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**The Deposit Insurance Scheme under the Financial Sector Regulation Act 9 of
2017**

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Declaration of originality

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Summary

This study explores the features of South Africa's recently adopted Explicit Deposit Insurance Scheme (EDIS). EDIS serves as a mechanism designed to enhance financial system stability during bank failures by instilling confidence in depositors regarding the recovery of their insured funds, thereby reducing the likelihood of a bank run. EDIS, initially pioneered by the United States in 1933, has become a global mechanism adopted by various countries. South Africa's recent transition from implicit deposit insurance, characterised by a lack of rules governing coverage and compensation, to a rules-based EDIS is captured in the Financial Sector Regulation Act 9 of 2017 (as amended). This development aligns the country with international best practices, particularly the International Association of Deposit Insurer's Core Principles for Effective Deposit Insurance Systems (Core Principles). This study benchmarks South Africa's EDIS against these Core Principles to assess its alignment with international standards and identify any potential shortcomings. Additionally, the study examines the deposit insurance systems in the United States and Kenya to extract valuable lessons for South Africa, considering the extensive experience of these jurisdictions in managing such systems.

Compliance of LLM dissertation with the SDGs

This dissertation complies with SDG 1 (no poverty), 8 (decent work and economic growth) and 16 (peace, justice and strong institutions). Deposit insurance ensures the protection of deposits in the event of a bank failure, which means that depositors will not live in poverty if a bank fails since they will not lose their money. Deposit insurance also ensures the maintenance of financial stability which, in turn, contributes to economic growth. Lastly, deposit insurance is one of the measures used to ensure that financial institutions remain strong and are held accountable for their actions (e.g. in the event of bank failure, the bank owners take accountability for the failure).

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Chapter 1: Introduction to the Study

1.1 Introduction

Banks play a significant role in promoting financial stability and economic growth. One of the main roles of a bank is to take deposits from the public, which then form part of the bank's property as the bank becomes the owner of the money deposited into a client's bank account, while the client acquires a personal right against the bank in respect of such deposits.¹ The bank, in turn, lends this money to the borrowers who seek to, *inter alia*, purchase homes or establish businesses.² The critical role banks play underscores the necessity for stringent bank supervision to guarantee their safety, stability and optimal performance, given that these vital financial institutions are not immune to failure.³

If a bank is not safe and sound, that is, if it engages in risky ventures that ultimately lead to failure and insolvency, depositors face the risk of losing their money. This was particularly prevalent during South Africa's previous era of implicit deposit protection, which remained in place until recently.⁴ In the past, when banks failed, depositors' funds held by the banks would form part of the insolvent estate and the South African Reserve Bank (SARB) would compensate the depositors of a failed bank fully or partially using taxpayers' money.⁵

¹ Ramdhin "The bank-customer relationship" in Sharrock (ed) *The law of banking and payment in South Africa* (2016) 117.

² The South African Reserve Bank "Designing a deposit insurance scheme for South Africa - a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 2.

³ Okeahalam "The political economy of bank failure and supervision in the Republic of South Africa" 1998 *African Journal of Political Science*.

⁴ South Africa's new deposit insurance framework was adopted in June 2023 in terms of the Financial Sector Laws Amendment Act. See National Treasury "Financial Sector Laws Amendment Act, 2021: Commencement of certain provisions" 2023 available at https://www.gov.za/sites/default/files/gcis_document/202303/48294gon3202.pdf accessed 9 October 2023 80.

⁵ Okeahalam 1998 *African Journal of Political Science* 36-37. Examples of banks that were bailed out by the SARB include Bankorp and ABSA Bank. See Anchored in Law "The unfinished story: The SA Reserve Bank bailout of Bankorp Group and Absa Bank part 1" 2021 available at <https://www.anchoredinlaw.net/wp-content/uploads/2021/04/The-Unfinished-Story-The-SA-Reserve-Bank-Bailout-of-the-Bankorp-Group-and-Absa-Bank-Part-1.pdf> accessed 21 November 2023.

Furthermore, the consequences of a bank's failure extend beyond its liquidity and the loss of funds for consumers. They also encompass disruptions to economic growth and the potential for businesses to face bankruptcy due to restricted access to credit.⁶ Such failure also exacerbates poverty, leads to loss of confidence in financial institutions,⁷ and undermines the stability of the financial system. Additionally, it has contagion effects⁸ and can cause a run on other banks. A bank run occurs when a bank experiences a higher demand for deposit withdrawals than it can handle, thereby forcing the bank to suspend payments.⁹ A large number of depositors will panic and withdraw their money for fear of suffering losses.¹⁰

Although South Africa has a robust financial system as evidenced by its supervisory and regulatory framework,¹¹ a number of small to medium-sized South African banks have failed in the past. These failures were due to various reasons, but the most common cause of failure was corrupt banking practices by bank management.¹²

It is important to note that the failure of a single bank can cause disastrous consequences, including loss of deposits, especially if a bank is a systemically important financial institution (SIFI).¹³ A SIFI is a bank whose failure or distress has the potential to disrupt economic activity and the financial system at large due to its

⁶ Kawadza "The South African financial safety net: in support of the proposed deposit protection framework" 2018 *SALJ* 529.

⁷ *Ibid.*

⁸ Contagion occurs when depositors lose confidence in the financial system due to bank runs at other banks, thereby causing them to withdraw their deposits from both solvent and insolvent banks. See Temzelides "Are bank runs contagious?" 1997 *Business Review* 3.

⁹ Temzelides "Are bank runs contagious?" 1997 *Business Review* 3.

¹⁰ World Bank Group "Financial safety nets and bank resolution frameworks in Southern Africa: key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/handle/10986/31511> accessed 2 May 2022 2.

¹¹ Van Heerden 2020 *Journal of International Banking Law and Regulation* 46.

¹² African Bank and VBS Bank serve as examples of banks that failed due to corrupt banking practices. See National Treasury "Update on the curatorship of African Bank Ltd" 2014 available at <https://static.pmg.org.za/150310africanbank.pdf> accessed 17 September 2023. See also South African Government "South African Reserve Bank on VBS Liquidation" 2018 available at <https://www.gov.za/speeches/south-african-reserve-bank-vbs-liquidation-30-oct-2018-0000> accessed 23 October 2022.

¹³ Kawadza "The South African financial safety net: in support of the proposed deposit protection framework" 2018 *South African Law Journal* 528.

size, systemic interconnectedness and complexity.¹⁴ As a result of the special nature of banks and the risk that these businesses pose to financial stability and the losses that a bank failure may occasion to banks' depositors and other creditors, it is essential that banks are regulated and supervised, both from a prudential and market conduct perspective.¹⁵ On a prudential level, government regulators have deemed it prudent to implement financial safety nets¹⁶ in the financial system. These financial safety nets include banking regulation and supervision, early intervention measures, a bank resolution framework and an explicit deposit insurance scheme (DIS or EDIS).¹⁷ The focus of this study is on the latter. Financial safety nets are crucial in that they have a potential to increase financial stability and consumer protection.¹⁸

An EDIS is a measure used to effect stability in the financial system by giving depositors the confidence that they will recover their insured funds when a bank fails, thereby lessening the probability of a bank run.¹⁹ The main objective of an EDIS is to contribute to the enhancement of financial stability and consumer protection by offering protection to the depositors who are less financially sophisticated in the event of a bank failure.²⁰ A DIS serves as a mechanism for funding the reimbursement of insured deposits and can also be used in *tandem* with a bank resolution framework²¹

¹⁴ National Treasury "Strengthening South Africa's resolution framework for financial institutions" 2015 available at <http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf> accessed 15 April 2022 3.

¹⁵ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 20.

¹⁶ A financial safety net is a framework that includes prudential regulation, resolution, supervision, deposit insurance and lender of last resort. See International Association of Deposit Insurers "Financial Safety-Net" available at <https://www.iadi.org/en/core-principles-and-guidance/glossary/financial-safety-net/> accessed 26 September 2023.

¹⁷ Kawadza 2018 *SALJ* 528.

¹⁸ *Ibid.*

¹⁹ Helfer "What deposit insurance can and cannot do" 1999 available at <https://www.imf.org/external/pubs/ft/fandd/1999/03/tigert.htm#author> accessed 15 July 2022 23.

²⁰ The South African Reserve Bank "Designing a deposit insurance scheme for South Africa - a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 1.

²¹ Bank resolution refers to the restructuring of a distressed bank using resolution tools by a resolution authority in order to preserve public interests such as financial stability, the continuity of a bank's critical functions and minimal cost to taxpayers. The Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions serve as international standards for the

in instances where funding is needed to capitalize a bridge bank, recapitalize a failing bank or fund the transfer of liabilities to other banks.²² Deposit insurance can be traced as far back as 33 AD when the then Roman Emperor, Tiberius Caesar, granted assistance to “reliable bankers” following a banking crisis.²³

An EDIS was spearheaded by the United States of America (US) in 1933 after the Great Depression of 1929, thereafter inspiring other countries to follow suit.²⁴ The roots EDIS can be traced as far back to started the New York Stock Exchange crisis of October 1929 in the USA.²⁵ This culminated in a large scale bank failure in 1930, triggering widespread attempts to convert deposits to cash.²⁶ This, in turn, led to a cash shortage.²⁷ To address this, the US government introduced the “New Deal”-programme in an attempt to stop the dominos from falling even further.²⁸ In particular, this culminated in a formal structure established through the Banking Act of 1933²⁹ (Glass-Steagall Act) that introduced the Federal Deposit Insurance Corporation (FDIC) to oversee and implement the EDIS in the US. Another measure imposed by

resolution of banks. Notably, South Africa is in the process of implementing a bank resolution framework that will work in tandem with an EDIS. See Single Resolution Board “What is a Bank Resolution” 2016 available at <https://www.srb.europa.eu/en/content/what-bank-resolution> accessed 23 October 2022. See also Financial Stability Board “Key Attributes of Effective Resolution Regimes for Financial Institutions” 2014 available at https://www.fsb.org/wp-content/uploads/r_141015.pdf accessed 20 April 2022.

²² World Bank Group “Financial safety nets and bank resolution frameworks in Southern Africa: key issues and challenges” 2019 available at <https://openknowledge.worldbank.org/handle/10986/31511> accessed 24 May 2022 7.

²³ Carr “Banking on capital punishment” 2001 *Reserve Bank of New Zealand Bulletin* New Zealand 52. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 23.

²⁴ Federal Deposit Insurance Corporation (FDIC) “A brief history of deposit insurance in the United States” 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 20 July 2022 1.

²⁵ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 23. See also Flood “The great deposit insurance debate” 1992 *The Federal Reserve Bank of St. Louis Review* 53.

²⁶ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 23-24. See also FDIC “A brief history of deposit insurance in the United States” 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 20 July 2022 20.

²⁷ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 103. See also FDIC “A brief history of deposit insurance in the United States” 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 20 July 2022 20.

²⁸ Golembe “The deposit insurance legislation of 1933: An examination of its antecedents and its purposes” (1960) *Political Science Quarterly* 181.

²⁹ Banking Act of 1933.

the Banking Act 1933 to limit possible bank failure and risk-taking was the restrictions on combining investment banking and commercial banking activity.³⁰In 2008, the US was confronted with its most severe financial crisis since the Great Depression. The Global Financial Crisis of 2008 (GFC) stressed the importance of an EDIS within the financial safety net.³¹ According to Laeven, many countries started to implement or upgrade their EDIS after the disastrous collapses of financial institutions during the GFC³² in an attempt provide liquidity to banks in the event of a bank run.³³ International standard setting bodies also encouraged jurisdictions to have well-designed EDISs to give effect to consumer protection and maintain financial stability.³⁴ According to the *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience*,³⁵ the GFC illustrated the need for effective depositor compensation measures.³⁶ The Report also urged authorities to decide on an international set of principles for an effective EDIS.³⁷

Subsequently, the growth of EDISs, and the need for providing guidance to countries lacking EDIS and refining these deposit insurance systems, enhanced the need for

³⁰ Kawadza “The South African financial safety net: In support of the proposed deposit protection framework” 2018 *South African Law Journal* 524.

³¹ Singh and LaBrosse “Developing a framework for effective financial crisis management” 2011 *OECD Journal: Financial Market Trends* 14. See also Lugulu *Addressing the Moral Hazard Through Explicit Deposit Insurance: A Comparative Appraisal of the Kenya Deposit Insurance Act, 2012* (LLD-thesis, UP, 2019) 25-30.

³² Between 2007 and 2008, IADI membership increased and there were 119 countries who operated a DIS by the end of 2007/2008. See International Association of Deposit Insurers “Annual Report 2007/2008” available at <https://www.iadi.org/en/assets/File/Annual%20Reports/IADI%20Annual%20Report%202007-2008.pdf> accessed 1 November 2023 14. As a result of the GFC more countries became members of IADI during 2009/2010. See International Association of Deposit Insurers “Annual report 2009/2010 working together to build more resilient financial systems” available at <https://www.iadi.org/en/assets/File/Annual%20Reports/IADI%20Annual%20Report%202009-2010.pdf> accessed 1 November 2023 10. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 24-25.

³³ Laeven “Bank risk and deposit insurance” 2002 *The World Bank Economic Review* 110.

³⁴ According to Jones and Knaack, the 2008 GFC showed the effects of inadequate regulation and supervision at the center of the financial system. They viewed the GFC as a call to strengthen international regulatory cooperation. See Jones & Knaack “Global financial regulation: Shortcomings and reform options” 2019 *Global Policy* 193.

³⁵ Financial Stability Forum (FSF) “Report of the Financial Stability Forum on enhancing market and institutional resilience” 2008 available at https://www.fsb.org/wp-content/uploads/r_0804.pdf?page_moved=1 accessed 24 September 2023.

³⁶ *Ibid* 50.

³⁷ *Ibid* 51.

establishing an internationally agreed set of principles for effective EDIS.³⁸ Hence, the Basel Committee on Banking Supervision (Basel Committee)³⁹ and the International Association of Deposit Insurers (IADI) issued the *Core Principles for Effective Deposit Insurance Systems* in 2009. A *Compliance Assessment Methodology for the Core Principles* was completed in 2010. The Core Principles and their compliance assessment methodology (together: the Core Principles) serve as a benchmark for jurisdictions intending to establish EDIS as well as those intending to reform their existing systems.⁴⁰ The Core Principles were revised in 2014 in order to strengthen the standards in areas such as funding, governance, coverage and reimbursement speed.⁴¹

The South African financial sector has become increasingly globalized and concentrated, as has most financial sectors, and this can threaten the country's financial stability.⁴² Globally, the GFC exposed deficiencies in the financial regulatory

³⁸ According to the FSF Report, there was to be a variety of designs for deposit insurance systems that met the principles' objectives, and as a result, they were expected to be adaptable to a wide range of country conditions. See Financial Stability Forum "Report of the Financial Stability Forum on enhancing market and institutional resilience" 2008 available at https://www.fsb.org/wp-content/uploads/r_0804.pdf?page_moved=1 accessed 24 September 2023 51.

³⁹ The Basel Committee on Banking Supervision (Basel Committee) sets global standards for prudential regulation of banks and provides a forum for cooperation on banking supervision. As part of its mandate, the Basel Committee aims to enhance financial stability by strengthening banking regulation, supervision, and practices across the globe. See Bank for International Settlements "Basel Committee Charter" 2018 available at <https://www.bis.org/bcbs/charter.htm> accessed 15 April 2022.

⁴⁰ International Association of Deposit Insurers "IADI core principles for effective deposit insurance systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 5.

⁴¹ *Ibid* 6.

⁴² Matasane A *Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 28. See also Demirguc-Kunt & Kane "Deposit Insurance: Handle with care" Central Bank of Chile Working Paper No 227 2003 available at https://www.researchgate.net/publication/4813291_Deposit_Insurance_Handle_With_Care accessed 24 September 2023. Some of the financial stability risks that South Africa is currently facing are the risk of secondary sanctions being imposed on the country due to its neutral stance on the Russia-Ukraine war; insufficient and unreliable electricity supply; long-term placement on the Financial Action Task Force greylist; a widespread outflow of capital; domestic growth that is slow and inequitable; higher interest rates for an extended period; repricing of government debt at an accelerated rate; and a decline in market depth, and a reduction in liquidity in the domestic financial markets. See South African Reserve Bank "Financial stability review" 2023 available at <https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/First%20Edition%202023%20Financial%20Stability%20Review.pdf> accessed 24 September 2023 26-27.

policies and frameworks of most developed countries and exposed the central flaws of globalization and of economic models and assumptions.⁴³ After the GFC many governments reviewed their countries' financial regulatory frameworks to create more stronger banking systems for the future, and South Africa, as a Group of Twenty (G20) member⁴⁴ that committed itself to the post-GFC international financial reform agenda,⁴⁵ participated in the adoption of an EDIS.

Until recently, South Africa has maintained an implicit deposit insurance scheme, which meant that no legislation was put in place to deal with deposit protection. In the event of bank failure, the government would step in and use public funds to rescue a failing bank and compensate depositors.⁴⁶ This is known as the bail-out approach. However, the bail-out approach was not helpful as the taxpayers' money was used to rescue a failing bank and this ran the risk of undermining market discipline and causing moral hazard (excessive expenditure caused by eligibility for insurance benefits).⁴⁷ According to the SARB, South Africa's delay in adopting EDIS was due to affordability issues, the risk of moral hazard due to excessive risk that could be undertaken by depositors and institutions, and the concentrated banking system dominated by a few big banks.⁴⁸ Other concerns include the fact that traditional deposit insurance only paid out in cases of liquidation, which meant that a big fund would have to be established to cater for the depositors of the large banks, resulting in high costs to the

⁴³ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 28. See also Tetey *Managing Bank Resolution in South Africa* (Master of Management-dissertation (WBS), Wits University, 2014).

