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Regulatory Regime Governing Deposit Insurance under the Ethiopian Law: A Comparative Review in Light of International Core Principles' Perspectives

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Abstract

Adopting deposit insurance has become an increasingly custom to ensure the stability of banking systems and protect bank depositors from incurring large losses due to bank failures. Almost in all jurisdictions there are financial safety nets in place to guarantee the safety of the banking system and its depositors. It also inspires trust in the system and safeguards against any shocks. It has got a global recognition which has got the status of international core principles of deposit insurance. Unlike its previous trend, Ethiopia is recently taking significant measures to liberalize the previously state owned service sector. In September 2022, the Ethiopian council of ministers have approved the long awaited act the national financial policy that allows foreign banks to engage in banking business in Ethiopia. This measure is very significant as it marks a breakthrough in the opening of the door for foreign banking investment in Ethiopia. It was revealed in many studies that countries which undergone a finance liberalization have encountered a financial crisis. In most of the states, explicit deposit insurance has been adopted after they have encountered a banking crisis. Unlike these states, Ethiopia has not yet experienced any events of bank failure. However, the country has enacted a regulation that governs the Establishment and Operation of Ethiopian Deposit Insurance Fund ahead of banking liberalization to foreign banks. Hence, this step can be quantified as a wise approach measure that has drawn lessons from other states' failure. In this paper, a modest attempt is made to comparatively review the Ethiopian deposit insurance regulation in light of the international core principles that serve as standard for harmonization. The Ethiopian deposit insurance legislation stepped miles to accommodate most of the core principles of the IADA and BCBS. The law governs deposit insurance by explicitly separate legislation in addition to the prudent legislation provided for regulating the financial sector. Most of the contents of the legislation comply with core principles of DI. However, there are also loopholes and vagueness in governing specific issues of deposit insurance that should require reconsideration in the subsequent legislation.

Keywords

Financial Law, Deposit Insurance, Banking Crisis, Financial Shocks, Explicit Deposit Insurance, Basel Principles, IADI, Prudent Regulation

1. Introduction

Almost all countries actually have financial safety nets in place which include explicit and implicit deposit insurance (Demirguc-Kunt et al., 2007). Nowadays, explicit deposit insurance has become an increasingly used tool by governments in an effort to ensure the stability of banking systems and protect bank depositors from incurring large losses due to bank failures (http://www.nber.org/papers/w12862). Apart from the implicit governance, most of the states of the world have come adopt explicit deposit insurance after they had encountered the bank failure in their financial system as safety net to protect depositors and the financial stability as whole (Demirguc-Kunt et al., 2007).

Currently, the number of banks and other deposit taking institutions are increasing in Ethiopia (https://nbe.gov.et/banks-in-ethiopia-continue-to-grow-despite-challenges). As indicated above, until now there are around 30 banks that are already joined in engaging the banking business (National Bank of Ethiopia Quarter Report, 2022). Despite the increment by the government on amount of paid up minimum capital, the number of banks emerging is oppositely (National Bank of Ethiopia Directive No. SBB/78/2022).

Furthermore, in 2019 the government has also lifted up the restrictions on foreign nationals who have Ethiopian origin to either fully or jointly own share companies in Ethiopia (Article 2(5) (a) and (b) of Amendment Proclamation Number 1159 Governing Ethiopian Banking Business, 2019). This can be one of the factors that fostered the increment of the banking sector. There is also a new move by the Ethiopian government in liberalizing the financial sector to foreign banks. As globalization is developing, it is inevitable to be part of the system and strive for survival. Ethiopia is taking certain measures to fully fill the preconditions provided by WTO to be benefited and compete in trading in the global value chain (https://www.wto.org).

In early September 2022, the Ethiopian Council of Ministers has already approved the financial policy that allows foreign banks to engage in the Ethiopian banking system (https://www.retailbankerinternational.com). Since the policy has already approved, it is expected that the practical enforcement of the policy enable foreign banks to join the Ethiopian banking system and play significant roles in creating sources of capital for more financial inclusions, attracting foreign direct investments, financial innovations and acquisition of technology and enhance best financial supervision and governance. However, there are short run and long run effects foreign banks entry in the newly emerging markets like Ethiopia that might entail banking crisis and financial instability. This indicates that liberalizing the banking sector requires to develop a better supervising capacity to effectively regulate these multinational companies and having deposit insurance system can be taken as one means of developing legal and institutional framework to create stable financial system that benefits and transform overall development by boosting the economy.

Unlike the previous closed policy in restricting foreign companies in investing in Ethiopia, now there are new emerging trends in liberalizing some monopolized sectors by the government. The telecommunication sub-sector has been under the total control of the government and now it is opened itself for private ownership (https://weetracker.com/2022/02/01/ethiopia-telecom-liberalization-complicated). Ethiopia has liberalized the telecommunication sectors by taking positive measures and Safari.com of Kenya is started doing business in Ethiopia. Some Kenyan banks have already opened their offices in Addis Ababa (https://www.safaricom.co.ke/media-center-landing/). This is can be taken as the best track of Ethiopia in its commitment for the liberalizing the sector. Therefore, the increment in number of banking and other financial institutions and the liberalizing the sector for foreign banks can create competitions and as it was experienced in many jurisdictions there is an opportunity to face banking failures or bank run.

