NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

Deposit Insurance in the Republic of Macedonia

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Contents

Zoran Jovanovski, M.A.*

1. DEPOSIT INSURANCE AS AN ELEMENT FOR PROTECTION OF THE BANKING SYSTEM STABILITY

1.1. The need for deposit insurance

Stable financial system creates favorable preconditions for development of financial intermediation and efficient allocation of resources, which are factors of crucial importance for the prosperity of the national economy. Within the financial sector, banking sector plays particularly important role and that is why a priority is put on its stability. Achieving and maintaining stability of the banking system is encouraged by many factors:

1. Stable banking system accelerates the economic growth. This comes from the increased confidence of the population in the banks' operations, which causes an increase in savings and creates favorable conditions for more intensive investment activities of the domestic economic agents. Lack of "major disturbances" in banks' operations in a national economy also encourages the inflow of foreign investments.

2. Stable banking system provides preconditions for protection of "small depositors". When there is a high degree of stability in banks' operations, the danger from unexpected and frequent bankruptcies is reduced. Then, the deposits of the "small depositors" are protected as well, which is considered to be an important element in maintaining the overall confidence in the financial system.

3. Stable banking system provides protection from a potential breakdown of the country's payment system. Banking system plays the main role in the payment system. The reform in the payment system in the Republic of Macedonia is also directed towards that aim. Destabilization in the banking system could affect adversely the realization of payments among the agents in the national economy.

Stability of the banking system is provided at two levels: 1/ primary protection and 2/ supplementary protection. Primary protection is realized through the so-called structural and prudent regulation. Through the licensing system the structural regulation defines the entry and exit conditions for the institutions in the banking system, protecting, at the same time, its stability. Prudent regulation ensures the compliance of the banking activities and application of the consistent supervision standards for the level of risk in banking operations.

Supplementary protection of the depositors and the banking system stability is provided by the systems for insurance of the deposits deposited in the banks and savings houses. By one definition, the protection provided by the deposit insurance system

* The author is a Head of the Research Division, Research Department, in the National Bank of the Republic of Macedonia.

represents a guarantee that the deposit will be paid off to the depositors in full or partially.[1] By another definition, deposit insurance is a limited but formal scheme which provides a legally enforceable guarantee for the principal (sometimes for the interest as well) of the deposit.[2] Systems for deposit protection represent the last “shield” in the deposit protection, because these systems are usually applied only after a bank or a savings house goes into bankruptcy.

On one hand, the task of deposit insurance is to reduce the depositors’ uncertainty about the fate of their deposits in a situation where particular bank or savings house has serious solvency problems. Deposit insurance keeps the bankruptcy of a bank at a local level, and serves as a prevention against depositors’ panic and deposit run from the other banks as well. This is actually an attempt to prevent the so-called domino effect, where insolvency of one bank threatens to spread to the other banks and to put in danger the entire banking system. On the other hand the objective of the deposit insurance systems is not to protect all the parties equally, but a special attention is paid to the protection of “small depositors”. This is due to the fact that the “small depositors” can not gather or adequately process all the information about which bank or savings house it is best to deposit in (the problem of asymmetric information).

However, deposit insurance systems have their disadvantage, which is that they can act in direction of suppressing market competition within the banking sector. This disadvantage can, indirectly, also have an adverse impact on the degree of efficiency in the market allocation of financial resources in the national economy. The threat of moral hazard is another disadvantage of the deposit insurance system. It is manifested through the increased risks that might be taken by the customers, because of the guarantee provided by the deposit insurance systems.

1.2. Types of deposit insurance systems

Worldwide, systems for deposit protection are usually introduced after a bankruptcy of a bank or another financial institution, i.e. in case of disturbed confidence of the financial agents in the financial system of the country. Serious banking problems are common thing in the world and according to the International Monetary Fund (Lindgren, Garcia, Saal, 1996) in the period 1980 - 1995, 131 out of 181 member countries members of this institution had such an experience.

Basically, there are to ways for deposit protection: implicit and explicit system for deposit insurance. Basic features and differencies between these two systems are shown in table 1.

[1] Gillian Garcia, “Deposit Insurance: Obtaining the Benefits and Avoiding the Pitfalls”, International Monetary Fund, Working paper, June, 1996, str.1
[2] Monetary and Exchange Affairs Department, "Deposit Insurance and Crisis Management", International Monetary Fund, August 1996.

Table 1

Implicit and explicit system for deposit protection

Feature	Implicit system	Explicit system
Existence of rules and procedures for conducting the deposit protection	No	Yes
Obligation for deposit protection	No legal obligation; Government decides arbitrarily upon protection	There is a legal obligation for deposit protection up to the insured limit:Insurer decides arbitrarily upon protection of uninsured depositors
Level of protection	Varies from no protection to full protection	Varies from limited protection to full protection
Ex ante financing	No	Usually banks through payments of premiums; Government can provide initial financial injection and regular payments, if possible
Financing in case of banks' failure	Government	From a Fund; lack of funds can be eliminated through banks' special payments or by credits or additional resources from the Government or the Central Bank

In general, the systems for deposit protection are matter of evaluation and trade-off between the cost for providing explicit deposit protection on one hand, and potential losses which would occur in case of panic, on the other. In the actual comparison of the benefit and loss the opinion that usually prevails is that the cost of providing deposit protection is worth while. In that sense, EU with a Directive of May 1994 has imposed to the member countries to introduce explicit system of deposit insurance, and this document states: "Each member country on its territory should provide introduction and official acknowledgment of one or more deposit insurance schemes… No credit institution... should accept deposits if it is not a member of such scheme... Deposit insurance scheme has to specify that total deposits of each depositor must be covered up to 20,000 ECU in case the deposits are not available." (Directive 94/19/EU, pg. 8-9.).[3]

EU generally defines deposit as "every credit balance deriving from assets placed on account or from temporary sitiations which result from ordinary banking transactions and which the credit institution must pay out in acordance with the applicable contracting conditions and any certified debt of the credit institution".[4] Credit institution is considered "an enterprise whose activity is consisted of accepting deposits or other means of payment from the public and extending credits for its account".[5] This means that the EU Directive covers not only banks' deposits but also deposits of the savings houses and other similar institutions whose characteristics are compatible with the definition of credit institution. According to the Directive of the EU a "not accesible deposit" is "a deposit which is due and there is a legal obligation for its payment, but is not paid off by the credit institution

[3] Gillian Garcia, "Deposit Insurance: Obtaining the Benefits and Avoiding the Pitfalls", International Monetary Fund, Working paper, June, 1996, page 1.
[4] Gillian Garcia, "Deposit Insurance: Obtaining the Benefits and Avoiding the Pitfalls", International Monetary Fund, Working paper, June, 1996, page 9.
[5] "Profesija Bankar", Skopje, edition 29, January 1998, page 16.

according to legal and contractual obligations".[6] The Directive gives the opportunity EU member countries to exclude certain deposits and depositors from insuring or to guarantee a lower amount of compensation. This document also gives a detailed list of deposits that could be excluded from insuring: deposits of one credit institution deposited in another credit institution on its own behalf and account, deposits of insurance houses and pension funds, Government and local government deposits, deposits of credit institutions managers who hold at least 5% of their capital and deposits of their close relatives, securities issued by the credit instituion, deposits with no specified owner and other deposits.

