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The Latest Case of Information Asymmetry Issue on The Retail Core Banking Services Market in The Czech Republic

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Abstract

The paper is focused on the latest information asymmetry issue in the Czech Republic on the retail banking services market. The problem considers credit union (savings cooperative) business that seemed stable after the problematic restructure 10 years ago. But during this January the payment from Deposit Insurance Fund of the Czech Republic had to compensate the consumers of the MSD credit union. This subject provided services with higher interest rates even during the last years of technically zero interest rate of the central bank. A question information asymmetry and the moral hazard arose again. All that is written in famous study for European central bank by Vesala et Gropp supporting the explicit deposit insurance system is correct but the conditions has partially changed. Credit unions try to compete with banks undertaking a higher level of credit risk but still being within Basel II accords. The paper is considering the question of the future development – to try to compete with the conventional banks as FIO credit union successfully did or to return to "Austrian" model. Next future trend is outlined in sum up of the deposit insurance system characteristics backed by other several studies. Also the problem of information asymmetry overcome is being discussed with the result that mostly used monitoring indicator cannot be applied to credit union market.

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1. Introduction

The banking industry is an environment where the information asymmetry takes its role in many parts. This paper is focused on deposit retail banking services. Due to the nature and the role of banking industry in modern economy differs from other markets. Other markets mostly rely on rationality and vigilance of the consumers when choosing their supplier. However on this market a public or state-guaranteed insurance supports trust in the market. This

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environment may lead to moral hazard (refers here to the tendency of insurance protection to alter an individual's motive to prevent loss.) caused by unobservable behaviour and the insurance system. This question arose on the deposit retail banking services lately because of the MSD credit union bankruptcy in December 2013.

2. Legal framework and related works

2.1. National deposit insurance funds

The European Communities (1994) established that all member states have to adopt a system of deposit insurance, which guarantees compensation in the amount of at least 20 000 EUR with a maximum of 10 % participation and less from the side of the claim-holder (households and non-financial companies). Due to the global financial crisis in 2008 a further significant increase in guarantees was approved on the ECOFIN. A new guarantee would be across the EU increased to at least EUR 50 000. Also another major change was discussed – full insurance. Most countries adopted 0 % participation model to support the claim-holders' trust. In 2009, see European Communities (2009), was approved with the target of 100 000 EUR limit since 2011.

In the Czech Republic a Deposit insurance fund (further only as DIF) is established accordingly the Act No. 21/1992 Coll., as amended. Main characterises can be retrieved from Deposit insurance fund (2014). All banks, credit unions (further only as CUs) and branches of foreign banks participate in the deposit-claims insurance scheme by contribution of 0, 04 % of the average volume of insured deposit claims for the relevant calendar quarter. If the volume of funds of the Fund rises over 1, 5% of the average volume of insured deposit claims then the contribution is divided by 4. The bank shall calculate the average volume of insured deposit claims using the stock of insured deposit claims as of the last day of each calendar month of the relevant calendar quarter. DIF automatically insures current, savings, term and deposit accounts held for individuals and legal entities (non-financial).

2.2. Moral hazard on the deposit insurance backed market

Generally, considering the moral hazard, the studies test hypothesis that the public safety net, providing assistance to banks in distress (this includes "the last resort" creditor as well) and protecting banks' claim-holders from losses (deposit insurance fund), increases the propensity by bank managers to take on excessive risk (credit or market one). Another general opinion is that introduction of such system-wide insurance is detrimental to market discipline, respectively increases the moral hazard. There is mentioned also a double moral hazard issue including to managers change in behaviour also depositors. Within the insurance system the demand does not have to be vigilant any more since there is no risk (we abstract from time delay in repayment from the insurance system). Gropp and Vesala (2004) studied that problem focused in the banks. They studied countries that did not provide deposit insurance until the European Communities (1994) introduced it. The result was rather surprising and in conflict to general approach. Risk-taking activities were reduced by banks with higher amount of subordinated debt, low charter values and smaller market share. The establishing of the explicit system removed implicit insurance/government-backed system expectation. However the bailout rescue was not abandoned later in 2009, this result was the only logical explanation. Another important study by Bichler & Mächler (2001) shows that fund insurance prevents the "run on bank" scenario for weaker banks considering insured deposits. But in the Swiss system there were also uninsured ones. Every bank had a limit to which the sum of deposit is insured. This means that middle and large institutions have the deposits insured only partially. They show that this system does not negate the depositor response to bank balance sheet characteristics since variations in banks specific fundamentals can explain 75 % of the variation in uninsured savings deposits. Borio, Hunter, Kaufman, & Tsatsaronis (2004) sum up the problem regarding market indicators prediction of bank fragility that can significantly reduce moral hazard in uninsured or just partially insured environment. Of all the possibilities they choose Distance to default as leading indicators of bank fragility. So the empirical analysis does not support the general theoretical conclusion. However Borio et al. (2004, p. 113) emphasize that "Financial innovation will tend to be a step ahead of regulators and banks' opaqueness may have only increased by trends towards off-balance-sheet operations and by the use of financial instruments whose precise risk characteristics may be difficult to understand.". This note was foreseeing considering the 2008-2010 events.