Yet unlike other states, Ethiopia has not experienced any events of either bank illiquidity or bank runs (Maireg, 2018). Nevertheless, the Ethiopian council ministers have enacted a regulation that govern the Establishment and Operation of Ethiopian Deposit Insurance Fund ahead before the banking sector liberalization to foreign investments (Establishment and Operation of Ethiopian Deposit Insurance Fund Council of Ministers Regulation Number 482, 2021, Here after, the EDIR).

Since 2018 Ethiopia is taking progressive measure in liberalizing the financial systems to the global world. After all, Ethiopia should not wait until banks become victims of a crisis whilst it can be backed up by explicit deposit act as a means of prevention than as a means of cure. It can be stated as a wise approach measure that has drawn lessons from other states' failure. This law is enacted by the council as regulation number 481 on February 25, 2020.

The promulgation of the law is aimed to protect the depositors; by introducing the insurance deposit fund as an additional financial safety net to mitigate risks and strengthening the country's financial system by ensuring its safety, soundness and stability (Preamble of the EDIR, 2021).

The Ethiopian deposit insurance fund regulation is composed of six parts and included 43 provisions. This regulation can be cited as the first law that explicitly govern deposit insurance under the Ethiopian banking and finance law.

Therefore; in the upcoming sections this paper reviews the contents of deposit insurance regulation of Ethiopia in terms of the international core principles on deposit insurance set by the International Association of Deposit Insurers' and Basel Committee for Banking Supervision (2009, 2014) as a standard to be observed by the member states. In doing so, the historical evolution of the core principles of deposit insurance and general overview of the Ethiopian banking sector were also reviewed.

2. Overview of Evolution and International Core Principles of Deposit Insurance

2.1. Evolution of Deposit Insurance

Banks are the most important financial institutions for intermediating between savers and borrowers, assessing risks, executing monetary policy, and providing payment services and subject to risk (Armour et al., 2016). However; if not properly managed they encounter a financial crisis that amounts bank failure (Armour et al., 2016). Therefore; government intervention and regulation in the area of consumer protection are justified on the basis of inherent information asymmetries and power imbalances in markets and consumers should be accorded protection for their saving and to build public trust in cases where bank crisis occurred (Chai, 2018). As the problems become acute most of the states have come to introduce the deposit insurance system as part of their financial legal framework in averting and the risk of potential bank failures (Laeven, 2002).

Deposit Insurance System is system established to protect depositors against the loss of their insured deposits in the event that a bank is unable to meet its obligations to the depositors. It aims to protect depositors against the loss of their savings when depository institution fails. Such protection reinforces trust in the financial system and averts deposit runs (Laeven, 2002).

Deposit insurance scheme are two types. One is implicit (de facto) and the other is explicit (de jure). Explicit regulation of deposit insurance has got serious attention helps to manage risks associated with financial failures (Demirguc-Kunt et al., 2005). Explicit deposit insurance is needed to protect depositors. Ordinary depositors lack the ability to determine and monitor the credibility of the institutions and government has the duty protect them (Demirguc-Kunt et al., 2005). It also prevents bank runs by mitigating the severity of the cost of deposit losses to individuals. The basic objectives of deposit insurances are providing protection for small depositors, enhancing public confidence and systemic stability preventing bank runs, increasing savings and encourage economic growth, enabling small and new banks to compete with large ones, define the boundaries to the government's exposure to loss and require banks to contribute to the resolution of failed banks in the forms of premiums (Deposit Insurance and Digital

Financial Inclusion, 2016). If the system has no any clear regulation that govern for deposit insurance, it is assumed that the system is implicit that relies on the observation of the ordinary prudent regulation and supervision of banks which establishes a de facto insurance system for banks (Chai, 2018).

The historical evolution of deposit insurance goes back to 1933 in USA when the *Federal* Deposit Insurance Corporation (FDIC) was established. This corporation is the oldest existing formal deposit insurance system in the world (Shambe, 2003). Initially the mandate of the FDIC was to fully compensate all depositors, insured and uninsured, in the event of a bank failing. It is the first formal system of deposit insurance schemes established with the purpose of preventing the extensive bank runs after the great depression in US. In the period (1933 to 1982) 99.8% of all depositors of 620 banks that failed were fully compensated in America (Shambe, 2003). The presence of a full coverage for depositors was blamed for undermining the market discipline and "Too big to fail" concept had harmed small institutions (Shambe, 2003).

In general; it can be said that FDIC was enacted to contain the level of moral hazard by introducing risk adjusted premiums, Applying Structured Early Intervention and Resolution to troubled banks and Restricting the FDIC's power to bail out large banks under exceptional circumstances with the permission of the boards and Prohibiting the FDIC from protecting uninsured depositors or creditors. Beginning date, coverage limits, how they are going to be funded, and how bank failures will be resolved are among the basic elements that an explicit certain deposit insurance law should include as the main ingredients.

Later on, as financial crisis increase countries have come to develop Deposit system and European Union has also passed Deposit Guarantee Scheme Directive in 1994 which became the standard for the newly created single banking market and fully implemented by its members. It is served as sources for the Core principles of Deposit insurance (Korea Deposit Insurance Corporation, 2005). It was formed to increase stability and soundness of the banking system, to protect savers and to achieve competitive equality between institutions operating across borders within the European Union.

In the year 2002, International Association of Deposit Insurers (hereafter IADI) was formed to enhance the effectiveness of deposit insurance systems by promoting guidance and international cooperation (International Association of Deposit Insurer's, IADI, 2020). It is a global standard setting body for Deposit that also collaborates with the Basel committee in banking regulation and supervision (International Association of Deposit Insurer's, IADI, 2020).