Worldwide, particularly in the developing countries and countries in transition, there is a tendency for introduction of explicit systems for deposit insurance, because they are considered to have some advantages:

- They have better administrative procedure for solving situations of bankruptcy of a bank as well as for protection of depositors;
- They are more efficient in protecting "small" depositors, because they have a guarantee for at least partial compensation;
- They significantly contribute to settling and maintaining public confidence in the country's banking system.

Disadvantage of the explicit systems for deposit protection is that they could possibly weaken the competition among financial institutions. Thus, existence of a deposit insurance institution can create a feeling among the depositors that all the banks are equally (non-) risky, and that it does not matter in which bank they deposit their money. It means that depositors may not respond to the market impulses sent by the banks which have improved the quality of their operations and want to attract new depositors. Also, the immobility of deposits may create an illusion that some less stable banks are operating well, so that they might start taking risk which is larger than the one they should take. These disadvantages are removed by setting the maximum limit for compensation and by fractional deposit insurance.

However, selecting an explicit deposit insurance system could possibly strengthen the competition in the banking sector. This comes out from the formal character of the explicit system, which helps smaller banks in maintaining certain level of reputation which otherwise could not be possible in competition with big banks.

Functioning of explicit system for deposit insurance means existence of an institution that will perform this function, and which is often called Fund or Agency for deposit insurance. The existence of a Fund builds up the confidence of the depositors in the banking system, because there is an institution they can call upon in a case of bankruptcy of a bank or savings house. Another positive aspect from this Fund is that it is collecting the needed resources during a certain period of time, i.e. banks' expenses for paying premiums are distributed over a longer period of time.

1.3. Basic elements of the explicit system of deposit insurance

Functioning of a Fund for deposit insurance is determined by the design of its basic elements. Usually, the main components that are taken into consideration are the following:

[6] "Profesija Bankar", Skopje, edition 29, January 1998, page 16.

1. *Legal status of the Deposit Insurance Fund.* The answer to this question is closely related to the definition of the role, rights and obligations of various subjects who are potentially involved in the process of deposit insurance. Thus, according to the set-up, the Fund could be either public or private.

2. Character of the membership in the Deposit Insurance Fund. The membership can be mandatory or voluntary. There is an opinion that voluntary membership is inferior compared to the mandatory membership, because it creates an environment in which financial institutions which are not members of the Fund could offer higher interest rates (they do not have the expenses for paying deposit insurance premiums to the Fund) and to attract more deposits. As these financial institutions are not members of the Fund it is considered that deposits deposited there are characterized by a higher level of risk and that with voluntary membership in the Fund deposits would move into more risky institutions.

However, there is also an opinion that in the evaluation of all the available information about the functioning of the financial system, depositors, to a smaller or larger extent are able to assess the risk of depositing funds in financial institutions that are not members of a voluntary deposit insurance Fund. Thus, it is thought that with voluntary membership financial institutions that are not members take the risk of loosing deposits, because for the depositors the higher interest rates would not be sufficient compensation for the risk of loosing their deposits in case of bankruptcies of these institutions.

As a principle, it is considered that when the membership of the banks and savings houses in the Fund is mandatory, then in fact the strongest banks and savings houses subsidize the weakest ones.

3. Financing of Deposit Insurance Fund. This component has a complex structure and it includes the following items:

a/ Founding capital of the Fund. Regarding the subject paying the funds, the choice is directly determined by the character of the Fund (public or private). The amount of the Fund's founding capital is determined in correlation with the other variables which are related to the financing of the Fund (the risk rate of the financial system, the total amount of funds needed by the Fund, premium rate).

b/ Types of insured deposits. The scope of deposits to be insured is determined by the type of depositor (households, and possibly other depositors), by the deposit's maturity (checking and giro accounts, sight deposits, time deposits) and by the currency of denomination (only deposits in domestic currency or also foreign currency deposits).

c/ Total amount of Fund's assets. The amount of assets depends on the overall estimated risk of the operations of financial institutions in the country.

d/ Premium rates to be paid by the financial institutions to the Fund and the base for calculation of the premiums. In case of a risky event there is a possibility for the Government to make payments to the Fund on a regular basis, or occasionally.

e/ Level of compensation of an individual depositor in a single financial institution in case of a risky event. There are two key issues to be considered, like the proportional degree of compensation of the total amount of the deposit, and the maximum compensation of an individual depositor in a single financial institution.

f/ The way in which the Fund can invest the premiums paid by the financial institutions - members. Having the depositors compensation as a primary objective, the

Fund must have very liquid assets. Therefore, the Fund should invest collected premiums in a way which will minimize the risk, and maintain assets liquidity (i.e. government securities).

g/ Financing the Fund when its assets are insufficient to execute in full the predetermined compensation. There is a possibility for an extraordinary payment of premiums by financial institutions - members, payment by the government, or taking a loan.

4. Management of the Deposit Insurance Fund. Administration of the Fund primarily depends upon its character (public, private). Thus, the Fund could be managed by the financial institutions which have founded it and pay premiums, Central Bank, Ministry of Finance, or combined Management Board. However, there is an opinion that there should be no representatives from the financial institutions - members in the Management Board of the Fund, due to the threat of conflict of interest. Regarding the Fund's administration, very important is the issue of its authorizations as for example the right to conduct supervision of the operations of the institutions - members.

5. Deposit Insurance Fund's activities in relation to the institutions - members. The spectrum of Fund's activities can have different scope. There is an opinion that the Fund should only collect premiums from the member institutions, invest them, and compensate in case of a risky event. However, there is another opinion according to which the Fund could prevent when necessary by undertaking activities for rehabilitation of the financial institutions - members, in order to reduce the risk from their operations for the country's financial system. Fund's scope of activities could include its informing and monitoring of the banks' operations.

