DEVELOPMENT OF DEPOSITS GUARANTEE IN THE BANKING SYSTEM OF MOLDOVA

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Abstract: Money kept in house versus money deposited in the bank is a dilemma arising primarily out of fear of losing. To mitigate these risks and to enhance confidence in the banking system, the authorities propose to increas the deposit guarantee ceiling. Experts argue that this is an important measure to increase confidence in the banking sector and believes that this ceiling should be increased to a minimum of 50 thousand lei, while the medium and long term - more than that. Experts estimate based on figures for average wage and GDP per capita, suggesting that banking statistics is not just a basis for calculating real and objective determination of coverage.

JEL classification: G21, G20

Key words: deposits guarantee, Deposit Guarantee Schemes, depositors, banking financial stability, banking system

1. INTRODUCTION

Banking instability, often manifested by bank failures can have negative effects on the economy, as this can lead to damage of the proper functioning of the national mechanism for payment to discourage saving process, reduce financial intermediation and losses for depositors. In order to prevent these consequences in many countries were created institutional arrangements that would guarantee the banking stability, comprising the following elements: prudential regulations that aim to prevent excessive risk-taking by banks, bank supervision ensures compliance with banking legislation and prevents banks to engage in unsound banking practices; lender of last resort facilities provided by the central bank, consisting in providing liquidity to banks to prevent their failure.

In many countries these institutional arrangements were completed with deposit guarantee schemes, which aim to maintain confidence in the banking system and to protect small depositors when banks fail. Currently, nearly all industrialized countries have formal deposit guarantee schemes, although their form and scope of coverage varies from country to country.

Regarding developing countries, manifests a growing interest also face institutional arrangements for the protection of deposits, implementation of the schemes of this type being achieved in many countries with the technical assistance of the IMF and World Bank.

The existence of a the deposit guarantee scheme has a number of positive effects. First, such a system must ensure preservation of the integrity of the financial system of a country, providing protection against massive withdrawals of funds ("Banks runs") that could affect the stability of banks and the payments system. Given that depositors know they are protected in the event of a bank failure, they are less inclined to lose confidence in the banking system.

2. Deposit Guarantee Schemes in international practice: evolution and principles

Deposit Guarantee Schemes (DGS) seek to protect the depositors of each credit institution and ensure the stability of the banking system as a whole. DGS articulates itself in the context of periodic crises in financial systems and is the expression of the development of financial and banking systems at the confluence of the twentieth and twenty-first centuries. The first two bank deposit experiments are attested in the United States of America at the beginning of the nineteenth century and the beginning of the 20th century.

Unlike the states in the center of European capitalism, there was no Central Bank in the US until 1913, for which the banking system and the assets of the depositors were more vulnerable than in the case of the European economies. Thus, the first deposit insurance program was the "New York Security Fund" created in 1829 to cover the losses of depositors and banknote holders from funds collected from banks secured through annual assessments. The second experiment was created in the context of the financial and banking crisis of 1907, when in the years 1908-1917 eight states - Oklahoma, Kansas, Nebraska, Texas, Mississippi, South Dakota, North Dakota and Washington - adopted deposit guarantee. All eight guarantee funds failed during the 1920s, starting with the Washington fund in 1921.

After these two experiments at the federal level and not necessarily successful, the Great World Economic Crisis from 1929-1933, which began in the US capital market, led to the establishment of the first national deposit guarantee fund in the world. Since the fall of the capital market in October 1929 and until March 1933, 9,000 banks have been bankrupt in the US, and one of the first anti-crisis measures of the Congress and the American Executive was the adoption of the Banking Act of 1933, known as The Glass-Steagall Law. Among the provisions of this document was the establishment of the Federal Deposit Insurance Corporation (FDIC), an independent government corporation responsible for securing bank deposits.

