Remarks by
Prof. Emmanuel Tumusiime-Mutebile
Governor, Bank of Uganda

International Association of Deposit Insurers – Africa Regional Committee Conference

Serena Lake Victoria Hotel & Spa, Kigo

September 16 – 19, 2019

Hon. Minister of Finance, Planning and Economic Development

The Board Chairman and Members of the Board of the Deposit Protection Fund of Uganda

The Secretary General of the International Association of Deposit Insurers

The Auditor General

Board Members and Chief Executive Officers of Deposit Insurance Agencies

Board Members and Chief Executive Officers of Financial Institutions

Chief Executive Officers of Financial Sector Safety Players

Distinguished delegates

Ladies and gentlemen

Good morning to you all.

A warm welcome to you all; especially to the participants who have travelled from abroad to Uganda, and to this splendid resort at Kigo right next to Lake Victoria. Thank you all for honouring our invitation to the first conference by the **Africa Regional Committee** of the **International Association of Deposit Insurers**, hosted in Uganda.

I must say that the theme of this conference, **'Why Deposit Insurance'**, was very well chosen. It points attention to **deposit insurance**, which is a key component of the financial system safety net that is meant to promote financial stability.

Fundamentally, deposit insurance exists to protect the banking system against the risk of bank "runs", that is, unrestrained demand for cash by savers, which can cripple the financial intermediation process, disrupt the payments system, and constrain economic performance.

In the normal course of events, healthy banks are encouraged to lend the deposits that are entrusted to them in a process called financial intermediation, where banks make savings available for investment and economic development. However, when banks face difficulties and become unable to service their obligations when they fall due, their creditors, including depositors, risk suffering ruinous losses.

By relying on customer deposits that can be withdrawn on little or no notice, banks are exposed to the risk of a run on deposits as panic-stricken customers take out their funds quickly ahead of bank insolvency.

In order to mitigate the risk of bank runs as well as to protect the interests of depositors, deposit insurance systems are established to guarantee the nominal value and liquidity of deposits up to a certain size, funded with premiums paid by the institutions whose deposits are insured. Deposit insurance protects depositors, gives them comfort that their funds are not at risk, and ensures the viability of banking systems.

In Uganda, the need for effective deposit insurance was exposed during the resolution of several local banks that failed during the late 1990s and early 2000s. Indeed, the Bank of Uganda (BoU) has recently been the subject of a Parliamentary probe seeking final closure of the numerous issues and contested claims that arose out of the associated receivership and liquidation processes.

Notably, the depositors of those failed banks were fully compensated, for the most part, using taxpayers' funds as the Government sought to preserve public confidence in the economy.

Needless to say that such implicit deposit insurance by the government imposed an unanticipated financial burden on the limited fiscal purse.

Seeking to financial sector soundness, several reforms were undertaken in the banking systems. These reforms included but were not limited to: tightening banking laws and regulations designed to constrain undue bank risk-taking and inappropriate insider dealings; upgrading bank supervision and examination systems; providing liquidity through the central bank to prevent bank illiquidity problems from turning into insolvencies; and intervening to resolve failing banks.

Of specific relevance was the introduction of a deposit insurance scheme that was operated within the BoU. An effective deposit insurance system is expected to yield faster, smoother, and more predictable resolutions of failing banks, not least because it follows predetermined "rules of the game," rather than being discretionary and *ad hoc*.

And it stands to reason to say that a more rules-based deposit insurance scheme operates best when it is autonomous.

It was no surprise, therefore, that in 2016, the **Financial Institutions Act 2004** was amended to provide for the establishment of the **independent Deposit Protection Fund of Uganda**, among other reforms.

Another vital reform, worth highlighting here, is the recent lifting of the deposit insurance threshold to USh 10 million from USh 3 million previously.

The higher threshold is likely to enhance public confidence and encourage greater customer deposits, thereby expanding the funds available for financial intermediation by the banking sector. Larger pools of deposits would reduce the cost of loanable funds for banks, spur credit expansion, and ultimately support faster economic growth.

At this point, it is necessary to address any concerns about the safety of the deposits that exceed the insurance threshold of USh 10 million.

The protection of large uninsured depositors of failing banks, will continue to take place through various forms including: *a purchase and assumption transaction*, in which all of the deposits (insured and uninsured alike) of the failing bank are transferred to another bank; *a financially assisted merger* of the failing bank with another bank; or *the provision of financial assistance* to the failing bank to avert its failure as happens during statutory takeover by the regulator.

Mindful of the risk that deposit insurance would encourage moral hazard through encouraging banks to take greater risks, I want to assure you that the BoU is committed to effective supervision of bank risk-taking, with particular attention to the quality and types of assets that banks acquire as well as the amount of capital that they hold relative to the risks they take. In addition to the risk-based micro-prudential supervision, the BoU also undertakes macroprudential regulation and supervision to ensure the stability of the entire system, including through stress testing to ensure that the sector is resilient to shocks.

Effective deposit insurance can contribute to financial stability, only with strong bank regulation and supervision in place. Deposit insurance is no substitute for effective regulation and supervision of banks. Through a risk-based supervision framework, the BoU is committed to spotting problems well before insolvency occurs and compelling banks to take prompt and pre-emptive corrective action.

As I come to the end of my remarks, I must stress the need for the nascent Deposit Protection Fund (DPF) of Uganda as an autonomous institution to prove its credibility and fitness for purpose before it gets tested in a period of difficulty.

The DPF must be well funded, capably staffed, and maintain the support of the central bank as well as that of the government as partners in ensuring the stability of the financial system. The DPF must also maintain strong links with regional and international peers so as to learn from the diversity of experiences as well as maintain touch with best practices.

I look forward to working with the DFP as it plays its role within the Africa Regional Committee of the International Association of Deposit Insurers by contributing to the stability of financial systems through international cooperation and maintaining such a virtuous network as has gathered here for this conference.

It is now my honour to invite the Honourable Minister of Finance to address this gathering.

I thank you all for listening to me.