2. DEPOSIT INSURANCE IN THE REPUBLIC OF MACEDONIA

2.1. Current position of the Savings Insurance Fund

After the monetary independence, there was a serious need for establishing a system for deposit insurance in the Republic of Macedonia. The need was primarily motivated by the problem of paying off the so-called “frozen foreign currency deposits”, restructuring of the banking system and bankruptcies of some banks and savings houses (mainly, the Bank for Foreign Trade a.d. Skopje) which caused a lack of confidence in the domestic financial system. Therefore, a Fund was established, which is supposed to provide an adequate protection of the assets deposited in the banks and savings houses.

Legal framework for the Deposit Insurance Fund in the Republic of Macedonia is given in the Banks and Savings Houses Act, Articles 99-107 (“Official Gazette of the Republic of Macedonia” 29/96). According to the regulation, the Deposit Insurance Fund is called Savings Insurance Fund (hereinafter Fund), it is located in Skopje and is established by the banks and savings houses in the Republic of Macedonia, as a shareholding company. The founding capital of the initial shareholders was a denar equivalent of DM10,000.

The Fund insures savings of individuals, including their checking accounts, denar and foreign currency deposits. In four years, the total assets of the Fund should amount at least to 15% of the total savings in the Republic of Macedonia. In case there is a lack of funds and a risky event occurs, Fund’s shareholders have an obligation to do additional payments.

The Fund insures the savings and participates on the inter-bank money and short-term securities market. Fund’s assets comprises of: initial capital, paid premiums for savings insurance, and income on investing these funds in non-risky and very liquid investments. Regulations state that the premium rate should vary from 1% to 5% p.a. from the total savings in the banks and savings houses and it should be determined by the Fund, depending on the solvency of each member institution. Utilization of Fund’s assets starts after exhausting the compulsory reserves of the bank or savings house dealing with illiquidity.

Banks and Savings Houses Act states that the Fund should have: Assembly, Management Board and Director. The Assembly is consisted of representatives from the shareholders of the Fund. Management Board should have seven members, who elect the Director of the Fund. According to the Law, supervision of the Fund’s operations is executed by the National Bank of the Republic of Macedonia.

Banks and Savings Houses Act states that the Fund should have a Statute approved by the National Bank of the Republic of Macedonia, which should regulate Fund’s operations in more detail. Existing Statute is approved as a legally valid act by the Primary Court Skopje I and was approved by the Governor of the National Bank of the Republic of Macedonia (January 20, 1997) as being in compliance with the provisions of the Banks and Savings Houses Act.

Fund’s Statute states that the premium should consist of two components: technical premium, which is an inflow to the so-called security fund, and a part of the premium intended to cover the expenses of the Fund’s day-to-day operations, where these expenses are determined by the Management Board. According to the Statute, the Fund has: Assembly, Management Board and Supervision Board. Members of the Supervision Board are supposed to receive an annual money prize on charge of the Fund’s operating expenses, according to its financial status. Members of the Management Board can also receive a money prize defined by the acts regulating their election, and they can receive a portion of the Fund’s net income.

Fund’s Statute states that the Management Board can require additional information from member institutions, can report to the Supervision Department of the National Bank of the Republic of Macedonia registered irregularities in some member institutions, and can point out the need for additional supervision of those members.

Provided that this Fund is established as a shareholding company, regulation of certain components of its operations in the Fund’s Statute comes from the provisions of the Commercial Code, which covers shareholding companies. Thus, it stipulates formation of net income from the Fund’s operations and its partial payment as dividend (once the total assets amount to the required 15% of the savings). The profit from Fund’s operations is to be distributed proportionally to the share in the Fund’s capital, i.e. equally among the member institutions. At the same time, with regard to managing of the Fund as a shareholding company, the Statute stipulates that there should exist Management Board and Supervision Board, which corresponds to the so-called double level system for managing a shareholding company and is incorporated in the provisions of the Commercial Code.

2.2. Functioning of the Fund since its establishing

As of March 31, 1998 the founding capital of the Fund equaled denar 9.18 million. Founding capital was created by equal payments of 34 founders (banks and savings houses).

In the period January 1997 - April 1997, in the Republic of Macedonia 3 banks out of 21 bank and one subsidiary of a foreign bank were not insured. From May 1997 to March 1998, the number of uninsured banks was reduced to two. The existence of uninsured banks is due to the measures of the National Bank of the Republic of Macedonia against these banks, which include prohibition for accepting savings. Regarding the savings houses in the Republic of Macedonia, since the establishment of the Fund larger fluctuations were registered in the number of insured and uninsured savings houses. After the initial number of 10 insured and 6 uninsured savings houses, in the course of 1997 there were 11-12 insured and 1-2 uninsured savings houses, and at the end of the first quarter of 1998 savings were insured in 13, and not insured in 2 savings houses, while the remaining savings houses did not accept any savings. Variations in the number of insured and uninsured savings houses were determined by the measures of the Central Bank against some of the savings houses.

Fund’s assets depend on the amount of founding capital, changes in the household savings in the banks and savings houses, as a basis for insurance, and the level of the insurance premium rate. Subject of insuring are denar sight deposits, which include the checking accounts of individuals, denar time deposits, foreign currency sight and time deposits. Tables 2, 3 and 4 show quarterly changes of the savings which are subject of insuring, with a distinction between banks and savings houses.

Table 2 shows that since the establishing of the Fund, total savings at the banks and savings houses are permanently increasing, and at the end of the first quarter of 1998 are larger by denar 1,001 million, or by 18.2%, compared to the end of the first quarter of 1997. From a structural point of view, such an increase is a result of the increase in the foreign currency sight deposits by denar 907 million, or by 78.2%,[7] and the increase in the foreign currency time deposits by denar 318 million (176.7%).[8] In the period March 1997 - March 1998 denar deposits with the banks declined, where denar sight deposits (checking accounts of individuals included) declined by denar 117 million, or by 7.7%, and denar time deposits by denar 107 million, or by 4.0%, respectively. Regarding the insurance coverage of the households savings deposited with the banks in the Republic of Macedonia, excluding the ratio on March 31, 1997, when uninsured savings represented 2.8% of the total savings with the banks, in the remaining quarters, ending with March 31, 1998, the ratio of uninsured savings was lower than 1.0%.

Table 2

Households savings with the banks in the Republic of Macedonia

(quarterly, in million denar)

	I.97	II.97	III.97	IV.97	I.98
Savings					
Checking accounts and denar sight deposits	1,516	1,.339	1,420	1,477	1,399
Denar time deposits	2,645	2,621	2,.583	2,610	2,538
Foreign currency sight deposits	1,160	1,266	1,619	1,968	2,067
Foreign currency time deposits	180	220	269	368	498
Total savings	**5,501**	**5,446**	**5,891**	**6,423**	**6,502**
Insured savings					
Checking accounts and denar sight deposits	1,494	1,327	1,409	1,468	1,397
Denar time deposits	2,633	2,611	2,574	2,603	2,532
Foreign currency sight deposits	1,046	1,238	1,599	1,947	2,038
Foreign currency time deposits	173	220	269	365	498
Total insured savings	**5,346**	**5,396**	**5,852**	**6,383**	**6,465**
Total insured savings	**155**	**50**	**40**	**40**	**37**

Table 3 shows that the amount of total savings deposited with the savings houses in the Republic of Macedonia remained unchanged in the period March 1997 - March 1998 (increase by denar 2 million only). In this period, insured savings went up by denar 18 million, or by 7.4%. The ratio of uninsured savings to the total savings was 7.2% as of March 31, 1997, and it dropped to 1.1% as of March 31, 1998.

