



IADI - Deposit Insurance in the Systemic Crisis: Initiatives and Challenges Ahead

FSI-FSVC-MENA FRTI Joint Regional Seminar on Global Financial Turmoil and the Changing Face of Financial Sector Supervision

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www.iadi.org

Discussion Topics

1. What is Deposit Insurance?
2. About IADI
3. Interventions in the Crisis
4. The IADI-BCBS joint Core Principles for Effective Deposit Insurance Systems
5. Where next globally?

What is deposit insurance?

- The principal objectives for deposit insurance systems are to contribute to the stability of the financial system and protect depositors
- Some countries include consumer protection, failure resolutions
- Deposit insurance cannot by itself deal with systemic crisis
- Countries with well-designed DI systems weather crisis better

International Deposit Insurance

- 103 countries operate explicit deposit insurance schemes
- Most established within last 25 years
- Newer systems often a “paybox” part of a central bank
- More advanced programs seek to mitigate risk

See www.iadi.org for latest survey data

What keeps a bank open?

When permitted by government or regulators, banks can – and do -- operate without capital, but they **MUST remain “liquid” on a daily basis**

*Liquidity insolvency: the inability to pay depositors and other current (short term) accounts on demand – will force a bank to fail *immediately*.*

Liabilities must be secure(d) and creditors' must be confident of repayment.

Creditors will withdraw their money or seek protection (collateral) when they loose confidence.

To remain liquid, ALL banks must “fund” their assets every day.

For any bank, confidence is necessary to “remain liquid”

Bank investors and creditors, according to risk (1 = most, 5 = least)

1. Shareholders (**share price risk**)
2. Subordinated debt holders (***insolvency risk***)
3. Unsecured liabilities, including uninsured deposits
4. Secured liabilities (easy access to sufficient collateral)
5. Insured depositors (*timely access to all insured deposits*)

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Origins and objectives of the International Association of Deposit Insurers (IADI)

IADI's Origins

IADI was established in 2002 following deliberations of the Financial Stability Forum:

- IADI is a non-profit organization constituted under Swiss Law...
- And a separate legal entity domiciled at the *Bank for International Settlements* in Basel, Switzerland.

52 deposit insurance organizations are IADI members, 20 other participants' include central banks and International Financial Organizations

Origins and objectives of the International Association of Deposit Insurers (IADI)

IADI is co-located with other international organizations that promote financial stability

The Bank for International hosts several committees and organizations that promote monetary and financial stability including :

- International Association of Deposit Insurers (IADI)
- Basel Committee on Banking Supervision (BCBS)
- Financial Stability Forum (FSF) and Financial Stability Institute (FSI)
- International Association of Insurance Supervisory (IAIS)
- Committee on Payment and Settlement Systems
- Committee on the Global Financial System
- Markets Committee

Origins and objectives of the International Association of Deposit Insurers (IADI)

IADI's Objectives and Initiatives

Contribute to the stability of financial systems by promoting international cooperation:

- ***Undertake research on DI issues (Core Principles).***
- Provide members with forums and opportunities to meet (collaborate, interact, and share experiences) among DI's and with other interested parties world-wide.
- ***Provide training and development.***
- Databank and website, International Deposit Insurance System Survey, logistical assistance, etc.

IADI activities support members in the Crisis

Collaboration with organizations that promote financial stability

- IADI/BCBS joint initiative on an international set of core principles (David Walker)
- Partnership with the Financial Stability Institute to develop conferences and training, including a Cross Border Seminar, Core Principles Conference, and on-line training
- Working with the Financial Stability Forum on convergence and transitioning in response to G-20 Declaration
- Working with the EFDI to consider joint efforts on training, research, and information sharing

IADI participants include IMF, World Bank, Regional Development Banks (ADB, EBRD, IADB), central banks (S. Africa Nat Treasury, Mongolia, Algeria Thailand, Singapore, Philippines)

For information on events and activities: www.iadi.org

IADI activities support members in the Crisis

Core Principles Collaboration with Basel Committee, CP-s reflect experience from 10,000's bank failures and previous systemic crises

Conferences Europe Regional Committee (Prague), 4th DICJ Roundtable (Tokyo), Cross boarder seminar (Basel), 7th Annual Asia RC Conference (Almaty), Africa Regional Conference (Kenya), Core Principles (Basel), more

