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Comments on the S. No. 1260 "*FURTHER INCREASING THE MAXIMUM DEPOSIT INSURANCE COVERAGE, AMENDING FOR THIS PURPOSE REPUBLIC ACT NO. 3591, AS AMENDED, OTHERWISE KNOWN AS THE PHILIPPINE DEPOSIT INSURANCE CORPORATION (PDIC) CHARTER*" and S. No. 2089 "*AN ACT AMENDING SECTIONS 1, 3, 4, 5, 6, 8, 9, 10, 11, 18, 22, 24, 26 AND 28 OF REPUBLIC ACT NO. 3591, AS AMENDED, OTHERWISE KNOWN AS THE PHILIPPINE DEPOSIT INSURANCE CORPORATION CHARTER AND FOR OTHER PURPOSES*"

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We laud the abovementioned legislative initiatives to increase depositor confidence, encourage formal savings, improve efficiency of financial regulation, and prevent bank instability under current pandemic conditions which have had severe effects on the economy. Following are just a few comments.

General comments

Changes in deposit insurance coverage and pricing ideally should be determined through a proper study (economic, financial, and actuarial) that examines the overall effect on the banking industry and its depositors (current and potential), and especially on longer-term banking stability. There should be a proper balance among financial/fiscal stability and financial inclusion/equity goals.[2] The opinion of financial sector regulators, industry representatives, and independent parties (experts provided with the required information) need to be carefully considered.

It has been well established in the empirical literature that deposit insurance can increase depositor confidence and prevent bank runs (the latter being the reason why such insurance was originally created), but it may also encourage financial intermediaries to take excessive risk (see Anginer and Demigurc-Kunt, 2018, for a review).[3] Recent studies on deposit insurance policy focusing on ASEAN countries continue to confirm such observations.

Based on a sample of 406 ASEAN banks, Kim et al. (2014) observed that non-beneficial effects of deposit insurance seemed to rise with extensive coverage but that such insurance-related moral hazard (the greater tendency for risk-taking when the cost of such actions are taken away) may be curbed through better regulatory quality.[4] Similarly focusing on a panel of 127 ASEAN banks, Kusairi

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[2] It is informative to note here that based on financial inclusion surveys of the BSP, the reason why those who save but not formally through banks cite lack of money as a reason (about 65%) and not necessarily mistrust or fear.
[3] Anginer, D., and Asli Demigurc-Kunt. 2018 (Sep). Bank runs and moral hazard. WB Policy Research Working Paper No. 8589. Washington, DC: World Bank Group.
[4] Kim, Iljoong, Inbae Kim, and Yoonseon Han. 2014. Deposit insurance, banks' moral hazard, and regulation: evidence from the ASEAN countries and Korea. *Emerging Markets Finance and Trade*, Volume 50.

et al. (2018) noted how deposit insurance policy negatively affected the ratio of retail deposits to total assets while increasing the ratio of loans to total assets.[5]

Though decisions for the Philippines should still be made in the context of the Philippine financial system, it would be prudent to consider such empirical findings. *The important takeaway from the empirical research is that any expansion of coverage must be well studied, with risks carefully weighed, and matched by better regulatory quality, if not stronger regulations, for longer term financial stability.*

On removing regulatory overlaps

The goal ideally and ultimately is to develop independent institutions with defined functions and clear accountability. This would also make for a more efficient financial regulatory system. Unifying/lodging certain regulatory functions (e.g., in allowing mergers and acquisitions, issuing cease and desist orders, and bank examination) at the BSP, which is the organization responsible for supervising the operations of banks, may be a good starting point. This allows PDIC to concentrate on other regulatory functions such as ensuring adequacy of deposit insurance and liquidation.

Legislation in the past had swung back and forth on the matter of giving PDIC the ability to better manage risks and costs (e.g., through the power to examine banks and deposit accounts) to protect the depositing public over and above other goals. *Such argument remains and hopefully related concerns would still be addressed even as the institution is transformed into a paybox and attached to the BSP "for policy and program coordination."*

On increasing the maximum deposit insurance coverage and greater flexibility to increase the amount

A simple readjustment based on inflation suggests maximum deposit insurance coverage of about PhP 700,000 rather than PhP 1 million. This would naturally have implications for the actuarially fair price, which must be considered. [6]

The need for rigorous assessment cannot be overemphasized in relation to the setting of insurance premiums. Mispricing of deposit insurance could lead to excessive (implicit) taxation of the financial sector, on one hand, or an excessive subsidy of the sector and thus fiscal strain, on the other. Pricing deposit insurance as accurately as possible is important, especially for countries that have an ex-ante funded deposit insurance regime like the Philippines, as built-up funds may be misused (Laeven 2002).[7]

Pricing of deposit insurance is notoriously difficult however as one needs to consider both individual bank and joint/systemic macro-financial risks to assess bank default probabilities. *Hiring the right team of experts for the task—which requires, economic, financial, and actuarial knowledge—is therefore advisable. With proper risk assessment system in place, the possibility of risk-based premiums can also be explored to see if this would work in the local setting.*

On the other hand, greater flexibility to adjust the deposit insurance ceiling is needed, particularly during high-stress scenarios. This would allow deposit insurance to continue to perform its role and

[5] Kusairi, Suhal, Nur Azura Sanusi, and Abdul Ghafar Ismail. 2018. Dilemma of deposit insurance policy in ASEAN countries: does it promote banking industry stability or moral hazard?
[6] It should be noted also that the proposed widening coverage (in amount as well as deposit product covered) would change the average risk profiles of insured deposits, and likely upward.
[7] Laeven Luc. 2002. Pricing of deposit insurance. World Bank Financial Sector Strategy and Policy Department.

purpose as part of the financial sector safety net and in maintaining financial stability. The corresponding change in the PDIC charter is therefore a useful development.

On removal of the exemption of PDIC from salary standardization laws

This change may have repercussions for current and potential staff, depending on which direction salaries are intended to go. Earlier reasoning to exempt PDIC employees from the SSL was to ensure recruitment and retention of competent professionals to strengthen the institution.

On dividend declaration (removal of exemption from RA 7656)

To preserve the integrity of the deposit insurance fund, it may be beneficial to maintain a defined standard or rule in relation to the payment of dividends, one that considers institutional as well as macro-financial conditions, to further build confidence in the deposit insurance and banking systems.