Table no. 1 Evolution FDGC the deposit guarantee limits

Date	The limits of deposits guarantees
1934 (January)	$2,500
1934 (June)	$5,000 (temporary)
1935	$5,000 (permanet)
1950	$10,000
1966	$15,000
1969	$20,000
1974	$40,000
1980	$100,000
2008	$250,000 (temporary)
2010	$250,000 (permanent)

Source: Christine Bradley, A Historical Perspective on Deposit Insurance, Federal Deposit Insurance Corporation. Washington: FDIC Banking Review, December, 2010, p. 6-17.

The bank deposit guarantee limits have increased in the US as assets and deposits increase in the banking system, but also due to the instability of the financial-banking system, implicitly of the crises in the banking system. Thus, on January 1, 1934, the date of FDIC's establishment, the guarantee threshold was $ 2,500, and in the context of the 2008 financial crisis, the limit was raised to $ 250,000 (see Table 1).

The first attempt to create a mechanism for guaranteeing bank deposits on the European continent was attested in Czechoslovakia in the 1920s, but it lasted for several decades until effective national Deposit Guarantee Scheme were articulated in the European states. In the 1970s, DGS are established in Germany, Belgium, and Italy, each of which has different characteristics. Only with the signing of the Single European Act in 1986, which had as its central objective the completion of the European common market by 1993, the European Commission comes with recommendations for the European Community Member States to set up bank deposit protection mechanisms as one of the common market elements.

In a common market created on January 1, 1993, where goods, services, capital, and labor are freely circulating, there is a risk that bank deposits will be attracted to those countries that have the most efficient Deposit Guarantee Scheme, implicitly the highest guarantee thresholds deposits. In this context, Directive 94/19 / EC of the European Parliament and of the Council of 30 May 1994 on Deposit Guarantee Schemes is adopted. The Directive requires all credit institutions operating in the European Union to adhere to a Deposit Guarantee Scheme. The Directive requires the formal introduction and recognition by each Member State of one or more Deposit Guarantee Schemes within their own territory. Deposit-guarantee schemes introduced and officially recognized in a Member State cover depositors from branches set up by the credit institution in the other Member States.

At the same time, the Directive stipulates that the minimum amount of bank deposit guarantee in the European Union is € 20,000, as well as the terms of payment of claims from Deposit Guarantee Scheme. The Directive specifies the procedure to be followed when a credit institution fails to fulfill its obligations as a member of the Deposit Guarantee Scheme; the competent authorities shall take appropriate measures, including penalties, which may go as far as the authorization of the credit institution is revoked, in order to ensure that latter will fulfill its obligations [1].

The financial crisis triggered in October 2008 has generated many uncertainties about deposit guaranteeing in the European Union. Against this background, measures have been taken to strengthen the coverage of deposits, by increasing the minimum level of collateral and by laying the foundations for a Community Deposit Guarantee Scheme. As a first step, Directive 2009/14 / EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19 / EC on Deposit Guarantee Schemes, as regards the guarantee threshold and the payment of compensation. Following which Directive 2014/49 / EC of the European Parliament and of the Council of 16 April 2014 on Deposit Guarantee Schemes is adopted. This Directive does not amend but replaces Directive 94/19 / EC and enter into force in June 2014.

Deposit Guarantee Scheme have become current and expanded around the world as an indispensable component of modern banking systems. Regional and international debates on bank deposit guarantees have been established, such as the European Deposit Insurance Forum (EFDI) and the International Deposit Insurance Association (IADI). Deposit Guarantee Scheme have grown even further in the current context of the financial crisis of 2008 when only five new national guarantee funds were created in just one year.

In a July 2014 International Monetary Fund (IMF) study, 112 out of 18 IMF member states had explicit bank deposit guarantees (59%) at the end of 2013, as opposed to 84 countries in 2003. At the same time, approximately 84% of the developed countries have explicit bank deposit guarantees.