Executive Training resolution practices, claims and recoveries, e-learning training via the Financial Stability Institute (FSI-Connect), with 161 tutorials including deposit insurance, resolutions, and bank supervision

Research topics Handling a Systemic Crisis, Transitioning, Cross Boarder Issues, Claims and Recoveries, Public Awareness, Differential Premium Systems, Coverage, Funding and Evaluation of DIF Sufficiency, Mandates, Governance, Islamic Banking Issues

Database, New website, Collaboration with FSI and EFDI, Technical Assistance Possibilities up-to-date and unique information on deposit insurance programs, DI surveys, collaboration with others, other possibilities to provide technical assistance to members

Origins and objectives of the International Association of Deposit Insurers (IADI)

IADI's MENA participants include:

1. Jordan Deposit Insurance Corporation
2. Savings Deposit Insurance Fund of Turkey
3. Institut National de Garantie des Dépôts (Lebanon)
4. Bank Al-Maghrif, Fonds Collectif de Garantie des Dépôts (Morocco)
5. Bank Deposit Security Fund (Sudan)
6. Bank of Algeria
7. Deposit Insurance Corporation of Algeria
8. Union of Arab Banks (partner)

IADI Conferences and Training in 2009

IADI and the FSI are jointly developing on-line FSI Connect tutorials on deposit insurance topics:

Deposit Insurance – An Introduction [Available Now](#)

[Coming during 2009:](#)

1. Premiums and Fund Management
2. Reimbursing Insured Depositors – Claims Management
3. Asset Management and Recovery

IADI provides FSI Connect subscriptions to its members. The subscription enables IADI members to use 161 tutorials on topics including financial sector supervision, key risks and their management, complex financial instruments, and accounting.

Ten IADI Conferences and Training in 2009

21-23 April, **Claims Management Executive Training**, Washington DC

14 May, Seminar on **Financial Stability and Deposit Insurance**, Mexico City

27 – 29 May, conference on **Primary Responsibility of Deposit Insurer in Bank Failure**,
Almaty Kazakhstan

3 – 4 June, IADI - FSI **Cross Boarder Resolutions**, Basel Switzerland

7 – 9 July, **Role of Deposit Insurance in the Stability of the Financial System**, Kenya

20 -21 August, Latin America Regional Conference, Lima Peru

25 – 27 August, **Claims Management Executive Training**, Istanbul

23 – 24 September, IADI – FSI - BCBS 8th Annual Conference on **Deposit Insurance Core Principles**, Basel Switzerland

3 – 5 November, **Claims Management Executive Training**, Kuala Lumpur

Nov – Dec, TBD Deposit Insurance in MENA, Islamic Banking

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What happened?

- Increasing leverage in the banking and shadow banking system
- Rapid extension of credit and falling credit standards
- Increasing complexity of the securitised credit model
- Property price booms
- Underestimation of bank and market liquidity risk
- A self-reinforcing cycle of irrational exuberance

Source: FSA, Financial Risk Outlook, 9 February 2009

General Comments on the Financial Crisis

1. Crisis demonstrates importance of deposit insurance
2. Well-designed deposit insurance systems weather crisis better than poorly designed ones
3. No deposit insurance system can by itself deal with systemic crisis
4. Credible deposit insurance systems can contribute to financial stability and support the safety net during crisis by:
 - Protecting depositors and contributing to stability
 - Possibly administering temporary blanket guarantees
 - Supporting effective failure resolution activities
 - Asset management and liquidation
 - Support transition from blanket guarantee to limited coverage when financial stability returns

Examples of reforms initiated or under consideration

1. Two countries have implemented explicit deposit insurance (Australia and New Zealand)
2. Strengthening supervision, implementing ability to close failing banks, and pay depositors promptly, new public consultation on accelerated payout, public awareness consideration (UK)
3. European Union: provides for minimum coverage level of 50,000 Euros, eliminates co-insurance. Under discussion (Council of the European Union): faster payout requirement, raising coverage to 100,000 maximum, pre-funding and risk-adjusted differential premium systems
4. Authority to restructure/rehabilitate/market banks, provide liquidity to troubled banks, loans to acquirers, inject capital and arrange P&A acquisitions, purchase troubled assets (DIA Russia Federation)
5. Possible enhancements to risk-based premium system, restructuring mortgages when less costly than foreclosure (USA)
6. A number of countries have legislative initiatives in process to increase coverage, improve resolution process (bridge bank authority), etc (Philippines ex).

