

# FINANCIAL STABILITY FORUM

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Guidance for Developing Effective Deposit Insurance Systems

Background Documents

Working Group on Deposit Insurance

September, 2001

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# Acknowledgements

The preparation Financial Stability Forum (FSF) Report *Guidance for Developing Effective Deposit Insurance Systems* took the energy of many talented people. I want to particularly thank the members of the Working Group on Deposit Insurance, the research committee, and all of you who have contributed your hard work and thoughtfulness. We have looked at deposit insurance issues from a practitioner's perspective and developed the guidance based on research, consultation and the knowledge brought by so many.

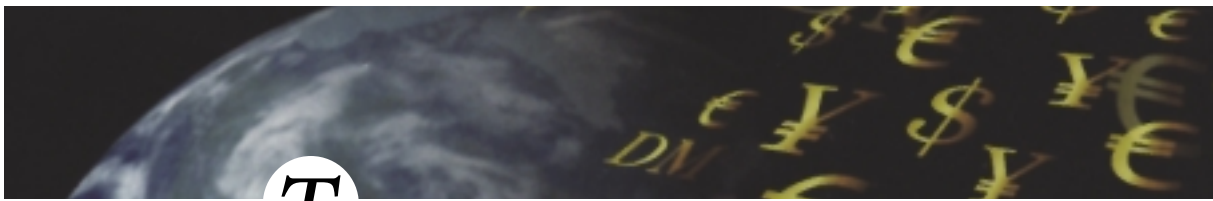
The FSF Report and the documents contained in this "volume" is the culmination of a process that began with the creation of the Study Group on Deposit Insurance that was asked to assess the desirability and feasibility of setting out international guidance on deposit insurance arrangements. The Study Group's report was tabled at a meeting of the Financial Stability Forum in March 2000. On the basis of the conclusions in that report, I was invited to constitute the FSF Working Group on Deposit Insurance, to develop such guidance and to deliver a final report.

We have made tremendous progress in developing the guidance, but I recognize that more work remains. To name just a few examples, deposit insurers around the world will have to deal with the consequences of technological change, financial sector consolidation and conglomeration, increasing cross-border deposit-taking activities, the growing use of deposit-like substitutes, and issues related to the Internet and electronic commerce. Even the issues that we addressed specifically in the FSF report will have to be continuously examined in light of new practices and innovations. Change is the only constant in the financial sector. All of us will have to continually search out new information and examine our policies, practices and systems to ensure that they remain current and relevant.

The Working Group began a process that helped deposit insurance practitioners and other members of the financial safety net to better understand the nature of the challenges they face, think about possible solutions and know who to call in times of need. Given the comments that I received during the past two years there is a great need to continue our knowledge sharing. Deposit insurers should consider how best this can best be accomplished.

J.P. Sabourin  
President and Chief Executive Officer  
Canada Deposit Insurance Corporation

September 22, 2001



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# Introduction

The FSF was created in 1999 to promote international financial stability, to improve the functioning of markets, and to reduce systemic risk. In recognition of the increasing use of deposit insurance as an integral component of an effective financial safety net, the Chairman of the FSF invited Mr. Jean Pierre Sabourin, President and Chief Executive Officer, Canada Deposit Insurance Corporation, to constitute a Working Group on Deposit Insurance (“the Working Group”) to develop guidance and to deliver a final report to the FSF by September 2001.

The mandate of the Working Group was to develop guidance on sound deposit insurance arrangements for countries considering the adoption of a deposit insurance system or the reform of an existing one. The mandate also specified that such guidance should be developed through a consultative process that included countries interested in deposit insurance issues. The guidance developed by the Working Group is reflective of, and adaptable to, a broad set of circumstances, settings and structures.

In fulfilling its mandate the Working Group engaged in a wide range of activities. These activities included: the publication of a series of business plans and sixteen discussion papers on specific issues, outreach sessions, seminars, conferences, utilisation of a Web site to solicit feedback and share knowledge, and the production of the FSF Report *Guidance for Developing Effective Deposit Insurance Systems*. The Working Group met with over 400 people from 119 countries who have been kept fully informed about the development of the guidance topics.

This “volume” provides a comprehensive package of the documents produced by the Working Group as well as information on the process used. The Working Group’s discussion papers explore specific deposit insurance topics in greater detail than what is found in the FSF Report. As well, this document includes a copy of the research plan, the agendas that were used for the outreach sessions, seminars and conferences, lists of participants at these various sessions and a list of individuals who provided feedback on the discussion papers and the draft report. The contributions and comments from interested parties around the world provided helpful information and perspectives to the members of the Working Group and contributed to the comprehensiveness of the process and the FSF Report.



# I

## *Research*



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# *Process*

The Working Group developed a research plan on the discussion papers contained in this Part. Sub-groups were formed for each guidance topic. A Working Group member headed each sub-group and a Research Committee member provided support. The focus for each sub-group was articulated in a business plan outlining its objective and methodology. It also delineated the methods used to generate feedback. A web site, outreach sessions, seminars and conferences were the main vehicles that were used to validate the approach.

# Research Plan

June 22, 2000

A proposed research agenda for the development of guidance on deposit insurance is presented below. The dates and topics are subject to change on the basis of the consultative process. The focus of the proposed research, the methodology, and certain deliverables are provided for the main topics. The research effort will include a search of the relevant literature, case studies, and consultations with practitioners of deposit insurance and interested parties, as appropriate. The papers that result from this effort will be used as the basis for the formulation of guidance on deposit insurance.

In order to develop guidance on deposit insurance, it is vital to draw upon the interest, experience, and expertise of the members of the Working Group, practitioners and others. To that end, participants from the Working Group, and/or their designees, will be requested to participate in the analysis of selected topics. In addition, requests for information on pertinent topics will be sent to interested parties in order to solicit their input.

A subgroup of the Working Group will be established for each topic listed in the Research Plan. A Coordinator, who is a member of the Working Group, will head each subgroup. The Coordinator will be responsible for ensuring that the relevant deliverables are completed in the specified timeframe. A member of the Research Committee will offer guidance and provide assistance to the participants in each case. In order to carry out the Research Plan, the following steps will be employed.

- Members of the Research Committee<sup>1</sup> will develop a draft business plan for each topic identified in the Research Plan.
- The draft business plan will be given to the Coordinator and subgroup members for their review and modification, as appropriate.
- The Coordinator of the subgroup will submit the revised business plan to George Hanc, Chair of the Research Committee, for his review.

- Upon review by George Hanc, the Business Plan will be submitted to J.P. Sabourin, Chair of the Working Group, for his review.
- The revised business plan will be returned to the Coordinator and subgroup members for implementation.

The result of these efforts will be papers that will include: relevant background information, the identification of pertinent issues, a summary and conclusions, and specific recommendations regarding possible guidance.<sup>2</sup> On the basis of these papers, the Research Committee will produce documents for review by members of the Working Group.

Observations on the Research Plan are welcome and should be directed to [ghanc@fdic.gov](mailto:ghanc@fdic.gov) and copied to [dwalker@cdic.ca](mailto:dwalker@cdic.ca).

## Part A: General Policy Issues

### 1 Public-Policy Objectives

*Focus:* The public-policy objectives underlying a deposit insurance system must be consistent with a country's political, legal, and economic infrastructure. The deposit insurer must be aware of the trade-offs associated with its objectives, and have sufficient powers to achieve them.

*Methodology:* Literature review and consultations with practitioners

*Deliverables:*

- Draft to Research Committee — Wednesday, September 6, 2000
- Draft to Working Group — Wednesday, September 20, 2000

*Subgroup Coordinator:* Canada

*Suggested participants:* IMF, Jamaica, Mexico, Philippines

*Research Committee member:* Greg Cowper, [gcowper@cdic.ca](mailto:gcowper@cdic.ca)



## 2 **Moral-Hazard Issues**

*Focus:* Moral hazard exists in all insurance settings. The challenge for policymakers is to design a deposit insurance system that meets the stated public-policy objectives while limiting moral hazard to the extent practicable.

*Methodology:* Literature review and consultations with practitioners

*Deliverables:*

- Draft to Research Committee — Wednesday, September 6, 2000
- Draft to Working Group — Wednesday, September 20, 2000

*Subgroup Coordinator:* USA

*Suggested participants:* Chile, France, Germany, Italy, Japan, The World Bank

*Research Committee member:* George Hanc, ghanc@fdic.gov

## Part B: Situational Analysis and Transitional Considerations

### 3 **Situational Analysis, Conditions and Implementation Considerations**

*Focus:* When determining how to design, implement, or enhance a deposit insurance system, existing conditions (political, economic, and legal) must be considered.

*Methodology:* Case studies drawing on the experience of countries that have established a deposit insurance system and how their situations affected their systems; consultations with practitioners and others; and the Strategic Analysis Model.

*Deliverables:*

- Draft to Research Committee — Wednesday, September 6, 2000
- Draft to Working Group — Wednesday, September 20, 2000

*Subgroup Coordinator:* IMF

*Suggested participants:* Argentina, France, Mexico, The World Bank

*Research Committee member:* George Hanc, ghanc@fdic.gov

### 4 **Special Considerations When Transitioning from Blanket Deposit Guarantees to Limited-Coverage Explicit Deposit Insurance Systems**

*Focus:* A number of countries implemented blanket government guarantees to prevent the collapse of their financial systems and restore or achieve financial stability. As financial stability returns, many of these countries are focusing on ways to make a smooth transition from blanket guarantees to limited-coverage deposit insurance systems.

*Methodology:* Case studies and literature review.

*Deliverables:*

- Draft to Research Committee — Wednesday, September 6, 2000
- Draft to Working Group — Wednesday, September 20, 2000

*Subgroup Coordinator:* Mexico

*Suggested participants:* Hungary, IMF, Japan

*Research Committee member:* Christine Blair, cblair@fdic.gov

## Part C: Terms and Conditions for Establishing an Effective Deposit Insurance System

The focus, methodology and deliverables for each of the components of Part “C” are as follows:

*Focus:* Architects of a deposit insurance system must consider certain fundamental issues. These include:

- Membership — what institutions should be members of the deposit insurance system;
- Who and what types of accounts should be covered, and the limits of that coverage;

- Should there be an insurance fund, and, if so, what is the optimal size of that fund;
- Determination of the administration and timing for distributing claims;
- Issues relating to depositor priority;
- Information sharing;
- Issues relating to human and other organizational resources;
- Issues relating to public and private systems; and
- Public awareness.