World Bank has also initiated centers like The Financial Sector Advisory Center (FinSAC) (Austrian Ministry of Finance and the World Bank's Private and Financial Sector Department, 2011) which guides and cooperate with states particularly within Europe and central Asia states including china as a technical unit of the World Bank's Finance aiming to deliver policy and technical advices for the better performance of the deposit insurance systems (Nolte & Khan, 2017).

After intensive engagement with the issue of deposit Insurance, International Associations of Deposit Insurers have published the first Core Principles for Effective Deposit Insurance Systems jointly with the Basel Committee for Banking Supervision in 2009 (Armour et al., 2016). These core principles were revised by IADI and BCBS in 2014 (International Association of Deposit Insurer's, IADI, 2020). After the 2008 financial crisis many states have come to develop deposit insurance in their system. More than 121 of the states have adopted the explicit deposit insurance system until 2015 (IADI, 2020).

Weak financial institutions, inadequate regulation and supervision, and lack of transparency have been at the sources of global financial crises. These have highlighted the importance of systemic risk monitoring and management (https://www.imf.org).

When financial crises occur, they can have far-reaching effects. They can deepen economic downturns, trigger capital flight, and lower exchange rates. They can have large fiscal costs that come from rescuing troubled financial institutions. Because financial institutions and countries are increasingly connected, financial shocks in one area can quickly spill across financial sectors and national borders. That makes resilient, well-regulated, and well-supervised financial systems essential for economic and financial stability (Demirguc-Kunt et al., 2008).

A stable, sound and effective financial system is all about resilience of financial systems to stress. In stability, the system will absorb the shocks primarily via self-corrective mechanisms, preventing adverse events from having a disruptive effect on the real economy or on other financial systems (https://www.worldbank.org). Hence, creating a stable sound and effective financial system require governments to take concrete measures in applying the international standards set for banking supervision and monitoring, developing legal frameworks and institutions that are able to track wrong signals to the financial systems, sound monetary policy that promotes low inflation and high employment.

IMF, WB, the European Commission (EC) and the European Forum of Deposit Insurers have approved these core principles of Deposit insurance and these Core Principles are intended as a framework supporting effective deposit insurance practices and the revised Core Principles will continue to provide a comprehensive standard for establishing or enhancing effective deposit insurance systems. National authorities are also empowered to put in place supplementary measures that they deem necessary to achieve effective deposit insurance in their jurisdictions (Armour et al., 2016).

2.2. International Core Principles of Deposit Insurance

In the previous section, the historical evolution of the concept regarding deposit insurances is discussed. As it is revealed in many studies countries have been recognizing the legal frame work governing deposit insurance after they have encountered financial crisis. The potential risk with banking failure has initiated the international association of deposit insurers to come up with core principles in collaboration with the Basel committee working on banking regulation and supervision. Hence, these core principles were approved by International Monetary Fund, World Bank, The European Commission (EC) and the European Forum of Deposit Insurers to serve as comprehensive standard for enhancing effective deposit insurance systems across the globe.

Basically there are 16 core principles (International Association of Deposit Insurers publication, IADI, 2014). All principles have their own specific essential criteria to be implemented (http://www.iadi.org/).

The first Principle argues that the law governing deposit insurance should indict that it is enacted to govern and protect customers from future risks related with the banking crisis or failure. The principle requires that the law should adequately cover the financial safety as its Public Policy Objectives to be achieved (International Association of Deposit Insurers publication, IADI, 2014).

Principle 2 is about Mandate and Powers of deposit insurer institutions. The mandate and powers of the deposit insurer should support the public policy objectives and be clearly defined and formally specified in legislation (Principle 2 of IADI, 2014). In terms of its governance, the deposit insurer should be operationally independent & accountable. Representatives of the other financial safety-net organizations that participate in the governing body do not serve as Chair or constitute a majority (Principle 3 of IADI, 2014).

The deposit insurer's should have the duty to protect depositors and contribute to financial stability, there should be a formal and comprehensive framework 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 (Principle 4 of IADI, 2014).

Principle governing Cross Bordering Issues requires for formal information sharing and coordination arrangements should be in place among deposit insurers in relevant jurisdictions (Principle 6 of IADI, 2014). It has an essential criterion that requires for deposit insurer should create connection with of foreign banks branches and relevant safety net participants (Essential Criteria under Principle 6 of IADI, 2014).

There is also a Principle which requires for Deposit Insurer's to play role in contingency planning and crisis (Principle 7 of the IADI, 2014). The deposit insurer should have in place effective contingency planning and crisis management policies and procedures that can respond to the risk of, and actual, bank failures and other events. Principle 7 provides that membership in a deposit insurance system should become compulsory for all banks. Whereas, principle 8 governs the coverage of the deposit insurance fund that imposes duty on Policy makers to define clearly the level and scope of deposit coverage. Hence, Coverage should be limited, credible and cover the large majority of depositors. But leave a substantial amount of deposits exposed to market discipline (Principle 8 of IADI, 2014).

Principle 9 is about sources and Uses of the Fund. It states that the deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims, including assured liquidity funding arrangements. Funding for the deposit insurance system is provided on an ex ante basis.