Beyond the technical aspects related to the implementation of national bank deposit funds, the increased development of the guarantees of the financial-banking systems and a fundamental debate, namely the one related to "moral hazard". Moral hazard is in the discussion on three dimensions. The risk of lending institutions, sometimes managing irresponsibly depositors' assets, knowing that the Government will intervene to save the banks, as was the case with the Republic of Moldova when the Government, through a secret ruling, guaranteed on November 13, 2014, 9.4 billion lei by the NBM Banca de Economii, Banca Sociala and Unibank. Moral hazard for guarantee funds - the tendency to take risks from insured institutions that may occur when depositors or the rest of the creditors are, or think they are protected from any potential loss, because the insured institutions will not be allowed to fall. With this belief, it does not monitor the performance of the credited institution. The moral hazard of depositors - the tendency of depositors to deposit money at the most advantageous interest without looking at banks' performance, knowing that deposits are covered by guarantee funds.

In July 2008, the Basel Committee on Banking Supervision (BCBS) and the International Association of Deposit Insurers (IADI) decided to work together to develop a set of Internationally Accepted Fundamental Principles, based on the IADI Fundamental Principles for Efficient Guarantee Systems deposits. The 18 fundamental principles agreed and launched by the international financial community refer to: 1. the objectives of public policy, 2. the reduction of moral hazard, 3. the mandate of the Deposit Guarantee Scheme (DGS), 4. the powers granted to it, 5. the good governance 6. Relations with other members of the financial stability network 7. Cross-border cooperation of Deposit Guarantee Scheme, 8. Compulsory participation in a Deposit Guarantee Scheme 9. Covering of depositors 10. Transition from unlimited coverage to limited coverage 11 the financing of Deposit Guarantee Scheme, 12. informing the public, 13. the legal protection of the personnel in the scheme, 14. the relationship with the parties responsible for the bankruptcy, 15. the early detection, the intervention and the resolution of the situation of problematic banks, 16. the efficient bank resolution process, 17. repayment of funds to depositors, 18. recovery of claims by Deposit Guarantee Scheme [2].

The Fundamental Principles are designed to be adapted to a wide range of circumstances and structures in each country. The Fundamental Principles will be a voluntary general framework for effective Deposit Guarantee Practices; national authorities are free to apply additional measures they deem necessary in their own jurisdiction.

Fundamentals are not built to cover all the needs and circumstances of each banking system. Instead, according to the document, country-specific circumstances need to be addressed in the context of existing laws and powers to achieve public policy objectives and the mandate of the Deposit Guarantee Scheme.

3. Guarantee of bank deposits in the Republic of Moldova: structure and financial means

The Deposit Guarantee Systeme in the Republic of Moldova is established together with the Law "On Securing the Deposit of Individuals in the Banking System" no. 575-XV, adopted by Parliament on 26.12.2003 and published in the Official Gazette no.30-34 /

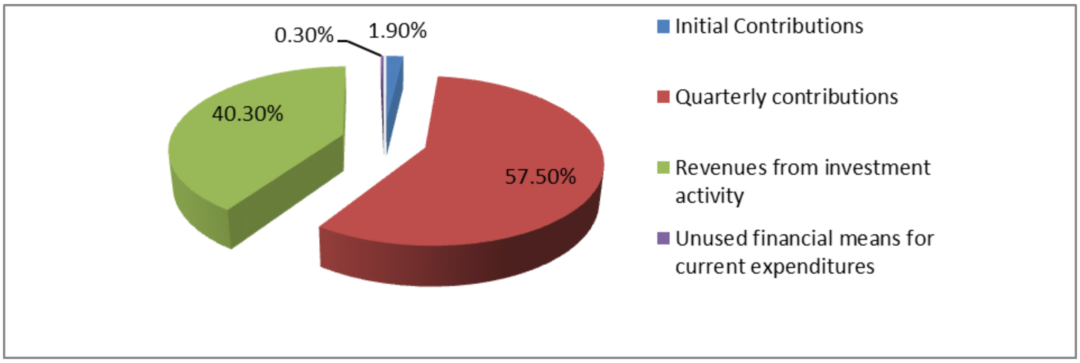
169 of 20.02.2004. The law came into full force on July 1, 2004 and aims to guarantee the deposits of individuals from the banks authorized by the National Bank of Moldova. At the end of 2010, the Parliament of the Republic of Moldova amended the Law on Deposit Guarantee of Individuals in the Banking System by Law no. 241 of 24.09.2010 for amending and completing some legislative acts [3].