*Methodology:* Literature review, consultations with practitioners, and case studies of past and current practices

*Deliverables:*

- Status Report — November Working Group Meeting
- Draft to Research Committee — December 1, 2000
- Draft to Working Group — December 15, 2000

## 5 Membership

Issues include:

- What institutions should be members of the deposit insurance system

*Subgroup Coordinator:* Argentina

*Suggested participants:* Germany, Italy, The World Bank

*Research Committee member:* Greg Cowper, gcowper@cdic.ca

## 6 Coverage

Issues include:

- Who and what types of accounts should be covered; and
- The limits of that coverage.

*Subgroup Coordinator:* Chile

*Suggested participants:* Germany, Hungary, Italy, IMF, USA

*Research Committee member:* Rose Kushmeider, rkushmeider@fdic.gov

## 7 Funding

Issues include:

- Should there be an insurance fund;
- If so, what is the optimal size of that fund;
- Access to government funding.

*Subgroup Coordinator:* France

*Suggested participants:* Canada, Chile, Hungary, Italy, Mexico, USA

*Research Committee member:* Christine Blair, cblair@fdic.gov

## 8 Reimbursing Depositors

Issues include:

- Determining the administration and timing for the distribution of claims.

*Subgroup Coordinator:* Hungary

*Suggested participants:* Italy, Philippines, USA

*Research Committee member:* Rose Kushmeider, rkushmeider@fdic.gov

## 9 Depositor Priority and Right of Set-off

Issues include:

- Creditor preference; and
- The position of depositors vis-à-vis other creditors of the insured institution.

*Subgroup Coordinator:* Canada

*Suggested participants:* Germany, IMF (netting), USA

*Research Committee member:* David Walker, dwalker@cdic.ca

## 10 Structure and Organization

Issues include:

- Mandate and objectives
- Corporate governance
- Human resources

*Subgroup Coordinator:* Philippines

*Suggested participants:* Canada, Germany, Jamaica, The World Bank

*Research Committee member:* David Walker, dwalker@cdic.ca

**11 Public Awareness**

Issues include:

- Informing the public regarding the products covered by deposit insurance; and
- Informing the public about the limits of deposit insurance coverage.

*Subgroup Coordinator:* Jamaica

*Suggested participants:* Hungary, Japan, Mexico, Philippines

*Research Committee member:* Detta Voesar, dvoesar@fdic.gov

**12 Interrelationships Between Safety-Net Players**

Issues include:

- Risk information;
- Information sharing/confidentiality; and
- Public and/or private deposit insurance systems.

*Subgroup Coordinator:* Italy

*Suggested participants:* Argentina, Chile, Jamaica, Japan, France

*Research Committee member:* Detta Voesar, dvoesar@fdic.gov

**13 Powers**

*Subgroup Coordinator:* IMF

*Suggested participants:* France, Hungary, Italy, Japan, USA

*Research Committee member:* Rose Kushmeider, rkushmeider@fdic.gov

**Part D: Remaining Issues****14 Failure Resolution**

*Subgroup Coordinator:* United States

*Participants:* France, Hungary, Italy, Japan and IMF

*Research Committee member:* George Hanc

**15 Claims and Recoveries**

Subgroup

Coordinator: Canada

Participants: Hungary, Philippines, Mexico and USA

Research Committee member: Greg Cowper

**16 Cross-Border Issues**

*Subgroup Coordinator:* Germany

*Participants:* Canada, Mexico, Hungary and USA

*Research Committee member:* David Walker

# Sample Business Plan

## Situational Analysis, Conditions and Implementation Considerations: Business Plan

July 26, 2000  
Final, Working Group Version

The Background Paper of the Study Group on Deposit Insurance emphasized the conditions that should be taken into account in the development of an effective deposit insurance system. Although it is understood that in many cases conditions are not perfect, it is important to identify gaps and to develop plans to incorporate the necessary changes required in conditions when developing an effective deposit insurance system. To better understand the process of situational analysis against conditions, the experience of countries that have considered adopting, or significantly altering, deposit insurance systems will be documented and analyzed.

### Issues to be Addressed

- 1** What conditions need to be taken into account in deciding whether to: (1) adopt explicit, limited deposit insurance; or (2) significantly alter the terms and conditions of existing deposit insurance systems? Among the issues that could be considered are:
  - Macroeconomic conditions
  - State of the banking system
  - Private sector confidence
  - Regulatory/supervisory regimes
  - Accounting/disclosure regimes
  - Pre-existing deposit protection system, if any (implicit/explicit/limited/unlimited)
  - Public awareness
- 2** Have some of these conditions proved to be more important than others, in particular countries?
- 3** What issues were taken into consideration in determining the type of deposit insurance system or deposit insurance agency (what institutions covered, what amounts covered, etc). Possible examples are:
  - Concentration of the banking system
  - Competition
  - Private sector expectations
- 4** Granted that conditions will never be ideal, does experience suggest that there are some basic criteria that should be attained before adopting explicit, limited deposit insurance?
- 5** What type of process was used to evaluate country conditions, identify gaps, and develop plans to incorporate changes? (The Study Group developed a Strategic Analysis Model as a tool to assist policy-makers in determining how to design, implement, and enhance an effective deposit insurance system.)
- 6** Were there obstacles that impeded the establishment or alteration of deposit insurance systems? If so, how were these obstacles overcome?
- 7** Based on experience, what lessons were learned?
- 8** Are there other issues that should be addressed in this analysis?
- 9**

## Analysis of Issues

These issues are best addressed by reviewing case studies of actual experience in countries that have adopted deposit insurance or significantly altered their existing deposit insurance systems. Subgroup members are asked to prepare a brief report on the “Issues to be Addressed” based on experience in their own countries and/or their knowledge of experience in other countries.

Subgroup members include Argentina, France, IMF, Mexico, and the World Bank. Subgroup members should provide their reports to the Research Committee member by August 9, 2000.

## Subgroup Survey

Deposit insurers and other interested parties will be asked to comment on their experience as it relates to the “Issues to be Addressed.” The request will be posted on the Working Group’s Web site. It would be particularly useful to get the input of countries that have faced different macroeconomic conditions and have different legal, regulatory, and accounting regimes and banking structures.

## Preparation of Subgroup Issue Paper

Based on the submissions of subgroup members and survey respondents, a draft subgroup issues paper will be prepared by the subgroup coordinator in conjunction with the Research Committee member. After review and comment by the full subgroup, the resultant report will be provided to the Research Committee for its review and then to the full Working Group.

Background: Situational Conditions Commonly Thought to be Important in Assessing the Development of An Effective Deposit Insurance System

1. Political situation
2. Legal framework
3. Condition of the economy and financial markets
4. State of the banking system
5. Regulatory, supervisory, and accounting regimes
6. Public attitudes
7. Disclosure regime
8. Are there other situational conditions that should be considered in determining whether to adopt explicit, limited deposit insurance or to significantly alter existing systems?

*Subgroup coordinator:* IMF

*Subgroup members:* Argentina, France, Mexico, The World Bank

*Research Committee member:* George Hanc: ghanc@fdic.gov

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## Endnotes

- 1 The Research Committee, chaired by George Hanc, includes: Christine Blair, Greg Cowper, Rose Kushmeider, Detta Voesar, and David Walker.
- 2 Guidance may take a number of forms and is to be determined by the Working Group.

# Discussion Papers

## *P*ublic-Policy Objectives

### *Abstract:*

Countries base their deposit insurance systems on a variety of public-policy objectives. After consultation and analysis, the Subgroup on Public-Policy Objectives identified a number of common objectives that may be classified under three broad categories: 1) those contributing to the stability of the financial system; 2) the protection of less-financially-sophisticated depositors; and 3) other. Although countries often choose similar objectives, analysis suggests that there is variation in how they are achieved. Thus, policymakers should endeavour to understand the trade-offs and implications associated with particular objectives, and should structure their deposit insurance systems accordingly. It is also important to revisit these objectives over time.

The following represents the work of the Subgroup on Public-Policy Objectives.<sup>1</sup> The paper focuses on: 1) the identification of public-policy objectives used by different countries; 2) the trade-offs associated with particular public-policy objectives; and 3) the structural and other implementation issues that may arise when particular public-policy objectives are chosen.

### **Background**

The development of public policy by governmental bodies and officials involves the selection of goals and the means of achieving them within a specified context. Public-policy objectives, which involve formal and informal expressions of normative intent, provide purpose and focus. These objectives can be stated explicitly—for example, through a legislative mandate—or implicitly by the way a particular activity is conducted or structured. Implicit public-policy objectives by their nature can be more difficult to identify since they must be

inferred from the way activities are undertaken or administered. At times, the public-policy objective may result in a decision not to act; at other times, multiple public-policy objectives may be pursued through a single activity.

The implementation of a public policy may lead to unintended or unforeseen consequences. In certain cases, such unintended consequences may be inevitable; in other cases, unintended consequences may be addressed by restructuring the policy and activity to make it more consistent with the original intent of policymakers.

Although the determination of public-policy objectives is the responsibility of governments, the private sector often plays a role in the implementation and administration of particular public policies. With respect to deposit insurance, many countries have privately operated systems that fulfil public-policy objectives. The choice of how a deposit insurance system is to be operated depends on factors that are unique to each country.



The selection of public-policy objectives is often a complex process. The Financial Stability Forum's Working Group on Deposit Insurance (the Working Group) suggested in its *Background Paper* that when countries select public-policy objectives, they should take certain conditions into consideration such as the state of their economy, the legal and supervisory framework, the structure of the banking system, the quality of accounting, regulatory and auditing standards, and the disclosure regime.<sup>2</sup> The Working Group also suggested that for countries to fulfil their public-policy objectives, there should be congruence between the objectives and how the deposit insurance system is structured. Although this paper does not examine structural issues specifically, it is important to emphasise that the effectiveness of the deposit insurance system will depend on the level of congruence or fit between public-policy objectives and structures.

A variety of methods exist for determining public-policy objectives. One method suggested by the Working Group is for policymakers to begin with a public-policy paper. The analysis contained in the paper should take into account relevant conditions referred to above. The paper also could set out the key attributes and elements that are important to a deposit insurance system, so as to determine the mandate and the powers to be given to the deposit insurer. As well, the paper should outline the role of the deposit insurer within the financial safety net and the deposit insurer's relationship with the other participants in the regulatory and supervisory regime. The paper would form the basis for discussion and help policymakers formulate their decisions.