Principle 10 is the duty to create public awareness on deposit insurances issues in particularly in cases of bank failures. The essential criteria also impose these insurers to protect depositors and contribute to financial stability (Principle 10 of the IADI, 2014). In the event of a bank failure, the deposit insurer must notify depositors, via media such as press releases, print advertising, websites and other media outlet about where, how and when insured depositors will be provided with access to their funds (Principle 10 of the IADI, 2014). Principle 11 is concerning Legal Protection. Deposit insurers and individuals working for the deposit insurer in the discharge of its mandate must be protected from liability arising from actions for their decisions, actions or omissions taken in good faith in the normal course of their duties. Legal protections do not prevent depositors or other individual claimants or banks from making legitimate challenges to the acts or omissions of the deposit insurer in public or administrative review procedures (Essential Criteria 4 under Principle 11 of IADI, 2014).

Principle 12 deals with Parties at Fault Bank Failures. The deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in a bank failure. In addition, parties responsible for bank failure shall be subjected investigation and held liable for criminal and civil actions. Principle 13 is governs Early Detentions and Timely Interventions that the deposit insurer should have frame work on early detection of, and timely intervention in, troubled banks. Intervention before the bank becomes non-viable protects depositors and contributes to financial stability.

Principle 14 demands to take an effective failure resolution regime that can enable the deposit insurer to provide for protection of depositors and contribute to financial stability. The legal framework should include a special resolution regime that regulates in case where banking crisis is occurred. Reimbursement of Depositors is provided under principle 15. It demands deposit insurer systems to reimburse depositors' insured funds promptly, in order to contribute to financial stability. There should be a clear and unequivocal trigger for insured depositor reimbursement. In European council the deposit insurer is able to reimburse most insured depositors within seven working days (Principle 15 of IADI, 2014). The last Principle provides that deposit insurer should have the right to recover its claims in accordance with the statutory creditor hierarchy (Principle 16 of IADI, 2014). The contents of these principles are vast and characterized by multi-dimensional aspect that aimed to govern related matters with relative flexibility and contexts. Similarly; these principles have essential criteria to be observed by deposit insurers. It is worth noting to indicate that all the principles of IADI were not discussed here as the writer had attempted to make a modest comparative analysis with the Ethiopian regulation enacted to govern deposit insurance cases in Ethiopia in light of certain international core principles on deposit insurance.

3. General Overview of the Ethiopian Banking System

Historical Evolution and Ongoing Trends

The history of Ethiopian banking goes back to 1905 that owned by the Ethiopian government in partnership with the National bank of Egypt then under British rule (Isubelew, 2019). Later on bank of Abyssinia were liquidated and the bank of Ethiopia was established in 1931 (Isubelew, 2019). A well-structured banking system started to since 1940s the banking system had started develop and a state bank which owned by the government was established in 1942 (Gashayie & Singh, 2016). A number of foreign bank branches and a private bank were operating in competition with the government owned commercial bank. However they were nationalized and merged in to one government owned mono banking system in 1976 (Gashayie & Singh, 2016).

Post 1991 proclamation number 84/94 was enacted to deregulate and liberalize financial sector again which has brought in the emergence of a new number of private banks (Proclamation 84/1994, National Bank of Ethiopia Establishment Amendment Proclamation Number 591, Ethiopian House of People's Representative, 2008. Here after, NBE, 591/2008). In 2008, the economic development of the country induced the legislator to amend the law in force and enact proclamation number 591/2008 as an amendment to proclamation 83/1994.

The amended proclamation has empowered the national bank in conformity with the proportional economic growth in the country (Article 5 second paragraph under the preamble of proclamation 591, 2008, see also 2nd paragraph under the preamble of this proclamation). The previous proclamation 83/1994 empowers the national bank with certain mandates. However the amendment proclamation 591/2008 has empowered the national bank of Ethiopia to perform 19 mandates (Article 5 of proclamation of 591, NBE, 2008). This proclamation gives huge monitoring and supervision power to the national bank. Proclamation Number84/1994 was later replaced by Banking Business Proc. No. 592/2008 that clearly stipulate what constitute banking business and provisions to regulate other related issues.

Proclamation 591/2008 has also later amended by proclamation 1159/2019 that has come up to allow digital financing and agent banking to engage in financial service business to access and realize inclusionary financials service in Ethiopia (Ethiopian House of Peoples' Representatives, proclamation 592/2008 and 1159/2019). This has also allowed foreign nationals of Ethiopian origin to fully own shares or jointly with Ethiopians by lifting the restrictions previously imposed on foreigners of Ethiopian origin.

Currently, there are 30 commercial banks, one development bank, 18 insurance companies, one re-insurance company, 40 microfinance institutions, six Capital goods Finance/Lease companies, and eight payment instrument issuer operators are operating in Ethiopia. With the expansion of bank branches, the ratio of branch per population reached to 1:11,516. I.e. one bank branch serves 11,516 people (https://nbe.gov.et/banks-in-ethiopia).

Besides, the number of deposit accounts has increased from 40.04 billion birr to 83.3 billion birr. Hence, the total deposits, over the last four years, have increased from 899 billion in 2019, to 1.7 trillion in 2022 (https://nbe.gov.et/banks-in-ethiopia).

4. Deposit Insurance Fund Regulation in Ethiopia: A Comparative Review in Light of International Core Principles of Deposit Insurance

Ethiopia has enacted its first deposit insurance law in 2020. The legislation is passed by the council of ministers by regulation number 482/2020. It is established as an independent institution empowered to manage and administer and effect payment of deposit insurance of all financial institutions in case of bank failure (Article 4(1) of the EDIR, 2021). It is established as a single fund institution that is empowered to serve all financial institutions including government banks and private ones under one umbrella (Article 3 and 16 of the EDIR, 2021).