⁴⁴ The G20 is a forum focusing on issues related to the global economy such as international financial stability and it comprises the African Union, the European Union and 19 countries. See G20 "About G20" available at <https://www.g20.org/en/about-g20/#overview> accessed 21 November 2023.

⁴⁵ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 29. G20 Research Group "The G20 Seoul summit leaders' declaration" available at <http://www.g20.utoronto.ca/2010/g20seoul.html> accessed 24 September 2023.

⁴⁶ South African Reserve Bank "Designing a deposit insurance scheme for South Africa – a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 2.

⁴⁷ Avgouleas and Goodhart "Critical reflections on bank bail-ins" 2015 *Journal of Financial Regulation* 3; Marshall "Moral hazard" 1976 *The American Economic Review* 880.

⁴⁸ South African Reserve Bank "Designing a deposit insurance scheme for South Africa – a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 9.

depositors; and also due to the fact that the too-big-to-fail (TBTF) banks are less likely to get liquidated, they would contribute the most to the fund yet their depositors would be least likely to claim from it.⁴⁹

However, since the South African government no longer has the capacity to pay for the cost of failing banks, in 2015, the SARB and the South African National Treasury took a decision to establish an EDIS in South Africa to bring the country in line with the level of depositor protection in other G20 countries (South Africa was the only G20 country without an EDIS) and international best practice.⁵⁰ Another reason was to close the gap in the financial safety net that existed due to the lack of guaranteed deposit protection.⁵¹ The regulatory journey to establish an EDIS in South Africa began with a position paper titled “*Strengthening South Africa’s Resolution Framework for Financial Institutions*”,⁵² issued in 2015. The position paper stated that since South Africa subscribes to the Financial Stability Board’s Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes), it needs to have an EDIS in place in order to contribute to financial stability by providing prompt access to covered deposits.⁵³ In 2017, the SARB published a follow-up discussion paper titled “*Designing a Deposit Insurance Scheme for South Africa*” for public comment. The discussion paper stipulates the rationale for an EDIS, the structure, and the proposals on the key design features.⁵⁴ Subsequently, the South African EDIS framework was outlined in the Financial Sector Laws Amendment Bill 2018, presented in Parliament in August 2018. It underwent further amendments in 2020, becoming the Financial Sector Laws Amendment Bill B15 of 2020 and was ultimately enacted as the Financial Sector Laws Amendment Act 23 of 2021 (FSLAA) on 28 January 2022. Certain

⁴⁹ *Ibid.*

⁵⁰ *Ibid* 2-3.

⁵¹ *Ibid.*

⁵² National Treasury “Strengthening South Africa’s resolution framework for financial institutions” 2015 available at <https://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf> accessed 15 April 2022.

⁵³ *Ibid* 13-35.

⁵⁴ South African Reserve Bank “Designing a deposit insurance scheme for South Africa – a discussion paper” 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022

provisions of the FSLAA came into effect on 24 March 2023 and others on 1 June 2023.⁵⁵ There is a great need for an EDIS in South Africa given the current risks to its financial stability, such as insufficient electricity supply, placement on the greylist by the Financial Action Task Force (FATF) due to non-compliance with international standards on money laundering, high cost of living, and lack of employment.⁵⁶

The establishment of an EDIS aims to ensure an efficient, pre-planned and orderly provision of deposit protection, avoiding the chaotic scramble for funds in the event of a bank failure.⁵⁷ In other words, the plan is to have readily available funds in the form of insurance to compensate depositors affected by a bank failure. Additionally, the EDIS serves to contain the impact of a bank's failure, preventing its negative effects from spreading to other financially sound banks. Moreover, the scheme contributes to overall financial stability, aligning with the Key Attributes, which recommend countries to have an EDIS in place or any other form of arrangement to recover public costs after the resolution of a bank, as well as to protect depositors from loss.⁵⁸

The primary goal of this study is to assess the effectiveness of South Africa's EDIS in fulfilling its intended purpose. The study focuses on evaluating the alignment of South Africa's EDIS with international best practice standards, specifically the Core

⁵⁵ The South African Reserve Bank "Deposit insurance body established as Finance Minister Enoch Godongwana publishes commencement schedule as part of the implementation of the Financial Sector Laws Amendment Act" 2023 available at <https://www.resbank.co.za/content/dam/sarb/publications/media-releases/2023/codi-establishment/Deposit%20Insurance%20body%20CODI%20established%20.pdf> accessed 9 October 2023 1-2. See also National Treasury "Financial Sector Laws Amendment Act, 2021: Commencement of certain provisions" 2023 available at https://www.gov.za/sites/default/files/gcis_document/202303/48294gon3202.pdf accessed 9 October 2023 80.

⁵⁶ Nyaude "A credit in banking crises" 2023 available at <https://indd.adobe.com/view/9cb1660d-2fc4-41ed-8e42-2e43ec469ec0> accessed 24 September 2023 28-29. See also South African Reserve Bank "Financial stability review" 2023 available at <https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/First%20Edition%202023%20Financial%20Stability%20Review.pdf> accessed 24 September 2023 1.

⁵⁷ The South African Reserve Bank "Designing a deposit insurance scheme for South Africa – a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 9.

⁵⁸ Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2014 available at https://www.fsb.org/wp-content/uploads/r_111104cc.pdf accessed 15 April 2022 12.

Principles, and aims to identify any shortcomings. Additionally, through a comparative analysis of South Africa, the US, and Kenya, the study seeks to investigate the implementation of EDIS in these countries. By examining the challenges and lessons learned from each, the study aims to provide insights that can contribute to the enhancement of South Africa's EDIS.

1.2 Selection of Comparative Jurisdictions

The US is chosen as a comparative jurisdiction because it pioneered an EDIS, therefore a number of lessons can be learnt from it. The FDIC was established under the Banking Act of 1933 to insure bank deposits and reduce economic disruptions resulting from bank failures.⁵⁹ The FDIC was made a permanent agency of the government in terms of the Banking Act of 1935.⁶⁰ Kenya, on the other hand, is chosen as a comparative jurisdiction because, like South Africa, it is a developing economy that is also one of the early adopters of an EDIS. Kenya established an EDIS in 1985 under the Banking Act 56 of 1968 as amended by the Banking Amendment Act 17 of 1985 and it was managed by a body called the Deposit Protection Fund Board (DPFB), which became operational in 1986.⁶¹ The Fund is aimed to protect small depositors in the event of bank insolvency and thereby enhance financial stability.⁶² The Kenya Deposit Insurance Act 10 of 2012 (KDI Act) was enacted by the government in 2012, thereby repealing an EDIS under the Banking Act 56 of 1968 and establishing a new EDIS managed by the Kenya Deposit Insurance Corporation (KDIC). Furthermore, the US and Kenya are chosen for comparative analysis because they have both suffered bank failures after the adoption of an EDIS and have improved their deposit insurance schemes over the years, which developments are useful in the evaluation of South Africa's newly established EDIS.

⁵⁹ Federal Deposit Insurance Corporation *The first fifty years: A history of the FDIC 1933-1983* (2019) 3.

⁶⁰ *Ibid* 51.

⁶¹ Central Bank of Kenya "Role of bank supervision department" 1994 available at <https://www.centralbank.go.ke/images/docs/Bank%20Supervision%20Reports/Annual%20Reports/BSD%20Report%201994.pdf> accessed 25 July 2022 11.

⁶² *Ibid*.

1.3 Statement of the Problem

As mentioned above, South Africa is in the process of transitioning to an EDIS with some of the provisions of its new deposit insurance scheme having come into effect on 24 March 2023.⁶³ South Africa's EDIS is contained in Chapter 12A of the FSRA⁶⁴ as amended by the FSLAA.⁶⁵

This study seeks to analyse the design features of South Africa's EDIS to establish the extent to which the EDIS is aligned with international standards, namely, the Core Principles and to identify any shortcomings. In this regard the study will determine whether the EDIS will be effective in protecting depositors whilst curbing moral hazard that gives rise to bank failures. It is against this background that this study seeks to address the following research questions:

- a) What are the international standards for assessing a country's EDIS?
- b) Does South Africa's EDIS align with the international standards?
- c) How has the USA implemented and improved its EDIS since its establishment?
- d) How has Kenya implemented and improved its EDIS over the years?
- e) What lessons may South Africa learn from the experiences of the USA and Kenya to enhance the effectiveness of its EDIS?

1.4 Research Objectives

The study seeks to achieve the following objectives:

- a) To analyse international best practice in relation to the design features of an effective EDIS;
- b) To analyse the extent to which South Africa's EDIS in terms of the FSRA as amended by the FSLAA is aligned with international standards and the shortcomings thereof;

⁶³ National Treasury "Financial Sector Laws Amendment Act, 2021: Commencement of certain provisions" 2023 available at https://www.gov.za/sites/default/files/gcis_document/202303/48294gon3202.pdf accessed 9 October 2023 80.

⁶⁴ Financial Sector Regulation Act 9 of 2017.

⁶⁵ Financial Sector Laws Amendment Act 23 of 2021.

- c) To analyse the challenges and practices in respect of EDIS in the selected comparative jurisdictions, namely, the US and Kenya, to determine whether they can offer any guidance and lessons for South Africa; and
- d) To propose improvements to South Africa's EDIS in accordance with the lessons learnt from the comparative jurisdictions and the international standards.

1.5 Research Motivation

The purpose of a DIS is to enhance financial stability by protecting the banking system from potential bank runs that can disrupt the process of financial intermediation, the payments system and cause drastic macroeconomic effects.⁶⁶ A DIS is also useful in that it protects small depositors from losses during a bank failure and it also provides a formal mechanism for resolving failing banking institutions.⁶⁷ In the past, the South African government compensated depositors of failing banks using taxpayers' money.⁶⁸ This meant that the bank shareholders and creditors did not bear any loss of funds in the event of bank failure since the government would bail them out. This encouraged bank owners and bank managers to engage in risky ventures with the aim to make larger profits, thereby creating a moral hazard. The absence of an EDIS in South Africa presented a gap in the financial safety-net, which comprises a combination of crisis management tools, an effective resolution framework, and a regulatory and supervisory framework.⁶⁹ The establishment of an EDIS will, to a significant extent, prevent the use of public funds to rescue failing banks and provide the SARB with various options for financing a specific resolution strategy, such as funding the transfer of deposits to a bridge bank or issuing guarantees.⁷⁰ It is also imperative that South Africa's EDIS complies with the Core Principles as a minimum requirement for its EDIS to be effective because the Core Principles are the standard

⁶⁶ Mas and Talley "Deposit insurance in developing countries" 1990 available at [file:///C:/Users/u19300680/Documents/Downloads/\[Finance%20&%20Development\]%20Deposit%20Insurance%20in%20Developing%20Countries.pdf](file:///C:/Users/u19300680/Documents/Downloads/[Finance%20&%20Development]%20Deposit%20Insurance%20in%20Developing%20Countries.pdf) accessed 20 July 2022 43.

⁶⁷ *Ibid.*

⁶⁸ The South African Reserve Bank "Designing a deposit insurance scheme for South Africa – a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 2.

⁶⁹ *Ibid* 8.

⁷⁰ *Ibid* 10.

against which the effectiveness of a DIS is measured. Furthermore, South Africa can benefit from observing the practices in the US and Kenya to draw lessons on managing an effective EDIS. Therefore, the establishment of an EDIS in terms of the FSRA as amended by the FSLAA motivated this study, to analyse the extent to which the new EDIS is aligned with international best practice. Lastly, the effects of a bank failure on depositors such as loss of funds and the measures in place to deal with the losses and the persons responsible for such losses also serve as motivation for the study.

1.6 Literature Review

According to Glonti and Vashakmadze, the aim of a DIS is to avoid the bankruptcy of banks and to gain depositor confidence in the financial system.⁷¹ A DIS will increase the number of deposits and solve the problem of private savings.⁷² The authors maintain that if a jurisdiction fails to provide a safe DIS together with strong banking regulations and a robust central bank, then the introduction of a DIS will only result in catastrophic consequences and instead of solving the bankruptcy problem, it will lead to moral hazards.⁷³ Demirguc-Kunt and Huizinga opine that depositor protection that is excessively generous can cause banks to take more risks which will result in bank failure.⁷⁴ These authors are of the view that a DIS should make room for market discipline by containing design features such as limited coverage, private deposit insurance, private loss and co-insurance.⁷⁵ These features will incentivize depositors and creditors to continue to monitor the banks' activities.⁷⁶ Also, when banks engage in excessive risk taking, depositors can discipline the banks by withdrawing their funds or demanding higher interest rates.⁷⁷

⁷¹ Glonti and Vashakmadze "Deposit insurance, as the basis for ensuring financial sustainability of the banking system" 2018 *Journal of Applied Finance & Banking* 44.

⁷² *Ibid.*

⁷³ *Ibid* 49.

⁷⁴ Demirguc-Kunt and Huizinga "Market discipline and deposit insurance" 2004 *Journal of Monetary Economics* 376.

⁷⁵ *Ibid.*

⁷⁶ *Ibid* 376-381.

⁷⁷ *Ibid* 384.

Calomiris and White state that a DIS is regarded as necessary for depositor protection and banking system stability.⁷⁸ According to the authors, there was no interest in a DIS in the USA until the early 1930s.⁷⁹ The USA adopted a DIS as a result of the Great Depression in 1933 which resulted in a loss of deposits.⁸⁰ However, there were oppositions to the adoption of a DIS such as the bank regulatory agencies and the Roosevelt administration.⁸¹ Those who supported the establishment of a DIS argued that it was fair and necessary and that it was only just that the depositors not be forced to bear losses as a consequence of the banks' mistakes.⁸² On the other hand, those who were against the establishment of DIS, namely the bankers, argued that it was unfair for well-managed banks to fund poorly run banks.⁸³

Kenya established an EDIS in 1985 after the failure of several banking institutions in 1984 with the aim of giving creditor preference to the depositors in the event of bank insolvency.⁸⁴ The body in charge of liquidating banks in Kenya is the KDIC, which was statutorily appointed by the Central Bank of Kenya.⁸⁵ According to Mwangi, the KDI Act is silent on aspects such as the period within which deposits must be paid out in the event of bank failure and this may encourage the KDIC to exploit this loophole.⁸⁶ Furthermore, this loophole exposes depositors to potential loss of funds.⁸⁷ Another issue raised by Mwangi is that the close-knit relationship between the Central Bank of Kenya and KDIC may cause issues of accountability and may not produce the results that the stakeholders expect.⁸⁸ Mwangi argues that the extent to which the Kenyan

⁷⁸ Calomiris and White in Goldin and Libecap *The Regulated Economy: A Regulated Approach to Political Economy* (1994) 145.

⁷⁹ *Ibid.*

⁸⁰ *Ibid.*

⁸¹ *Ibid* 146.

⁸² *Ibid* 170.

⁸³ *Ibid.*

⁸⁴ Central Bank of Kenya "Role of Bank Supervision Department" 1994 available at <https://www.centralbank.go.ke/images/docs/Bank%20Supervision%20Reports/Annual%20Reports/BSD%20Report%201994.pdf> accessed 25 July 2022 11-13.

⁸⁵ *Ibid.*

⁸⁶ Mwangi *Preventing Bank Failure: An Assessment of the Risk Regulatory Framework for Banks in Kenya* (LLM-thesis, Strathmore University, 2021) 49.

⁸⁷ *Ibid.*

⁸⁸ *Ibid.*

legislation is aligned with the Core Principles is lacking.⁸⁹ Mwangi states that these issues raise the question of whether the bank resolution and crisis management mechanisms in the Kenyan legislation are sufficient to comply with the Core Principles.⁹⁰

According to Kawadza, if South Africa's EDIS is implemented properly, it could play a significant role in preventing moral hazard and enhancing deposit protection and financial stability.⁹¹ Furthermore, Kawadza argues that by providing an arrangement that is contractually binding and which is supported by a robust supervisory and prudential framework, an EDIS is a step in the right direction.⁹² Ellyne and Cheng point out the adverse effects of an EDIS, namely, that the cost of an EDIS for large South African banks would be impracticable and unfair as it would give rise to an environment where prudent banks will ultimately have to subsidize the riskier banks.⁹³ A further contention is that the mispricing of risk could cause banks to be less risk-averse, thereby increasing the potential for moral hazard.⁹⁴ Van Heerden expressed the view that the envisaged South African EDIS was not yet aligned with the Core Principles in a number of ways and suggested a number of improvements prior to the enactment of the FSLAA.⁹⁵

1.7 Research Methodology

This study will adopt a desktop methodology which will comprise of a study of legislation, South Africa's financial sector regulators' policy documents, international best practice standards on deposit insurance, textbooks, and journal articles on deposit insurance to assess whether South Africa's deposit insurance scheme is optimal. In this regard the study will analyse and rely on primary and secondary

⁸⁹ *Ibid.*

⁹⁰ *Ibid.*

⁹¹ Kawadza 2018 SALJ 524.

⁹² *Ibid.*

⁹³ Ellyne and Cheng "Valuation of deposit insurance in South Africa using an option-based model" 2014 *African Development Review* 148.

⁹⁴ Fratianni "Financial Crises, Safety Nets and Regulation" 2008 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1286903 accessed 25 July 2022 23.

⁹⁵ Van Heerden "Deposit protection in South Africa: recent developments" 2020 *Journal of International Banking Law and Regulation* 53.

sources. The study will further provide a comparative study of the US and Kenya's deposit insurance schemes to elicit lessons for South Africa.