Based on Law no. 575-XV of 26.12.2003, on July 1, 2004 was established the Deposit Guarantee Fund in the banking system. The Fund is constituted as a legal entity governed by public law and has as its object, under the conditions and within the limits stipulated by the law, the guarantee of the deposits of individuals from the banks authorized by the National Bank of Moldova. The Management and Supervision Body of the Fund are the Board of Directors, the members of which are approved by the Decisions of the Parliament of the Republic of Moldova.

The funds authorized by the National Bank of Moldova are admitted and obliged to participate in the formation of the Deposit Guarantee Fund's means. The amount of the Bank's obligation towards the depositor is calculated by adding up all its deposits, including interest due and unpaid on the date of the unavailability of deposits. Under Article 14 (1), where the Fund has accrued, equivalent to 12% of the total of guaranteed deposits registered in the banking system at the last reporting date, for the payment of guaranteed deposits, the Management Board may decide to suspend the payment of quarterly contributions.

As an exception, the Deposit Guarantee Fund can benefit from loans from the Ministry of Finance. As other income as a source of Fund formation, the Law indicates the Fund's investment income and budget subsidies. In accordance with art. 35 (2) of the Law no. 575-XV of 26.12.2003, the Fund, within 4 months from the end of the financial year, will publish the annual financial report. The last such available report is from 2013, where it is stated that from the moment of the Deposit Guarantee Fund's establishment the funds for guaranteeing the deposits of individuals were accumulated in the amount of 339.1 milion lei, including:

- initial and quarterly contributions of licensed banks - 223.9 mil. lei;
- incomes obtained from the investment activity of the Fund - 156.9 mil. lei;
- unused means for current expenditures - 1,2 mil. lei.



Source: Raport de activitate a fondul de garantare a depozitelor în sistemul bancar pentru anul 2016. Available: http:// http://fgdsb.md/ro/wp- content/uploads/2017/05/Raport-de-activitate-2016_final.pdf., last accessed 2017/09/25.

Figure no. 1 Structure of deposit guarantee funds for 2016%.

According to article 9 (3) of the Law no. 575-XV from 26.12.2003, the Deposit Guarantee Fund may invest the available financial means only in securities issued by the Government or by the National Bank of Moldova.

The Deposit Guarantee Fund guarantees deposits in the form of a credit balance resulting from funds existing in the accounts of natural persons or from transient situations created by bank operations to be repaid by the bank under applicable legal and contractual conditions as well as those in the form of a debt to a natural person, represented by a debt instrument issued by the bank. Credit balances that serve as a guarantee for the operations performed by the bank on behalf of the depositor are not considered deposits. Deposits of individuals carrying out entrepreneurial activity do not fall under the scope of the Act.

The deposit guarantee ceiling (the maximum amount payable to a depositor) was originally set at MDL 4,500. After the changes made in 2010, the deposit guarantee ceiling is 6,000 Moldovan lei, regardless of the number and size of the deposits or the currency in which they were established at the bank. This ceiling may be amended by decision of the Fund's Board of Directors to be adjusted to the amount of the Fund's available funds.

Table no. 2 Evolution of deposit guarantee fund for individuals.