## Public-Policy Objectives for Deposit Insurance Systems

Public-policy objectives vary according to national conditions. Countries may structure their deposit insurance system to achieve one or more objectives. These objectives may shift over time in response

to changes in economic, financial and/or social circumstances. Policymakers may alter the mandate, roles and responsibilities of the deposit insurance system in response to these changes.

To aid its deliberations, the Subgroup examined information provided by members of the Working Group on the public-policy objectives underlying their deposit insurance systems. The Subgroup also considered information provided through the Working Group's public Web site and Outreach Sessions. As a result of this consultative process the Subgroup identified three broad categories of public-policy objectives. First, contributing to financial system stability; second, protecting less-financially-sophisticated depositors; and third, other objectives. In certain circumstances some objectives may be closely related to, or components of, broader objectives. A general discussion of these broad categories follows.

### ***Contributing to financial-system stability***

A common public-policy objective for deposit insurance systems is to contribute to the stability of a country's financial system. This objective is based on a concern that depositors may lose confidence in an institution under certain circumstances.

### ***Minimising the risk of runs***

Without deposit insurance there is a greater likelihood that depositors might "run" by removing their deposits from an institution in response to difficulties—either real or perceived—at that institution. Once a run begins at one institution, it may lead to runs at others—regardless of their condition—as depositors may find it difficult to differentiate between sound and unsound institutions. This is often called the contagion effect. As a result, sound institutions may face difficulties when they are compelled to liquidate their asset portfolios, often at depressed prices, in order to meet withdrawals.

The ability of a deposit insurance system to stem or avoid bank runs depends on the extent to which depositors feel protected from loss in the event of

a failure. The level of coverage, the speed with which insured deposits are repaid, and the credibility of the guarantee will affect whether the deposit insurance system is capable of enhancing financial stability. However, a policy trade-off exists between maximising financial stability through a blanket guarantee and the problem of maintaining market discipline. Over the long term, financial stability may be enhanced by limiting coverage and fostering market discipline since distortions in market incentives may be lessened.

It is important to note that a deposit insurance system on its own cannot ensure financial system stability. This is especially true in cases of a systemic crisis. A deposit insurance system is more effective when it is part of a coordinated financial safety net that includes, among other things, supervisory and regulatory arrangements and lender-of-last-resort facilities. Bankruptcy and insolvency laws and a government's economic policies also will play a crucial role in mitigating and avoiding problems in the financial sector.

#### ***Creating formal mechanisms for resolving failed institutions***

The introduction or reform of a deposit insurance system may be linked to a country's attempt to put in place laws and mechanisms that deal with failed institutions. Experience suggests that the failure of depository institutions must be handled in unique ways to deal with the tendency of troubled institutions to deteriorate rapidly, while minimising adverse effects on the overall financial system. The introduction of deposit insurance may be linked to the creation of a country's failure-resolution framework.

#### ***Contributing to an orderly payments system***

Deposit insurance helps to promote financial stability by contributing to the smooth functioning of the payments system. Deposits allow individuals and businesses to save and withdraw money when it is needed. By promoting confidence in the system, deposit insurance facilitates the smooth transfer of

deposits between parties. For the payments system to function, depositors must be certain that their money on deposit is as sound as currency.

In addition, some deposit insurance systems are able to provide a form of emergency financial assistance, which may involve guaranteeing the payment transactions of troubled institutions. Such assistance may help to avoid interruptions in payment and settlement flows. In so doing, such assistance provides time for safety-net participants to devise solutions to resolve troubled institutions.

#### ***Resolving a financial crisis***

Deposit insurance systems are often introduced when a country is undergoing or has undergone a period of significant financial instability. When problems within the financial sector occur, deposit insurance facilitates the ability of institutions to maintain a stable deposit base and is a means of assuring depositors that their funds are secure.

There are certain issues that should be considered when a deposit insurance system is introduced. As mentioned earlier, a deposit insurance system by itself cannot restore financial stability. In addition, deposit insurance will be more effective when it is introduced as part of a comprehensive framework that includes sound macroeconomic policies, regulatory and supervisory arrangements, legal frameworks, and lender-of-last-resort facilities. These statements are valid regardless of whether the financial system is in crisis.

A deposit insurance system that is introduced to avert short-term financial instability may lead to long-term problems if issues such as moral hazard are not addressed.<sup>3</sup> Mechanisms exist that minimise such costs, although they may be difficult to introduce during periods of financial instability.

#### ***Protecting less-financially-sophisticated depositors***

An oft-cited public-policy objective for deposit insurance is the protection of less-financially-sophisticated depositors, who often are distinguished

by the small size of their deposits. Less-financially-sophisticated depositors are protected for the following reasons. First, deposit insurance protects individual depositors against the consequences associated with the failure of an insured institution. Second, the provision of deposit insurance relieves insured depositors of the difficult and complex task of monitoring and assessing the condition of their financial institution. The opaqueness of information on depository institutions makes it difficult, if not impossible, for less-sophisticated depositors to obtain and analyse the financial condition of these institutions. This is often not the case for sophisticated depositors and other general creditors. As a result, less sophisticated depositors may be at an informational disadvantage. A deposit insurance system can help address the inequity that exists between sophisticated and unsophisticated creditors, and as a result may help improve discipline on institutions.

If the main public-policy objective is to protect less-financially-sophisticated depositors, then the level of coverage may be such that sophisticated depositors will run when an institution is perceived to be in trouble. This is the nature of the trade-off between choosing financial stability as a public-policy objective and choosing protection of less-financially-sophisticated depositors.<sup>4</sup> Conversely, limited coverage may provide an incentive for financially-sophisticated depositors to exert market discipline, which helps constrain overly risky behaviour by insured institutions.

### ***Other public-policy objectives***

Although financial stability and the protection of less-financially-sophisticated depositors are the primary objectives of numerous deposit insurers, some countries have identified other public-policy objectives as important to their system. In some cases, these may be subsidiary objectives or by-products of the pursuit of financial stability or the protection of less-financially-sophisticated depositors. What follows is a sample of some of the less prominent public-policy objectives identified by commentators and the Working Group.

### ***Redistributing the cost of failures***

In countries where there is no formal deposit insurance system the cost of protecting depositors often falls on the government. Establishment of an explicit deposit insurance system can reduce the government's financial obligation for such protection by limiting coverage and by providing a mechanism through which surviving institutions may cover all or a portion of the costs associated with resolving failures. However, the ability of surviving institutions to contribute to the cost of failures will depend on their financial condition. It may be necessary for the deposit insurer to adjust premiums to reflect the remaining institutions' ability to contribute. The government also may have to contribute to part of the cost, at least in the short term.

### ***Promoting competition in the financial sector by reducing competitive barriers in the deposit-taking industry***

By facilitating the entry of new firms into the deposit-taking industry and by helping smaller institutions compete for deposits against larger institutions, deposit insurance may promote competition. In the absence of deposit protection, depositors are likely to prefer using large, well-known institutions that are perceived to be less risky. This perception reflects a number of factors. First, large institutions may have more-diversified portfolios than smaller institutions. Second, larger institutions may be protected by an implicit government guarantee because they are considered to be too big to fail. Third, such institutions may have a long history with a high level of brand and franchise awareness among the public. The benefits of encouraging new entry and competition may be improved economic efficiency, lowered interest rates and spreads, and increased investment and economic development.

The adoption of this objective may require adjustments in the structure of the deposit insurance system to address issues such as moral hazard. For example, a country may opt for generous coverage in order to encourage the formation of

new institutions. However, generous coverage may require stronger supervisory discipline to compensate for any lost market discipline, as well as other measures to control risks to the deposit insurance system. This public-policy objective may have implications for which institutions are eligible for membership in the deposit insurance system.<sup>5</sup> In addition, a focus on promoting competition may compromise the ability of risk-minimising deposit insurance systems to carry out their mandate. In this case the public-policy objective may conflict with the mandate of the deposit insurer.<sup>6</sup>

### ***Encouraging economic growth***

The introduction of deposit insurance may encourage the flow of funds into depository institutions, thereby providing the basis for lending and investment. In addition, the risk premium depositors require on their funds may decrease, which may allow insured institutions to lower their lending rates. Lower financing costs, in turn, may stimulate investment and other economic activity. However, it should be noted that deposit insurance can only indirectly stimulate economic growth.

### ***Reducing the effect of a recession***

One of the benefits of deposit insurance is that it can mitigate the consequences of failures of insured institutions on depositors. This benefit, in turn, may be particularly important during a recession. However, the contribution made by the establishment of a deposit insurance system to solving macroeconomic problems, such as a recession, is limited.

### ***Facilitate the enactment of legislation, regulation and supervisory regimes***

The establishment of a deposit insurance system may provide the impetus for legislators to overcome political barriers to institute other reforms as needed to maintain a sound financial system. The drawback of pursuing this objective is that the resultant framework eventually developed may only reflect the specific issues associated with deposit insurance, and may not be sufficiently comprehensive to contribute to overall financial stability.

### ***Facilitate the transition from a blanket guarantee to limited coverage***

Countries may introduce an explicit, limited-coverage deposit insurance system as a way of facilitating the transition away from a full deposit guarantee provided by the government or other public entity.<sup>7</sup> In such cases, deposit insurance systems may allow governments to reduce coverage, and may provide a mechanism for managing the required change in public and market attitudes toward deposit protection. The successful implementation of this public-policy objective requires a well-developed transition plan, a commitment to limited coverage, and a period of relative financial stability.

## **Conclusions**

Before structuring or modifying a deposit insurance system, policymakers should identify the public-policy objectives they are trying to achieve and the trade-offs involved. Public policies should address the specific needs and conditions of the country.

The choice of public-policy objectives should be guided by a country's contextual conditions, including: the state of the economy; the legal and supervisory framework; the structure of the financial system; the quality of accounting, regulatory and auditing standards; and the disclosure regime. As time passes and conditions change, a country's public-policy objectives may need to be adjusted to account for the new circumstances. In many countries a process exists for periodically reviewing their deposit insurance system's public-policy objectives. In this way, countries can ensure that their deposit insurance system remains consistent with economic and social conditions, and is better able to deal with the challenges it encounters.