1.8 Limitations to the Study

The main focus of this study is whether the deposit insurance scheme employed by South Africa will be effective in protecting depositors and maintaining financial stability in the event of bank failure. As such, the focus of the study will cover aspects such as South African legislation governing deposit insurance, the features of the DIS as well as international standards. When a bank fails, various factors contribute to its downfall, such as inability to meet prudential measures like capital and liquidity requirements. Other factors, such as issues related to bank resolution and the potential for liquidation, are considerations in the aftermath of failure. However, detailed discussions of these post-failure aspects are beyond the scope of the present study and will only be referred to when necessary.

1.9 Chapter Overview

Chapter 1 considers the importance of an EDIS in the protection of depositors and the enhancement of financial stability in the event of a bank failure. It sets out the main focus of the study, which is to measure South Africa's newly established EDIS against international best practices as well as to identify any shortcomings. This chapter further provides a brief historical background on the research topic, outlines the research problem and research questions that the study seeks to tackle, defines the research objectives, discusses the motivation for the study, explores the relevant literature, details the research methodology employed and the limitations to the study.

Chapter 2 will analyse the international best practice standards for EDISs with a specific focus on the Core Principles as the minimum requirements. These principles serve as a benchmark by which countries can assess the effectiveness of their respective EDISs.

Chapter 3 will analyse South Africa's EDIS captured in the FSRA as amended by the FSLAA⁹⁶ to establish whether it is in line with international standards, as well as to identify any weaknesses.

Chapter 4 is a comparative study of the US's EDIS features, with a particular focus on the implementation of the scheme in the event of bank failure. Furthermore, the challenges which the US has experienced in respect of its EDIS will also be considered, to serve as best practice guidance for South Africa.

Chapter 5 is also a comparative analysis of Kenya's EDIS features, with a specific focus on the implementation of the scheme when a bank fails. The challenges experienced by Kenya in respect of its EDIS will also be considered to provide best practice guidance for South Africa.

Chapter 6 concludes the study and sets out recommendations for effective implementation of South Africa's EDIS.

⁹⁶ Financial Sector Regulation Act 9 of 2017.

Chapter 2: International Best Practice for Deposit Insurance Schemes

2.1 Introduction

As discussed in chapter 1, the history of EDIS can be traced back to the Great Depression of 1929 which originated in the US and led to the failure of many banking institutions worldwide.⁹⁷ One of the major consequences of the Great Depression was the bank runs as large numbers of panic-stricken depositors withdrew their funds from banks.⁹⁸ Similarly, the GFC emphasized the need for DIS globally.⁹⁹ In particular, the GFC stressed the pivotal role of a DIS within the broader financial safety-net as well as the importance of maintaining depositor confidence in the financial system.¹⁰⁰ Pruski and Kerlin maintain that without public confidence, it will be nearly impossible to manage a financial crisis and the lack thereof will render the responses to economic instability worthless.¹⁰¹

In the midst of the GFC, the BCBS and the IADI issued the Core Principles in June 2009 (revised in 2014) to ensure a high level of depositor confidence in the financial sector.¹⁰² The Core Principles are used by jurisdictions as a benchmark for assessing the quality of their deposit insurance systems and for identifying gaps in their deposit insurance practices and measures to address them.¹⁰³ The Core Principles are also

⁹⁷ Pruski and Kerlin “Characteristics of deposit insurance research and the challenges ahead” 2015 *Safe Bank Journal* 114.

⁹⁸ *Ibid.*

⁹⁹ *Ibid.*

¹⁰⁰ International Association of Deposit Insurers “IADI core principles for effective deposit insurance systems” 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 5-6.

¹⁰¹ Pruski and Kerlin 2015 *Safe Bank Journal* 113.

¹⁰² Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 60.

¹⁰³ International Association of Deposit Insurers “IADI Core Principles For Effective Deposit Insurance Systems” 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 5.

used by the International Monetary Fund (IMF) and the World Bank (WB) to assess the effectiveness of jurisdictions' deposit insurance systems and practices.¹⁰⁴

As mentioned above, a DIS is a measure used to effect stability in the financial system by giving depositors the confidence that they will recover their insured funds when a bank fails, thereby lessening the probability of a bank run.¹⁰⁵ It is important to ensure that a DIS does not lead to moral hazard.

2.2 Moral Hazard

As highlighted by the IADI, moral hazard is a situation whereby banks, creditors and depositors are motivated to engage in or accept more risks since the costs of such risks are usually borne by the government through the use of public funds.¹⁰⁶ Deposit insurance must be designed properly so as to avoid moral hazard.¹⁰⁷ According to the IADI, whilst the protection of depositors from the potential loss of funds through an EDIS protects them from the consequences of unsound and unsafe bank practices, this can encourage banks to engage in greater risky ventures than would otherwise be the case in the absence of an EDIS.¹⁰⁸ Calomiris supports the view that insurance encourages excessive risk-taking by banks, especially in instances where a bank did not lose much capital as a result of prior losses.¹⁰⁹ Calomiris further maintains that insurance has the effect of removing market discipline and causing instability in the system.¹¹⁰ Therefore, as with any insurance system, deposit insurance must be designed to minimize the impact of moral hazard on the behaviour of depositors,

¹⁰⁴ World Bank Group "Financial safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 43.

¹⁰⁵ Helfer "What deposit insurance can and cannot do" 1999 available at <https://www.imf.org/external/pubs/ft/fandd/1999/03/tigert.htm#author> accessed 15 July 2022 23.

¹⁰⁶ International Association of Deposit Insurers "IADI core principles for effective deposit insurance systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 11.

¹⁰⁷ *Ibid.*

¹⁰⁸ *Ibid.*

¹⁰⁹ Calomiris "Is deposit insurance necessary? A historical perspective" 1990 *The Journal of Economic History* 283.

¹¹⁰ *Ibid.*

shareholders and bank management, bearing in mind the fact that a majority of depositors cannot differentiate between safe and unsafe banks.¹¹¹ Thus, the IADI is intentional with the integration of moral hazard mitigation into the overall design system as evidenced by key design features such as differential premiums, restriction on coverage levels and scope, and early intervention and resolution by the deposit insurer.¹¹²

2.3 Core Principles for Effective Deposit Insurance Systems

The Core Principles comprise of 16 principles which will be discussed in more detail below:

2.3.1 Core Principle 1: Public Policy Objectives

Core Principle 1 provides that the principal goals for a DIS are to contribute to financial stability while protecting depositors.¹¹³ It is imperative that these objectives be formally clarified and disclosed to the public.¹¹⁴ The system's public policy objectives should be reflected in the design of the DIS.¹¹⁵

¹¹¹ International Association of Deposit Insurers "IADI Core Principles For Effective Deposit Insurance Systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 11.

¹¹² IADI sets out the preconditions that must be in place to reduce moral hazard, namely a sound financial system; strong prudential regulation, supervision and resolution; a well-developed legal framework; sound accounting and disclosure regimes; and the macroeconomic environment. See The World Bank Group "Financial safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 29. See also International Association of Deposit Insurers "IADI Core Principles For Effective Deposit Insurance Systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 11-15.

¹¹³ *Ibid* 18.

¹¹⁴ *Ibid*.

¹¹⁵ *Ibid*; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 43.

2.3.2 Core Principle 2: Mandate and Powers

Core Principle 2 specifies that the mandate and powers of the deposit insurer should support the public policy objectives and be clearly defined and formally specified in legislation.¹¹⁶ Mandates can vary and they include “paybox” schemes (which are used to reimburse depositors upon the closure of a bank but cannot be used for other resolution purposes); “paybox plus” schemes (which allow deposit insurers to contribute financially to a broader range of bank resolutions); “loss minimiser” schemes (which involves an explicit mandate to seek a cost-effective resolution method to meet the objective of providing insured depositors with access to their funds); and “risk minimiser” schemes (these provide the deposit insurer with comprehensive risk minimisation functions, such as risk assessment and management).¹¹⁷

According to LaBrosse, research has proven that the systems with a risk-minimiser mandate are the most effective because their purpose is to reduce the cost of bank failures and mitigate the risks inherent in providing deposit insurance and they are highly in support of early intervention.¹¹⁸ The systems with a loss-minimiser are also supportive of early intervention, including strategies for closure as a means of safeguarding the safety and soundness of the financial sector.¹¹⁹ According to Van Roosebeke and Defina, the share of deposit insurers with a paybox plus mandate increased to 46% in 2022, making it the widely used mandate.¹²⁰

From the above mandates, it appears that a paybox system alone will not suffice, therefore, a combination of a paybox plus mandate, a risk minimiser mandate and a

¹¹⁶ *Ibid* 19.

¹¹⁷ The World Bank Group “Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges” 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 4.

¹¹⁸ LaBrosse 2008 *Journal of Banking Regulation* 294-297.

¹¹⁹ *Ibid* 297.

¹²⁰ Van Roosebeke and Defina “Deposit insurance in 2023: Global trends and key issues” 2023 available at <https://mpr.a.uni-muenchen.de/117046/> accessed 1 May 2023.

loss minimiser mandate would be more effective, depending on a jurisdiction's suitability.

2.3.3 Core Principle 3: Governance

In terms of Core Principle 3, the deposit insurer is required to be operationally independent, transparent, well-governed, protected against external interference and accountable.¹²¹

2.3.4 Core Principle 4: Relationships with Other Financial Safety-Net Providers

Core Principle 4 specifies that to protect depositors and enhance financial stability, a formal and comprehensive framework should be in place for the close coordination of activities and information sharing on an ongoing basis between the deposit insurer and other financial safety-net participants.¹²²

2.3.5 Core Principle 5: Cross-Border Issues

Where there is a significant presence of foreign banks in a country, transparency must be in place among deposit insurers in relevant countries.¹²³

¹²¹ *Ibid* 21; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 43.

¹²² International Association of Deposit Insurers "IADI Core Principles For Effective Deposit Insurance Systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 23; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 43.

¹²³ International Association of Deposit Insurers "IADI Core Principles For Effective Deposit Insurance Systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 24; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 43.

2.3.6 Core Principle 6: Deposit Insurer's Role in Contingency Planning and Crisis Management

Core Principle 6 states that the deposit insurer should have in place effective contingency planning and crisis management policies and procedures to ensure that it can effectively respond to the risk of, and actual, bank failures, and other events.¹²⁴ The development of system-wide crisis preparedness strategies and management policies should be the joint responsibility of all safety-net participants.¹²⁵

2.3.7 Core Principle 7: Membership

In terms of Core Principle 7, it is compulsory for all banks to be members of a deposit insurance system, including state-owned banks.¹²⁶ Campbell and Moffatt observe that the focus of this protection is on the individual depositor and a failure to offer this protection can lead to political unrest and human suffering.¹²⁷

2.3.8 Core Principle 8: Coverage

Core Principle 8 stipulates that the level and scope of deposit coverage should be clearly defined by policymakers. Coverage should be limited, credible, and cover most depositors but leave a substantial amount of deposits exposed to market discipline.¹²⁸

¹²⁴ International Association of Deposit Insurers "IADI core principles for effective deposit insurance systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 25.

¹²⁵ *Ibid*; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 43.

¹²⁶ International Association of Deposit Insurers "IADI core principles for effective deposit insurance systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 26; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 43.

¹²⁷ Campbell and Moffatt 2014 *Nottingham Law Journal* 105.

¹²⁸ International Association of Deposit Insurers "IADI Core Principles For Effective Deposit Insurance Systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 27; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern

Deposit insurance coverage should be consistent with the deposit insurance system's public policy objectives and related design features.¹²⁹ According to Van Roosebeke and Defina, over the last five years, coverage levels have remained steady and for more than a decade, the majority of the larger jurisdictions have not changed their coverage levels.¹³⁰

2.3.9 Core Principle 9: Sources and Uses of Funds

Core Principle 9 specifies that the deposit insurer is expected to have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims, including assured liquidity funding arrangements.¹³¹ Responsibility for paying the cost of deposit insurance should be borne by banks.¹³² According to Van Roosebeke and Defina, deposit insurers are ex-ante funded in at least 84% of cases, whereby premiums are charged on member banks prior to bank failures.¹³³

2.3.10. Core Principle 10: Public Awareness

Core Principle 10 emphasizes the importance of informing the public on a continuous basis about the benefits and limitations of the DIS to protect depositors and contribute to financial stability.¹³⁴

Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 43.

¹²⁹ *Ibid.*

¹³⁰ Van Roosebeke and Defina "Deposit insurance in 2023: Global trends and key issues" 2023 available at <https://mpr.aub.uni-muenchen.de/117046/> accessed 1 May 2023.

¹³¹ International Association of Deposit Insurers "IADI core principles for effective deposit insurance systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 29.

¹³² The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 44.

¹³³ Van Roosebeke and Defina "Deposit insurance in 2022: Global trends and key emerging issues" 2023 available at <https://mpr.aub.uni-muenchen.de/112096/> accessed 1 May 2023.

¹³⁴ International Association of Deposit Insurers "IADI Core Principles For Effective Deposit Insurance Systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 32.

2.3.11 Core Principle 11: Legal Protection

Core Principle 11 provides that the deposit insurer and individuals working both currently and formerly for the deposit insurer in the discharge of its mandate must be protected from liability arising from actions, claims, lawsuits or other proceedings for their decisions, actions or omissions taken in good faith in the normal course of their duties.¹³⁵ This legal protection should be defined in legislation.¹³⁶

2.3.12 Core Principle 12: Dealing with Parties at Fault in a Bank Failure

Core Principle 12 states that “the deposit insurer or other relevant authority should have the power to seek legal redress against those parties at fault in a bank failure.”¹³⁷

2.3.13 Core Principle 13: Early Detection and Timely Intervention

Core Principle 13 provides that “the deposit insurer should be part of a framework within the financial safety-net that provides for early detection of and timely intervention in distressed banks.”¹³⁸ Ideally, intervention should take place before the bank becomes non-viable.¹³⁹ Such actions should protect depositors and contribute to financial stability.¹⁴⁰

¹³⁵ *Ibid* 34; The World Bank Group “Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges” 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 44.

¹³⁶ *Ibid*.

¹³⁷ International Association of Deposit Insurers “IADI Core Principles For Effective Deposit Insurance Systems” 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 35; The World Bank Group “Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges” 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 44.

¹³⁸ International Association of Deposit Insurers “IADI core principles for effective deposit insurance systems” 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 36; The World Bank Group “Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges” 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 44.

¹³⁹ *Ibid*.

¹⁴⁰ *Ibid*.

2.3.14 Core Principle 14: Failure Resolution

Core Principle 14 stipulates that an effective failure resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability.¹⁴¹ Accordingly, the legal framework should include a special resolution regime.¹⁴²

2.3.15 Core Principle 15: Reimbursing Depositors

In terms of Core Principle 15, the DIS should facilitate prompt reimbursement of depositors' insured funds to contribute to financial stability.¹⁴³ The trigger for depositor reimbursement has to be clear and indisputable.¹⁴⁴ There should be a clear and unequivocal trigger for insured depositor reimbursement.¹⁴⁵ The deposit insurer is required to reimburse a majority of depositors within a seven-day working period.¹⁴⁶ According to Van Roosebeke and Defina, although it is challenging for most deposit insurers to meet the seven-day period, the speed of reimbursements across the world has increased from 30% in 2013 to 65% in 2022.¹⁴⁷

¹⁴¹ International Association of Deposit Insurers "IADI core principles for effective deposit insurance systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 37; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 44.

¹⁴² *Ibid.*

¹⁴³ International Association of Deposit Insurers "IADI core principles for effective deposit insurance systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 39; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 44.

¹⁴⁴ *Ibid.*

¹⁴⁵ *Ibid.*

¹⁴⁶ *Ibid.*

¹⁴⁷ Van Roosebeke and Defina "Deposit insurance in 2023: Global trends and key issues" 2023 available at <https://mpr.ub.uni-muenchen.de/117046/> accessed 1 May 2023.

2.3.16 Core Principle 16: Recoveries

Core Principle 16 provides that in terms of the law the deposit insurer should have the right to recover its claims in line with the statutory creditor hierarchy.¹⁴⁸

2.4 Conclusion

From the above discussion it is clear that although the Core Principles are not binding,¹⁴⁹ an effective DIS is one which complies with all the 16 Core Principles. Important to note is that the deposit insurance system must be designed in a manner that prevents moral hazard and the IADI is intentional about this as can be seen from factors such as the coverage level restrictions, compulsory membership for banks and differential premiums. The next chapter will focus on South Africa's new deposit insurance system and will consider the extent to which this new DIS complies with the Core Principles.

¹⁴⁸ International Association of Deposit Insurers "IADI Core Principles For Effective Deposit Insurance Systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 41; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 44.

¹⁴⁹ Australian Prudential Regulation Authority and the Reserve Bank of Australia "Assessment of the financial claims scheme against the core principles for effective deposit insurance systems" 2009 available at <https://www.rba.gov.au/information/foi/disclosure-log/pdf/121304.pdf> accessed 24 September 2023 2.

Chapter 3: South Africa's New Deposit Insurance Framework

3.1 Introduction

This chapter focuses on South Africa's new deposit insurance framework, specifically, the alignment of its EDIS with the Core Principles. Accordingly, the design features of South Africa's EDIS in terms of the FSRA as amended by the FSLAA will be discussed in this chapter as well as the benchmarking assessment of the design features against the Core Principles.