[7] This increase includes the effects of the denar devaluation against the Deutsche mark in July 1997.
[8] This increase includes the effects of the denar devaluation against the Deutsche mark in July 1997.

Table 3

Households savings with the savings houses in the Republic of Macedonia

(quarterly, in million denar)

	I.97	II.97	III.97	IV.97	I.98
Total savings	263	290	283	263	265
Insured savings	244	288	277	259	262
Uninsured savings	19	2	6	4	3

Overall, in the period March 1997 - March 1998 total household savings deposited with the banks and savings houses in the Republic of Macedonia went up by denar 1,003 million, or by 17.4%.[9] ratio of uninsured savings to the total household savings with the banks and savings houses in the Republic of Macedonia was reduced from 3.0% as of March 31, 1997, to 0.6% as of March 31, 1998.

Table 4

Total households savings with the banks and savings houses in the Republic of Macedonia

(quarterly, in million denar)

	I.97	II.97	III.97	IV.97	I.98
Total savings	5,764	5,736	6,174	6,686	6,767
Insured savings	5,590	5,684	6,129	6,642	6,727
Uninsured savings	174	52	46	44	40

Since the Fund's establishing, the insurance premium rate has not been changed and it equaled 1.5% p.a. As of December 31, 1997, the total amount of collected insurance premiums was denar 63.7 million, and as of March 31, 1998 it amounted to denar 87.7 million. If net income from the Fund's operation in amount of denar 4.1 million is added, then total funds in the so-called security fund amount to denar 91.8 million, as of March 31, 1998.

The level of the current annual insurance premium rate in the Republic of Macedonia (1.5%) is not equally related to the level of various deposit interest rates. It means that the insurance premium does not burden equally the interest rates. Thus, in the analyzed period, annual insurance premium rate on average was 37.5% of the deposit interest rate on denar sight deposits, 11.33% and 12,24% of the deposit interest rates on 3 month and 12 month denar time deposits, respectively. Hence, the premium rate is a significant cost for the banks which have accepted more sight deposits and it represent higher share in the interest expenditures, compared to the burden on the denar time deposits' interest rates. With regard to the foreign currency deposits of households, insurance premium is a much larger burden for the banks. Thus, on average the premium is even equal with the foreign currency sight deposits' interest rate, and as of March 31, 1998 it represented 60% of the interest rate on households' 12 month foreign currency time deposits.

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[9] This increase includes the effects of the denar devaluation against the Deutsche mark in July 1997.

Table 5

Insurance premium rate in relation with the savings' interest rates

(quarterly, in percent)

		I.97		II.97		III.97		IV.97		I.98	
		int. rate/1	ratio /2	int. rate/1	ratio /2	int. rate/1	ratio /2	int. rate/1	ratio /2	int. rate/1	ratio /2
Denar sight deposits		4	37.5	4	37.5	4	37.5	4	37.5	4	37.5
Foreign currency sight deposits		1.5	100	1.5	100	1.5	100	1.5	100	1.5	100
Denar time deposits	over 3 mth.	11.25	11.33	11.25	11.33	11.25	11.33	11.25	11.33	11.25	11.33
	over 12 mth.	12.25	12.24	12.25	12.24	12.25	12.24	12.25	12.24	12.25	12.24
Foreign currency time deposits	over 12 mth.	2.5	60	2.5	60	2.5	60	2.5	60	2.25	66.67

1/ Interest rates are on annual level, interest rates on foreign currency deposits refer to interest rates on deposits denominated in Deutsche marks.

2/ Ratio of the annual insurance premium rate (1.5%) to the relevant deposit interest rate.

Overall, table 5 shows that the current level of the annual savings insurance premium rate in the Republic of Macedonia is unbearably high cost for the banks and savings houses. If the current premium rate remains unchanged, the burden on the banks and savings houses will become larger in the future, because interest rates will decline as a result of the permanently low inflation rate in the Republic of Macedonia, and due to the expected growth in saving. Therefore, there is a need for a continuous reduction in the annual insurance premium rate.

The level of the savings' insurance premium rate also affects the lending interest rates of the banks and savings houses. Current annual premium rate (1.5%) represents 10.2% of the effective collected lending interest rate by Macedonian banks (14.7%). This indicates that the possible reduction of the current premium rate, for example, from 1.5% to 1.0%, or within certain period of time to 0.3%, would reduce the burden on the banks' effective lending interest rate from the current 10.2% to 6.8%, or 2.0%, respectively.

Regarding the Fund's investments, as of December 1997 the balance shows that denar 65 million are paid for purchasing Central Bank bills in the amount of denar 67 million. As of March 31, 1998, denar 96.9 million are paid for purchasing Central Bank bills in the amount of 99 million.

2.3. Problems faced by the current Savings Insurance Fund

Generally speaking, in its day-to-day operations the Savings Insurance Fund in the Republic of Macedonia faces the following problems:

1. Lack of independence in the Fund's operations and its decision-making. The shareholders of the Fund are under the impression that they can not adequately design its operations. They believe that a shareholding company, according to the principles of a market economy, must enjoy a full freedom in maximizing its profit, as a main objective of its functioning, because it bears the risk of failure. Hence, current legislation which determines banks and savings houses participation in the Fund is mandatory, or the lack of opportunity for the Fund to determine the level of the premium rate (which is given in the Banks and Savings Houses Act) put the Fund's shareholders under the impression that an obligation is imposed to them by the National Bank of the Republic of Macedonia, while the necessary independence in operating a shareholding company is not provided.

2. Insufficient informations for the Fund's shareholders. Determining the premium rate depends upon the solvency of each financial institution which is a member of the Fund. Hence, the Fund is in a need of additional information (data) for the operations of the member institutions. At the same time, the Fund strives to make the data for the banks' and savings houses' solvency available to the public.

3. Limited activities of the Fund. According to the Fund, its Statute and the provisions of the Banks and Savings Houses Act limit excessively the activities of the Fund, regarding the investing of collected premiums. The Fund would like to invest in other areas as well, in addition to those currently specified.