The structure of the deposit insurance system should be consistent with a country's chosen public-policy objectives. Public-policy objectives can be stated explicitly—for example, through a legal mandate—or implicitly—for example, by the way the system is structured. Implementation of an effective deposit insurance system involves understanding all of the

relevant public-policy objectives and their implications, and structuring the scheme accordingly.

Many public-policy objectives for deposit insurance systems exist. Although some objectives are more well-known than others, countries choose their objectives according to their country-specific goals and circumstances.

Although the determination of public-policy objectives is the responsibility of governments, the private sector often plays a role in the implementation and administration of particular public policies. With respect to deposit insurance, many countries have privately operated systems that fulfil public-policy objectives.

In practice, policymakers may present their objectives in a paper, such as a consultation document. This paper could contain analyses of country conditions and set out key attributes and elements of the deposit insurance system. Consideration also should be given to the deposit insurer's role within the financial safety net and its relationship to other safety-net participants.

Policymakers should review periodically the objectives and structure of the deposit insurance system and make changes as appropriate. Such a review may be needed in response to changes in economic, financial and/or social circumstances. Policymakers may alter the mandate, roles and responsibilities of the deposit insurance system in response to these changes.

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## Endnotes

- <sup>1</sup> The Subgroup on Public-Policy Objectives is comprised of representatives from Canada (coordinator), Jamaica, Mexico, Philippines, and the International Monetary Fund.
- <sup>2</sup> Financial Stability Forum Working Group on Deposit Insurance, *A Consultative Process and Background Paper*, June 2000.
- <sup>3</sup> These issues are discussed in the papers on moral hazard and transitioning.
- <sup>4</sup> See the papers on moral hazard and coverage for further discussion of these issues.
- <sup>5</sup> See the paper on membership.
- <sup>6</sup> See the paper on structure and organisation.
- <sup>7</sup> See the discussion paper on transitioning.



## Options for Addressing Moral Hazard

### Abstract:

Moral hazard is present in deposit insurance systems, as is true of other insurance settings. Greater efforts to contain its effects are needed in many countries if deposit insurance is to be effective. Various methods are available for this purpose, which may be grouped under three headings: (1) good corporate governance and management of individual institutions; (2) market discipline exercised by uninsured depositors and other creditors; and (3) regulatory discipline exercised by supervisors and deposit insurers.

All of the methods for controlling moral hazard have potential advantages and disadvantages. Choices among them generally involve trade-offs among competing public-policy objectives and risks, and reflect a variety of factors existing in a particular country. Thus, in choosing among methods for reducing moral hazard, policymakers may wish to consider: (a) the primary objectives of deposit insurance in their country; (b) the conditions that determine the effectiveness of particular methods of curtailing moral hazard; (c) the commitment and the ability of the country to meet these conditions; and (d) progress in advancing a reform agenda to eliminate gaps in the country's ability to implement particular methods. Decisions relating to the design of deposit insurance systems need to take these considerations into account.

This paper represents the work of the Subgroup on Moral Hazard.<sup>1</sup> It is designed for deposit insurance practitioners and other interested parties, and draws on the experience of various countries that have addressed the moral-hazard issue, as well as on the extensive literature on the subject.

### Moral Hazard and Deposit Insurance

Moral hazard refers to the incentive for increased risk-taking that is present in deposit insurance as well as in other kinds of insurance. To the extent that depositors are protected, they have little

incentive—and in some cases limited access to the necessary information—to monitor the performance of insured institutions. As a result, in the absence of regulatory or other restraints, funds are available for weak institutions and for high-risk ventures at lower cost than otherwise would be the case. Unless effective steps are taken to curtail moral hazard, the deposit insurance system faces the possibility of increased losses and the economy as a whole may suffer from imbalances if more funds are channelled into high-risk activities.

Incentives for increased risk-taking are greatest under a system of blanket guarantees, whereby full protection is provided to all depositors and other



stakeholders in response to a financial crisis that threatens the collapse of the financial system. Accordingly, a number of countries with blanket guarantees have moved, or are considering moving, to limited-coverage deposit insurance systems. Even in a limited-coverage system, however, moral hazard remains a concern. Greater efforts are needed in many cases to contain moral hazard by means of the design of the deposit insurance system and the actions of supervisory and deposit insurance authorities.

**This paper addresses the following questions:**

What means of reducing moral hazard are available in principle and what trade-offs are involved in their use?

What means of curtailing moral hazard have been adopted in particular countries and what can be learned from this experience?

What conditions—political, legal, financial, supervisory, resource availability, *etc.*—may affect the suitability of specific measures to curtail moral hazard in particular countries?

## Incentive Effects of Deposit Insurance on Stakeholders of Insured Institutions

At the heart of the moral-hazard issue are the incentives provided by deposit insurance to stakeholders—depositors, other creditors, owners, managers and directors—and to bank supervisors and deposit insurers. These incentives differ considerably in different deposit insurance systems—blanket guarantee, implicit, and limited-coverage deposit insurance.

### ***The effects on depositors***

Depositors, as noted above, have little or no incentive to monitor the performance of insured institutions or discipline their risk behaviour in a system of blanket guarantees. A similar situation is likely

to exist in an implicit insurance system, although depositors may exercise greater caution if there is uncertainty as to the willingness and capacity of government to provide *ad hoc* protection when an institution fails. In an explicit, limited-coverage system, on the other hand, uninsured depositors and other unsecured creditors are aware that they are likely to sustain losses in the event of the failure of an insured institution; they consequently have strong incentives to monitor the performance of their institution and keep their funds in institutions they regard as sound. However, such incentives may be lessened if depositors are able to diversify their holdings among a number of institutions while staying within insurance limits.

Whether limiting deposit insurance coverage provides effective depositor discipline depends, of course, on whether the limits are enforced when an institution fails. Also required are strong accounting and disclosure regimes and a financially sophisticated group of depositors able to distinguish between sound and unsound institutions on the basis of available data.

### ***The effects on owners***

Owners also have different incentives under blanket guarantees and limited-coverage deposit insurance. Blanket guarantees generally are issued in response to a financial crisis and often are designed to shield both institutions and their borrowers from losses. In these circumstances, there are few penalties for undertaking excessive risks. In limited-coverage systems, on the other hand, losses and failures are clear possibilities. Although benefiting from the low cost of insured deposits, owners may seek to control an institution's risk in order to protect their investment. Such incentives, however, are weakened if the institution is poorly capitalised or insolvent. Consequently, owners have little or no equity left to lose, and their liability if an institution fails is limited to the amount of their investment. They may then be tempted to put the deposit insurer or the government's funds at risk.

### ***The effect on managers and directors***

Managers and directors also may benefit from having access to low-cost insured deposits to fund asset growth. However, because of concerns about their professional reputations and potential liability, they may exercise a restraining influence on excessively risky activities at their institutions. This influence is likely to be greatest in limited-coverage systems when failures are a possibility, particularly if bankruptcy is viewed by the society with disfavour and has significant financial consequences, if inappropriate actions are subject to legal sanctions, and if compensation schemes are consistent with the safe-and-profitable operation of the institution.

### ***The effects on supervisors and deposit insurers***

Supervisors and deposit insurers may encounter serious difficulties in attempting to curtail excessive risk in a system of blanket guarantees adopted in a financial crisis. Actions by supervisors and deposit insurers are likely to be more effective in systems of limited-coverage insurance. Risky behaviour by insured institutions, and the losses that are likely to result from such behaviour, may be curtailed by various regulatory actions as described below. However, provisions may be needed to require, by statute or otherwise, early intervention by supervisors and deposit insurers in the case of troubled institutions. Otherwise, an insolvent institution may be allowed to continue to operate as a result of forbearance or political pressure, with the prospect that losses will be greater when it finally is closed.

## **Methods of Reducing Moral Hazard**

In principle, various measures are available to curtail moral hazard. They generally fall under the following headings: (1) good corporate governance and management; (2) market discipline exercised by depositors and other creditors; and (3) regulatory discipline exercised by supervisory and, in some

countries, deposit insurance authorities. For ease of exposition, these methods are discussed separately in this paper. However, many deposit insurance systems have elements of all three, and these methods are most effective when they work in tandem to curtail moral hazard. Depending on conditions in different countries, the relative importance of, and the reliance placed on, the three methods may vary considerably. As noted later in this paper, some countries may not have conditions that are conducive to controlling moral hazard.

### ***Corporate governance and management***

Among other things, good corporate governance encompasses internal standards, processes, and systems for ensuring appropriate direction and oversight by directors and senior managers, adequate internal controls and audits, risk management, evaluation of the institution's performance, alignment of compensation with sound business objectives, and management of capital and liquidity positions. Good corporate governance and management can help assure that business strategies are consistent with safe-and-sound operations, and thus can act as the first line of defense against excessive risk-taking.

However, the effectiveness of corporate governance and management may at times be weakened by competitive pressures or by other external forces that reduce earnings and capital positions. Institutions may then be tempted to reach for yield by undertaking riskier loans and investments. They also may be tempted to reduce expenses by reducing resources for internal controls, audits, risk management, and other processes that help control risk. At the extreme, as noted earlier, owners of an insolvent or barely solvent institution may conclude that they have little to lose by engaging in high-risk activities. Accordingly, efforts to establish good corporate governance and management must be accompanied in most cases by market and/or regulatory discipline if moral hazard is to be contained.

## ***Market discipline***

Market discipline exposes some stakeholders—uninsured depositors, other creditors, and stockholders—to the risk of loss in the event an institution fails.<sup>2</sup> Efforts by these stakeholders to limit their exposure result in market signals such as shifts of funds from institutions perceived to be unsound to those perceived to be sound and movements in the prices of publicly traded securities issued by the institutions. Whether such market signals provide an accurate assessment of risk depends in large part on the availability of relevant information on the condition and performance of institutions. The assembly and analysis of such information are facilitated by the activities of rating agencies, security analysts, financial commentators, and other professionals. Ultimately, the effectiveness of market discipline depends on the existence of strong accounting and disclosure regimes to ensure the availability to the public of accurate and consistent information on risk.

The chief means of exercising depositor or creditor discipline include: limits on the amounts insured, exclusion from coverage of certain categories of deposits, coinsurance, depositor preference, mandatory subordinated debt, and other publicly issued securities.