3.2 South Africa's Journey to Establishing an EDIS

The South African banking sector is dominated by four largest banks that control approximately 90% market share, making it a highly concentrated sector.¹⁵⁰ The SARB is the central bank of the country and derives its powers and mandate from the South African Reserve Bank Act 90 of 1989 read with the Banks Act 94 of 1990 and the Constitution of the Republic of South Africa, 1996. South Africa is a G20 member and a member of the Bank for International Settlements.¹⁵¹

Although South Africa is a G20 member as well as a member of the Bank for International Settlements, it never adopted an EDIS until recently.¹⁵² Consequently, if a bank failed, it was possible, but not certain, that public funds would be used to bail out the bank and protect depositors.¹⁵³ As discussed in chapter 1, several small to medium-sized South African banks have failed in the past. Notable instances include Alpha Bank, which succumbed to high level fraud in 1990, and Pretoria Bank, which failed in 1991 due to poor management.¹⁵⁴ In 1994, Prima Bank faced insolvency due to liquidity problems stemming from high volume of non-performing loans, while African Bank encountered liquidity problems in 1995, as a result of inadequate capital and mismanagement.¹⁵⁵ Among the list of failed banks are the Islamic Bank of South

¹⁵⁰ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 188.

¹⁵¹ *Ibid* 190.

¹⁵² *Ibid* 192.

¹⁵³ *Ibid*.

¹⁵⁴ Okeahalam 1998 *African Journal of Political Science* 36.

¹⁵⁵ *Ibid* 36-37.

Africa, which failed in 1997 due to improper management systems and accounting irregularities and poor leadership.¹⁵⁶ African Bank Limited faced another setback in 2014, primarily due to management issues and liquidity challenges.¹⁵⁷ Additionally, VBS Mutual Bank's failure in 2018 can be attributed to severe liquidity problems and corrupt management practices.¹⁵⁸ In response to the crises, some of these banks were placed under curatorship, with the SARB injecting substantial sums of money in an effort to salvage them.¹⁵⁹ While some, like African Bank were successfully rescued, others, such as VBS Mutual Bank, proved beyond salvation and were subsequently liquidated.¹⁶⁰ These failures should have served as a trigger for the adoption of an EDIS by the government, however, due to the small size of the banks and the fact that the banking sector is considered robust and safe, South Africa delayed in adopting an EDIS.¹⁶¹ The SARB's reason for the delay was that in addition to a concentrated banking sector and affordability issues, the risk of moral hazard posed a greater threat

¹⁵⁶ *Ibid* 37.

¹⁵⁷ National Treasury "Update on the curatorship of African Bank Ltd" 2014 available at <https://static.pmg.org.za/150310africanbank.pdf> accessed 17 September 2023.

¹⁵⁸ Motau "The great bank heist investigator's report to the prudential authority" 2018 available at <https://www.resbank.co.za/en/home/publications/publication-detail-pages/media-releases/2018/8403> accessed 2 May 2022 3.

¹⁵⁹ Okeahalam 1998 *African Journal of Political Science* 36-38. See also South African Reserve Bank "Annual report" 1998 available at <https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/1998/4017> accessed 23 September 2023 12; Lugulu *Addressing the Moral Hazard Through Explicit Deposit Insurance: A Comparative Appraisal of the Kenya Deposit Insurance Act, 2012* (LLD-thesis, UP, 2019) 185; Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 196.

¹⁶⁰ The rescue of African Bank was successful because the bank was separated into a "good bank" and a "bad bank" in terms of which well-performing loans would be transferred to the "good bank" and the non-performing loans would remain in the "bad bank" which would eventually be liquidated. Another reason for the successful rescue of African Bank is because SARB, together with a consortium of local banks and the Government Employees' Pension Fund injected R10 billion to the bank. On the other hand, VBS Mutual Bank could not be saved because the bank was factually insolvent due to high level fraud and its assets were greatly outweighed by its liabilities and the Commissioner recommended that the bank be placed into liquidation. See South African Government "South African Reserve Bank on VBS Liquidation" 2018 available at <https://www.gov.za/speeches/south-african-reserve-bank-vbs-liquidation-30-oct-2018-0000> accessed 23 October 2022.

¹⁶¹ Okeahalam and Maxwell "Deposit insurance design and bank regulation in South Africa" 2001 *Journal of Financial Regulation and Compliance* 142.

to financial stability.¹⁶² The absence of an EDIS in South Africa created a gap in the design of the financial safety-net aimed at promoting financial stability.¹⁶³

While the GFC did not have the same financial impact on South Africa as it did on a global scale, it had an impact on the course and model of financial sector regulation in the country.¹⁶⁴ Financial regulation reforms were undertaken in South Africa following a financial regulatory system review that began in 2007 and gained momentum following the GFC.¹⁶⁵ At the core of these reforms to financial regulation that took place in South Africa after the GFC, is the transition from a silo sectoral model of financial regulation to a Twin Peaks model of financial regulation which is captured in the FSRA.¹⁶⁶ The Twin Peaks model was adopted in South Africa with the primary objective of ensuring a more efficient, safe and sound financial sector.¹⁶⁷ The Twin Peaks model consists of three key components, namely, the Prudential Authority serving as the prudential regulator, and the Financial Sector Conduct Authority, acting as the market conduct regulator.¹⁶⁸ These entities aim to ensure the safety and soundness of regulated institutions, protect consumers of financial services and promote confidence in the South African financial system, respectively.¹⁶⁹ The SARB is responsible for overseeing overall financial stability.¹⁷⁰ Following South Africa's

¹⁶² The South African Reserve Bank "Designing a deposit insurance scheme for South Africa – a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 9.

¹⁶³ The South African Reserve Bank "Designing a deposit insurance scheme for South Africa – a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 8. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 193.

¹⁶⁴ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 193.

¹⁶⁵ *Ibid.*

¹⁶⁶ Godwin "Introduction to special issue – the twin peaks model of financial regulation and reform in South Africa" 2017 *Law and Financial Markets Review* 151-153.

¹⁶⁷ Section 7(1) of the Financial Sector Regulation Act 9 of 2017.

¹⁶⁸ Sections 11 – 58 of the Financial Sector Regulation Act 9 of 2017. See also Van Heerden and Van Niekerk "The financial stability mandate of the South African Central Bank in the post-crisis landscape" 2018 *Journal of International Banking Law and Regulation* 414. See further Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 194.

¹⁶⁹ *Ibid.*

¹⁷⁰ *Ibid.*

commitment to the international financial reform agenda at the G-20 Seoul Conference in 2010, the SARB and the National Treasury developed a new legislative framework to facilitate the resolution of failing financial institutions in an orderly manner to reduce the use of public funds to bail them out.¹⁷¹ In *tandem* with this resolution framework, South Africa also introduced a legislative framework for an EDIS.¹⁷²

In 2015, the SARB and National Treasury issued a policy document titled “*Strengthening South Africa’s Resolution Framework for Financial Institutions*” which outlined the proposals and motivation for strengthening the framework for the resolution of financial institutions.¹⁷³ This document also outlined the initial considerations of an EDIS and its design features as discussed below. In 2017, the SARB and National Treasury published a follow-up document titled “*Designing a Deposit Insurance Scheme for South Africa*” which contained the structure, rationale, and more detailed proposals for the establishment of an EDIS.¹⁷⁴ In 2018, the Financial Sector Laws Amendment Bill was tabled in Parliament to give effect to the proposals outlined in the aforementioned policy documents, and an updated version of this Bill was introduced in 2020.¹⁷⁵ The FSLAA was finally signed into law by the President in 2022 and on 24 March 2023 the Corporation for Deposit Insurance (CODI) was established at the same time that various sections of the FSLAA dealing with deposit insurance took effect (sections 166AE; 166AH to 166AS; 166AU to 166BB;

¹⁷¹ National Treasury “A safer financial sector to serve south Africa better” 2011 available at <https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf> accessed 1 March 2022 20. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 195.

¹⁷² Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 195.

¹⁷³ National Treasury “Strengthening South Africa’s resolution framework for financial institutions” 2015 available at <https://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf> accessed 15 April 2022.

¹⁷⁴ South African Reserve Bank “Designing a deposit insurance scheme for South Africa – a discussion paper” 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022.

¹⁷⁵ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 200.

and 166BF), while the remaining provisions took effect on 1 June 2023.¹⁷⁶ According to the SARB, the DIS is expected to be fully operational during the first quarter of 2024.¹⁷⁷

3.3 The Design Features under the Financial Sector Laws Amendment Act

The objective of South Africa's DIS is to safeguard covered deposits in the event of a bank failure, thereby enhancing and protecting the stability of the country's financial system and ensuring consumer protection.¹⁷⁸

According to the SARB, one of the design features of South Africa's EDIS is the paybox plus mandate.¹⁷⁹ The significance of a paybox plus mandate is that not only will it provide for the reimbursement of covered deposits but it will also fund other forms of resolution.¹⁸⁰ This mandate is ideal because South Africa's DIS is expected to operate together with the resolution framework, thus it is plausible that the DIS supports the various forms of resolution. Of importance is that although the DIS will be located within the SARB, it will be a subsidiary of the SARB, that is, a separate legal entity with its own legislative framework.¹⁸¹ Another design feature is that not only will membership of the DIS be compulsory for all banks but it will also be automatic for all registered banks. All deposits will qualify for coverage, except deposits by the

¹⁷⁶ National Treasury "Financial Sector Laws Amendment Act, 2021: Commencement of certain provisions" 2023 available at https://www.gov.za/sites/default/files/gcis_document/202303/48294gon3202.pdf accessed 9 October 2023 80.

¹⁷⁷ South African Reserve Bank "Project for the establishment of the Corporation for Deposit Insurance" 2022 available at <https://www.resbank.co.za/content/dam/sarb/publications/media-releases/2022/codi-newsletter/Corporation%20for%20Deposit%20Insurance%20October%202022%20Newsletter.pdf> accessed 24 September 2023.

¹⁷⁸ National Treasury "Strengthening South Africa's resolution framework for financial institutions" 2015 available at <https://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf> accessed 15 April 2022 18.

¹⁷⁹ *Ibid* 3.

¹⁸⁰ *Ibid*.

¹⁸¹ *Ibid* 4.

government, the private financial sector such as pension funds, insurers, banks, and bearer deposit instruments such as promissory notes.¹⁸²

Also, of utmost importance is the fact that deposits will be covered up to R100 000 per depositor per bank.¹⁸³ According to the SARB, this coverage amount is sufficient to cover 98% of the retail depositors in South Africa.¹⁸⁴ It appears that this limit is an attempt to instill market discipline and avoid moral hazard, and it is also in line with the purpose of deposit insurance which is to protect small, unsophisticated depositors.

South Africa will follow an ex-ante funding model and in the case of shortfalls, the SARB will provide emergency funding and liquidity.¹⁸⁵ In instances where the funds of the DIS are insufficient for depositor payouts, the SARB will inject funds and thereafter claim a refund in terms of its legal right to collect such from the remaining banks as well as its preferred claim in the proceeds of liquidation.¹⁸⁶ As regards the timeframe for the payout of deposits, initially depositors will be reimbursed within 20 business days after the closure of a bank if ownership of the bank account is easily determinable and then within 7 business days in accordance with international best practice.¹⁸⁷ Furthermore, deposits belonging to foreign nationals and foreign currency deposits held at domestic branches of South African banks will also be covered.¹⁸⁸ However, deposits held at subsidiaries of South African banks abroad as well as those at foreign branches will not be covered.¹⁸⁹

3.4 Benchmarking South Africa's EDIS against the Core Principles

3.4.1 Alignment with Core Principle 1: Public Policy Objectives

South Africa's deposit insurance framework is aligned with Core Principle 1 as section 166AF(1) of the FSRA as amended by the FSLAA states that the objective of the CODI

¹⁸² *Ibid.*

¹⁸³ *Ibid.*

¹⁸⁴ *Ibid* 30.

¹⁸⁵ *Ibid* 5.

¹⁸⁶ *Ibid.*

¹⁸⁷ *Ibid* 6.

¹⁸⁸ *Ibid* 4.

¹⁸⁹ *Ibid.*

is to support the SARB in carrying out its responsibility and objective of maintaining and protecting financial stability in accordance with section 3(2) of the South African Reserve Bank Act 90 of 1989 and of restoring, enhancing, protecting or maintaining financial stability in terms of section 11 of the FSRA.¹⁹⁰ Furthermore, the amendment of the object of the FSRA to provide for depositor protection through the establishment of a DIS and a Corporation meets the requirements of Core Principle 1.¹⁹¹

3.4.2 Alignment with Core Principle 2: Mandate and Powers

The FSRA is aligned with Core Principle 2 in that section 166AF(2)(a) and (b) provides the mandate of the Corporation, namely to establish, administer and maintain the Deposit Insurance Fund in accordance with chapter 12A of the FSRA, in the interests of depositors and to promote awareness among depositors in respect of the protections afforded by chapter 12A.¹⁹² The Act further provides the powers of the Corporation, including the power to collect insurance premiums from member banks in terms of section 166BG(1);¹⁹³ charging member banks insurance levies that are payable in terms of legislation to fund the administration of the fund and the operations of the Corporation in terms of section 166BC(1) and (2);¹⁹⁴ and reimbursing insured depositors of a bank in resolution in terms of section 166AA(1)(b).¹⁹⁵ Other powers include obtaining information in respect of banks in accordance with section 166AG(3);¹⁹⁶ and cooperating and collaborating with the SARB and the financial sector regulators so that these regulators may provide information promptly to the Corporation regarding any matter that may affect the functions of the Corporation in accordance with section 166BA(1).¹⁹⁷ The Corporation is also empowered to request information relevant to the fulfillment of its functions from members of the Corporation, the Financial Sector Conduct Authority and the Prudential Authority in terms of section

¹⁹⁰ Section 166AF(1) of the Financial Sector Regulation Act 9 of 2017.

¹⁹¹ Section 60 of the Financial Sector Laws Amendment Act 23 of 2021.

¹⁹² Section 166AF(2)(a) and (b) of the Financial Sector Regulation Act 9 of 2017.

¹⁹³ Section 166BG(1) of the Financial Sector Regulation Act 9 of 2017.

¹⁹⁴ Section 166BC(1) and (2) of the Financial Sector Regulation Act 9 of 2017.

¹⁹⁵ Section 166AA(1)(b) of the Financial Sector Regulation Act 9 of 2017.

¹⁹⁶ Section 166AG(3) of the Financial Sector Regulation Act 9 of 2017.

¹⁹⁷ Section 166BA(1) of the Financial Sector Regulation Act 9 of 2017.

166BF;¹⁹⁸ and entering into contracts in terms of section 166AX(2)(c).¹⁹⁹ The Corporation will be located within the SARB as the SARB's subsidiary.²⁰⁰ South Africa's paybox plus mandate is also aligned with the Core Principles since this mandate allows the Corporation to play a role in resolution funding and coordination.²⁰¹ Of importance, however, is that when implementing this combination, caution must be taken to not encroach upon the principle of separation of powers, especially in respect of the risk minimiser mandate whereby the deposit insurer will have prudential responsibilities which normally fall under the ambit of the Prudential Authority and the resolution functions which are exercised by the Resolution Authority, which is the SARB.

The FSRA, however, makes no mention of the Corporation's power to transfer deposits to another bank, compel banks to comply with their legal obligations to the Corporation and setting policies, operating budgets, practices and systems.

3.4.3 Alignment with Core Principle 3: Governance

The FSRA is aligned with Core Principle 3. Section 166AH provides that the Corporation must manage its affairs and the Fund in an effective and efficient manner, and establish and execute effective and appropriate governance processes and systems, taking into account international standards.²⁰² In regard to capacity and capability, section 166AY(1) provides that SARB must provide the Corporation with accommodation, personnel, resources, use of assets, facilities and other services as agreed to by the SARB and as determined by the Corporation in terms of section 166AX(1).²⁰³ Section 166BG(2) addresses the disclosure of information for

¹⁹⁸ Section 166BF of the Financial Sector Regulation Act 9 of 2017.

¹⁹⁹ Section 166AX(2)(c) of the Financial Sector Regulation Act 9 of 2017.

²⁰⁰ South African Reserve Bank "Project for the establishment of the Corporation for Deposit Insurance" 2022 available at <https://www.resbank.co.za/content/dam/sarb/publications/media-releases/2022/codi-newsletter/Corporation%20for%20Deposit%20Insurance%20October%202022%20Newsletter.pdf> accessed 24 September 2023.

²⁰¹ Section 166BA(1) of the Financial Sector Regulation Act 9 of 2017. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 216-251.

²⁰² Section 166AH of the Financial Sector Regulation Act 9 of 2017.

²⁰³ Section 166AY(1) of the Financial Sector Regulation Act 9 of 2017.

stakeholders and it states that the Corporation must publish premiums that have been collected on its website and in the Register.²⁰⁴ The FSRA also addresses the terms of service of the Corporation's governing body in section 166AI(3)(a) and (b).²⁰⁵ The Governor is also permitted in terms of subsections 166AI(5) and (6) to remove a director from office if the director becomes disqualified.²⁰⁶

In terms of subsection 166AI(8) the Governor and Minister have the power to appoint one board member, with the exception of the Chief Executive Officer (CEO) of the Corporation and the SARB's Group Chief Financial Officer, as chair.²⁰⁷ This is to avoid a conflict of interest as well as maintain independence. The independence of the Corporation is not clearly specified. According to Matasane, since the SARB and the government hold shares in the Corporation, there is the danger that the government may require the Corporation to provide resolution funding where it is inappropriate to do so or to refrain from providing the funding in instances where funding should be provided.²⁰⁸ Section 166AQ(1) and (2) also deals with conflict of interest and it provides that a director must disclose as soon as possible, in writing or at a meeting of the Board, any interest that he/she has or that a person related to the director has.²⁰⁹

Section 166AP sets out the ethical standards that are expected from the members and directors of the Corporation and it states that these persons must act honestly in all matters relating to the Corporation and in good faith, for a proper purpose and with the degree of diligence and care that is expected from a reasonable person in their position.²¹⁰ Section 166AU deals with auditing and bookkeeping and it stipulates that the Corporation must ensure that a proper account of all assets, transactions and liabilities of the Fund and the Corporation are kept and that financial statements are

²⁰⁴ Section 166BG(2) of the Financial Sector Regulation Act 9 of 2017.