4. A need to control the entry and exit of banks and savings houses in the Fund. For the Fund it is a problem that it can not exclude or deny banks and savings houses the operations of which are considered as highly risky. An additional problem for the Fund is the lack of opportunities to control the operations of the member institutions. The right to have control is considered by the Fund as "natural", because the Fund is directly responsible and would bear the consequences from a possible failure of the banks and savings houses.

2.4. Reasons why the Savings Insurance Fund should not operate as a classic shareholding company

There are several reasons why the Fund should not operate as a classic shareholding company:

1. Basic objectives of the functioning of an insurance Fund in the Republic of Macedonia. The Fund operates in order to insure households' savings, to improve the confidence of the economic agents in the country's banking system, and to prevent posible systemic risk in the banking sector, i.e. a "domino effect" when there is a failure of a bank or a savings house that might result in a massive deposit run. Operations of the Fund can not be viewed as being equal by their nature with the operations of a clasic shareholding company the main objective of which is profit.

2. Legal provisions regarding the mandatory membership of the banks and savings houses in the Fund. If the Fund operates as a classic shareholding company, it has to have the authorization to regulate the entry and exit of the member institutions, i.e. membership should be mandatory. However, under those circumstances, the Fund must face competition and operate in a market economy environment, i.e. it would not be the only fund of that type in the country. This is due to the risk that the opportunity given to the initial founders of the Fund to have a control over the entrance of new members when there is only one Fund, may transform it into a cartel which denies the entrance of new members. Consequently, with the confidence in the financial system of the Republic of Macedonia being damaged, potential competitors may be put in an unfavorable position as their deposits would be not insured.

Provisions of the Banks and Savings Houses Act which regulate the operations of the Savings Insurance Fund in the Republic of Macedonia clearly state that the membership of banks and savings houses in the Fund is mandatory. This implies that the Fund could not be a classic shareholding company. At the same time, this provision indirectly refers to the predetermined scope of Fund's activities: to collect insurance premiums from the financial institutions and to invest them in safe investments, without jeopardizing the liquidity of the Fund. Actually, it is expected that the Fund through simple and safe operations will become financially capable to compensate the depositors in a case of a risky event.

Due to the predetermined narrow scope of activities of the Fund it can not have the freedom of a classic shareholding company, which for example can extend commercial credits and extend rehabilitation loans to the members in crisis.

3. Unsatisfied needs of the shareholders for more information about the operations of the banks. At the last session of the Fund's Assembly (February 1998) it was suggested that banks and savings houses should submit a monthly balance sheet report to the Fund. One can raise the question how useful it is for the Fund to have the monthly balance sheet of the member institutions, when the truly relevant information for the Fund is the credit portfolio of the members. However, in order to evaluate the credit portfolio, information are needed which could be obtained from additional supervision of the members' operations, that must unavoidably include on-site control, an equivalent to the supervision on-site control of the National Bank of the Republic of Macedonia. Such a level of control can not be performed by the Fund, due to technical, personnel and other reasons.

Under the asumption that the Fund is even able to perform a sucessful control, it has no authorization to give an order to a member institution to do certain changes in its operations. Even if we consider the hypothetical assumption that the Fund can give an order, it still has no practical meaning, because the Fund has no authorization to revoke the licence to the member institution which is acting in compliance with the Fund's order.

At the same time, the National Bank of the Republic of Macedonia can not submit confidential information to the Fund (supervision reports) in order to satisfy the needs of the member institutions for more information. Also, there is the problem of using the insiders' information on the operations of the competition.

4. Unsustainability of duality in performing the supervisory function. Insurance Fund in the Republic of Macedonia has no personnel or tehnical equipment to perform succesfully supervision of the member institutions, needed to determine their solvency and the premium they have to pay. What is even more important is that possible supervisory activities of the Fund would provide it with an access to confidental information on the operations of the member institutions, which might have a reflection on the operations of the member institutions out of the Fund.

At the same time, there would be a duality in performing the supervisory function, i.e. besides the National Bank of the Republic of Macedonia the Fund, as a shareholding company, would be in the same role. This is not an acceptable solution, at least due to three reasons. First, one could raise the issue of authorizations and responsibilities in the involved institutions. Thus, the Governor of the National Bank of the Republic of Macedonia, institution responsible in the face of the Law for the banks' supervision, is elected by the Macedonian Parliament based on a proposal of the President of the country. On the other hand, the president of the Management Board of the Fund, (as a classic shareholding company) would be elected by a small number of shareholders. In order to have the privilege to have an access to the relevant information on the operations of the member-institutions, the president of the Management Board of the Fund should be elected in a same procedure as the Governor of the Central Bank and should bear the same responsibilities. Consequently, supervisory function with all the authorizations and responsibility associated could only be executed by the National Bank of the Republic of Macedonia in a strictly formal procedure.

Second, dual supervision would be unnecessary cost for the banks and savings houses, because if the Fund functions as a classic shareholding company its members will have to pay for the employment and training of the personnel for that purpose, as well as for the purchase of offices and equipment.

Third, dual supervision would initiate the conflict in the authorizations. Thus, the Fund can be hold responsible only for the safety and possible deposit compensation payout in a case of a risky event. However, the National Bank of the Republic of Macedonia is responsible for the stability of the entire banking system. It means that when there is dual supervision existing, there is a risk of authorization conflict. For example, when some bank or savings house has problems, the Fund may be interested in quick liquidation of that bank or savings house, while the National Bank of the Republic of Macedonia could rely on the assessment that such a liquidation could not be allowed from the point of view of the entire banking system stability.

5. Eliminating the opportunity for the shares of the Fund to be quoted on the Macedonian stock exchange. If the Fund operates as a clasic joint stock company, it may want to let its shares to be quoted on the Macedonian stock exchange. It is a legitimate right that belongs to a shareholding company which meets the requirements set up by the stock exchange. Such an opportunity could let the majority of the Fund’s shares to be bought out by an economic agent, whose motives might be to gain an access to the information emerging from the control over the operations of the Fund’s member institutions.

3. FUTURE FUNCTIONING OF THE SAVINGS INSURANCE SYSTEM IN THE REPUBLIC OF MACEDONIA

3.1. Functioning of a modified Savings Insurance Fund in the Republic of Macedonia

So far we have presented the reasons why the Savings Insurance Fund in the Republic of Macedonia should not function as a classic shareholding company, having all the rights and authorizations. Hence, it is not an adequate solution to adjust the existing legislation (Banks and Savings Houses Act) so that the Fund would become a shareholding company with unlimited authorizations.