Indicator	2004-2010	2011	2012	2013	2014	2015	2016	TOTAL
initial contributions	7,404.8	-	-	-	-	-	-	7,404.8
quarterly contributions	82,333.2	19,974.7	21,752.6	23,842.5	26,011.5	24,619.7	25,331.9	223,866.0
Total means received from banks	89,738.0	19,974.7	21,752.6	23,842.5	26,011.5	24,619.7	25,331.9	231,270.8
Income from investment activity	36,839.1	10,714.5	14,049.9	7,349.3	10,742.7	25,021.7	52,202.2	156,919.4
Unused resources for current expenses	416.4	185.6	189.6	101.8	77.2	98.1	133.2	1,202.1
other receipts	3.0	-	-	-	-	-	-	3.0
Payment of guaranteed deposits	-	(48,091.8)	(1,990.2)	(14.6)	(7.8)	(16.2)	(127.8)	(50,248.4)
Total resources for deposit insurance	126,996.5	(17,217.0)	34,001.9	31,279.0	36,823.6	49,723.3	77,539.5	339,146.9

Source: Raport de activitate a fondul de garantare a depozitelor în sistemul bancar pentru anul 2016. Available: http:// http://fgdsb.md/ro/wp- content/uploads/2017/05/Raport-de-activitate-2016_final.pdf., last accessed 2017/09/25.

Since the establishment of The Deposit Guarantee Fund on 1 July 2004 until the end of 2016, they were paid guaranteed deposits after license revocation activity of the banks in the total amount of 50.2 million lei.

At the end of 2016, the funds of the Bank Deposit Guarantee Fund amounted to 339.1 million lei or 12.2% of the total of guaranteed deposits registered in the banking system.

The value of guaranteed deposits in total deposits in the Republic of Moldova continues a trend of decline for the entire period. Thereby at the end of 2016 the share value of guaranteed deposits in total deposits was decreased by 7.4 p.p. compared to the end of 2010, which represents a decrease of more than 31.4%.

The value of the Fund's financial resources of the Deposit Guarantee accumulated during its activity in total deposits, recorded in Moldova's banking system constitute a different level from one year to another. Since the end of 2011 the value of financial resources in total guaranteed deposits increased by 6.7 p.p. or approximately 121.8%.

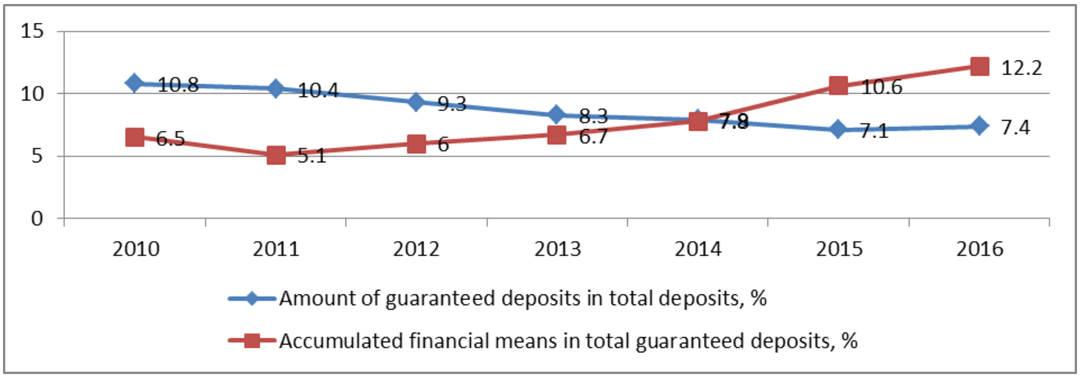


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Figure no. 2. The amount of guaranteed deposits in total deposits, %.

Currently, there is an urgent necessity for examining the possibility of increasing the ceiling of deposit insurance.