²⁰⁵ Section 166AI(3)(a) and (b) of the Financial Sector Regulation Act.

²⁰⁶ Section 166AI(5) and (6)(a)(b) and (c) of the Financial Sector Regulation Act 9 of 2017.

²⁰⁷ Section 166AI(8) of the Financial Sector Regulation Act 9 of 2017.

²⁰⁸ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 242.

²⁰⁹ Section 166AQ(1)(a) and (b) and (2) of the Financial Sector Regulation Act 9 of 2017.

²¹⁰ Section 166AP of the Financial Sector Regulation Act 9 of 2017.

also kept in respect of each financial year and submitted to the SARB and the Minister after auditing.²¹¹

The FSRA does not address the assessment of the Corporation as a whole but rather focuses on the assessment of the performance of the Corporation's CEO in terms of section 166AL(2)(a).²¹² As regards the meetings that must be held by the governing body, section 166AK(1) provides that the meetings of the Board must convene at a time determined by the Board or the chairperson of the Board.²¹³

3.4.4 Alignment with Core Principle 4: Relationships with Other Safety-Net Participants

The FSRA is aligned with Core Principle 4 because section 166BA of the FSLAA provides for cooperation and collaboration between the Corporation, SARB and financial sector regulators.²¹⁴ In terms of this section, the regulators must respond to the Corporation's requests, including requests to issue directives, determine standards and promote awareness among depositors of the protections afforded by chapter 12A of the FSRA.²¹⁵ The Corporation is also empowered to enter into memoranda of understanding with a regulator, the SARB or a body in another jurisdiction that exercises functions and powers similar to those of the Corporation.²¹⁶ Furthermore, the Corporation can request information from the Prudential Authority and the Financial Sector Conduct Authority in terms of section 166BF.²¹⁷ Mention is not made of confidentiality rules and multiple deposit insurers operating in the same jurisdiction.

3.4.5 Alignment with Core Principle 5: Cross-Border Issues

²¹¹ Section 166AU of the Financial Sector Regulation Act 9 of 2017.

²¹² Section 166AL(2)(a) of the Financial Sector Regulation Act 9 of 2017.

²¹³ Section 166AK(1) of the Financial Sector Regulation Act 9 of 2017.

²¹⁴ Section 166BA of the Financial Sector Regulation Act 9 of 2017.

²¹⁵ Section 166BA(1) and (2) of the Financial Sector Regulation Act 9 of 2017.

²¹⁶ Section 166BB(1)(a)-(c) of the Financial Sector Regulation Act 9 of 2017.

²¹⁷ Section 166BF of the Financial Sector Regulation Act 9 of 2017.

The FSRA does not meet the requirements of Core Principle 5. According to Matasane, this Core Principle is not addressed despite the fact that South African banks such as Standard Bank operate in other countries.²¹⁸

3.4.6 Alignment with Core Principle 6: Deposit Insurer's Role in Contingency Planning

The FSRA does not address the role of the Corporation in contingency planning and is therefore not aligned with Core Principle 6. Matasane is of the view that due to the fact that the Board of the Corporation comprises officials from the SARB, National Treasury and other regulators, it is probable that a memoranda of understanding will be concluded to include the Corporation in contingency planning and crisis management.²¹⁹

3.4.7 Alignment with Core Principle 7: Membership

The FSRA is aligned with this Core Principle because section 166AG(1) states that a bank will be a member of the Corporation from the date it is registered or licensed in terms of the relevant financial sector law that allows it to operate as a bank.²²⁰ Furthermore, subsection (2) provides that if a bank was registered or licensed prior to the establishment of the Corporation, such a bank will be a member of the Corporation from the date of establishment of the Corporation.²²¹ It appears from these sections that membership of the Corporation is compulsory for all banks. The FSRA is silent on the issue of banks that do not yet comply with all membership or supervisory requirements; instances where the deposit insurer is not the party responsible for granting membership; notice to depositors when membership is cancelled; and coordinating the withdrawal of a bank's licence upon termination of a bank's membership.

²¹⁸ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 244.

²¹⁹ *Ibid* 245.

²²⁰ Section 166AG(1) of the Financial Sector Regulation Act 9 of 2017.

²²¹ Section 166AG(2) of the Financial Sector Regulation Act 9 of 2017.

3.4.8 Alignment with Core Principle 8: Coverage

Coverage is dealt with in section 166AB(1), which states that the maximum amount a depositor of a bank in resolution can apply for is the lesser of the total of the accounts' credit balances held by the depositor alone; and for each account held by the depositor together with other persons, an amount calculated as the credit balance divided by the number of account holders; and the amount prescribed by the Minister.²²² The SARB indicated that the coverage amount of R100 000 will cover 98% of retail depositors.²²³ According to Matasane, this is aligned with the Corporation's public policy objectives as it will be established to protect small, unsophisticated depositors who lack the means to monitor their deposits.²²⁴ Accordingly, the FSRA is aligned with Core Principle 8.

3.4.9 Alignment with Core Principle 9: Sources and Uses of Funds

The FSRA is aligned with Core Principle 9 in that section 166BD(1) and (2) establishes a Deposit Insurance Fund, which is held by the Corporation.²²⁵ In terms of section 166BG(1) the Corporation will collect premiums from member banks in order to enable the Fund to make payments.²²⁶ In respect of investment, section 166BE(1) empowers the Corporation to invest funds.²²⁷ Furthermore, in terms of section 166AO(2), the Board must establish an investment committee, which must make recommendations to the Board regarding the investment as well as review the Fund's investment

²²² Section 166AB(1)(a)-(b) of the Financial Sector Regulation Act 9 of 2017.

²²³ The South African Reserve Bank "Designing a deposit insurance scheme for South Africa – a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 30.

²²⁴ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 230-231.

²²⁵ Section 166BD (1)-(2) of the Financial Sector Regulation Act 9 of 2017.

²²⁶ Section 166BG(1) of the Financial Sector Regulation Act 9 of 2017.

²²⁷ Section 166BE(1) of the Financial Sector Regulation Act 9 of 2017.

portfolio.²²⁸ The Corporation will operate an ex-ante EDIS funded through the payment of premiums by member banks.²²⁹

3.4.10 Alignment with Core Principle 10: Public Awareness

The public awareness requirement is met by section 166AF(2), which provides that the functions of the Corporation include the promotion of awareness among depositors regarding the protection afforded by chapter 12A of the FSRA.²³⁰ Section 166BG(2) also covers the aspect of public awareness in that it requires the Corporation to publish the collected premiums on its website and Register.²³¹ The FSRA is silent on the manner in which depositors will be notified in the event of bank failure. In this regard, Matasane is of the view that the Corporation should create a budget for campaigns aimed at promoting public awareness. Matasane's view is correct in that the campaigns will assist in the promotion of market discipline and avoidance of moral hazard.²³²

3.4.11 Alignment with Core Principle 11: Legal Protection

Section 285 of the FSRA ensures compliance with Core Principle 11 as it insulates the Corporation, its staff members and any of its appointees or delegates from liability in respect of any loss or damage suffered by any person as a result of an action or decision taken in good faith in the exercise of a power, duty or function in accordance with a financial sector law.²³³

3.4.12 Alignment with Core Principle 12: Dealing with Parties at Fault in a Bank Failure

The FSRA does not specify how parties at fault in a bank failure will be dealt with, however, section 140 of the FSRA provides legal protection to parties who may be

²²⁸ Section 166AO(2) of the Financial Sector Regulation Act 9 of 2017.

²²⁹ Section 16BC(2) of the Financial Sector Regulation Act 9 of 2017. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 231.

²³⁰ Section 166AF(2) of the Financial Sector Regulation Act 9 of 2017.

²³¹ Section 166BG(2) of the Financial Sector Regulation Act 9 of 2017.

²³² Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 231.

²³³ Section 285 of the Financial Sector Regulation Act 9 of 2017.

required to produce documents or answer questions for purposes of an investigation.²³⁴ This means that since the Corporation falls under the financial sector regulators, this provision is also applicable to the Corporation's employees.²³⁵ Furthermore, Van Heerden opines that the Corporation has to rely on the provisions of the Banks Act in this regard.²³⁶

3.4.13 Alignment with Core Principle 13: Early Detection and Timely Intervention

Core Principle 13 is met by section 27 of the FSRA, which provides that the Corporation may enter into a memoranda of understanding with the SARB and a foreign body so as to cooperate and collaborate with each other in relation to a resolution.²³⁷ This section makes it clear that the Corporation is part of the broader financial safety-net, which means that the Corporation will collaborate with other financial safety-net providers, and thus meet the requirements of Core Principle 13.²³⁸ Van Heerden points out sections 74, 76 and 77 of the Banks Act, which can be viewed as timely corrective measures which are exercised prior to early intervention measures.²³⁹

3.4.14 Alignment with Core Principle 14: Failure Resolution

The FSRA is aligned with Core Principle 14 in that section 166AJ(b) requires the Board to act for the Corporation in applying the Fund during resolution.²⁴⁰ Moreover, section 166AA(1) states that during resolution, the Corporation must apply the Fund to ensure that depositors have access to their deposits and the Corporation is required to do this by reimbursing the bank for payments made to depositors; reimbursing depositors;

²³⁴ Section 140 of the Financial Sector Regulation Act 9 of 2017. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 232.

²³⁵ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 232.

²³⁶ Van Heerden 2020 *Journal of International Banking Law and Regulation* 53.

²³⁷ Section 27 of the Financial Sector Regulation Act 9 of 2017.

²³⁸ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 233.

²³⁹ Van Heerden 2020 *Journal of International Banking Law and Regulation* 53.

²⁴⁰ Section 166AJ(b) of the Financial Sector Regulation Act 9 of 2017.

and making payment in terms of an agreement.²⁴¹ Creditor hierarchy is addressed in section 166U(1), which provides that the SARB as the designated resolution authority must ensure that a resolution action is not taken if it is of the opinion that the result of such action would reduce the value of a creditor's claim.²⁴² The SARB is also required to develop resolution planning for all designated institutions.²⁴³

3.4.15 Alignment with Core Principle 15: Reimbursing Depositors

Core Principle 15 is met by section 166AA(1) which states that the Corporation must ensure that depositors have access to their deposits during resolution.²⁴⁴ The Corporation's capability and capacity to carry out the reimbursement process is addressed in section 166AX(1) which places a duty on the Corporation to determine the accommodation, facilities, personnel, resources, use of assets and other services required for the effective functioning of the Corporation.²⁴⁵ The SARB is tasked with providing these facilities to the Corporation in terms of section 166AY(1).²⁴⁶ As regards the auditing of the reimbursement process, section 166AU provides for the auditing of the Corporation's financial statements.²⁴⁷ Furthermore, the Corporation will operate a paybox plus mandate which will allow the Corporation to, *inter alia*, facilitate prompt reimbursements of deposits.²⁴⁸ As regards the timeframe for the payout of deposits, initially depositors will be reimbursed within 20 business days after the closure of a bank if ownership of the bank account is easily determinable and then within 7 business days in accordance with international best practice.²⁴⁹

²⁴¹ Section 166AA(1) of the Financial Sector Regulation Act 9 of 2017.

²⁴² Section 166U(1) of the Financial Sector Regulation Act 9 of 2017.

²⁴³ Section 166A(1) of the Financial Sector Regulation Act 9 of 2017. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 233.

²⁴⁴ Section 166AA(1) of the Financial Sector Regulation Act 9 of 2017.

²⁴⁵ Section 166AX(1) of the Financial Sector Regulation Act 9 of 2017.

²⁴⁶ Section 166AY(1) of the Financial Sector Regulation Act 9 of 2017.

²⁴⁷ Section 166AU of the Financial Sector Regulation Act 9 of 2017.

²⁴⁸ The South African Reserve Bank "Designing a deposit insurance scheme for South Africa – a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 5.

²⁴⁹ *Ibid* 6.

3.4.16 Alignment with Core Principle 16: Recoveries

The FSRA is in line with Core Principle 16 as section 166AD provides that the Corporation is entitled to recover any money paid out to a depositor in resolution by assuming the rights and remedies of the depositor.²⁵⁰

3.5 Conclusion

South Africa's move from implicit deposit insurance to an EDIS will further strengthen the country's banking sector as well as enhance depositors' confidence in the financial system as their deposits will be protected in the event of a bank failure. Although South Africa's financial system has remained robust, a few bank failures did occur in the past and taxpayers' funds were used to bail out these banks through the use of an implicit deposit insurance which was subject to the availability of funds and did not provide a guarantee to bail out the failing banks.

The introduction of an EDIS commenced with several discussion papers and policy documents which set out the design features of the proposed EDIS and was met with resistance from the financial sector.²⁵¹ The FSLAA is now law, and some provisions are in operation. The features are now part of the FSRA. It is evident that South Africa's deposit insurance framework is aligned with the IADI Core Principles to a great extent as it complies with all of the Core Principles except for Core Principles 5, 6 and 12 dealing with cross-border issues, the deposit insurer's role in contingency planning and dealing with parties at fault in a bank failure, respectively.

²⁵⁰ Section 166AD of the Financial Sector Regulation Act 9 of 2017.

²⁵¹ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 235.

Chapter 4: The United States' Deposit Insurance Framework

4.1 Introduction

The first EDIS was pioneered in the United States of America (US) during the throes of the Great Depression in the early 1930s, driven by the dual mission to protect depositors and stabilise the nation's banking system.²⁵² This chapter will analyse the evolution of the US EDIS, starting with an overview of the US banking regulatory framework to provide context, followed by the establishment of the FDIC under the Banking Act of 1933 and its development through subsequent legislation. This chapter outlines the features of the US EDIS and the different stages that contributed to the development of the Federal Deposit Insurance System such as the GFC. Furthermore, it will highlight the lessons learned from the US EDIS in the post-GFC era, underscored by its role in recent bank failures such as Silicon Valley Bank, Signature Bank, and First Republic Bank, where the EDIS framework was used to safeguard depositors.

4.2 The United States' Journey to Establishing an EDIS

The US has a dual banking system which was introduced by the National Bank Act of 1864.²⁵³ This dual system comprises federally chartered banks and state-chartered banks. The US EDIS was established under the Banking Act of 1933.²⁵⁴ As part of President Roosevelt's New Deal Program, the Federal Deposit Insurance System was introduced through the establishment of the FDIC to restore depositor confidence in the banking system which had been weakened by the Great Depression.²⁵⁵ Due to the Great Depression, many US banks collapsed, resulting in the establishment of the FDIC.²⁵⁶ In the late 1930s, large numbers of depositors withdrew their funds and this

²⁵² Federal Deposit Insurance "A Brief History of Deposit Insurance in the United States" 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 10 July 2022 20-27.

²⁵³ The National Bank Act of 1864 – 12 USC 38. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 101.

²⁵⁴ Section 12B of the Banking Act of 1933.

²⁵⁵ Omarova "One Step Forward, Two Steps Back? The Institutional Structure of U.S. Financial Services Regulation after the Crisis of 2008" 2014 Cornell Law School Legal Studies Research Paper Series, Paper No. 16-2 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2692234 accessed 26 October 2023 2. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 102.

²⁵⁶ Calomiris "The political lessons of Depression-era banking reform" *Exford Review of Economic Policy* 541. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 103.

forced banks to liquidate assets and restrict credit, which aggravated liquidity problems.²⁵⁷ Banks failed to meet withdrawals and were closed as a result.²⁵⁸ Consequently, bank runs became more common as depositors lost confidence in the banking system and withdrew their funds due to fear of loss.²⁵⁹ Supporters of DIS believed that the DIS was necessary for the restoration of depositor confidence in the US financial system.²⁶⁰

The National Housing Act of 1934 was also enacted by Congress²⁶¹ and it established the Federal Savings and Loan Insurance Corporation which insured the accounts of institutions that qualify for insurance, including the federal and state-chartered savings associations' deposits.²⁶² The main purpose for the establishment of the Federal Savings and Loan Insurance Corporation was intended to prevent depositors from taking deposits from savings associations as they had concerns about the financial health of their savings association.²⁶³

4.2.1 Deposit Insurance under the Banking Act of 1933

As indicated above, the Banking Act of 1933 established the FDIC and the main purpose for this establishment was to prevent a banking crisis,²⁶⁴ insure the deposits of all eligible banks entitled to insurance benefits under the Act, as well as to purchase, hold, and liquidate assets of national banks which had been closed by vote of the

²⁵⁷ Federal Deposit Insurance “A Brief History of Deposit Insurance in the United States” 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 10 July 2022 20.

²⁵⁸ *Ibid.*

²⁵⁹ *Ibid.*

²⁶⁰ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 103.

²⁶¹ Section 402(a) of the National Housing Act of 1934. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 103.

²⁶² Section 403(a) of the National Housing Act of 1934. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 103.

²⁶³ Clark, Murtagh and Corcoran “Regulation of savings associations under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989” 1990 *The Business Lawyer* 1017. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 104.

