable rate of interest, but you don't have the value of your checking account fluctuate depending on whether the bank in question is doing well or not.

If you have any reason to think a bank won't let you have access to your full deposit when you want it, it makes sense to withdraw it. And because banks usually don't keep all their assets as liquid as their liabilities – especially the deposit liabilities – bank runs can bring down even healthy institutions.

For central banks, it makes sense to protect depositors to remove the incentive to run. This is because bank runs offer what economists call a dual equilibrium problem. If a run starts, it becomes rational for all investors to try and get their cash out, and the affected bank will fail. Runs can also spread to other banks, severely disrupting the stability of the entire financial system.[1] A bank run is one of the great nightmares of the central banker. However, by guaranteeing deposits, you can remove the incentive to run.

If the guarantee is credible, depositors don't have to worry about getting their money, and so the incentive to run is removed. Such guarantees can therefore create an alternative equilibrium which is much more benign, where bank runs don't even get started. Unsurprisingly, most jurisdictions have introduced deposit insurance to try and ensure they get the benign equilibrium, not the nightmare one.

Of course, the fact that we are only introducing deposit insurance in South Africa now, in the 21st century, does not mean we have spent the past century ignoring the risks. The facts are that depositors have been well protected in South Africa. We have not had a 'wild west' financial system – literally like the American wild west, up until the introduction of deposit insurance during the Great Depression[2] – where banks failed routinely, amid repeated financial crises, and depositors lost their money. We have had a much more orderly system and even where banks have been in trouble, ordinary depositors have been protected. For example, when VBS went into curatorship, its regular depositors were provided with accounts at another bank which carried over their cash balances, for amounts up to R100,000.[3]

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[1] For a fuller discussion, see https://www.econstor.eu/bitstream/10419/154144/1/ecbwp1711.pdf

[2] The US introduced deposit insurance in 1933. For details of this, and preceding waves of bank failures, see: https://www.fdic.gov/about/history/deposit-insurance/1930-1939.html#:~:text=The%20Banking%20Act%20of%201933%20is%20signed%20into%20law%20by,basic%20coverage%20level%20of%20%242%2C500.

[3] For details, see https://www.resbank.co.za/content/dam/sarb/publications/media-releases/2021/vbs-guaranteed-retail-deposits-at-

What we are really gaining with a formal deposit insurance scheme is a more explicit and consistent set of arrangements. As with any insurance, insuring deposits entails costs. By building a scheme in advance of any particular crisis, we formalize how the costs will be apportioned. We also develop a clearer set of rules for how depositors will be treated, in a hypothetical future bank failure I therefore see CODI as a tying up loose ends, where we take a promise of insurance that was previously implicit, and formalize it, so you get the same benefits of protecting depositors which you always had, but you take away the impromptu element, and the inefficiencies it entails.

Hopefully, one further benefit we might get is better competition for deposits. The interest rates on checking accounts are famously low. Right now, the policy rate is 8.25%. This is a rate determined by the SARB, and it is the rate we pay on most deposits banks keep with us. Benchmark rates are close to this rate. For example, our ZARONIA benchmark, which reflects overnight deposits by companies at banks, is currently at 8.12%. At the same time, according to the data compiled by our statistics team, checking accounts are paying an average of 4.64%. That's a gap of 3.61 percentage points, which is a big deal.

Of course, these accounts are usually bundled with other services, like overdraft facilities and payment cards. And they pay more than physical cash – notes and coin – where the interest rate is zero. But still there is a comfortable spread between what banks pay on deposits and what they can earn, even just from leaving the cash at the SARB overnight. The relevance of this for deposit insurance is that if someone is eying a better rate at another bank, but they aren't switching because they are worried about the safety of that bank, they no longer need to worry.

Yes, a small new bank is probably not quite as safe as a big established bank. But with CODI, your R100,000 deposit is equally safe in any member bank. It would be good for South Africans if this caused a bit more competition for deposits, and we would be happy to see deposit rates move a bit closer to the policy rate.

Ladies and gentlemen, to conclude, the Reserve Bank has a mandate for financial stability, and with the introduction of deposit insurance today we take a step forward to make the financial system even safer. It is not a giant leap, because it was never that dangerous to be a

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South African depositor. But a formal system of deposit insurance is the global best practice, and in South Africa we aim to have a world-class financial system, nothing less.

Thank you.