### ***Insurance levels and the extent of coverage***<sup>3</sup>

Limits on the amount of a deposit that is insured expose some depositors to the risk of loss in the event their institution fails and provide motivation for shifting funds to institutions believed to be safe. A similar effect is achieved by excluding from coverage funds held by depositors thought to be capable of monitoring the performance of their institutions—such as interbank deposits.<sup>4</sup> This assumes that uninsured depositors have the necessary information and financial sophistication to distinguish between sound and unsound institutions. It also assumes that supervisory and deposit insurance officials have the authority to rehabilitate or close weak institutions and that they will respond appropriately. Finally,

it assumes that deposit insurance limits will be uniformly applied to depositors of all failed insured institutions.

Ultimately, choices as to levels and scope of coverage involve trade-offs among risks and policy objectives. If set too high, there is the prospect of excessive risk-taking. If set too low, there is the risk of runs on both sound and unsound institutions, as well as more gradual shifts of funds out of depository institutions. Whether high or low levels, and broad or narrow coverage, are chosen may depend, in part, on the public-policy objectives sought by the adoption of limited-coverage deposit insurance. Although public-policy objectives may not always be clearly stated, it appears that low levels and narrow coverage may have been chosen by some countries whose primary objective is to protect households with small amounts of savings. On the other hand, it appears that other countries may have chosen higher levels and broader coverage because policy-makers seek primarily to promote financial-market stability, encourage new entrants, or facilitate development of a domestic banking industry.<sup>5</sup> As noted below, whether these objectives are actually realised depends on many factors other than insurance limits.

Choices on levels and coverage may depend on the nature and quality of safety-net arrangements in a particular country. Countries with strong supervisory, regulatory, and enforcement systems may rely heavily on such systems to curtail the moral hazard that may result from adopting relatively high levels and broad coverage. In each case, choices made by different countries with respect to levels and coverage involves a trade-off of moral hazard against the possibility of runs. Such choices are not made in a vacuum, but in the light of other features of the regulatory and deposit insurance systems that may mitigate the unfavourable consequences—whether increased moral hazard or increased possibility of runs—arising from the particular choices made regarding levels and coverage. Among the factors that may influence these choices

are institutional conditions affecting a country's ability to utilise various methods of curtailing moral hazard, such as the strength of the legal, accounting, disclosure, and supervisory regimes. General weakness in these regimes makes control of moral hazard more difficult.

Choices between the two extremes also may reflect a country's past financial history; countries that have a history of instability may opt for higher levels and broader coverage because they may be more concerned about runs than countries with a record of stability. Cost considerations may be important and low levels and narrow coverage may be chosen in countries where the resources available to the deposit insurer are insufficient and supervisors and regulators do not or cannot take prompt corrective action with respect to troubled institutions. Still another factor may be the availability of deposit-like alternatives, such as money-market funds, or the presence of publicly owned institutions, that could siphon liquid funds from private depository institutions if levels and coverage are unduly stringent. Within the financial-services industry, unduly stringent levels and coverage may result in a shift of funds to institutions perceived to be too big to fail.

Finally, it should be recognised that countries may pursue various objectives through their choices of insurance levels and coverage—as well as other design features of the deposit insurance system—but may not achieve the outcomes they desire unless other features of the deposit insurance system and the overall safety net are in place. Thus, low levels and narrow coverage will not achieve the objectives of protecting small depositors while avoiding runs on both sound and unsound institutions, unless there is a high degree of transparency that permits financially sophisticated depositors to distinguish between sound and unsound institutions. Nor is it clear that low insurance levels and narrow coverage will avoid moral hazard if supervisors and deposit insurers are unable to rehabilitate problem institutions before they become insolvent and policymakers are unwilling to close insolvent institutions for

fear of the financial and political consequences of imposing losses on a substantial number of depositors. By the same token, high levels and broad coverage may not achieve their objectives—financial stability, competition, development of a domestic financial system—unless countries have the supervisory arrangements and personal-liability incentives necessary to curtail moral hazard. With respect to financial stability it also is useful to distinguish between short- and long-run outcomes. High levels and broad coverage, like blanket coverage, may help to stabilise the financial system in the short run. In the long run, however, excessive risk-taking may result in instability unless other safety-net features, particularly regulatory discipline, serve to curtail moral hazard.

Members of the Subgroup reported on various measures to reduce moral hazard. With respect to limits on insurance, there are wide variations among the members' countries. Some countries protect virtually the entire amount on deposit and others have relatively high limits compared with other countries. These countries seek to reduce moral hazard primarily through means such as supervisory activity by public authorities, peer-monitoring by insured institutions, and, in rare cases, the imposition of unlimited liability on controlling stockholders of failed institutions. On the other hand, some countries use relatively low limits as an important means of controlling moral hazard. Most countries exclude interbank deposits from coverage, and a substantial number exclude foreign-currency deposits.

### *Coinsurance*

Coinsurance generally provides that insured depositors are not protected in full, but only for a portion—for example, 90 percent—of their insured balances. The possibility of losses may induce some insured depositors to monitor more closely the performance of their institutions. Coinsurance also provides a means of sharing the cost of failures with depositors. Several forms of coinsurance are available that have potentially different implications for the moral-hazard issue,

vulnerability to runs, and the treatment of small and large deposits.<sup>6</sup> Most countries with limited-coverage systems impose no losses on holders of insured balances, but a minority has implemented coinsurance features.<sup>7</sup>

Coinsurance, as well as low insurance limits, may pose equity issues because the size of insured balances is not necessarily correlated with depositors' total wealth. Retirees may have a disproportionate amount in balances at insured institutions. Some depositors have large balances only temporarily—for example, recipients of inheritances, legal settlements, or the proceeds of home sales—and suffer losses because their institutions happen to fail at that time. Moreover, many small depositors may lack the resources or the sophistication to evaluate risk and in periods of stress may run on both strong and weak institutions alike.<sup>8</sup> Some of these issues may be addressed by protecting some minimum amount in full and imposing losses only above that amount.

### *Depositor preference*

Although depositor preference can reduce moral hazard, it also has disadvantages.<sup>9</sup> Under depositor preference, insured and uninsured depositors usually are made whole before other creditors receive any of the proceeds from the liquidation of a failed institution's assets.<sup>10</sup> Depositor preference shifts the costs of failure to unsecured creditors and gives them stronger incentives to monitor risk. As a result, other creditors may act to protect themselves by adopting netting arrangements, collateral demands, and additional charges. At the same time, uninsured depositors have reduced incentives to monitor risk. Regulators also may have reduced incentives for prompt corrective action if the deposit insurer's claims have high priority. The net effect of depositor preference depends on the relative ability and willingness to monitor and control risk on the part of other creditors and those who rank ahead of them when an institution fails.

### *Mandatory subordinated debt*

In principle, subordinated debt is a potentially effective vehicle for exercising market discipline, because it is typically issued with long-term maturities and ranks below all other forms of insured-institution debt. Mandatory subordinated debt also may provide an additional cushion for the protection of the deposit insurer. Subordinated debt required on top of existing equity requirements and sold to other than insured institutions, can provide protection analogous to reinsurance for the deposit insurance authority by transferring some of its risk to the capital markets.

Prices on such debt may provide an indication of the market's assessment of the condition of particular institutions. Unlike equity investors, holders of subordinated debt cannot gain on the upside from increased profitability and their attitude toward risk is likely to be similar to that of deposit insurers. Market signals may be particularly useful if such debt is issued on a continuous basis, although the effects might be distorted during periods of market turbulence. However, because of the relatively high cost of issuance and the need for market liquidity, mandatory subordinated debt may be feasible only for large institutions in countries that have highly liquid bond markets. Few countries have adopted mandatory subordinated debt requirements.

### *Other publicly issued securities*

Market discipline also may be exerted by holders of other securities issued to the public by depository institutions—including senior debt and equity investments. Since they are unprotected, holders of unsecured senior debt are motivated to monitor performance. Equity investors also have similar incentives, although, as noted earlier, they may have a greater tolerance for risk than deposit insurers. Public issuance of securities exposes insured institutions to scrutiny from rating agencies and security analysts, which is helpful in assessing their performance and in strengthening support for greater transparency and disclosure of information on their risk.



### ***Regulatory discipline***

As indicated earlier, market discipline operates by building appropriate incentives in the design of the deposit insurance system and by relying on market forces to curtail excessive risk-taking. Regulatory discipline, on the other hand, generally involves intervention by public or private authorities to prevent market forces from producing results deemed to be socially undesirable, such as runs or excessive risk-taking. Regulatory discipline may take the form of statutory prescriptions, discretionary powers vested in public authorities, or agreements reached among participants in privately managed deposit insurance systems. As used in this paper, regulatory discipline is a generic term that encompasses actions to curtail moral hazard by all participants in financial safety nets, including supervisory authorities, deposit insurers, and central banks.

Although market discipline can be a valuable means of controlling moral hazard, many countries have placed primary reliance on regulatory discipline. This reflects the view that market forces may at times lead to unacceptable results, as well as the view that supervisors and deposit insurers have access to more comprehensive information on risk through on-site examinations and off-site monitoring than is contemporaneously available to the market. Supervisors and deposit insurers also may be successful in rehabilitating troubled institutions or limiting the cost of their failure, provided that they have the necessary legal authority and the incentives to act promptly before the problems become irreversible.

Regulatory discipline may be exerted in a number of ways. For example, privately funded and privately managed deposit insurance systems may rely on mutual monitoring by insured institutions. Mutual monitoring by privately owned institutions in a private deposit insurance system is facilitated if it is applied to a financial system, or a sector of the system, that is composed of a relatively small number of large institutions. In most countries, regulatory discipline is provided solely by public authorities. To be effective, regulatory discipline

requires cooperation among all of the safety-net participants. The authorised powers of the safety-net participants differ in various countries, particularly in the case of deposit insurance, which includes both paybox and risk-minimising systems. However, all of the participants should have access to information on the condition of institutions.<sup>11</sup> An integrated approach to handling troubled institutions also is needed; for example, it is important in most situations to ensure that central-bank advances are not used to prolong the life of insolvent institutions.

Regulatory discipline has many elements. These include, among others, requirements for the establishment and insurance of new institutions, qualifications for managers and directors, authorised powers, regulatory approval of changes of control, risk management requirements, and provisions for adequate internal controls and external audits. Although not within the responsibilities of deposit insurers in many countries, these regulatory and supervisory requirements have significant implications for controlling moral hazard.