²⁶⁴ Federal Deposit Insurance Corporation “The FDIC and RTC experience managing the crisis” 2023 available at <https://www.fdic.gov/resources/publications/managing-the-crisis/documents/managing-the-crisis.pdf> accessed 3 May 2024 212.

directors of the banks or by the Comptroller of the Currency.²⁶⁵ The FDIC had various powers including, *inter alia*, the power to sell the assets of a closed bank, to wind up the affairs of a closed bank, and to enforce the individual liability of directors and shareholders.²⁶⁶

Initially, a Temporary Federal Deposit Insurance Fund (temporary fund) was established and operated from January 1934 until a permanent Corporation came into operation on 1 July 1934.²⁶⁷ Under the Banking Act of 1933, the law required that all banks that were licensed members of the Federal Reserve become members of the temporary fund by 1 January 1934, while other banks were required to become members of the temporary plan with the approval of the FDIC and upon certification of their solvency.²⁶⁸ Initially, coverage under the temporary fund was limited to 2,500 dollars (approximately R47 130) for each depositor.²⁶⁹ With effect from 1 July 1934, the coverage limit was increased from 2,500 dollars to 5,000 dollars (approximately R90,128) for each depositor.²⁷⁰ Hogan and Johnson believe that the temporary fund contributed greatly to stabilizing the US banking sector by preventing bank failures.²⁷¹ Due to the inability of some of the banks to cooperate with the FDIC as required by law, numerous bills aimed at enhancing the effectiveness of bank deposit insurance in the US were introduced by Congress and this resulted in the enactment of the Banking Act of 1935.²⁷²

²⁶⁵ Section 12B(a) of the Banking Act of 1933. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 104.

²⁶⁶ Section 12B(l) of the Banking Act of 1933. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 107-108.

²⁶⁷ Federal Deposit Insurance “A Brief History of Deposit Insurance in the United States” 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 10 July 2022 27. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 105.

²⁶⁸ Federal Deposit Insurance “A Brief History of Deposit Insurance in the United States” 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 10 July 2022 27.

²⁶⁹ *Ibid.*

²⁷⁰ *Ibid* 30.

²⁷¹ Hogan and Johnson “Alternatives to the Federal Deposit Insurance Corporation” 2016 *The Independent Review* 433. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 105.

²⁷² Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 108.

4.2.2 Deposit Insurance under the Banking Act of 1935

The Banking Act of 1935 became effective on 23 August 1935 and it introduced the permanent deposit insurance fund.²⁷³ Accordingly, the temporary fund was terminated.²⁷⁴ The Banking Act of 1935 did not amend the provisions of the Banking Act of 1933 entirely, however, it did change the nature of deposit insurance as set out in the Banking Act of 1933.²⁷⁵ One of the significant changes brought about by the Banking Act of 1935 is that it changed the criteria for membership of the FDIC under the permanent plan in the sense that all banks that were insured when the temporary fund was closed were automatically admitted to insurance under the permanent plan, except those that expressed an intention to withdraw from the fund and those that failed to pay the assessments.²⁷⁶ Under this new Act, the authority was conferred upon the FDIC to reimburse depositors directly or through an existing bank instead of using a bridge bank.²⁷⁷ The powers of the FDIC were also extended to include the purchase of assets, providing guarantees and making loans in order to facilitate a merger or acquisition if such action would reduce the risk or possible loss to the FDIC.²⁷⁸ One notable feature of the federal deposit insurance under the 1935 Act is that it granted the FDIC the authority to terminate, following a notice and hearing, the insurance of any bank which was involved in unsafe or unsound practices.²⁷⁹ Under the Banking

²⁷³ Federal Deposit Insurance “A Brief History of Deposit Insurance in the United States” 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 10 July 2022 36. See also section 12B(l)(1) of the Banking Act of 1935.

²⁷⁴ *Ibid.*

²⁷⁵ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 109.

²⁷⁶ Section 12B(f)(1) of the Banking Act of 1935. See also Federal Deposit Insurance “A Brief History of Deposit Insurance in the United States” 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 10 July 2022 37 and Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 109.

²⁷⁷ Federal Deposit Insurance “A Brief History of Deposit Insurance in the United States” 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 10 July 2022 38. See also Federal Deposit Insurance Corporation “The FDIC and RTC experience managing the crisis” 2023 available at <https://www.fdic.gov/resources/publications/managing-the-crisis/documents/managing-the-crisis.pdf> accessed 3 May 2024 66.

²⁷⁸ *Ibid.* See also section 12B(n)(4) of the Banking Act of 1935 and Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 111.

²⁷⁹ Section 12B(i)(1) of the Banking Act of 1935. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 110.

Act of 1935 the insurance coverage of 5,000 dollars was retained, together with most of the provisions of section 12B of the Banking Act of 1933.²⁸⁰

According to Preston, the period between 1933 when the FDIC was established and 1950 when the Federal Deposit Insurance Act (FDIC Act) was established served as a period of retrieval in the US from the consequences of the Great Depression and this was followed by increased business activity as a result of the establishment of the federal deposit insurance system.²⁸¹ Further changes to the US EDIS were introduced by the FDIC Act of 1950 as discussed below.²⁸²

4.2.3 Federal Deposit Insurance Act of 1950

In 1950, the FDIC officials proposed amendments to the deposit insurance law and a bill was drafted which eventually resulted in the promulgation of the FDIC Act of 1950.²⁸³

The FDIC Act resulted in the withdrawal of section 12B of the Banking Act and made it a standalone Act.²⁸⁴ The insurance coverage limit was increased from 5,000 dollars to 10,000 dollars in 1950 with the aim of providing full coverage for an additional 3 million accounts along with an increase of 12 billion dollars in insured deposits.²⁸⁵ The FDIC Act introduced a significant change by expanding the FDIC's powers to include assistance to troubled banks through measures such as loans, asset purchases and

²⁸⁰ Section 12B of the Banking Act of 1933. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 111.

²⁸¹ Preston "The Banking Act of 1935" 1935 *Journal of Political Economy* 760. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 112.

²⁸² Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 112.

²⁸³ Federal Deposit Insurance Corporation "Annual report of the Federal Deposit Insurance Corporation" 1950 available at <https://www.fdic.gov/about/financial-reports/reports/archives/fdic-ar-1950.pdf> accessed 26 October 2023 4. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 112.

²⁸⁴ See the Preamble of the Federal Deposit Insurance Corporation Act of 1950. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 112.

²⁸⁵ Federal Deposit Insurance "A Brief History of Deposit Insurance in the United States" 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 10 July 2022 45. See also Federal Deposit Insurance Corporation "Annual report of the Federal Deposit Insurance Corporation" 1950 available at <https://www.fdic.gov/about/financial-reports/reports/archives/fdic-ar-1950.pdf> accessed 26 October 2023 4 and Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 112.

deposits, commonly referred to as open bank assistance.²⁸⁶ However, these powers were only accessible to the FDIC when it determined that a bank was at risk of closure and that its continued operation was crucial for maintaining adequate banking services within the community.²⁸⁷ The FDIC was also granted the power to conduct special examinations on both State banks and national banks.²⁸⁸ In terms of section 8(a) of the FDIC Act, the FDIC was responsible for ensuring the safety and soundness of insured banks.²⁸⁹ The changes under the FDIC Act offered the FDIC a more flexible approach to dealing with financially distressed banks.²⁹⁰

According to Bradley, the US EDIS operated effectively under the FDIC Act.²⁹¹ However, in the late 1960s, the system faced challenges as interest rates offered by securities markets caused a significant reduction in the flow of funds to depository institutions, resulting in numerous insured institutions failing.²⁹² Recognising the need to stimulate savings and promote liquidity within member institutions, the US Congress opted to increase deposit insurance coverage.²⁹³ The coverage amount was raised

²⁸⁶ Section 13(c) of the Federal Deposit Insurance Act of 1950. See also Federal Deposit Insurance Corporation “The FDIC and RTC experience managing the crisis” 2023 available at <https://www.fdic.gov/resources/publications/managing-the-crisis/documents/managing-the-crisis.pdf> accessed 3 May 2024 20. See further Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 113-114.

²⁸⁷ *Ibid.*

²⁸⁸ Section 10(b) of the Federal Deposit Insurance Corporation Act of 1950. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 114.

²⁸⁹ Section 8(a) of the Federal Deposit Insurance Corporation of 1950. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 114.

²⁹⁰ Federal Deposit Insurance Corporation “Annual report of the Federal Deposit Insurance Corporation” 1950 available at <https://www.fdic.gov/about/financial-reports/reports/archives/fdic-ar-1950.pdf> accessed 26 October 2023 6. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 114.

²⁹¹ Bradley “A historical perspective on deposit insurance coverage” 2000 *FDIC Banking Review* 14. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 115.

²⁹² *Ibid.*

²⁹³ *Ibid.*

from 10,000 dollars to 15,000 dollars in 1966;²⁹⁴ further increased to 20,000 dollars in 1969, and then doubled to 40,000 dollars in 1974.²⁹⁵

According to Gail and Norton, US regulators and Congress were concerned about the thrift industry's health and financial stability during the 1980s as it adversely affected the health of the US banking sector.²⁹⁶ Consequently, Congress enacted the Financial Institution Reform, Recovery and Enforcement Act of 1989 as a response to these issues.²⁹⁷

4.2.4 Financial Institution Reform, Recovery and Enforcement Act of 1989

The Financial Institution Reform, Recovery and Enforcement Act of 1989 was enacted to resolve the savings and loan crisis that occurred in the 1980s as well as to reform the supervision of savings associations and banks.²⁹⁸

Prior to the enactment of the Financial Institution Reform, Recovery and Enforcement Act of 1989, loans and savings associations were insured by the Federal Savings and Loan Insurance Corporation.²⁹⁹ The idea behind the establishment of the FDIC and the Federal Savings and Loan Insurance Corporation was to have both agencies operate independently and collect premiums from banks and savings associations to

²⁹⁴ Section 301(a) of the Financial Institutions Supervisory Act of 1966.

²⁹⁵ Federal Deposit Insurance "A Brief History of Deposit Insurance in the United States" 1998 available at <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 10 July 2022 45. See also Federal Deposit Insurance Corporation "The FDIC and RTC experience managing the crisis" 2023 available at <https://www.fdic.gov/resources/publications/managing-the-crisis/documents/managing-the-crisis.pdf> accessed 3 May 2024 230.

²⁹⁶ Gail & Norton "A decade's journey from "deregulation" to "supervisory reregulation": The Financial Institutions Reform, Recovery, and Enforcement Act of 1989" 1990 *The Business Lawyer* 1105. Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 116.

²⁹⁷ *Ibid.*

²⁹⁸ Helmer "Banking on solvency: The takings of FIRREA's cross-guarantee provision" 1995 *Valparaiso University Law Review* 234. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 116 and Federal Deposit Insurance Corporation "Annual report of the Federal Deposit Insurance Corporation" 1989 available at <https://archive.fdic.gov/view/fdic/654> accessed 26 October 2023 74. See further Federal Deposit Insurance Corporation "The FDIC and RTC experience managing the crisis" 2023 available at <https://www.fdic.gov/resources/publications/managing-the-crisis/documents/managing-the-crisis.pdf> accessed 3 May 2024 743.

²⁹⁹ Section 403(a) of the National Housing Act of 1934.

cover losses if an institution failed.³⁰⁰ However, because of the cost of rescuing failed thrifts, the Federal Savings and Loan Insurance Corporation went insolvent in 1988.³⁰¹ Thus the Financial Institution Reform, Recovery and Enforcement Act of 1989 was enacted as a response.³⁰²

The Financial Institution Reform, Recovery and Enforcement Act of 1989 was created primarily to promote the independence of the FDIC;³⁰³ to establish the Resolution Trust Corporation meant to administer failed savings associations;³⁰⁴ and to provide funding from both private and public institutions to deal with failed financial institutions, among other objectives.³⁰⁵ Notably, the Financial Institution Reform, Recovery and Enforcement Act of 1989 abolished the Federal Savings and Loan Insurance Corporation and replaced it with the Resolution Trust Corporation.³⁰⁶ The Resolution Trust Corporation was exclusively managed by the FDIC.³⁰⁷

Among the major changes introduced by the Financial Institution Reform, Recovery and Enforcement Act of 1989 is tasking the FDIC with, *inter alia*, the responsibility to

³⁰⁰ Taylor “The FDIC’s enhanced powers over savings associations: Does FIRREA make it “SAIF?” 1991 *Fordham Law Review* S384. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 117.

³⁰¹ *Ibid.*

³⁰² Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 117.

³⁰³ Section 20(e) of the Financial Institution Reform, Recovery and Enforcement Act of 1989. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 117.

³⁰⁴ Section 501(b) of the Financial Institution Reform, Recovery and Enforcement Act of 1989. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 117.

³⁰⁵ Section 101(8) of the Financial Institution Reform, Recovery and Enforcement Act of 1989. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 117.

³⁰⁶ Section 501(b)(1)(A) of the Financial Institution Reform, Recovery and Enforcement Act of 1989. See also Federal Deposit Insurance Corporation “The FDIC and RTC experience managing the crisis” 2023 available at <https://www.fdic.gov/resources/publications/managing-the-crisis/documents/managing-the-crisis.pdf> accessed 3 May 2024 2. See further Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 118.

³⁰⁷ Section 501(b)(1)(C) of the Financial Institution Reform, Recovery and Enforcement Act of 1989. See also See also Federal Deposit Insurance Corporation “The FDIC and RTC experience managing the crisis” 2023 available at <https://www.fdic.gov/resources/publications/managing-the-crisis/documents/managing-the-crisis.pdf> accessed 3 May 2024 113. See further Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 118.

insure the deposits of savings associations and taking enforcement actions against the savings associations.³⁰⁸ The Financial Institution Reform, Recovery and Enforcement Act of 1989 entrusted the FDIC with the administration of two new insurance funds, namely, the Savings Association Insurance Fund³⁰⁹ and the Bank Insurance Fund.³¹⁰ To protect these funds, cross-guarantee provisions were introduced, holding depository institutions liable for FDIC losses due to institutions' default or assistance provided by the FDIC.³¹¹ This measure aimed to boost the FDIC's insurance funds and ensure the stability of the deposit insurance system.

The Financial Institution Reform, Recovery and Enforcement Act of 1989 introduced significant changes, including the establishment of two insurance funds. However, unresolved issues persisted, particularly regarding the potential destabilising effects of having different premium requirements for each fund.³¹² Recognising the need for further reforms, the Federal Deposit Insurance Corporation Improvement Act of 1991 was enacted to address these concerns.

4.2.5 Federal Deposit Insurance Corporation Improvement Act of 1991

Under this Act, a system of prompt corrective action was established to resolve issues of insured financial institutions at the least cost to the deposit insurance fund and the

³⁰⁸ Section 205(2) and section 902 of the Financial Institution Reform, Recovery and Enforcement Act of 1989. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 118-119.

³⁰⁹ Section 211(6)(A) of the Financial Institution Reform, Recovery and Enforcement Act of 1989.

³¹⁰ Section 211(5)(A) and 211(6)(A) of the Financial Institution Reform, Recovery and Enforcement Act of 1989. See also Federal Deposit Insurance Corporation "The FDIC and RTC experience managing the crisis" 2023 available at <https://www.fdic.gov/resources/publications/managing-the-crisis/documents/managing-the-crisis.pdf> accessed 3 May 2024 743. See further Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 120.

³¹¹ Section 203(e)(1)(B) of the Financial Institution Reform, Recovery and Enforcement Act of 1989. See also Federal Deposit Insurance Corporation "The FDIC and RTC experience managing the crisis" 2023 available at <https://www.fdic.gov/resources/publications/managing-the-crisis/documents/managing-the-crisis.pdf> accessed 3 May 2024 743. See further Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 121.

³¹² Federal Deposit Insurance Corporation "Keeping the promise: Recommendations for deposit insurance reform" 2001 available at <https://www.fdic.gov/deposit/insurance/initiative/direcommendations.pdf> accessed 26 October 2023 1. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 124.

FDIC was authorised to charge higher premiums to risky banks.³¹³ To address the abovementioned issues, the FDIC made proposals to merge the Bank Insurance Fund and the Savings Association Insurance Fund and these proposals resulted in the enactment of the Federal Deposit Insurance Reform Act of 2005.³¹⁴

4.2.6 Federal Deposit Insurance Reform Act of 2005

Under the Federal Deposit Insurance Reform Act of 2005, the Bank Insurance Fund and the Savings Association Insurance Fund were merged into a single fund called the Deposit Insurance Fund and all assets of the two separate funds were transferred to the Deposit Insurance Fund.³¹⁵ Under this Act, the coverage amount was increased from 40,000 dollars to 100,000 dollars.³¹⁶

Although the Federal Deposit Insurance Reform Act of 2005 made some changes to the US EDIS, the GFC occurred in 2008 and caused a drastic increase in the number of insured financial institutions and a depletion of the Deposit Insurance Fund.³¹⁷ As a measure to address these issues, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in 2010.

4.2.7 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

The Dodd-Frank Act of 2010 increased the coverage limit from 100,000 dollars to 250,000 dollars for retail depositors and the increase applied retroactively to banks that failed during the GFC.³¹⁸ The Dodd-Frank Act of 2010 also broadened the resolution powers of the FDIC in respect of systemically important financial

³¹³ Sections 38(1) and 131(a) of the Federal Deposit Insurance Corporation Improvement Act of 1991. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 124.

³¹⁴ Federal Deposit Insurance Corporation “Keeping the promise: Recommendations for deposit insurance reform” 2001 available at <https://www.fdic.gov/deposit/insurance/initiative/direcommendations.pdf> accessed 26 October 2023 1.