As mentioned earlier, The Ethiopian deposit insurance fund regulation is composed of six parts and included 43 provisions (EDIR, 2021). Under part one, definitions of term used in the substance and scope of application are included. It is applicable to all financial institutions licensed by the national bank of Ethiopia (Article 3 of the EDIR, 2021). It is applicable to all financial institutions licensed by the national bank of Ethiopia (Article 1 - 3 of the EDIR, 2021).

Part two deals about establishment of the fund, power, functions and organizations of the fund, meeting and benefits of board members, appointment, power and functions of the chief executive officer of the fund (Article 4 to 15 of EDIR, 2021).

Payment of premium, incomes of the fund and financing the find are captioned as financial provisions under part three (Article 16 and et. seq. of EDIR, 2021). Part 4 basically contains insurance event, insurable deposits, amounts of insurable deposits and coverage limits (Article 21 and et. seq. of EDIR, 2021). Membership and payments of deposits are governed under part five (Article 24 to 28 of EDIR, 2021). The final part consists of miscellaneous provisions (Article 29 - 43 of the EDIR, 2021). Hence; regulation 482/2021 can be regarded as the first law that is newly injected to explicitly govern deposit insurance under the Ethiopian banking and finance law.

4.1. Objectives, Mandates and Governance of the Fund

The aim of the legislation is to strengthen the country's the financial system by insuring its safety by protecting depositors and introducing deposit insurance fund so that they it can redress depositors in cases of banking crisis happened in minimizing risks for the whole stability of the system (Preamble of the EDIR, 2021). So, the basic policy objective of this regulation compatible with core principle 1 of deposit insurance that it is enacted to explicitly regulate (de jure) deposit insurance as pointed out under its preamble.

The mandates and power of the fund is stipulated and the regulation has come with establishing an independent fund having its own juridical personality (Article 4(1) and (2) of EDIR, 2021). The fund is held accountable for the national bank of Ethiopia. The mandates of the fund are to determine initial annual premiums, setting and revising coverage limits of the insurance deposit collecting premiums, making payments to the depositors. Actually enormous mandates were given to the fund (Article 6 of EDIR, 2021, See also principle 2 of IADI, 2014).

As far as governance is concerned the regulation has established a board of directors as a higher body to support and supervise the overall functions of the fund (Article 7(1) and (2) of EDIR, 2021). The board members are composed of seven members in which the governor, vice governor, ministry of Finance, banking supervision and micro finance directors are the permanent members of the board (Article 8 of the EDIR, 2021). The other two members will be appointed upon government. Chief and vice executives of the fund are recommended by the NBE and appointed by the government (Article 8 of the EDIR, 2021). This shows that the fund has established an independent and accountable institution that can execute and achieve the objectives of the fund.

As it can be understood from the composition of the board five of them are still from the public institution. Representatives of the private banks and other deposit taking institutions are not empowered to the permanent membership of the board. Even the regulation restricts the membership of the private institutions since the two non-members will be nominated by the government recommendations. Therefore; there is a chance that the representatives of the private institutions might not be a member of the board. Even the regulation is silent on the terms of the board members and it poses a question whether board members are elected for unlimited period or not.

Under the core principles what is provided as a restriction is the representatives of the deposit institutions should not serve as a chair person and majority decision maker (Core principle 3 of the IADI, 2014). Unless these representatives are not majority decision maker it is preferable to include in the membership of the board. As the regulation has twisted both government and private institutions to be administered under one fund system; positive and meaningful participation of these private institution should be reflected in its composition (Art. 8(2) of EDIR, 2021).

Therefore; the governance and organization of the fund is established under the government and it is within the framework of the international core principles (Art. 8(2) of EDIR, 2021). However; the regulation has narrowly restricted the representation of the private financial institutions that can shake the confidence on the ownership of the fund.

4.2. Membership

Almost in many jurisdictions financial institutions are compelled to be a member of the Deposit Insurance Fund. However, there some states that allows for voluntary membership to the fund. Taking into consideration the rationale for explicit deposit insurance that targets to react against illiquidity of the financial institutions flexible approach to membership is not recommendable since it paves the way the way for withdrawal of members and the financial failure of one institution will also impact the financial stability of the others.

Regarding membership of the fund the EDIR under its article 26(1) lays down that all financial institutions are duty bound to be the member of the fund (Art.3 of EDIR, 2021). Therefore; likewise the core principles the regulation has provided that membership to the fund is compulsory. Therefore all financial institutions are expected to be a member of the fund in the case of Ethiopia too.

4.3. Insurance Coverage

The need to care for insurance coverage amount is to secure the interest of the depositors in the case where bank failure has occurred. Therefore; it is essential to observe what kind of protection is bestowed to depositor under the Ethiopian deposit insurance regulation.

The regulation forward that the total amount of DI of the depositor shall be determined by adding up all the accounts Deposit Insurances of the depositor maintained in different accounts up to the date of the insurance event (Article 23(1) of EDIR, 2021). This coverage will also include the interests accrued on the deposits. In addition deposits in foreign currency shall be repaid by the domestic exchange rates (Article 23(1) of EDIR, 2021). In similar way joint accounts and deposits per depositor per member financial institutions are also protected under the regulation (Art 23(7) of EDIR, 2021).