It is suggested that the Fund mainly maintains its legal position and way of functioning, although some changes would be made. The Fund would keep its current name and would have the following basic components:

1. Legal status of the Fund. It is proposed that the Fund should remain to exist as a shareholding company, specific by its nature in the future as well, i.e. it would not be a classic type of shareholding company, as its functioning is legally regulated by the Bank and Savings Houses Act. Banks and savings houses would remain further to be founders of the Fund. However, it is suggested that the current common shares are transformed into priority shares, with no voting power. At the same time, the government should not be isolated from the functioning of the Fund, because in a case of a “systemic risk”, i.e. insolvency of the entire banking system, the Fund has no capacity to overcome the problem, but an intervention from the government would be necessary.

2. Type of membership in the Fund. The membership in the Fund would remain to be mandatory for all the banks and savings houses. Mandatory membership should improve the general public confidence in the financial system, which is an issue of essential importance in the Republic of Macedonia.

Table 6 presents international experiences regarding the type of membership in the explicit deposit insurance schemes. The table shows that mandatory type of membership prevails and that the proposed solution is compatible with the international trends. It is of a great importance that the membership is also mandatory in the countries of Central and Eastern Europe.

Table 6

Type of membership in the explicit deposit insurance schemes

Country	Year when established	Membership	
		Mandatory	**Voluntary**
U.S.A.	1934		x
Japan	1971	x	
Germany	1966		x
Holland	1979/95	x	
G. Britain	1979/95	x	
Austria	1979	x	
Greece	1995	x	
Czech Republic	1994	x	
Hungary	1993	x	
Poland	1995	x	
Total number of analyzed countries : 51		**37**	**11**

Source: IMF MAE OP/96, August, Deposit Insurance and Crisis Management

3. Financing of the modified Savings Insurance Fund

a/ Founding capital of the Fund. No changes are proposed with regard to the founding capital. At the same time, the regular financing would continue to be execute by the banks and savings houses through payment of premiums. Table 7 shows that such a way of financing an explicit deposit insurance system is compatible with the international trends.

Table 7

Financing an explicit deposit insurance fund

Country	Financing [/1]	
	private	**public**
U.S.A.	x	The government provides initial capital, suffered losses
Japan	x	The government and CB provided initial capital, CB extends loans
Germany	x	
Holland	x	CB extends interest free loans
G. Britain	x	CB extends loans and suffered losses
Austria	x	
Greece	?	
Czech Republic	x	CB extends loans
Hungary	x	
Poland	x	The government and CB can participate
Total number of analyzed countries: 51	**45 countries**	**32 countries**

Source: IMF MAE OP/96, August, Deposit Insurance and Crisis Management

1/ "Financing" reflects the permanent responsibility for making payments in a Fund or ex post in order to compensate the depositors in the bank in bankruptcy. Also, situations are shown where the government provided initial capital, has an obligation to extend credits or it has carried over the burden of losses.

b/ types of deposits to be insured. Regarding the scope of deposits to be insured, there is a dilemma whether the current scope of deposits insured by the Fund in the Republic of Macedonia (denar and foreign currency deposits and checking accounts of individuals) should be changed. Regarding the insurance of foreign currency deposits, they are treated equally as the denar deposits, and should continue to be insured. This encourages saving in foreign currency, which is considered to be of particular importance in the Republic of Macedonia. It is suggested to exclude from insurance the deposits of the management of the banks and savings houses and deposits which provide preferential terms (for example, higher interest rate for the same type of deposit).

Table 8 presents international trends with regard to the scope of deposits which are subject of insurance. In a prevailing number of countries inter-bank deposits are excluded from insurance, and in 13 out of 51 analyzed countries foreign currency deposits are not insured.

Table 8

Types of deposits which are insured in the explicit deposit insurance schemes

Country	Deposit which are insured	Households' deposits, only [1]	Excluded for. currency deposits	Excluded inter bank deposits
U.S.A.	all domestic			
Japan	most [2]		x	x
Germany	most [3]			x
Holland		x		x
G. Britain				x
Austria		x		x
Greece				x
Czech Republic		x		x
Hungary				x
Poland	most [4]			x
Total number of analyzed countries: 51		**8**	**13**	**35**

Source: IMF MAE OP/96, August, Deposit Insurance and Crisis Management

1/ Only household deposits are insured.

2/ Japan insures demand deposits and time deposits in domestic currency.

3/ Germany insures all deposits except inter-bank deposits.

4/ Poland does not insure the deposits of large shareholders of the banks, general managers and directors.

c/ Total amount of the Fund's assets. In general, one should not have ambitions that in case there is a systemic risk the Fund would be capable to overcome the problem by itself. One should expect the Fund to be financially capable to "cover" the total insured deposits of several smaller banks.

It is estimated that the current level of Fund's assets (15% of the total savings) is too high to be reached in the legally determined deadline of four years. It should be taken into account that the level of Fund's assets does not depend only on the needs to provide adequate coverage of the savings, but also on the objective ability of the banks and savings houses to pay the insurance premium. Having in mind that the assets which the Fund had at its disposal equaled denar 91.8 million at the end of the first quarter of 1998, and that the credibility of this institution depends on the level of its assets, it is suggested the total amount to correspond to the suggested progressive reduction of the annual premium rates. At the same time, although the inflow of funds in the Fund from paid premiums would slow down due to the reducing of the premium rate, on the other hand, the Fund would increase its total assets from the returns on investing collected premiums and by transforming the shareholders' dividend into capital.

d/ annual insurance premium rate and basis for calculation of the premiums. For the banks and the savings houses payment of premiums is a cost which can not be recovered, there is no interest income, and its purpose is to protect the savings of all the banks, not a single bank. Under such circumstances it is logical to expect that the members of the Fund would transfer the cost of savings insurance to their ultimate customers. Therefore, determining the annual insurance premium rate becomes an issue of essential importance.

General problem in deposit insurance is to determine the risk which has to be covered by the premiums. Thus, savings insurance premiums actually have to correspond with the expectations (risk) that a certain bank or savings house will become insolvent and the Fund will be activated. Such a risk is not actuarial by its nature and therefore it is very difficult to be precise in its determination.