Interventions to provide stability

Interventions that *directly* protect bank depositors:

Examples

1. Higher DI coverage levels (may be applied to all insured deposits or specific categories) **≈ 27 countries**
2. Blanket guarantees (may be applied to all liabilities, all deposits, specific deposit categories) **≈ 18 countries** CU2
3. Combinations of higher coverage and blanket guarantees **several countries**
4. Suspension or elimination of co-insurance (not temporary)

Blanket guarantees are usually temporary, some with termination dates. Higher coverage limits are sometimes temporary with termination dates.

Interventions to provide stability

Interventions that protect financial institutions, and thereby *indirectly* protect bank depositors and other creditors:

examples

1. Nationalization of banks, insurance companies, investment firms
2. Reduction of target interest rates and other Central Bank monetary policy actions
3. Government capital infusions through stock purchase, common or preferred
4. Gov't purchase or guarantee of subordinated debt
5. Liquidity programs, including secured or unsecured borrowings, currency exchange
6. Purchase or guarantee of assets, troubled or not
7. Regulatory forbearance to encourage lending
8. Expediting applications to converting “non-bank” investment companies to banks to provide access to core deposits and capital injection (TARP)
9. Use of Systemic Risk rules to arrange mergers among very large banks
10. Modifying accounting rules, e.g. fair value practices “mark-to-market”.

Some countries: limiting executive compensation, incentives must consider long-term values, restricting dividends, etc.

Interventions to provide stability

North America

US – temporary coverage increase, several bank guaranty programs (FDIC guarantee on newly issued sub debt)

Canada – seeking new resolution authorities

Mexico – no changes to date

Interventions to provide stability

Europe

Several countries raised Coverage to an amount closer to the EU minimum level of 50,000 L: Bulgaria, Croatia, Czech Republic, Estonia, Finland, Romania, Sweden, UK, and most EU members

Counties that raised coverage significantly above the EU minimum: Belgium, Greece, Lithuania, Netherlands, Portugal, Spain

Blanket deposit guarantee programs: Austria, Denmark, Greece, Iceland, Ireland, Slovakia, Slovenia, Turkey

Debt guarantee programs: Ireland, Denmark, France, Germany, Italy, Netherlands, Spain, United Kingdom

No change in deposit insurance coverage: France and Italy

Interventions to provide stability

Asia and Pacific

No changes to deposit insurance coverage level: Japan, India, South Korea

Temporary blanket guaranty on deposits or significant increase: Taiwan, Australia, Hong Kong, Singapore, Malaysia, Indonesia

Philippines: charter changes to increase coverage from 250,000 to 500,000, ability to examine insured banks, funding and resolution authority

Interventions to provide stability

Middle East

Blanket guarantees: UAE, Jordan, Kuwait, Saudi Arabia

Coverage increase: Bahrain

Intention to establish DI: Egypt

No changes announced: Lebanon, Oman

Interventions to provide stability

Africa

Has been insulated from the systemic problems posed by the financial crisis to date

Only Nigeria is considering a change to increase coverage

Interventions to provide stability

Latin America

No changes announced

Little or no exposure to subprime

Impacted by liquidity crunch and global recession

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Core Principles Background

The Report of the Financial Stability Forum on Enhancing Markets and Institutional Resilience, released on April 7, 2008, pointed out that:

- events during the recent international financial turmoil illustrate the importance of effective depositor compensation arrangements
- Authorities should agree on an international set of principles for effective deposit insurance systems
- recognize that there may be a variety of different designs for deposit insurance arrangements that meet the objectives behind the principles
- Should be adaptable to a broad range of country circumstances
- take close account of the broader characteristics of safety-net arrangements, including those of the regulatory and supervisory framework and of resolution procedures for failing institutions.

Background Continued

- The Basel Committee on Bank Supervision acknowledge that a carefully designed system of deposit insurance can contribute to public confidence in the financial system and limit contagion from banks in distress
- IADI developed a draft set of Core Principles for Effective Deposit Insurance Systems in February 2008
- In July 2008 a joint working group from the Cross-border Resolution Group of the BCBS and the Guidance Group of IADI formed to develop Recommended Core Principles to be submitted to the BCBS/IADI for their review and approval
- In March 2009, IADI and the BCBS published a joint Core Principles for Effective Deposit Insurance Systems for public consultation

See www.iadi.org

Core Principles Objectives and Methodology

The objectives of the Core Principles are to:

- Enhance the effectiveness of deposit insurance systems.
- Be reflective of and adaptable to a broad range of country circumstances, settings and structures.
- Draw heavily on the practical experience of deposit insurers.