Regarding the coverage limit for the insurance the regulation has followed the fixed coverage limit insurance (Art. 23(8) of EDIR, 2021). The amount of coverage limit to be paid for the depositors in case of bank failure will be 100,000 thousand birr (Art. 23(8) of EDIR, 2021). This coverage limits actually the minimum amount that that will be paid for depositors and the discretion is given for the funds to set the limit. It is obvious that covering all the deposit of the depositor is impractical and it is reasonable to fix the coverage limit. However, the coverage limit set in based on the GDP and market inflation of the states concerned (Laeven, 2002). For instance, The Kenyan parliament has amended the coverage limit of deposit insurance to one million shilling considering that the previous coverage is very to protect depositors (Kenyan Amendment bill Act, 2020). The amount fixed in the case of Ethiopia is inadequate considering the inflation rate in the country.

The coverage limit should balance the overall economic situation and it should not affect the interest of the depositors. Despite the discretionary power of the fund to reset the limit; the current 100,000 coverage limit set by the regulation is insufficient enough with the overall economic status and market inflation to reimburse reasonable savings of the individuals. The coverage to be fixed should be the one that also serves in building trust in banking services. Therefore; the coverage limit should be revisited so that it will meet and conform to the core principles of the deposit insurance.

4.4. Deposits Eligible for Insurance

Under the IADI, all deposits will not eligible for insurance. Interbank accounts, co insurances and foreign banks are mainly excluded from the scope of explicit deposit insurance to protect small depositors (Essential Criteria under Principle 8 of IADI, 2014). It has defined deposit insurance money as a deposit received by a member financial institution from the depositor.

With regard to coverage amount; there is no uniformity on the amount of insurance coverage in many jurisdictions (Demurguc, 2006). Some jurisdictions protect sum of the deposits of the depositors. Others only protect per depositor per account and persons with multiple accounts (Demurguc, 2006). Hence, the amount of insurance protection accorded to these depositors will be of paramount.

The regulation has excluded certain lists that should not be eligible as insurable deposit money (Art 22(1-7) of EDIR, 2021). The core principles clearly provide that similar accounts are eligible. However the regulation is silent about the eligibility of inter bank accounts, co-insurances and others. The exclusion lists are not open ended and they are exhaustive. The regulation is not quite clear in explicitly excluding these accounts. Still it can be argued that the regulation has tacitly excluded these as they are not in the eligible accounts for insurance. Thus, the regulation should be as more as clear as to the eligibility of deposits that are accorded protection.

4.5. Financing the Fund

Deposit insurance schemes can be established by contributing funds for the start up or without funding. In funded systems the members are expected to make periodic contributions (ex-ante) to the fund which will serve as source for paying out for depositor in the case of insurance event. Some developed countries use unfunded systems and require members to make contributions to the fund after the failure (ex-post). Most of the jurisdictions use permanent system funding. In similar way the Ethiopian regulation Deposit insurance has also followed the ex-ante funding require deposit insurers to pay the initial premiums (Art 16(1) of EDIR, 2021).

Furthermore, it also states that the government shall make contributions of 2 million birr to the fund (Art. 16(4) of EDIR, 2021). This by far shows that the concern of the government is in stabilizing and ensuring safety net frameworks to the financial system. The international standards also gear members to obey the permanent period contribution to minimize risks and the Ethiopian regulation has followed similar fashion.

4.6. Nature of the Fund

As the core principles states, states practice establishing fund either as single or dual or multiple funding systems (Deposit Insurance and Digital Financial Inclusion, 2016). Under the single funding system all financial institutions whether they government or private banks or any other deposit taking institutions they will be included under one fund system. Whereas; funding under dual systems financial institutions of the government and private will be governed under different fund system. There are also other states that govern under more than two funding systems. Size, risk management framework and overall efficiency of the institutions determine the type of funding system to be used (Laeven, 2002, Chai et al., 2018). As the size and risk of the institutions differ it requires to govern identical institutions with funding system that best match with them. In short large institutions that can be subjected many risk and other lesser institutions should not be governed under the same funding system.

In Ethiopia there are around 30 banks both government and private banks and there are also other macro different micro finances. All these institutions have their own peculiar features and their risk level differs from one another and it is tough to argue that all institutions have similar risks. But all these were categorized to be a member of one publicly hold funding system. Despite differential risks the regulation has governed all financial institutions under one funding system. So, it has to be questioned how it is possible to administer these institutions under single funding system.

4.7. Premium Contributions

Premiums are contributions made by the deposit insurance members to the fund for the purpose of reimbursement of depositors during financial crisis. Assessments show that bases of premium vary from one states to the other based on the specific risk levels. Thus, the level of risk will determine the amount of premium to be contributed. These risk based premiums are called risk adjusted premiums. Basing the level risk of their financial institution most of states use a differential rate calculation (Deposit Insurance and Digital Financial Inclusion, 2016). Others use a flat rate premium contribution (Deposit Insurance and Digital Financial Inclusion, 2016).

In flat rates deposit insurers contribute for uniform rate of premiums without considering risk profiles of the institution. Even though, this type of rate can be easily administered still it lacks prudence as it cannot really convey the risk of financial institutions. Henceforth, it is recommendable that to rely on risk adjusted differential premium systems based on data to minimize future risks.

The Ethiopian Deposit insurance regulation has also uses the flat rate method of paying premiums and it is provided that all institutions will contribute 0.3% of their annual deposit average (Art 16(5) of EDIR, 2021). So, it is not logical to use uniform premiums contributions for all types of financial institutions. The core principle also forwarded under its essential criteria that differential rate is better as it basis risk analysis (Principle 9 of IADI, 2014).

4.8. Reimbursement Mechanisms

The core principles require deposit insurance systems to make prompt payment through clearly set procedures without delay (Core Principle 15 of IADI, 2014). Now days, it has become a norm in European and many other countries to effect payment for most of deposit accounts in a week (Korea Deposit Insurance Corporation, 2005). The Principe also set to make payments with seven working days.