Table 9

Premium rates and limit in compensation

Country	Base for premium calculations	Premiums in %, p.a.	Compensation	
			in USD [/1]	per deposit / per depositor
U.S.A.	domestic deposits	up to 0.27	100,000	per depositor
Japan	insured deposits	0.12	100,260	per depositor
Germany	deposits	0.03	depends on bank capital	per depositor
Holland	-	ex post	23,050	per depositor
G. Britain	EU deposits	0.3	ECU 22,222	per deposit
Austria	-	-	18,000	per depositor
Greece	deposits	0.1-2.0	ECU 20,000	per depositor
Czech Republic	liabilities	0.5	co-insur.up to 3,565	per depositor
Hungary	deposits	0.2	9,000	per depositor
Poland		up to 0.4	up to ECU 1,000 100%, next 2,000 90%	per deposit
Total number of analyzed countries: 51	**deposits: 19 insured deposits: 10**	**0.0 to 2.0**	**44 limited 5 ful l9 co -insurance**	**per deposit: 5 per depositor:44**

Source: IMF MAE OP/96, August, Deposit Insurance and Crisis Management
1/ exchange rate of the USD as of end of June 1994

Table 9 shows international trends regarding the level of the annual premium rate. IMF's study which includes 51 countries on different continents and at different levels of development shows that the annual premium rates reach at most 2.0%. The rates in the countries in transition from Central and Eastern Europe vary from 0.2 to 0.5%. At the same time it should be pointed out that in the Matrix for macroeconomic and structural measures within the ESAF arrangements of the Republic of Macedonia with the International Monetary Fund it is stated that the upper limit of the annual premium rate should be 2.5%.

Due to the current high burden on the banks and savings houses produced by the current annual insurance premium rate it is suggested to decrease it gradually with the following dynamics: in 1998 to equal 1.0%, in 1999 to be 0.8%, in 2000 to be 0.6%, in 2001 to be 0.4%, and in 2002 to be further reduced to 0.3%. From year 2003 differential insurance premium rates could be *possibly* introduced. In such a case, it is suggested that the difference between the minimum and maximum premium rate should not exceed 30% of the rate. It means that from year 2003 for the most solvent members of the Fund the annual premium rate could possibly be 0.3%, while for those with the relatively worst solvency it would be 0.39%.

Suggested reduction of the premium rate corresponds with the expected improvements in the operations, mainly banks' operations. These improvements would come from the banks' mergers and acquisitions in accordance with the established schedule for minimum capital requirement increase, and would also come from the penetration of foreign strategic investors in the domestic banks, as it is the case with the largest bank in the country. The proposal for reducing the premium rate is also based on the expectations that over the time Fund's revenues would increase on basis of investing the collected funds (premiums).

Finally, an important factor causing a decline in the annual insurance premium rate is the implicit guarantee for the savings, emerging from the priority in the collection (Banks and Savings Houses Act) which is given to the Fund in case of a member institution bankruptcy. Thus, Fund's claims are ranked on third place in the overall sequence of the economic agents who have claims on that bank/savings house, and are ranked prior to: a/ claims of subjects who are not founders, or shareholders of the bank/savings house, and b/ claims of the founders, or shareholders of the bank/savings house.

e/ level of deposit compensation of an individual depositor in a single financial institution in a case of a risky event. It is suggested to keep the current level of savings coverage (75%). There is an opinion that the coverage could be 95% in order to improve even more the confidence of the depositors in the financial system. However, then it would represent almost a full coverage of the deposits. Table 9 shows that in only 5 out of 51 analyzed countries there is a compensation in full, while in 44 countries it is limited.

Something which is not regulated in the Fund's regulation, and which has to be done according to the Matrix of measures of the International Monetary Fund for 1998 (ESAF arrangement) is to incorporate a maximum nominal amount of deposit insurance. In the discusions of the representatives from the National Bank of the Republic of Macedonia and representatives from the International Monetary Fund the denar eqivavalent of DM 10,000 is determined to be the maximum amount of compensation in the Republic of Macedonia per individual depositor in a single member institution. The maximum amount of compensation is introduced in order to avoid the moral hazard at the member institutions and depositors.

Table 9 shows respective maximum amounts in USD and ECU, per country. The amounts vary among different countries, often in relation with the level of development of the country. International recommendation with regard to this issue is to provide a guarantee for compensation of an individual deponent in a single institution up to 1-2 times the amount of GDP per capita. In the Republic of Macedonia the limit of maximum compensation exceeds the 2 times of the amount of GDP per capita. On one hand, this is a result of the fact that the maximum limit of the EU (ECU 20,000) is too high to be applied in the Republic of Macedonia, and on the other hand the recession through which the Macedonian economy passed in this decade lowered the GDP per capita.

Another criteria for determining the maximum amount of compensation is to equalize it with the amount of an average annual wage paid in the national economy. For the Republic of Macedonia it is proposed for the maximum limit to equal the denar equivalent of DM 10,000 per individual depositor in a single member institution of the Fund, which is equivalent of approximately 2.9 average annual net paid wages in the country. Taking into acount both criteria, it is considered that the proposed maximum amount of compensation in amount of denar equivalent of DM 10,000 is adequate for the conditions in the country.

f/ The way in which the Fund can invest collected premiums from the member institutions. The Fund should be a conservative investor. This means that the collected premiums should be invested in safe investments which are also very liquid. Primarily, those are the Central Bank bills and government securities.

g/ The way of financing the Fund in a case of a risky event, when the Fund's assets are not sufficient for executing the predetermined compensation in full. This is one of the issues where part of interrelations among the major parties in the deposit insurance are specified. In a case of a risky event, members of the Fund would bear the responsibility on a solidarity basis, by increasing the insurance premiums (for example, by doubling the premiums), and additionally needed funds could be provided from the National Bank of the Republic of Macedonia reserves, while the lender of last resort would be the government, i.e. the government's budget. Table 7 shows that in some countries the Fund can take credits from the central banks. It is proposed to create legal possibility for the National Bank of the Republic of Macedonia to extend such credits from its reserve funds, in case of a risky event where the Fund does not have sufficient amount of assets to compensate the depositors.

4. Management of the modified Savings Insurance Fund. The modified Savings Insurance Fund would continue to have a director. At the same time there would be a Management Board consisted of seven members: representative of the National Bank of the Republic of Macedonia, five representatives of the banks and savings houses elected by the Association for Banking and Insurance, and one representative from the Association of Depositors. Inclusion of a representative of the depositors could positively affect the confidence in the financial system during the regular operations of the Fund and in a case of a possible risky event.

Table 10

Administration in the explicit deposit insurance schemes

Country	Administration		
	private	public	mixed
U.S.A.		x	
Japan			x
Germany	x		
Holland			x
G. Britain		x	
Austria	x		
Greece			x
Czech Republic		x	
Hungary		x	
Poland		x	
Total number of analyzed countries:51	**10**	**14**	**24**

Source: IMF MAE OP/96, August, Deposit Insurance and Crisis Management

Table 10 presents the international trends regarding the way of administering the explicit deposit insurance schemes. A conclusion could be made that there is no dominating way of management, in most of the cases administration is mixed, while in the transition economies from Central and Eastern Europe it is executed by the government.