Among the various tools of regulatory discipline, particular attention may be paid to those that are specifically designed for, or have a direct bearing on, controlling moral hazard. These include, minimum capital requirements, differential insurance premiums based on variations in risk, early intervention and prompt corrective action, and personal-liability incentives. It should be recognised that regulatory discipline requires a well-developed legal system and substantial human and technological resources. Also, regulatory discipline can be intrusive from the standpoint of institutions and can inhibit moderate risk-taking if unduly stringent.

### ***Capital requirements***<sup>12</sup>

Mandatory minimum capital requirements can be a powerful means of controlling moral hazard because owners have a greater stake in the sound operations of the institution if they have substantial equity at risk. Capital cushions also provide protection to the deposit insurer. However, if requirements are set too high and external capital



is unavailable, institutions may be forced to curtail lending in order to improve capital ratios, and this may lead to a credit crunch if the economy is already weak. High capital standards also may lead to regulatory arbitrage by institutions that seek ways to take on additional risk without increasing capital. The level at which minimum capital requirements are set, the extent to which they are enforced, and the extent to which accounting regimes accurately portray equity positions, need to be taken into account in framing policy in other regulatory areas and in the general design of the deposit insurance system.

### ***Differential premiums***

Properly structured, differential premium systems may discourage excessive risk-taking by institutions by increasing their premium assessments. Effective use of such systems requires the availability to the insurer of detailed and timely information on the risk characteristics of individual institutions. Also needed are substantial analytical capability and technological resources to develop acceptable grounds for differentiating among institutions according to risk. Lack of such information and resources may lead to the adoption of a premium structure with comparatively little differentiation among institutions. The introduction of risk-based premiums perhaps is accomplished best if most institutions in the country are generally healthy so that the premium structure may discourage excessive risk-taking in the future. If, on the other hand, a substantial number of institutions are already weak, risk-based premiums may aggravate their condition and deposit insurers may choose not to charge premiums commensurate with the risk posed by these institutions.<sup>13</sup> Most countries with limited-coverage deposit insurance systems have a flat-rate premium structure, but a minority has adopted risk-based premiums.<sup>14</sup>

### ***Early intervention and prompt corrective action***

Experience in a number of countries suggests that the problems of barely solvent and insolvent institutions tend to worsen over time, as operating losses

accumulate and owners' incentives for risk-taking increase. Early intervention by supervisors and deposit insurers in such cases can reduce moral hazard. Among the requirements for early intervention is adequate legal authority to take remedial actions such as directing institutions to recognise losses, seek additional capital, cease and desist from specific activities, change managers and remove directors, or comply with established requirements. Also crucial is the availability of comprehensive and timely information on the condition of institutions, as well as the authority, the incentives, and the financial resources to close institutions that are beyond rehabilitation. The importance of early intervention is highlighted by the ongoing consolidation of financial systems in many countries because of the potential effect of a large-institution failure on the financial position of the deposit insurer and on the economy as a whole.

### ***Personal-liability incentives***

Managers' and directors' incentives to control moral hazard can be reinforced by legal sanctions against improper activities that often increase institution risk, such as self-dealing, conflicts of interest, negligence, and failure to take required actions. Supervisory and deposit insurance personnel also should be subject to appropriate sanctions for improper official acts. However, they should be protected against the threat of litigation designed to intimidate them or otherwise influence their official actions.

Personal-liability incentives for managers and directors of institutions depend on the existence of a legal system that provides the basis for sanctions against inappropriate behaviour. Countries with such legal systems have adopted various sanctions. In some countries, the manager of a failed institution may lose his or her license to manage another financial institution and may be held liable for misconduct by the deposit insurer and the institution's creditors. As noted above, in a few countries, the controlling shareholder of the institution may face unlimited liability for any cost incurred by the insurance fund for that institution. In other

countries, directors and the chief executive officers of institutions who are replaced by the supervisor cannot take a similar position in another institution for a stated period of time. In still other countries, the deposit insurer may sue to recover losses resulting from wrongful acts by directors, officers, attorneys, accountants, appraisers, and others who have provided professional services to an institution that subsequently failed.

## Conclusions

**The main conclusions of this paper can be summarised as follows:**

Moral hazard is present in deposit insurance systems. Greater efforts to curtail moral hazard are needed in many cases. In general, moral hazard may be difficult to contain in countries that have serious gaps in their legal, accounting, disclosure, and supervisory regimes.

Various methods are available in principle for curtailing moral hazard. The moral-hazard issue may be addressed by ensuring good corporate governance and management of individual institutions, promoting market discipline exercised by uninsured depositors and other creditors, and instituting regulatory discipline exercised by supervisors and, in some countries, deposit insurers. These methods are most effective if they work in tandem to control moral hazard. Many financial systems have elements of all three. Owners, managers, and directors also may have incentives to control moral hazard, but reinforcement by regulatory action may be needed. Regulatory discipline can substantially affect the incentive structure faced by owners, managers, and directors, and effectively reduce moral hazard.

All of the methods for controlling moral hazard have potential advantages and disadvantages. Choices among these methods generally involve trade-offs among competing public-policy objectives and risks, and reflect a variety of factors existing in a particular country. Thus, in choosing among methods of reducing moral hazard, policymakers in a particular country may wish to consider: (a) the

primary objectives of deposit insurance in their country; (b) the conditions that may determine the effectiveness of particular methods of curtailing moral hazard; (c) the commitment and the ability of the country to meet these conditions; and (d) progress in advancing a reform agenda to eliminate gaps in the country's ability to implement particular methods.

## Endnotes

- <sup>1</sup> The members of the Subgroup on Moral Hazard are officials from the United States (coordinator), Chile, France, Germany, Italy, Japan, and The World Bank.
- <sup>2</sup> Losses sustained by uninsured depositors and other creditors generally refer to losses of principal. In addition, uninsured depositors in some countries are subject to substantial delays and uncertainties as to the timing and amount of recoveries, and to resultant liquidity strains. Payments to insured depositors in some countries also are subject to considerable delay. Although these conditions may tend to curtail moral hazard, they also may undermine the credibility of, and public confidence in, deposit insurance.
- <sup>3</sup> Discussions of insurance levels generally refer to the amount of insured balances that can be held by a depositor in individual accounts in a particular institution. Depending on applicable law in any particular country, an individual depositor may be able to own a considerably larger aggregate amount of insured funds in a single institution through the use of individual, joint-ownership, and trustee accounts.
- <sup>4</sup> In addition to interbank deposits, some countries exclude from coverage deposits of insiders and governments, deposits denominated in foreign currencies, illegal deposits—such as those made for the purpose of money-laundering—and high-rate deposits. Insurance levels and the scope of coverage are discussed in the paper on coverage.
- <sup>5</sup> This discussion refers to primary objectives of deposit insurance. Many countries pursue multiple objectives—for example, financial stability and consumer protection. These issues are discussed in the paper on public-policy objectives.

- <sup>6</sup> Several alternatives for coinsurance have been distinguished. First, there may be no protection up to a specified level (in a manner analogous to the deductible in many automobile insurance policies) and protection for a percentage of deposits above that level. Second, protection may be provided for a percentage of deposits—for example, 90 percent, up to a level—for example, EURO 20,000. Third, protection may be provided for a percentage of the amount on deposit, with the percentage declining as the amount increases. Finally, coinsurance can be applied selectively to specific deposit products; for example, one country has coinsurance for term deposits and 100 percent coverage for demand deposits.
- <sup>7</sup> Coinsurance exists in 20 of the 67 countries with explicit, limited-coverage deposit insurance systems for which data are available. See Gillian G.H. Garcia, *Deposit Insurance: Actual and Good Practices*, International Monetary Fund, Table 11.
- <sup>8</sup> The Financial Stability Forum's Working Group on Deposit Insurance report noted that not all coinsurance systems are able to maintain depositor confidence when the financial system is under stress. See, Financial Stability Forum Working Group on Deposit Insurance, *A Consultative Process and Background Paper*, June 2000, p. 6.
- <sup>9</sup> These issues are discussed in detail in the paper on depositor priority.
- <sup>10</sup> Preference also may be given to a particular group of depositors, such as depositors with small balances. In some countries, the deposit insurance authority, standing in the place of insured depositors, has preference over uninsured depositors as well as other creditors.
- <sup>11</sup> These issues are discussed in the paper on interrelationships among safety-net participants.
- <sup>12</sup> The Basel Committee on Banking Supervision is reconsidering capital requirements for internationally active banks.
- <sup>13</sup> These issues are discussed in greater detail in the paper on funding.
- <sup>14</sup> Risk-based premiums have been adopted by 24 of the 67 countries with explicit, limited-coverage deposit insurance for which data are available. See Gillian G. H. Garcia, *Deposit Insurance: Actual and Good Practices*, International Monetary Fund, Table 10. Such premium systems differ widely among countries, from relatively simple systems with few risk categories to more-complex systems.

# Discussion Papers

## Situational Analysis: Conditions and Implementation Considerations

### Abstract:

It is important to conduct a comprehensive situational analysis when considering the introduction of a deposit insurance system or when planning to alter an existing deposit protection arrangement. In conducting such an analysis, the economic and institutional conditions and their effect on the alternatives available for a deposit insurance system must be considered. Among the conditions that should be taken into consideration are the state of the economy including, current monetary and fiscal policy; the state and structure of the financial system; the legal framework; the state of the regulatory and supervisory systems; and accounting and disclosure regimes. Although it is understood that in many cases conditions are not perfect, it is important to have a process to evaluate the alternative deposit insurance systems available and how these alternatives are affected by the economic and institutional structure of the country. Through a situational analysis, gaps between existing conditions and more-desirable situations can be identified.

This paper emphasises the importance of conducting a comprehensive situational analysis when considering the introduction of a deposit insurance system or planning to alter an existing deposit protection arrangement.<sup>1</sup> In conducting such an analysis, the economic and institutional conditions and their effect on the alternatives available for a deposit insurance system must be considered. Among these conditions are the following: the state of the macroeconomy, current monetary and fiscal policy, the state and structure of the financial system, the legal framework, the strength of prudential regulation and supervision, and accounting and disclosure regimes. Although in many cases conditions may not be perfect, it is important to have a process to evaluate the alternative deposit insurance systems available and how these alternatives are affected by the economic and institutional structure of the country. Through a situational

analysis, gaps between existing conditions and more-desirable situations can be identified.