4. Development of Deposit Guarantee Scheme in the Republic of Moldova in the context of European integration

The development of Deposit Guarantee Scheme in the Republic of Moldova in the broader framework of financial and banking stability is linked to the process of European integration, implicit in the EU-Moldova Association Agreement. European integration and related reforms represent an opportunity (perhaps last) to institutional modernization and structural reforms in the Republic of Moldova, implicitly a mechanism for adjusting financial services to European Union norms and standards. Under different circumstances, more than two decades of transition betrayed the fact that our political class opposes structural reforms, the instability of the banking system in recent months is the most obvious example, while the exogenous mechanisms promoted by the European Union are the only ones relevant to such reforms.

Title IV of the Association Agreement - Cooperation in the Economic and Other Sectors - states in Chapter 2 that the Republic of Moldova will strive to create a functioning market economy and will gradually adjust its policies to EU policies. In Chapter 9 of Title IV, called Financial Services, it is stated that the Republic of Moldova will harmonize its legislation with the EU legislative acts and the international documents referred to in Annex XXVIII-A of the Association Agreement, according to the provisions of the respective Annex.

In addition, other rules and directives set out in Annex XXVIII-A which the Republic of Moldova undertakes to transpose into national law, are also Directive 94/19 / EC of the European Parliament and of the Council of 30 May 1994 on Deposit Guarantee Schemes. At the same time, an exact timetable for implementation is set out in the Annex, namely: the provisions of this Directive, except for the provision on the minimum compensation level for each depositor set out in Article 7 of this Directive, will be implemented within five years from the entry into force of this Agreement. The provision on the minimum compensation for each depositor set out in Article 7 of this Directive will be implemented within 10 years of the entry into force of this Agreement. [4].

Therefore, over the next 10 years, the Republic of Moldova has a "roadmap" that it has pledged to undertake by signing the Association Agreement with the European Union and, as a consequence, has to implement the existing common standards in the EU on Deposit Guarantee Scheme. Since the Association Agreement refers to Directive 94/19 / EC, the Republic of Moldova's obligations in the field of DGS will mean the transposition into national law of Directive 2009/14 / EC as well as Directive 2014/49 / EC, which amends and, respectively, replace the first.

The new legal framework required to be implemented under the EC Directives primarily concerns the minimum compensation level for each depositor, ie the deposit guarantee ceiling. From 2010, this ceiling has been increased to € 100,000 for all EU Member States, except for Ireland where unlimited deposit guarantees are guaranteed.

Table no. 3 Evolution of the Deposit Guarantee ceiling in the European Union

Year of establishment	1994	2009	2010
Ceiling Guarantee	*20.000 €*	*50.000 €*	*100.000 €*

Source: Directive 94/19/EC of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, http://eur-lex.europa.eu/legal-content/RO/TXT/PDF/?uri=CELEX:31994L0019&from=RO

Beyond the guarantee ceiling, which needs to be increased from MDL 6,000 to € 100,000 over the next 10 years, there are other relevant provisions of European legislation for the development of Deposit Guarantee Sistem in the Republic of Moldova, including:

Subject to the Bank Deposit Guarantee Act, not only individuals but also companies should be included. Among the other protected deposits stipulated in the European Directives are:

- pension systems for small and medium-sized enterprises;
- deposits of public authorities with budgets lower than 500 000 €;
- deposits of over € 100,000 for certain residential and social purposes.

The deadline for payment from the Bank Deposit Guarantee Fund will have to be shortened by 2024. Deposits are reimbursed within a maximum of 20 business days, since mid-2015. This will be gradually reduced to seven working days by 2024.

It is necessary to be introduced ex-ante funding mechanisms, generally set at 0.8% of guaranteed deposits.

The Deposit Guarantee Fund will have to improve the information for depositors, implicitly to submit Quarterly and Annual Operational Reports. For example, for now, there is no public data on the situation of 2014, the year in which money has disappeared from three banking institutions, including from Banca de Economii where most bank deposits were.

5. Conclusions

Deposit Guarantee Sisteme is one of the important instruments of contemporary financial and banking systems that emerged and developed with the entire system, while explicit deposit guarantees became the preferred option compared to the implicit deposit protection.