³¹⁵ Section 2102(a)(1) and section 2102(a)(2) of the Federal Deposit Insurance Reform Act of 2005.

³¹⁶ Section 2103(a)(2) of the Federal Deposit Insurance Reform Act of 2005.

³¹⁷ Federal Deposit Insurance Corporation “Crisis and response: An FDIC history, 2008–2013” 2017 available at <https://www.fdic.gov/resources/publications/crisis-response/index.html> accessed 26 October 2023 151.

³¹⁸ Section 335(a)(1) of the Dodd-Frank Act of 2010. See also Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 132.

institutions.³¹⁹ In its capacity as receiver, the FDIC was granted the power to organize a bridge company in terms of section 210(h)(1)(A) of the Dodd-Frank Act of 2010 to resolve a covered financial institution.³²⁰ Furthermore, the FDIC has the discretion to pay creditor claims.³²¹ It is important to note that although the Dodd-Frank Act had a significant impact on stabilizing the US financial sector, in 2018, a report was issued by the US Treasury with proposals to reform the orderly liquidation regime to be used only when it was absolutely necessary.³²²

4.3 US Compliance with the Core Principles

The US is a member of IADI. The US EDIS serves a public policy objective in that its EDIS was established in response to the Great Depression and to prevent depositor loss of confidence in the financial system.³²³ The US operates a risk-minimiser mandate and from the above discussion, the FDIC's powers as the designated resolution authority were extensively expanded under the Dodd-Frank Act of 2010.³²⁴ As regards governance, the operational independence of the FDIC has always been maintained and the FDIC has an active working relationship with other financial safety-net participants such as the Federal Reserve and the Office of the Comptroller of the Currency.³²⁵ According to Matasane, the US EDIS must revise its crisis planning efforts in order to mitigate the effects of future crises and to ensure that they have proper tools in place to deal with a crisis that unfolds quickly and unexpectedly since they did not have this in place during the GFC.³²⁶ In respect of membership, it is unclear whether the US deposit insurance has a compulsory membership requirement or not since the US self-assessment against the Core Principles merely states that

³¹⁹ Section 803 of the Dodd-Frank Act of 2010.

³²⁰ Section 210(h)(1)(A) of the Dodd-Frank Act of 2010.

³²¹ Section 210(a)(7)(A) of the Dodd-Frank Act 2010.

³²² United States Department of the Treasury "Orderly Liquidation Authority and Bankruptcy Reform" 2018 available at https://home.treasury.gov/sites/default/files/2018-02/OLA_REPORT.pdf accessed 26 October 2023 2.

³²³ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 141.

³²⁴ *Ibid* 142.

³²⁵ *Ibid* 142-143.

³²⁶ *Ibid* 145. See also Federal Deposit Insurance Corporation "FDIC 2019 annual performance plan" 2019 available at <https://archive.fdic.gov/view/fdic/9543> accessed 21 November 2023 8.

state and federal agencies that charter banks condition approval of a bank on receiving deposit insurance coverage.³²⁷ The US has placed a limit on the coverage amount in line with Core Principle 8.³²⁸ The US EDIS promotes public awareness through its industry and consumer awareness programs;³²⁹ provides legal protection to the staff of the FDIC in terms of section 806 of the Financial Institution Reform, Recovery and Enforcement Act of 1989 and in terms of the same Act provides ways to deal with parties at fault in a bank failure.³³⁰ Moreover, the US EDIS has implemented its early detection and timely intervention powers since its establishment; has applied several methods to resolve failed banks; and its mandate since inception has been to reimburse depositors as soon as possible.³³¹ The FDIC reimburses insured depositors on the business day following an institution's failure.³³² Finally, the US EDIS has clearly specified its recovery process in legislation in accordance with Core Principle 16.³³³

4.4 Recent Bank Failures in the US and the role of the FDIC

The recent bank failures in the US began with the failure of Silicon Valley Bank (SVB) on 10 March 2023 which was the largest collapse of a US bank since the GFC. When interest rates were low, SVB invested the rapidly growing deposits of its clients, which were mostly venture capital firms, in long-term securities aiming to get higher profits.³³⁴ In 2021, 90% of deposits in SVB exceeded the 250,000-dollar deposit insurance limit and over 95% of deposits were demand deposits, which means that they could be

³²⁷ Federal Deposit Insurance Corporation "US self-assessment against the core principles for effective deposit insurance systems" 2020 available at <https://www.fdic.gov/bank/international/2020-self-assessment.pdf> accessed 6 November 2023 26.

³²⁸ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 145-146.

³²⁹ *Ibid* 147.

³³⁰ *Ibid*.

³³¹ *Ibid* 148-149.

³³² Federal Deposit Insurance Corporation "US self-assessment against the core principles for effective deposit insurance systems" 2020 available at <https://www.fdic.gov/bank/international/2020-self-assessment.pdf> accessed 6 November 2023 57.

³³³ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 150.

³³⁴ Dinh "The US banking crisis of 2023 and its implications for Africa" 2023 available at <https://www.policycenter.ma/publications/us-banking-crisis-2023-and-its-implications-africa#:~:text=The%20ongoing%20banking%20crisis%20in,structure%20of%20their%20banking%20sectors> accessed 26 October 2023 2.

withdrawn at any time.³³⁵ Following the rise in interest rates, SVB depositors withdrew their money and SVB failed to meet this demand, thus it sold its securities at a major loss as the value of these assets had declined due to the rise in interest rates.³³⁶ This caused loss of depositor confidence, thereby encouraging more withdrawals which ultimately led to a bank run on SVB.³³⁷ Some of the causes cited by the US Federal Reserve for the failure of SVB include, the failure of SVB's board and management in managing risks and the failure of the Federal Reserve's supervisors to fully appreciate the dire problems in SVB's management of interest rate risk, liquidity and governance.³³⁸ To protect depositors, the FDIC acted swiftly by transferring all the deposits of SVB to Silicon Valley Bridge Bank which was operated by the FDIC.³³⁹ On 26 March 2023, the FDIC entered into a purchase and assumption agreement for all deposits and loans of Silicon Valley Bridge Bank with Raleigh, NC, a First-Citizens Bank & Trust Company.³⁴⁰ As part of this transaction Silicon Valley Bridge Bank was placed into receivership.³⁴¹ The FDIC also provided deposit guarantees of up to 250,000 dollars per account and its transparent communication reassured depositors and prevented panic.³⁴² According to Nyaude, this coordinated approach demonstrates the importance of information sharing, consultation and coordination among regulators during crises to maintain financial stability.³⁴³ To protect the US economy and strengthen depositor confidence, the US regulators expanded the depositor protection beyond the maximum statutory limit by invoking a systemic risk

³³⁵ *Ibid.*

³³⁶ *Ibid.*

³³⁷ *Ibid.*

³³⁸ *Ibid* 3.

³³⁹ Federal Deposit Insurance Corporation "Bank failures in brief – 2023" 2023 available at <https://www.fdic.gov/bank/historical/bank/bfb2023.html> accessed 26 October 2023.

³⁴⁰ *Ibid.*

³⁴¹ *Ibid.*

³⁴² *Ibid.* See also Nyaude "A credit in Banking crisis" 2023 available at <https://indd.adobe.com/view/9cb1660d-2fc4-41ed-8e42-2e43ec469ec0> accessed 24 September 2023 28-29.

³⁴³ *Ibid* 29.

exception³⁴⁴ in terms of which depositors were compensated in full, whilst protecting taxpayers from losses.³⁴⁵

Following the failure of SVB, on 12 March 2023, Signature Bank was closed by the New York State Department of Financial Services and the FDIC was named Receiver.³⁴⁶ The contagion from SVB spread to Signature Bank as depositors withdrew large amounts of money following the collapse of SVB.³⁴⁷ To protect depositors, all the deposits and assets of Signature Bank were transferred to Signature Bridge Bank which was operated by the FDIC.³⁴⁸ Signature Bank was acquired by Flagstar Bank and as part of this resolution, Signature Bridge Bank was placed into receivership.³⁴⁹ Just like SVB, a systemic risk exception was also invoked in the case of Signature Bank.³⁵⁰

On 1 May 2023, First Republic Bank was placed in receivership by the FDIC.³⁵¹ Following the failure of SVB, a large number of depositors withdrew their funds from First Republic Bank and by the end of March 2023, depositors had withdrawn half of the bank's 212 billion dollar assets and to stabilise the situation, 11 US banks injected

³⁴⁴ Systemic risk is financial market risk that poses a threat to financial stability. Systemic risk exception is invoked when the deposit insurer is of the view that a bank run by uninsured depositors would spread to other banks and therefore the insurer reimburses the uninsured depositors in order to maintain financial stability. See Congressional Research Service "Bank failures: The FDIC's systemic risk exception" 2023 available at <https://crsreports.congress.gov/product/pdf> accessed 19 November 2023.

³⁴⁵ Federal Deposit Insurance Corporation "Joint statement by the Department of the Treasury, Federal Reserve, and FDIC" 2023 available at <https://www.fdic.gov/news/press-releases/2023/pr23017.html> accessed 26 October 2023. See also Nyaude "A credit in Banking crisis" 2023 available at <https://indd.adobe.com/view/9cb1660d-2fc4-41ed-8e42-2e43ec469ec0> accessed 24 September 2023 29.

³⁴⁶ Federal Deposit Insurance Corporation "Bank failures in brief – 2023" 2023 available at <https://www.fdic.gov/bank/historical/bank/bfb2023.html> accessed 26 October 2023.

³⁴⁷ Hamurcu "Bank failure risk: a study on Silicon Valley Bank, Signature Bank and Silvergate Capital Corporation" 2023 *Financial Internet Quarterly* 36.

³⁴⁸ Federal Deposit Insurance Corporation "Bank failures in brief – 2023" 2023 available at <https://www.fdic.gov/bank/historical/bank/bfb2023.html> accessed 26 October 2023.

³⁴⁹ *Ibid.*

³⁵⁰ *Ibid.*

³⁵¹ *Ibid.*

30 billion dollars into the bank, rescuing it from the brink of collapse.³⁵² First Republic Bank was acquired by JP Morgan Chase.³⁵³

4.5 Conclusion

This chapter focused on the US EDIS and the evolution thereof over the years, with the FDIC playing a significant role throughout. This chapter revealed how the US regulators have remained flexible over the years by continuously introducing reforms to its legislation to improve its EDIS. According to Matasane, the US EDIS is not only the oldest model but also the most progressive system.³⁵⁴ It has also been shown that the US EDIS has always possessed all the features contained in the Core Principles even before the establishment of the Core Principles.³⁵⁵ This suggests a significant influence of the US EDIS on shaping design features of the Core Principles. How the FDIC dealt with the recent bank failures should serve as a guide to countries that operate an EDIS in that depositors were protected, and financial stability was maintained by having the legal tools in place and being proactive in a crisis situation to ensure that the whole system does not collapse because of a few banks that are failing. The FDIC used resolution tools such as bridge banks, communicated effectively with the public and when the need arose it invoked the systemic risk exception to maintain financial stability.

³⁵² Dinh “The US banking crisis of 2023 and its implications for Africa” 2023 available at <https://www.policycenter.ma/publications/us-banking-crisis-2023-and-its-implications-africa#:~:text=The%20ongoing%20banking%20crisis%20in,structure%20of%20their%20banking%20sectors> accessed 26 October 2023. See also See also Nyaude “A credit in Banking crisis” 2023 available at <https://indd.adobe.com/view/9cb1660d-2fc4-41ed-8e42-2e43ec469ec0> accessed 24 September 2023 28.

³⁵³ *Ibid.*

³⁵⁴ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 150.

³⁵⁵ *Ibid.*

Chapter 5: Kenya Deposit Insurance Framework

5.1 Introduction

Kenya adopted an explicit deposit insurance system (EDIS) in 1985 under the administration of the Deposit Protection Fund Board, following a series of bank failures resulting from the crises of the 1980s, making it the first African country with an EDIS.³⁵⁶ This chapter will provide an overview of the journey that resulted in the establishment of an EDIS in Kenya, with a particular focus on the Banking Act 56 of 1968 and the Kenya Deposit Insurance Act 10 of 2012 (KDI Act 2012), followed by an analysis of Kenya's compliance with the Core Principles.

5.2 Kenya's Journey to Establishing an EDIS

In 1930, Kenya experienced a banking crisis as a result of an increase in speculative land prices which were due to higher commodity export earnings.³⁵⁷ During the Great Depression, farmers who took bank loans to finance their land purchases defaulted on their payments and the government stepped in to bail-out these farmers as the economy relied heavily on agriculture.³⁵⁸ This marked the birth of implicit deposit protection, though its focus was on the protection of borrowers rather than the banks.³⁵⁹ From 1966 when the Central Bank of Kenya was established, it provided implicit deposit protection until 1985 when an EDIS was established.³⁶⁰ Two banks failed between 1984 and 1989.³⁶¹ The main causes of these failures include political interference, weak supervision and insider loans.³⁶² As opposed to the 1930s crisis where farmers suffered loss, the 1980s crises affected depositors whose plight likewise required government intervention in the form of compensation for losses

³⁵⁶ Banking Act 56 of 1968 as amended by the Banking Amendment Act 17 of 1985; Lugulu *Addressing the Moral Hazard Through Explicit Deposit Insurance: A Comparative Appraisal of the Kenya Deposit Insurance Act, 2012* (LLD-thesis, UP, 2019) 137.

³⁵⁷ Van Zwanenberg *Colonial Capitalism and Labour in Kenya, 1919-1939* (1975) 13.

³⁵⁸ *Ibid*; Lugulu *Addressing the Moral Hazard Through Explicit Deposit Insurance: A Comparative Appraisal of the Kenya Deposit Insurance Act, 2012* (LLD-thesis, UP, 2019) 83.

³⁵⁹ *Ibid*.

³⁶⁰ Lugulu *Addressing the Moral Hazard Through Explicit Deposit Insurance: A Comparative Appraisal of the Kenya Deposit Insurance Act, 2012* (LLD-thesis, UP, 2019) 84.

³⁶¹ Central Bank of Kenya "Role of bank supervision department" 1994 available at <https://www.centralbank.go.ke/images/docs/Bank%20Supervision%20Reports/Annual%20Reports/BSD%20Report%201994.pdf> accessed 25 July 2022 35.

³⁶² Brownbridge "Government policies and the development of banking in Kenya" in Brownbridge and Harvey (eds) *Banking in Africa: The impact of financial sector reform since independence* (1998) 80.

suffered.³⁶³ However, these insolvent banks were liquidated and none of the depositors were compensated as there is no guarantee of a bail-out under an implicit deposit insurance system.³⁶⁴ This resulted in the amendment of the Banking Act 56 of 1968 in order to alleviate the plight of these depositors.³⁶⁵

5.2.1 Deposit Insurance under the Banking Act 56 of 1968

In 1985, the Banking Act 56 of 1968 was amended by the Banking Amendment Act 17 of 1985³⁶⁶ to establish an EDIS to give preference to depositor reimbursement in the event of bank failure, and the Deposit Protection Fund Board was designated as the liquidator of insolvent banks.³⁶⁷ The Banking Act of 1968 was further amended in 1989;³⁶⁸ 1994;³⁶⁹ and 2006,³⁷⁰ to enhance bank safety and soundness.³⁷¹ As a result of these amendments and to strengthen bank supervision, insider loans were prohibited, except with the approval of the Deposit Protection Fund Board; and banks that violated lending laws were penalized.³⁷² Under the Banking Act of 1968, the EDIS provided for limited coverage of deposits, and banks were charged *ex-ante* premiums.³⁷³

One of the shortcomings of the EDIS under the Banking Act of 1968 was that the Deposit Protection Fund Board lacked the mandate to minimize risks to its insurance fund and it also relied on the Central Bank of Kenya to supervise banks and enforce

³⁶³ Beck *et al* "Banking sector stability, efficiency and outreach in Kenya" 2010 available at <https://ideas.repec.org/p/wbk/wbrwps/5442.html> accessed 1 November 2022 6.

³⁶⁴ Central Bank of Kenya "Role of bank supervision department" 1994 available at <https://www.centralbank.go.ke/images/docs/Bank%20Supervision%20Reports/Annual%20Reports/BSD%20Report%201994.pdf> accessed 25 July 2022 14-15.

³⁶⁵ *Ibid*; Banking Act 56 of 1968.

³⁶⁶ Banking Amendment Act 17 of 1985.

³⁶⁷ *Ibid*; Lugulu *Addressing the Moral Hazard Through Explicit Deposit Insurance: A Comparative Appraisal of the Kenya Deposit Insurance Act, 2012* (LLD-thesis, UP, 2019) 86.

³⁶⁸ Banking Amendment Act 9 of 1980.

³⁶⁹ Banking Amendment Act 13 of 1994.

³⁷⁰ Banking Amendment Act 9 of 2006.

³⁷¹ Lugulu *Addressing the Moral Hazard Through Explicit Deposit Insurance: A Comparative Appraisal of the Kenya Deposit Insurance Act, 2012* (LLD-thesis, UP, 2019) 87.

³⁷² Section 11-53 of the Banking Act 56 of 1968.