To better understand the process, the experience of countries that have considered adopting, or significantly altering, deposit insurance systems were analysed. In addition, consideration was given to understanding the relative importance of these conditions and whether there are some basic criteria that should be satisfied before adopting a deposit insurance system.

### Alternatives for Deposit Insurance Systems

The first step in establishing or significantly modifying a deposit insurance system is for policy-makers to determine their public-policy objectives.<sup>2</sup> Policymakers then face a wide range of possible

alternatives for the design of a deposit insurance system.<sup>3</sup> These include: the structure of the organisation—public, private, or jointly-administered systems; and the basic powers—paybox systems, which reimburse depositors on the instruction of another authority, or risk-minimising systems with greater capabilities to assess and manage risks. Policymakers should seek to ensure that an effective deposit insurance system is instituted, consistent with both the country's economic and institutional settings and aligned with the public-policy objectives they are attempting to achieve.

## Methodology to Analyse the State of Country Conditions

The methodology to assess the state of country conditions flows from the Strategic Analysis Model, which begins with the determination of the public-policy objectives, including the key attributes of the system desired.<sup>4</sup> After the public-policy objectives have been identified, policymakers should conduct a situational analysis of the conditions in their country. These conditions include: the macroeconomic environment, including current monetary and fiscal policy; the soundness of the financial system; the state of the legal, regulatory and supervisory systems; the quality of accounting; and the state of the disclosure and auditing regimes. The analysis should expose the strengths, weaknesses, opportunities and threats related to the conditions, and identify any changes necessary for the construction of an effective deposit insurance system.

If existing conditions are incompatible with the public-policy objectives, then either the objectives will have to be modified or different options for the design or structure of the deposit insurance system should be explored. Following the development of public-policy objectives that are aligned with the country's economic conditions and institutional framework, the next step is to develop a strategic plan for implementation.

## Analysis of Conditions

### **Macroeconomic conditions**

An important consideration in a situational analysis is the macroeconomic condition of the country, including its current monetary and fiscal policy. This is important since the macroeconomy can affect the financial system and influence the effectiveness of the deposit insurance system. Although macroeconomic stability is important for the successful implementation of a deposit insurance system, the boundaries between propitious and unpropitious macroeconomic conditions may be difficult to determine *a priori*.

Concerns about macroeconomic conditions often result in a loss of confidence in the entire financial system, which is difficult to restore through a single instrument such as deposit insurance. A loss of private-sector confidence is likely to result from the overall economic situation and the policy stance of the government, rather than more-narrow concerns about the state of the banking system. The introduction of a deposit insurance system, by itself, to protect depositors cannot address the basic causes of the macroeconomic deterioration. A deposit insurance system by itself cannot prevent a banking crisis, or cure one that has already begun. If introduced prematurely, a deposit insurance system can become so discredited that its reintroduction may be impractical when macroeconomic conditions are more favourable.

If the economic system is relatively stable, then the introduction or enhancement of a deposit insurance system is more likely to be effective in strengthening public confidence. That is, the failure of one depository institution will not necessarily spill over and affect public perceptions about the soundness of other depository institutions.<sup>5</sup>

### **State of the financial system**

A situational analysis will require an assessment of the soundness of the banking system, including a detailed assessment of the condition of the



depository institutions within that system and the extent of their problems. Factors that should be analysed include: capital, liquidity, credit quality, and risk-management policies and practices. An assessment also should be made as to whether these problems are confined to individual institutions or are likely to be systemic in nature. The issue is not whether there are unsound depository institutions in the system, but whether the banking system as a whole is sound.

The establishment of an effective deposit insurance system is much more difficult if underlying fundamental financial-system stability issues have not been addressed. Early introduction of a deposit insurance system, for example, could result in incentives for insolvent and illiquid depository institutions to compete for deposits by raising interest rates. Depositors, unconcerned about the financial health of the depository institutions because of the deposit insurance system, may shift resources from relatively risk-averse depository institutions to those adopting more-risky policies. This shift could increase the eventual cost of restructuring. It also is possible that policymakers, when faced with an insolvent banking system, may wish to combine the introduction of a deposit insurance system with a wide-ranging program of banking-system restructuring.

Moreover, it is important to be aware that deposit insurance, even when introduced at an appropriate time and in a well-designed form, cannot address all stability issues. Deposit insurance is one element in the financial safety net, which also includes a lender-of-last-resort facility and good supervisory and regulatory practices. If introduced in a coherent fashion, a deposit insurance system can be an important pillar of the restructuring program. If introduced in isolation, however, a deposit insurance system may not be effective.

### ***Market-based versus state-directed financial intermediation***

In undertaking a situational analysis of conditions in a country, policymakers need to consider whether financial intermediation is market-based or state-

directed. When resource-distribution and credit decisions are directed by the state, the state is viewed as being responsible for the results of such operations. Deposits in such systems generally are perceived as having full guarantees.

By contrast, financial systems characterised by market-based financial intermediation often can benefit from deposit insurance because they do not carry implicit government backing. A number of countries have state-owned banks that operate in response to market signals. If these deposits are not perceived as carrying a guarantee of the government, these countries also may benefit from the establishment of a deposit insurance system.

### ***Legal, regulatory, supervisory, accounting, and disclosure regimes***

It is important to assess the state of the legal, regulatory, supervisory, accounting, and disclosure regimes. If these regimes are strong, policymakers have a wider range of deposit insurance alternatives from which to design an effective deposit insurance system. Conversely, if these regimes are weak, fewer alternatives are available. In such circumstances, an effective deposit insurance system may be difficult to achieve.

### ***Legal regime***

It is important to assess the degree to which an appropriate legal regime is in place when considering the introduction of, or enhancements to, a deposit insurance system. A critical element of a sound legal regime is the ability to enforce laws. If laws do not exist, or the regime is characterised by inconsistencies, then it is very difficult for a deposit insurance system to be effective.

A well-defined legal regime, including bankruptcy provisions and certainty regarding property rights, contributes to the effectiveness of a sound deposit insurance system. Also, it is important that employees of the deposit insurer and other safety-net participants be provided with legal protection from personal liability for the actions they take on behalf of their organisations.

Deposit insurance systems with broad mandates will need other provisions established by law. Factors that should be considered include the ability of a legal regime to support early intervention and prompt corrective action by supervisory and regulatory authorities, facilitate prompt closure of problem institutions, and provide for the clear and orderly liquidation of assets and the resolution of creditor claims. If laws governing valuation methodologies, liquidation of assets, and the resolution of creditors' claims are nonexistent or deficient, it will be more difficult for the deposit insurer and other safety-net participants to fulfil their mandates.

### ***Regulatory and supervisory regimes***

The quality of regulation and supervision will have implications for the type of deposit insurance system chosen. If a country has strong prudential regulation and supervision, and pertinent information is shared with the deposit insurer, an explicit deposit insurance system is more likely to be effective. There are many aspects to a good supervisory and regulatory system. Such a system should allow only viable institutions to operate. In many countries this is done by ensuring that institutions are well capitalised and follow sound and prudent risk management, governance, and other sound business practices. Other characteristics include a sound licensing or chartering regime for depository institutions, and regular and thorough examinations or risk assessments of financial institutions.

In addition, supervisory and deposit insurance authorities require skilled and motivated staff, an adequate infrastructure, and access to sufficient funding to assist them in fulfilling their mandates. Authorities that are subject to an accountability regime, such as regular performance reviews, can provide additional integrity to a financial system.

### ***Accounting and disclosure regimes***

Accurate and reliable accounting and financial reporting systems enhance the effectiveness of a deposit insurance system. If information is readily available, accurate, and timely, it can be used by

management, depositors, the marketplace, and regulatory and supervisory authorities. The better the information that is disclosed by institutions, the more effective is market discipline.

Attributes of a sound accounting system include accurate and meaningful assessments of information in areas such as: asset valuation; the measurement of credit exposures, loan-loss provisioning, and non-performing loans; the treatment of unrealised losses and off-balance-sheet exposures; and capital adequacy, bank earnings and profitability. Sound external auditing and reporting systems for individual financial institutions help to foster market discipline. In many countries this has been achieved through adherence to sound-and-prudent accounting principles and practices, and methods to ensure compliance with agreed-upon accounting conventions. In order to be effective, accounting rules need to be applied consistently by all interested parties.

The presence of a system to provide for good public disclosure of financial information helps to ensure that accurate information on the state of financial institutions is transmitted on a timely basis to all interested parties. To be effective, a sound disclosure regime needs to provide detailed information and frequent disclosure. In addition, many countries hold directors, auditors, and senior management accountable, in part, for the level, accuracy and consistency of disclosure. This can enhance the exercise of market discipline over institutions and improve the effectiveness of a deposit insurance system.

### ***Structure of the banking system***

The structure of the financial system is an important consideration when adopting a deposit insurance system or enhancing existing deposit insurance arrangements. For instance, the number, type and characteristics of financial institutions have implications for the design of a deposit insurance system.

Countries faced with a highly concentrated banking system have adopted one of several approaches.

First, some countries have opted not to offer deposit insurance. In the absence of a deposit insurance system, it is recognised that taxpayers likely will be called on to provide resources to resolve any serious problems. Second, some countries have chosen to rely on privately funded, mutual guarantees among the large depository institutions in the financial system. Those depository institutions may understand each other's business better than public authorities and can be in a better position than public authorities to exert market discipline on one another. Third, some countries have chosen to establish a publicly managed and funded deposit insurance system. Such a system may be chosen because the government provides backing to the deposit insurer and to support public regulation and supervision of the activities, including competitive practices, of a concentrated banking system.

Countries that have banking systems characterised by a low degree of concentration may be well suited to a publicly managed deposit insurance system. In this case, the exposure of the deposit insurer is likely to be more diversified and the failure of one or a few banks may not represent a major financial burden. As a result, the requisite resources to protect depositors under such conditions are likely to be within the capacity of a deposit insurance system to fund. However, the existence of a large number of institutions may place greater burdens on the supervisory authorities. Moreover, if individual institutions are not diversified geographically, they may be more vulnerable to local economic problems, and may thereby pose greater risks to the deposit insurer.