Of the 188 IMF member states, 112 had explicit bank deposit guarantees at the end of 2013 (59%), as opposed to 84 countries in 2003. At the same time, some 84% of the developed countries have explicit bank deposit guarantees.

A Deposit Guarantee Scheme clarifies the authorities' obligations to depositors (or, if private, to members) limits the scope of discretionary decisions, strengthens public trust, helps maintain control over the costs of dealing with situations of entry into difficulty of banks and can provide countries with an orderly bankruptcy resolution procedure and a mechanism for banks to finance bankruptcy costs.

In crisis situations, implicit in repeated cycles of a capitalist economy, the importance of Deposit Guarantee Sisteme for depositors in credit institutions and for financial stability as a whole increase.

To be efficient and to avoid distortions that may lead to moral hazard, a deposit guarantee system must be part of a well-built, designed and implemented financial stability system. There must be a division of powers between the executive, the ultimate lender and the deposit guarantee fund.

In the Republic of Moldova, Deposit Guarantee Sisteme is established by Law no. 575-XV "On the guarantee of deposits of individuals in the banking system" and the establishment of the Deposit Guarantee Fund on 1 July 2004.

At the end of 2016, the funds of the Bank Deposit Guarantee Fund amounted to 339.1 million lei or 12.2% of the total of guaranteed deposits registered in the banking system.

Starting with 2010, the deposit guarantee ceiling is MDL 6,000, irrespective of the number and size of the deposits or the currency in which they have been established at the bank. The Deposit Guarantee Fund guarantees deposits in the form of a credit balance resulting from funds existing in the accounts of individuals or from transient situations created by bank operations to be repaid by the bank under applicable legal and contractual conditions as well as those in the form of a debt to a individual, represented by a debt instrument issued by the bank.

Deposit Guarantee Sisteme in the Republic is underdeveloped as well as the entire financial-banking system and the fact that the Government justified by protecting the depositors the guarantee of 9.4 billion lei offered by the National Bank for three commercial banks is a sufficient argument for a profound reform of the guarantee system.

The Deposit Guarantee Sisteme reform in the Republic of Moldova in terms of developing a modern and efficient guarantee system is a complex and step-by-step process, which should include the following elements:

The realization of the external preconditions for the good functioning of the Deposit Guarantee Scheme, namely:

- a well-developed legal framework and regime of accountability and public communication;
- solid governance of entities responsible for financial stability;
- prudential supervision and solid regulation;

- continuous assessment of the economy and the banking system.

Implementation of the provisions of the EU-Moldova Association Agreement, in particular the provisions of Annex XXVIII-A on the transposition into national law of Directive 2014/49 / EC on Deposit Guarantee Schemes, implicitly:

- stepwise increase of the guarantee threshold up to € 100,000;
- deposit guarantee for individuals, small and medium enterprises;
- decrease the payment term of the Bank Deposit Guarantee Fund;
- transparency of information related to the activity of the Guarantee Fund, etc.

The increase of the guarantee ceiling should be complemented by other measures to increase the stability of the banking sector in the Republic of Moldova, in order to reduce the insolvency risks of the banks. In the medium term, it is important to establish a direct link between the performance level of banks and the size of the contributions (so that the bank that takes a higher risk of lending activity - to make a percentage contribution higher than a bank with more prudent behavior, and thus lower risk of insolvency and use of the common fund by its depositors).

To increase from 12% to 20% the funds of the Guarantee Fund from the total of the guaranteed deposits, after which the Fund may suspend the compulsory collection from the banks. Taking into account the low level of the guaranteed ceiling, the insignificant number of constituent banks of the Fund, the unpredictability of the influence of the global financial crisis on the country's financial and banking system, the recent "behavior" of MDL exchange rate against the main world currencies becomes I am sure that this 12% limit may be insufficient in the event of a proportional crisis.

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