³⁷³ Section 34(2)-38 of the Banking Act 56 of 1968.

regulatory infringements.³⁷⁴ This caused banks to engage in risky ventures as they received liquidity assistance from the Central Bank of Kenya and the Deposit Protection Fund Board had no capacity to intervene in insured banks.³⁷⁵ Furthermore, moral hazard was not sufficiently limited as flat rates were charged by the Deposit Protection Fund Board, without consideration of risky bank profiles, although the coverage limit of 100 000 Kenyan shillings (an equivalent of R15 018) did limit moral hazard to a certain extent as it covered unsophisticated depositors only.³⁷⁶ The current coverage limit is Ksh. 500 000 (R75 091) and it covers all types of accounts.³⁷⁷ If a depositor has more than one account in one bank, then the accounts are consolidated as a single claim.³⁷⁸ Additionally, the EDIS under the Banking Act of 1968 was flawed because appointment of the Deposit Protection Fund Board from its member banks as well as the appointment of the Governor and Deputy Governor of the Central Bank of Kenya as the Chairman and Deputy Chairman of the Deposit Protection Fund Board respectively, limited the Deposit Protection Fund Board's independence.³⁷⁹ Pan maintains that the establishment of the Deposit Protection Fund Board during a period of weak bank supervision also affected the effectiveness of the EDIS.³⁸⁰ To address these flaws, the KDI Act 2012 was enacted.

5.2.2 Deposit Insurance under the Kenya Deposit Insurance Act 10 of 2012

In 2012, Kenya enacted the KDI Act 2012 to address the abovementioned shortcomings as well as strengthen the regulatory framework to alleviate moral hazard.³⁸¹ The KDI Act 2012 was amended in 2013 by the Kenya Deposit Insurance

³⁷⁴ Brownbridge 92.

³⁷⁵ *Ibid.*

³⁷⁶ Lugulu *Addressing the Moral Hazard Through Explicit Deposit Insurance: A Comparative Appraisal of the Kenya Deposit Insurance Act, 2012* (LLD-thesis, UP, 2019) 140; section 39 of the Banking Act 56 of 1968.

³⁷⁷ Kenya Deposit Insurance Corporation "Deposit insurance payout" available at <https://kdic.go.ke/> accessed 1 November 2022.

³⁷⁸ *Ibid.*

³⁷⁹ Beck *et al* "Banking sector stability, efficiency and outreach in Kenya" 2010 available at <https://ideas.repec.org/p/wbk/wbrwps/5442.html> accessed 1 November 2022 7.

³⁸⁰ Pan "Challenge of international cooperation and institutional design in financial supervision: Beyond transgovernmental networks" 2010 *Chicago Journal of International Law* 266.

³⁸¹ Section 5 of the Kenya Deposit Insurance Act 10 of 2012; Lugulu *Addressing the Moral Hazard Through Explicit Deposit Insurance: A Comparative Appraisal of the Kenya Deposit Insurance Act, 2012* (LLD-thesis, UP, 2019) 142.

Amendment Act 39 of 2013.³⁸² The KDI Act 2012 improved the effectiveness of the EDIS, which operated in *tandem* with a resolution regime that is administered by the Kenya Deposit Insurance Corporation (KDIC).³⁸³ The KDI Act 2012 also repealed sections relating to the Deposit Protection Fund Board and the Central Bank of Kenya's authority during liquidation.³⁸⁴ In terms of section 5(2) of the KDI Act 2012 the KDIC is mandated to promote financial stability and sound risk management among member banks through the provision of incentives.³⁸⁵ Moreover, the KDIC is further required to use public funds to curb systemic risk only with the approval of the Treasury Secretary.³⁸⁶ The KDIC is entrusted with a dual mandate, as a risk minimizer, it performs functions crucial to the administration of the EDIS, and as a loss minimizer, it has the authority to employ cost-effective resolution strategies during the resolution process. Importantly, membership under the KDI Act 2012 is mandatory for all banks and deposit-taking financial institutions.³⁸⁷

5.3 Kenya's Compliance with the Core Principles

It is important to note that Kenya is a member of IADI. Membership of the KDIC is mandatory for all commercial banks that are licensed and regulated by the Central Bank of Kenya.³⁸⁸ The KDIC promotes public awareness through press releases available on its website and a YouTube channel where it uploads videos to educate consumers about deposit insurance.³⁸⁹ When a bank fails, the protected depositors are notified through mainstream media, social media or any other relevant channel, on the process of lodging a claim to their protected deposits.³⁹⁰ The KDIC shall reimburse depositors within 30 days of its appointment as liquidator.³⁹¹ The deposit

³⁸² Kenya Deposit Insurance Amendment Act 39 of 2013.

³⁸³ Section 5 of the Kenya Deposit Insurance Act 10 of 2012.

³⁸⁴ Section 75 of the Kenya Deposit Insurance Act 10 of 2012.

³⁸⁵ Section 5(2) of the Kenya Deposit Insurance Act 10 of 2012.

³⁸⁶ Section 6(b) of the Kenya Deposit Insurance Act 10 of 2012.

³⁸⁷ Section 2 of the Kenya Deposit Insurance Act 10 of 2012.

³⁸⁸ Kenya Deposit Insurance Corporation "Deposit insurance" available at <https://kdic.go.ke/index.php/deposit-insurance> accessed 1 November 2022.

³⁸⁹ *Ibid.* See also KDIC Kenya available at <https://www.youtube.com/channel/UCVHNjHhngT54OQO-QZWA1pg> accessed 1 November 2022.

³⁹⁰ *Ibid.*

³⁹¹ Kenya Deposit Insurance Act Regulations LN 166 of 21 August 2015.

insurance coverage is limited to Ksh.500,000 per depositor, per bank which is designed to cover small, vulnerable and unsophisticated depositors.³⁹² According to the KDIC, the coverage amount provides full deposit insurance coverage for over 99% of deposits.³⁹³ Balances above the coverage limit are paid out to depositors once the assets of the failed bank have been recovered.³⁹⁴ Risk minimization is a key mandate of the KDIC and it allows the Corporation to exercise its early detection and timely intervention measures.³⁹⁵ Intervention mechanisms include open bank assistance, bridge banks, mergers and acquisitions, and liquidation.³⁹⁶ Kenya's legal framework includes a resolution regime that ensures that troubled banks are resolved in a timely and efficient manner.³⁹⁷ The KDIC works with other financial safety-net participants such as the Central Bank of Kenya, the National Treasury and other government agencies to resolve a troubled bank through measures such as resolution.³⁹⁸ The KDIC is protected from external interference by section 61 of the KDI Act 2012 in accordance with Core Principle 3.³⁹⁹ In terms of section 27 of the KDI Act 2012, licensed banks are required to make annual contributions to the Deposit Insurance Fund to ensure prompt reimbursement of depositor claims.⁴⁰⁰ Members of the KDIC are protected from personal liability by section 13 of the KDI Act 2012.⁴⁰¹ Finally, after the liquidation of a bank, section 50 of the KDI Act 2012 provides that the KDIC has the power to recover its claims in priority to all other claims.⁴⁰²

³⁹² Kenya Deposit Insurance Corporation "Deposit insurance" available at <https://kdic.go.ke/index.php/deposit-insurance> accessed 21 November 2023. See also section 28 of the Kenya Deposit Insurance Act 10 of 2012.

³⁹³ Kenya Deposit Insurance Corporation "Deposit insurance" available at <https://kdic.go.ke/index.php/deposit-insurance> accessed 21 November 2023.

³⁹⁴ *Ibid.*

³⁹⁵ *Ibid.* See also section 6 of the Kenya Deposit Insurance Act 10 of 2012.

³⁹⁶ *Ibid.*

³⁹⁷ Section 50(7)(a)-(b) and section 25(d) of the Kenya Deposit Insurance Act 10 of 2012.

³⁹⁸ Kenya Deposit Insurance Corporation "Deposit insurance" available at <https://kdic.go.ke/index.php/deposit-insurance> accessed 21 November 2023. See also section 6(g) of the Kenya Deposit Insurance Act 10 of 2012.

³⁹⁹ Section 61 of the Kenya Deposit Insurance Act 10 of 2012.

⁴⁰⁰ Section 27 of the Kenya Deposit Insurance Act 10 of 2012.

⁴⁰¹ Section 13 of the Kenya Deposit Insurance Act 10 of 2012.

⁴⁰² Section 50 of the Kenya Deposit Insurance Act 10 of 2012.

Kenya's EDIS complies with the Core Principles to a significant extent, although it has some shortcomings that need to be addressed, such as how the KDIC deals with cross-border issues and parties at fault in a bank failure, as well as contingency planning and crisis management. The KDI Act 2012 is silent on these aspects, which means that Kenya's EDIS is not aligned with Core Principles 5, 6, and 12.

5.4 Conclusion

As the pioneer of EDIS in Africa, Kenya has closed some of the gaps that existed under the Banking Act 56 of 1968 by enacting the KDI Act 2012 which brought about significant improvements in respect of its EDIS by adjusting it in line with international best practice standards. Nonetheless, Kenya needs to address the shortcomings of its EDIS such as how the KDIC deals with cross-border issues and parties at fault in a bank failure as well as contingency planning and crisis management.

Chapter 6: Conclusions and Recommendations

6.1 Introduction

This study has demonstrated the effects of bank failures on depositors, the globally recognized need for depositor protection as well as the international standards in place to support this safeguard. Additionally, the study traces the historical development of EDIS in South Africa, a G20 member, highlighting the country's substantial compliance with international standards. Despite this compliance, the study identifies weaknesses that still need to be addressed. Comparative analysis is conducted by exploring the EDIS legal frameworks in the United States and Kenya, offering valuable insights for South Africa. This chapter outlines the key lessons learnt from the preceding chapters, addressing the extent to which South Africa's EDIS complies with international best practices. Furthermore, it furnishes recommendations for enhancing the system, drawing upon lessons learned from the United States and Kenya.

6.2 Explicit Deposit Insurance System as a mechanism to protect depositors and promote financial stability

As indicated in chapter 1, the main objective of an EDIS is to contribute to the enhancement of financial stability and consumer protection. This is achieved by offering protection to depositors who are less financially sophisticated in the event of a bank failure. Banks are not immune from failure, and the failure of a single bank can affect financial stability in a country, ultimately disrupting global financial stability.⁴⁰³ Hence the importance of an EDIS is to effect stability in the financial system by giving depositors the confidence that they will recover their insured funds when a bank fails, thereby lessening the probability of a bank run.⁴⁰⁴ A DIS can also be used in *tandem* with a bank resolution framework in instances where funding is needed to capitalize a bridge bank or recapitalize a failing bank.⁴⁰⁵

⁴⁰³ The South African Reserve Bank "Designing a deposit insurance scheme for South Africa - a discussion paper" 2017 available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed 15 April 2022 1.

⁴⁰⁴ Helfer "What deposit insurance can and cannot do" 1999 available at <http://www.imf.org/external/pubs/ft/fandd/1999/03/tigert.htm#author> accessed 15 July 2022 23.

⁴⁰⁵ Single Resolution Board "What is a Bank Resolution" 2016 available at <https://www.srb.europa.eu/en/content/what-bank-resolution> accessed 23 October 2022.

6.3 Observations on the South African Deposit Insurance Framework

In addition to transitioning to a Twin Peaks model of financial regulation, the authorities took a big step by establishing an EDIS to align South Africa with international standards. This move aims to strengthen the country's robust banking sector and protect depositors against the risk of loss of funds in the event of a bank failure. The transition from implicit deposit insurance to an EDIS began with the introduction of several policy papers. These papers' features were eventually incorporated in the FSRA, as amended by the FSLAA.

South Africa's new EDIS aligns well with the IADI Core Principles, as demonstrated in chapter 3. However, there are some shortcomings that need to be addressed.⁴⁰⁶ As highlighted in chapter 3, South Africa's EDIS meets all the Core Principles, except for Core Principle 5 (Cross-Border Issues), Core Principle 6 (Deposit Insurer's Role in Contingency Planning and Crisis Management) and Core Principle 12 (Dealing with Parties at Fault in a Bank Failure). Addressing these is crucial for enhancing South Africa's EDIS.

6.4 Insights for South Africa from comparisons made with deposit insurance in the US and Kenya

6.4.1 Guidance from the US

The US EDIS was discussed in chapter 4 and the study showed how its EDIS was implemented during the Great Depression and how the country has consistently reformed its EDIS through the implementation of various legislation. This is a good lesson for South Africa to improve its EDIS as the need arises through the amendment of its legislation. South Africa should also take lessons from the manner in which the US swiftly handled recent bank failures and curbed financial instability as well as protected depositors by utilizing tools such as bridge banks, effective communication with the public and applying the systemic risk exception when it was absolutely necessary to do so. Another lesson that South Africa can learn from recent bank failures in the US is that depositors were protected, and financial stability was maintained by having the legal tools in place, the regulators cooperating amongst each

⁴⁰⁶ See para 6.5.

other and being proactive in a crisis situation to ensure that the whole system does not collapse because of a few banks that are failing. Nonetheless, it is important to consider the fact that the US has experienced a high number of bank failures, which forced it to strengthen its regulatory framework and have a progressive EDIS, as opposed to countries that have not experienced many bank failures and their EDIS are not yet fully compliant with the Core Principles.

6.4.2 Guidance from Kenya

One of the lessons that South Africa should learn from Kenya is that the Deposit Insurance Corporation should be independent from other government and regulatory bodies otherwise corruption will ensue, the deposit insurance fund will be misused and the purpose of an EDIS will be defeated. Another lesson for South Africa is that, just like the US, Kenya also demonstrates that public funds should only be used to curb systemic risk subject to the approval of the relevant regulatory body. Just like Kenya, South Africa should consider creating a YouTube channel to educate consumers on deposit insurance and this can be used to kickstart its public awareness campaign as this method of communication can reach a wide audience very quickly. The YouTube channel can also be used to answer frequently asked questions. Lastly, South Africa should consider incorporating a risk minimizer mandate into its key mandate which is currently the paybox-plus mandate.

6.5 Recommendations

a) Recommendation 1

Core Principle 3 states that the deposit insurer should be operationally independent.⁴⁰⁷ Currently, the independence of South Africa's Corporation for Deposit Insurance (CODI) is uncertain as it is located in the same building as the SARB and this creates the danger that the government may require CODI to provide resolution funding where it is inappropriate to do so or to refrain from providing the funding in instances where

⁴⁰⁷ International Association of Deposit Insurers "IADI Core Principles For Effective Deposit Insurance Systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 21.

funding is required.⁴⁰⁸ Therefore, South Africa should consider moving CODI from the same building as the SARB to a separate location in order to ensure its independence.⁴⁰⁹

b) Recommendation 2

Core Principle 6 states that the deposit insurer should have in place effective contingency planning and crisis management policies and procedures to ensure that it can effectively respond to the risk of, and actual, bank failures, and other events.⁴¹⁰ Since the FSRA does not specify the role of CODI in crisis management and contingency planning, it is recommended that the regulators clarify this position by putting policies in place to ensure that CODI responds effectively to bank failures or the risk thereof.

c) Recommendation 3

In terms of Core Principle 15 the deposit insurer is required to reimburse a majority of depositors within a 7-day working period.⁴¹¹ Since South Africa's EDIS is fairly new, the 20-day reimbursement period is understandable, however, in future CODI should ensure that depositors are reimbursed within a 7-day period in accordance with international standards, as opposed to the 20-day period which might lead to bank runs.⁴¹²

d) Recommendation 4

⁴⁰⁸ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 253.

⁴⁰⁹ *Ibid.*

⁴¹⁰ International Association of Deposit Insurers "IADI core principles for effective deposit insurance systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 25.

⁴¹¹ *Ibid* 44.

⁴¹² *Ibid* 254.

Core Principle 12 states that the deposit insurer or other relevant authority should have the power to seek legal redress against those parties at fault in a bank failure.⁴¹³ The FSRA currently does not specify the manner in which CODI will deal with parties at fault in a bank failure. In this regard, it is recommended that a provision should be inserted in the FSRA specifying how the Corporation will investigate the responsible parties and what sanctions will be imposed on those parties in order to ensure accountability.

e) Recommendation 5

Core Principle 9 specifies that the deposit insurer is expected to have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims.⁴¹⁴ Deposit insurance in South Africa will be funded by premiums from member banks and since these premiums will be on a flat-rate basis it means that all banks will pay the same premium irrespective of their risk profiles, however, this can cause banks to take greater risks and therefore lead to moral hazard.⁴¹⁵ It is recommended that banks should be charged premiums based on their risk profiles (risk-based premiums) as opposed to charging the same amount to all banks, regardless of their risk profiles.⁴¹⁶

f) Recommendation 6

South Africa should incorporate a systemic risk exception clause in the FSRA just like the US and Kenya as this will assist in maintaining financial stability when the need

⁴¹³ International Association of Deposit Insurers "IADI Core Principles For Effective Deposit Insurance Systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 35; The World Bank Group "Financial Safety nets and bank resolution frameworks in Southern Africa: Key issues and challenges" 2019 available at <https://openknowledge.worldbank.org/server/api/core/bitstreams/16ab87a1-b900-5a05-8ecb-a141a9b50693/content> accessed 1 May 2023 44.

⁴¹⁴ International Association of Deposit Insurers "IADI core principles for effective deposit insurance systems" 2014 available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 15 April 2022 29.

⁴¹⁵ Matasane *A Deposit Guarantee Framework for South Africa: A Comparative Appraisal* (LLD-thesis, UP, 2023) 254.

⁴¹⁶ *Ibid.*

arises to invoke the systemic risk exception to prevent a run on healthy banks and maintain financial stability by reimbursing uninsured depositors of a failed bank.

g) Recommendation 7

South Africa should consider creating a YouTube channel to educate consumers about deposit insurance, carry out its public awareness campaign as well as to answer depositors' questions. Communication via YouTube will be effective as it will reach a wide audience quickly.

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