The Principles are neutral with regard to different approaches to deposit insurance, so long as the overriding goals are achieved.

Core Principles Objectives and Methodology

The Core Principles are based on:

- IADI research and guidance papers (2002-2008), FSF Working Group (2001) and APEC Policy Dialogue on Deposit Insurance (2005).
- Discussions with Basel Committee (CBRG, ILG).

The Core Principles reflect the lessons learned from ++ 10,000s bank failures and + -100 systemic crises throughout the world.

The Core Principles Preconditions

The introduction or the reform of a deposit insurance system can be more successful when a country's banking system is healthy and its institutional environment is sound. Thus, an effective deposit insurance system needs to be based on a number of external elements or preconditions:

- an ongoing assessment of the economy and banking system;
- sound governance of agencies comprising the financial system safety net;
- strong prudential regulation and supervision; and
- a well developed legal framework and accounting and disclosure regime.

Where existing conditions are not ideal, it is important to identify them. If actions are necessary, they can be taken before, or in concert with, the adoption or reform of a deposit insurance system.

Summary of Recommended Core Principles

Principle 1 – Public-policy objectives

The first step in adopting a deposit insurance system or reforming an existing system is to specify appropriate public-policy objectives that it is expected to achieve. These objectives should be formally specified and well integrated into the design of the deposit insurance system.

The principal objectives for deposit insurance systems are to contribute to the stability of the financial system and protect depositors.

Recommended Core Principles Continued

Principle 2 – Mitigating moral hazard

Moral hazard should be mitigated by ensuring that the deposit insurance system contains appropriate design features and through other elements of the financial system safety net (see Preconditions paragraph 16).

Recommended Core Principles Continued

Principle 3 – Mandate

It is critical that the mandate selected for a deposit insurer be clear and formally specified and that there be consistency between the stated public-policy objectives and the powers and responsibilities given to the deposit insurer.

Recommended Core Principles Continued

Principle 4 – Powers: A deposit insurer should have all powers necessary to fulfill its mandate and these powers should be formally specified. All deposit insurers require the power to finance compensation payments, enter into contracts, set internal operating budgets and procedures, and access timely and accurate information to ensure that they can meet their obligations to depositors promptly.

Principle 5 – Governance: The deposit insurer should be operationally independent, transparent, accountable and insulated from undue political and industry influence.

Recommended Core Principles Continued

Principle 6 – Relationships with other safety-net participants:

A framework should be in place for the close coordination and information sharing, on a routine basis as well as in relation to particular banks, among the deposit insurer and other financial system safety-net participants. Such information should be accurate and timely (subject to confidentiality when required). Information-sharing and coordination arrangements should be formalized.

Recommended Core Principles Continued

Principle 7 – Cross-border issues:

Provided confidentiality is ensured, all relevant information should be exchanged between deposit insurers in different jurisdictions and possibly between deposit insurers and other foreign safety-net participants when appropriate. In circumstances where more than one deposit insurer will be responsible for coverage, it is important to determine which deposit insurer or insurers will be responsible for the reimbursement process. The deposit insurance already provided by the home country system should be recognized in the determination of levies and premiums.

Recommended Core Principles Continued

Principle 8 – Compulsory membership:

Membership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (e.g. retail and small business depositors) to avoid adverse selection.

Recommended Core Principles Continued

Principle 9 – Coverage:

Policymakers should define clearly in law, prudential regulations or by-laws what an insurable deposit is. The level of coverage should be limited but credible and be capable of being quickly determined. It should cover adequately the large majority of depositors to meet the public-policy objectives of the system and be internally consistent with other deposit insurance system design features.

Recommended Core Principles Continued

Principle 10 – Transitioning from a blanket guarantee to a limited coverage deposit insurance system:

When a country decides to transition from a blanket guarantee to a limited coverage deposit insurance system, or to change a given blanket guarantee, the transition should be as rapid as a country's circumstances permit. Blanket guarantees can have a number of adverse effects if retained too long notably, moral hazard. Policymakers should pay particular attention to public attitudes and expectations during the transition period.