The EDIR has also governed the period of making repayments for claims by customers (Article 27(6) of EDIR, 2021). The fund is expected to perform payments to depositors as determined by the board. As far as period of payment is concerned the regulation stipulates that the fund shall make payments in three months after the insurance event happened. In developing countries this might be taken as normal. Even some developing countries like Kenya, have shorter time period that is one month (Demirguc-Kunt et al., 2005).

Depositors have the right to claim their money when they need and financial institutions have duty bound to serve them. So why do depositors wait for three months to requires their payments in the case of deposit insurance system? After all the purpose of the law is basically to protect the depositors. Depositor insurance system should empower and organize its resources to serve clients in an easy and prompt procedure. Of course, the risk in bank failure is shared to the depositors too as their coverage amount is limited to certain amounts. In the case of Ethiopia; it is limited to 100,000 birr.

It is also questionable whether the practice will be in accordance with this regulation since there are many factors that might impede the fund to fully enforce its functions. From the depositors view the value of money substantially exist at a time of need and it has to pay as prompt as possible. So, the period prescribed for claiming deposit is quite longer and introduced a provision which unduly favor the fund to be relieved from liability.

The regulation also imposes an additional duty on the depositors that they shall handover their payments within the prescribed period. Failure to do so entails to miss the accrued interest on their money (Art. 27(6-9) of the EDIR, 2021)

Furthermore; the regulation has included a provision which prohibits depositors from claiming their deposits after five years of insurance event (Article 27(7) of EDIR, 2021). This provision prohibits depositors' right to request for the money that has saved with the banks or any other similar institutions in the form of reimbursement (Article 27(1) of EDIR, 2021). Normally; depositors can check their savings when do they need and unless it is publicized they might not be aware of the institution's failure. So, why it is important to put a period of limitation that bar depositors right to claim for their limited insurance coverage?

In this respect the regulation tends to favor the fund.

Under the Ethiopian law period of limitation is one form of relinquishing substantive rights (Art. 1845 of the Ethiopian Civil Code, Proclamation number 166/1960). It is a means through which individuals will waive their right to claim. Substantive rights can only be limited by the parliament when passed as an Act or proclamation. Executive organs cannot enact a law that waives individual's right and such laws against the principle of the FDRE constitution. There are also other laws that govern civil actions period of limitations basically in the civil code, in the new commercial code and other pertinent legislations.

In this case however, Ethiopian council of ministers which is the executive body of the government passed a regulation that includes a provision that waive individual's rights to claim their insurance coverage from the fund. As mentioned earlier this body cannot pass regulations that restricting substantive rights of the individuals.

The regulation has also over sighted to govern duty of the DI to notify the potential depositors of the failed institution through media and other mechanisms about the institution has encountered a financial crisis. The core principles impose a duty to inform the depositors about the financial illiquidity of the institution and how they can get to access to claim from their deposits from the system (Essential criteria 2 of Principle 10, IADI, 2014). Most of the provisions related with information are even vows for confidential information and disclosure of the information can be made exceptionally (Art. 28 and 30 of EDIR, 2021).

Besides; the regulation has included other provision which prohibit some depositors to claim payment whom the fund believes that they have profited from the bank failure (Art. 27(2) of EDIR, 2021). It impedes depositor's right to claim for insurance coverage when the fund believes them to have profited from the failure of the institution. But the regulation is not defining what being profited from the bank failure and how this fact can be investigated and determined by the by the fund. What is provided is only the discretionary power of the fund.

Therefore, a mere believe of the fund suffice to prohibit a certain depositor from claiming payment as the discretion is empowered to the fund. Any compliant mechanism procedures are not either set out the regulation by referral to board of directors or to the regular courts for review in cases where disputes aroused among depositors and the insurance fund.

The compliant resolution mechanism is prescribed under article 38 of the regulation. However, this procedure governs the relation between fund and financial institutions not depositors versus the funds.

Consequently; the discretionary power accorded to the fund to exclude depositors whom the fund believed that some depositors are profited from the failure is tantamount as it can create doubt on the prudent regulation of deposit insurance. The core principles also forward under its principle 11 that individual depositors should be given legal protections.

In general, issues that can be managed and governed at the fund level should be with sufficient justifications and a room should not be closed for individuals to bring their complaints to pertinent organs so that the fund is also liable for its actions.

4.9. Emerging Trends

There are also emerging trends in deposit insurance particularly with development of financial technologies (Fintech). Most of the jurisdictions have incorporated governance of digital finances in their legislations (Defina et al., 2021).

As the world adopts the digitization of information, security breaches continue to increase. Due to the complexity of digital financial systems, banks are left vulnerable to attack. Anti-Money Laundering and other know how mechanisms are mandated to detect fraud. Digitization of financial regulations can benefit banks by integrating technology into their risk management processes. Regulatory technology, a derivative of FinTech has the potential to help digitize regulatory risk management processes, saving time, money, and resources with greater accuracy than traditional processes. However; cyber-attacks are quite damaging to customers who may lose sensitive personal data and detrimental to the reputation of the bank, losing customer trust (https://legal.thomsonreuters.com).

The same is true in cases of banks that may entail tremendous loss as a result of crimes committed by cyber-attacks using internet services. Therefore; as there are potential for cyber-attack on financial institutions like banks whom are entrusted to keep credit of their customers; such attacks will result in banking crisis which finally demands deposit insurances to pay premiums coverage for the creditors.