The only concern of the Fund should be to collect the premiums, to invest them in a high quality investments and to compensate in case of a risky event. The level of the insurance premiums would be determined by the National Bank of the Republic of Macedonia, because it has the information on the banks and savings houses operations (supervision reports and other confidential information). This enables a coordination among the supervision, deposit insurance and the function of a lender of last resort. When identical premium rate is used for all the banks and savings houses, the premium rate would be known and made public in advance. If in the future (after year 2002) *possibly* starts the implementation of various premium rates for different banks and savings houses, then the Fund would be in a position "to punish" some less solvent members. This means that besides the function of insuring the households' savings, the Fund would also have the function to discipline the members. However, the existence of various premium rates should not discourage the membership in the Fund, where differential premium rates would allow for the less solvent members of the Fund to be overburdened. Therefore, it is suggested that the difference between the minimum and maximum annual premium rate should not exceed 30%.

Regarding the control over the operations of the Fund's operations, the National Bank of the Republic of Macedonia is obliged to perform this function by the provisions of the Banks and Savings Houses Act. The National Bank will execute these legal responsibilities by regular off-site and on-site controls.

5. Activities of the Savings Insurance Fund related to its member institutions. It is suggested that the modified Fund should not have any activities regarding possible rehabilitation of a bank or savings house facing financial problems. The National Bank of the Republic of Macedonia is a lender of last resort and is responsible to decide upon the fate of a single member of the Fund, i.e. its rehabilitation or liquidation. At the same time, an Agency for bank rehabilitation in the Republic of Macedonia already exists, and possible activities of the savings insurance Fund in the field of bank rehabilitation would only double the authorizations.

The Fund should be engaged in activities which would increase the amount of information available to the Fund, and should also monitor the procedures for accepting savings by the banks and savings houses. Thus, the Fund should know whether member institutions have windows for accepting savings, whether they have posted that savings are insured up to 75%, but not more than the amount of DM 10,000 in denar equivalent, whether pass books are being issued to the depositors, then whether lists of depositors are posted, then to be informed about the interest rates on savings etc.

Regarding the activating of the Fund, it is suggested that the Fund should not be activated when a bank or a savings house becomes illiquid, because the National Bank of the Republic of Macedonia could rehabilitate such a member of the Fund. It is suggested that the Fund should be activated, i.e. depositors' compensation should start after a bankruptcy of the Fund's member institution.

* * *

By the institutionalization of a Savings Insurance Fund, the Republic of Macedonia embraces an explicit system for savings protection, which means that there are defined rules and procedures for protection of the savings, and there is a legal obligation for compensation of the depositors up to the specified amount in case of a risky event, and also the financing of the Fund is specified. However, it is suggested the current Fund to be modified by incorporating certain changes in its operations and in the relevant legislation. These changes are the following:

1. To establish a Management Board of the Savings Insurance Fund which would include a representative from the National Bank of the Republic of Macedonia and Depositors Association, besides the five representatives from the banks and savings houses.

2. To reduce the premium rate for savings insurance in accordance with the proposed schedule for reduction, where the premium rate would drop from the current 1.5% to 0.3% in the year 2002. Within this period of time a linear premium rate would be applied to all of the institutions, and later differentiated premium rates could *possibly* be applied. Reducing the savings insurance premium rate should have a positive effect on the interest rate policy of the banks and savings houses. Thus, it is expected to reduce their expenses, which should lower the burden on the effective lending interest rate and should

respectively reduce it. This should additionally encourage the increase in investments and further growth of the country's economic activity.

3. To reduce the maximum annual premium rate to 2.5%. At the same time, the dividend should not be paid to the institutions - shareholders of the Fund, but it should be added to the Fund's capital.

4. To introduce the maximum amount of DM 10,000 in denar equivalent for compensating an individual depositor in a single financial institution in a case of a risky event. This means that the Fund should compensate the depositors up to 75 of the savings of an individual depositor in a single bank or savings house, but up to the proposed maximum limit of Dm 10,000 in denar equivalent.

5. To activate the Fund when there is a bankruptcy of a bank or a savings house, not when they are illiquid. It is suggested that a legal opportunity is provided to the National Bank of the Republic of Macedonia to extend from its reserves a credit to the Fund when there is a case of a risky event and Fund's assets are not sufficient to provide the legally defined amount of compensation to the depositors.

6. Not to insure the deposits of the management (and their families) of the member institutions of the Fund. This comes from the fact that the management is not in the same position with the "small depositor" who is not capable of collecting and processing all the information which bank or savings house is the best place to deposit the deposits (due to the problem of asymmetric information).

ABSTRACT

Additional protection of the stability of the banking system and deposited funds in the banks and savings houses is provided by the systems for deposit insurance (implicit or explicit). Wolrdwide, particularly in the developing countries and economies in transition, there is a tendency to introduce explicit systems, because they are considered to have the following advantages: *1/* they have better administrative procedure for dealing with banks' bankruptcies and depositors protection; *2/* they are more efficient in protecting the "small depositors", because at least partial compensation is guaranteed to them in a case of a risky event, and *3/* they contribute to a larger extent in improving the establishing and maintaining public confidence in the country's banking system. With a Directive from 1994 the European Union also urged to its member countries to introduce explicit deposit insurance schemes.

In the Republic of Macedonia there is a Savings Insurance Fund, as an explicit system for savings protection, established as a shareholding company by the banks and savings houses. The Fund regularly collects the insurance premiums, but points out some problems in its operations, like the lack of independence in the decision making, insufficient information, and limited scope of activities.

The Fund has a specific character and should not function as a classic shareholding company, because of the: *1/* basic objective of its functioning; *2/* current regulation requiring mandatory membership in the Fund; *3/* needs of the Fund for more information on the activities of the members being not satisfied; *4/* unsustainability of duality in executing the supervision function, and *5/* elimination of the possibility for the Fund's shares to be traded on the Macedonian stock exchange.

Regarding the Fund's operations, the following modifications are suggested: *1/* to establish a management body which would have seven members, five representatives from the banks and savings houses, a representative from the National Bank of the Republic of Macedonia, and a representative from the Depositors' Association; *2/* savings insurance premium rate to be linear for all member institutions and to be reduced gradually each year from 1.5% in 1997 to 1.0% in 1998, to 0.3% in the year 2002. At the same time, the dividend from the Fund's operations should be added to its capital; *3/* the maximum annual premium rate to be reduced to 2.5%; *4/* with a compensation level of 75% of the savings of an individual depositor in a single bank or savings house a maximum amount of compensation should be introduced, equal to denar equivalent of DM 10,000, and *5/* the Fund to be activated when a member institution has gone into bankruptcy, not when it is illiquid. It is also suggested that the National Bank is given a legal possibility to extend a credit to the Fund from its own reserves, when in a case of a risky event the Fund can not provide the legally specified compensation (although extra premiums may be paid).

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