Recommended Core Principles Continued

Principle 11 – Funding:

A deposit insurance system should have available all funding mechanisms necessary to ensure the prompt reimbursement of depositors' claims including a means of obtaining supplementary back-up funding for liquidity purposes when required. Primary responsibility for paying the cost of deposit insurance should be borne by banks since they and their clients directly benefit from having an effective deposit insurance system.

For deposit insurance systems (whether ex-ante, ex-post or hybrid) utilizing risk-adjusted differential premium systems, the criteria used in the risk-adjusted differential premium system should be transparent to all participants. As well, all necessary resources should be in place to administer the risk-adjusted differential premium system appropriately.

Recommended Core Principles Continued

Principle 12 - Public awareness:

In order for a deposit insurance system to be effective it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.

Recommended Core Principles Continued

Principle 13 - Legal protection:

The deposit insurer and individuals working for the deposit insurer should be protected against lawsuits for their decisions and actions taken in “good faith” while discharging their mandates. However, individuals must be required to follow appropriate conflict-of-interest rules and codes of conduct to ensure they remain accountable. Legal protection should be defined in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified.

Principle 14 – Dealing with parties at fault in a bank failure:

A 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.

Recommended Core Principles Continued

Principle 15 – Early detection and timely intervention and resolution:

The deposit insurer should be part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks. The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well defined and transparent criteria by safety-net participants with the operational independence and power to act.

Recommended Core Principles Continued

Principle 16 – Effective resolution processes:

Effective failure-resolution processes should: facilitate the ability of the deposit insurer to meet its obligations including reimbursement of depositors promptly; minimize resolution costs and disruption of markets; maximize recoveries on assets; reinforce discipline through legal actions in cases of negligence or other wrongdoings.

In addition, the deposit insurer or other relevant financial system safety-net participant should have the authority to establish a flexible mechanism to help preserve critical banking functions by facilitating the acquisition by an appropriate body of the assets and the assumption of the liabilities of a failed bank (e.g. providing depositors with continuous access to their funds and maintaining clearing and settlement activities).

Resolution types: Liquidation and reimbursement of depositor' claims, Purchase and assumption transactions, open-bank financial assistance

Recommended Core Principles Continued

Principle 17 – Reimbursing depositors:

The deposit insurance system should give depositors prompt access to their insured funds. Therefore, the deposit insurer should be notified or informed sufficiently in advance of the conditions under which a reimbursement may be required and be provided with access to depositor information in advance.

Depositors should have a legal right to compensation up to the coverage limit and should know when and under what conditions the deposit insurer will start the payment process, the time frame over which payments will take place, whether any advance or interim payments will be made as well as the applicable coverage limits.

Recommended Core Principles Continued

Principle 18 – Recoveries:

The deposit insurer should share in the proceeds of recoveries from the estate of the failed bank. The management of the assets of the failed bank and the recovery process (by the deposit insurer or other party carrying out this role) should be guided by commercial considerations and their economic merits.

✉ *Summaries provided by David Walker, CDIC*

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Convergence Trends

Convergence trends

- Implicit deposit insurance programs: Australia and New Zealand
- Expanded powers: examination and review of insured banks, risk assessment and intervention, resolution of failed institutions
- Coverage: use of co-insurance has been largely abandoned
- Funding: trend is towards ex-ante funding, differential premiums are becoming more prevalent
- Reimbursing depositors: ability to reimburse depositors promptly varies greatly from days to years
- Public awareness: initiatives becoming more common

Transitioning Considerations: G-20, FSF

Transitioning Considerations

- Financial stability needed, timing dependent on overall economic situation and condition of financial system
- Detailed timeline and goal set, sometimes extended
- Mechanism for newly failed banks should be in place
- Strong public awareness program
- Improvements in system design during transition

General Comments on the Financial Crisis

This crisis reinforces need for:

1. Better information sharing and coordination of arrangements for cross-boarder failure resolutions
2. More harmonized deposit insurance design related to:
 - Coverage
 - Prompt reimbursements
 - Credible funding
 - Better public awareness
3. Transitioning framework from blanket guarantees to limited coverage
4. Core Principles for Effective Deposit Insurance Systems



Thank you

www.iadi.org