Digital financial service is also introduced in Ethiopia (Ethiopian House of People's Representatives, 1159/2019). There different methods accessing digital financial services like Tele birr, Mela, Agelgil, Michu, etc. (https://www.researchgate.net/publication/364381217). Currently, the Kenyan MPESA is also joining the sector to provide digital service in Ethiopia (https://bitcoinke.io/2022/10/mpesa-gets-ethiopia-license). These digital financial services are characterized by common technological products and they are not immune from cyber-attacks and money laundering. Therefore; as the there is a potential insecurity to the system; depositors of these digital service should also be required to be protected by the deposit insurance. The scope of the regulation is to all financial institutions; nevertheless, it is not explicitly provided that deposit insurance legislation has really covers those digital financial institutions.

As it was mentioned before many states passed the deposit insurance legislation as an Act or equivalent with proclamation, US, EU member countries, from African states Kenya, Zimbabwe can be taken as illustrations and they have provisions to impose criminal and administrative penalty for the non-compliance of the law (International Association of Deposit Insurer's, IADI, 2020). All of them have passed it by their parliament. But in Ethiopia it was enacted as regulation status which is lower than proclamation in its legal hierarchy and it only imposed administrative penalty for the non-compliance of the regulation.

To summarize, the Ethiopian deposit insurance legislation stepped miles to accommodate most of the core principles of the IADA and BCBS, it failed to sufficiently govern issues with coverage limit, complaint mechanisms or legal protection of depositors, exclusions of eligible accounts for payment, nature of premium calculation, period of limitation, publication of information and period of payment for reimbursement. In general for the better realization of the objectives of the deposit insurance it is essential to revisit the loopholes in the current legislation and work to upgrade and harmonize with international core principles of deposit insurance.

5. Conclusion

Deposit insurance is a financial safety net system which is established by states to protect depositors against the loss of their insured deposits in the event that a bank is unable to meet its obligations to the depositors. It has been evolving since its beginning in 1933 in US as a federal deposit insurance corporation. Now, it has got the international standard and recognized by many states of the world as safety for financial system in the case of bank failures. Its basic importance is targeted to: provide protection for small depositors; enhance public confidence and systemic stability by preventing run on banks; increase savings and encourage economic growth; enable small and new banks to compete with large and/or state owned banks; define the boundaries to the government's exposure to loss and require banks to contribute to the resolution of failed banks.

In a competitive market system, banks fail whether the system is in financial crisis or not. The principal objectives of a deposit insurance system are to contribute to the stability of the financial system and to protect small depositors when banks fail.

A well-constructed deposit insurance system will achieve these objectives by significantly reducing the risk of bank runs and the disruptive breakdown of essential banking activities that accompanies such runs. It will also contribute to the smooth functioning of the payments system and the credit mechanisms, and it will facilitate the exit of problem banks.

Policymakers must consider moral-hazard issues when establishing a deposit insurance system. The incentives for banks to engage in riskier behavior than they would in the absence of insurance are referred to as moral hazard. Deposit insurance, when combined with measures to control moral hazard, can contribute to financial stability while maintaining sufficient discipline. As a result, policymakers must weigh the trade-offs between moral hazard and market discipline.

A stable, sound and effective financial system is all about resilience of financial systems to stress. Hence, creating a stable financial system requires governments to take concrete measures in applying the international standards set for banking supervision and monitoring, developing legal frameworks and institutions that are able to track wrong signals to the financial systems, sound monetary policy that promotes low inflation and high employment.

Ethiopia is taking certain measures to full fill the preconditions provided by WTO to be benefited and compete in trading in the global value chain. In September 2022, the Ethiopian council of ministers has approved the financial policy that allows foreign banks to engage in banking business in Ethiopia.

Ethiopia is on the move of liberalizing the financial sector to foreign banks. After the liberalization of financial sector to foreign banks, financial institutions had encountered crisis in many states. Ethiopia has recently adopted a legislation which governs deposit insurance. Domestic financial institutions are also increasing in number and size.

Nowadays banks deposit insurance is very important as there is potential for banking failures due to the continuous fierce competition. Absence of banking supervision, ineffectiveness, lack in acquainting with technology and involvement of multinational banks are among the basic challenges that can lead banks and other deposit taking institutions to bankruptcy or insolvency, ineffectiveness, lack of trust, governance. These factors are also existent in the Ethiopian banking system and having a good framework that governs deposit insurance is very important.

The Ethiopian deposit insurance legislation stepped miles to accommodate most of the core principles of the IADA and BCBS. It clearly governed Deposit insurance by explicitly separate legislation in addition to the prudent legislation provided for regulating the financial sector. Most of the contents of the legislation comply with core principles of DI.

However, there are loopholes, insufficient and/or vagueness in governing issues related with Governance of the fund; Scope of application; Coverage limit, Complaint mechanisms (legal protection of depositors); Exclusions of eligible accounts for payment, Nature of premium calculation, Nature of the Fund, Period of limitation, Discretionary power of the Fund publication of information and period of payment for reimbursement.

The regulation governing deposit insurance in Ethiopia is a recent act that has not encountered practical challenges. Yet, law lacks practical enforcement as it is not yet implemented and the absence of its practical experience impeded to review practical challenge of the law. Hence, it requires the role of government in institutionalizing the system to commence service so that it can meet its target to create sound, effective and stable financial system.

In general, for the better realization of the objectives of the deposit insurance, it is essential to revisit the loopholes in the current legislation to harmonize it with the international core principles of deposit insurance in the prospective legislations.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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