The type and characteristics of financial institutions have implications for deposit insurance. For instance, when countries undertake their situational analysis, they may encounter the issue of foreign ownership. Branches or subsidiaries of foreign banks may have the backing of the home-country bank. It may be more appropriate, however, to treat the branch or subsidiary as any other bank in the country's system as regards deposit insurance. There

are several reasons for this approach. First, the home bank may fail. Second, some jurisdictions do not extend deposit insurance to deposits in foreign branches or subsidiaries and do not insure deposits of non-residents. Finally, many jurisdictions require that the worldwide assets of a failed bank be frozen and used to cover home deposits first. If deposit insurance is extended to branches and subsidiaries of foreign banks, the deposit insurance authority will need to consider how it will manage its risks.

## Implementation Considerations

Public attitudes and expectations regarding deposit protection are important factors to be considered. The more aligned a deposit protection system is with public attitudes and expectations, the more likely it is that the system will be effective. For instance, if public awareness of the benefits and limitations of new or existing deposit protection systems is limited, then it may be more difficult for such systems to achieve their public-policy objectives. Therefore, it is important to undertake an analysis of public attitudes and awareness before the introduction of a new system or major modifications are made to an existing protection regime. If there are significant gaps between expectations and planned systems or reforms, then they will need to be addressed through public awareness programs.

## Conclusions

Countries considering the introduction or modification of a deposit insurance system should conduct a systematic situational analysis to guide their deliberations. In conducting such an analysis, the economic and institutional conditions and their effect on the options available for a deposit insurance system must be considered. Country-specific, historical factors and public sensitivity to the relevant issues also must be taken into account.

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## Endnotes

- <sup>1</sup> The Subgroup members are the International Monetary Fund (coordinator), Argentina, France, Mexico, and The World Bank.
- <sup>2</sup> As described in the paper on public-policy objectives, there is a wide range of more specific formulations that fall into these categories.
- <sup>3</sup> See papers on: membership, coverage, funding, reimbursing depositors, depositor priority and rights of set-off, structure and organisation, interrelationships, and powers.
- <sup>4</sup> The Strategic Analysis Model was developed to assist policymakers in the design of an effective deposit insurance system. See the Financial Stability Forum Working Group on Deposit Insurance, *A Consultative Process and Background Paper*, June 2000.
- <sup>5</sup> A distinction should be made in this analysis between the introduction of an explicit deposit insurance system and the introduction of blanket guarantees for all creditors, including depositors. Under conditions of extreme macroeconomic instability, when depositors are shifting out of the national currency and into a foreign currency held outside the banking system, a blanket guarantee, adopted in conjunction with a broad-based stabilisation plan, can strengthen confidence in the banking sector. However, there are substantial trade-offs in terms of increased moral hazard associated with blanket guarantees. See the paper on moral hazard.

# Discussion Papers

## *Special Considerations when Transitioning from Blanket Guarantees to an Effective, Limited-Coverage Deposit Insurance System*

### *Abstract:*

This paper addresses the experiences of countries that have sought to transition from a blanket guarantee to a limited-coverage deposit insurance system. The aim of the paper is to produce general guidelines on transition issues on the basis of the experiences of countries. The paper assumes that any country undergoing or considering a transition to an effective, limited-coverage deposit insurance system will establish clear public-policy objectives for the system and will conduct the appropriate situational analysis. The paper describes the main transition issues considered by the countries surveyed, emphasising their respective trade-offs.

This paper addresses the experiences of countries that have sought to transition from a blanket guarantee to a limited-coverage deposit insurance system.<sup>1</sup> The aim of the paper is to produce general guidelines on transition issues on the basis of the experiences of countries.<sup>2</sup> The paper assumes that any country undergoing or considering a transition to an effective limited-coverage deposit insurance system will establish clear public-policy objectives for the system and will conduct the appropriate situational analysis.<sup>3</sup> The paper describes the main transition issues considered by the countries surveyed, emphasising their respective trade-offs.

### **Background**

As a result of the frequency and magnitude of banking crises over the last two decades, attention has been focused on the role government should play in ensuring financial-system stability and in providing a safe savings mechanism for small depositors. For countries whose financial systems

were in crisis, the adoption of a blanket guarantee of deposits and other liabilities prevented the financial and payments systems from collapsing. Complete coverage of deposit liabilities during a crisis can foster the confidence necessary for depositors to avoid runs and help restore and maintain the stability of the financial system. However, an unlimited guarantee can increase moral hazard and foster inadequate risk-management practices among depository institutions. As financial stability returns, policymakers must consider whether to continue unlimited coverage or to transition to a limited-coverage guarantee. If a transition to a limited-coverage system is chosen, the different policy options to achieve a smooth and effective transition become crucial.

For countries whose economies and financial systems had been centrally planned and managed, a transition from the unlimited guarantee provided by the state to a limited-coverage deposit insurance system occurred as part of fundamental restructuring of their economic and financial



systems. As their financial systems become increasingly market-based, an unlimited state guarantee financed from public funds may become an expensive and unsustainable form of protection. In response, numerous countries have adopted, or are exploring the adoption of, an explicit, limited-coverage deposit insurance system. For all of these countries, the process of transitioning from an unlimited guarantee to a limited-coverage system presents similar trade-offs.

The design and implementation of a deposit insurance system that is consistent with the European Union's directives on deposit protection schemes are among the issues of particular concern to Central and Eastern European countries.<sup>4</sup> Other countries facing similar regional policies should take them into account when designing their transition programs.

The trade-offs and considerations associated with a transition also are important for countries planning or involved in transferring public financial-service providers, whose obligations are under an implicit state guarantee, to private control. These providers may be development banks, state commercial banks or some other form of financial intermediary that offers an obligation that is subject to the provisions of the transition program.

For many countries, the use of a blanket guarantee has been a successful tool for avoiding the collapse of the financial system and for restoring or achieving stability. The use of a blanket guarantee in the majority of the countries surveyed was precipitated by sudden developments such as currency devaluations, the emergence of large speculative markets, or significant changes in the social and economic fundamentals of the country. As noted by the Working Group,

“Experience shows that depositor and creditor confidence can erode quickly, and this may have a severe effect even on relatively healthy institutions. To maintain confidence, depositors and creditors require immediate and widespread government assurance of the safety and availability of their deposits and claims. Another reason for adopting

explicit blanket guarantees is the belief that they will provide the government the time and opportunity to restructure problem banks, thereby avoiding the need to deal with closure decisions.”<sup>5</sup>

The transition to a limited-coverage deposit insurance system involves trade-offs. These trade-offs can be better understood in the context of the history of each country's financial system. An understanding of this history is crucial when a country is experiencing important social and economic reforms, has a tradition of recurrent economic or financial crises, or lacks public support for the transition.

In comparing a blanket guarantee to a limited-coverage deposit insurance system, the first trade-off involves moral hazard, which potentially is greater under a blanket guarantee.<sup>6</sup> Maintaining a blanket guarantee can prove costly, particularly when depository institutions and others view the blanket guarantee as a license for excessive risk-taking. A second trade-off is the potential for destabilisation if the limited-coverage system is not implemented correctly. Given that a blanket guarantee can provide a false sense of security, it is important that officers of depository institutions, depositors, creditors, supervisors and regulators are provided during the transition with the correct incentives to address and correct existing gaps and problems.

## Considerations for Transitioning to an Effective, Limited-Coverage Deposit Insurance System

### *Institutional arrangements*

When considering how the transition will be implemented it is important to make sure that the institution(s) designated as responsible for the transition have the necessary expertise, tools and powers. The experience of the countries surveyed as to which institution should lead the transition was mixed. In some countries, the institution chosen to lead the transition was affected by a negative public perception of the previously existing institution.

As a result, it was deemed more prudent to create a new entity to be lead the transition.

Another important consideration indicated by the countries surveyed was whether the limited-coverage deposit insurance system should be managed as a separate entity. The alternative would be an “umbrella” approach, whereby regulation, supervision and deposit insurance are handled in one institution. There is no clear-cut answer to this question; however, most of the countries surveyed decided to assign the transition mandate to a separate institution.

Regardless of the institutional setting, a crucial issue to ensure the credibility and long-term viability of a new or modified deposit insurance system is the presence of effective corporate governance principles. Such principles can help to ensure a qualified, independent and accountable decision-making process.

### ***Coverage limits***

One of the first questions policymakers have to answer when transitioning from unlimited to limited coverage is how to set the limits of coverage. After analysing numerous cases around the world, the following conclusion was reached: there is no rule of thumb. Countries have followed different approaches to fit domestic circumstances.

An important consideration, however, is that, regardless of the specific figure chosen, the level of coverage should be sufficient to ensure that the deposit insurance system is credible—that it has the confidence of the public. Geographic factors also should be taken into consideration. For example, if there is a high level of capital flows between two countries, different coverage levels could foster unwanted capital flight.

Regarding the type of deposits to be insured, the experiences of the countries were driven by their public-policy objectives. In all circumstances, however, there should be a well-structured transition mechanism based on accurate and timely databases. Issues to be considered include whether to maintain

an unlimited blanket guarantee for a period of time or to eliminate certain types of deposits gradually from the list of guaranteed liabilities.

### ***Funding***

Contrary to the cost of a blanket guarantee, which is ultimately borne by taxpayers, the cost of a limited-coverage deposit insurance system is usually paid by, or shared with, depository institutions through insurance fees.<sup>7</sup> The transition to a limited-coverage deposit insurance system usually involves the imposition of new or revised premiums or levies on insured institutions. If those funds are insufficient to pay for the cost of the blanket guarantee—especially if it stems from a systemic crisis—the cost usually is shared between depository institutions and the government. The latter can resort to higher taxes, asset sales, or debt issues. In any case, it is important to have a clear mechanism in place to ensure that the deposit insurance system will have access to adequate funding during and after the transition.

### ***Insurance premiums***

Given that the transition to a limited-coverage deposit insurance system often proceeds when depository institutions may be in a weakened condition, the determination of insurance premiums should reflect this fact. The imposition of deposit insurance premiums or levies should not undermine the competitiveness of depository institutions or destabilise them. In some countries, the initial premiums imposed on depository institutions after a crisis are relatively high, because they include the cost of the crisis as well as the cost of deposit insurance. As stability returns, the level of premiums can be re-examined.

During the transition period countries need to consider whether they will levy flat or differential premiums. Some deposit insurance systems differentiate the fees paid by banks depending on the risk posed by the institution to the deposit insurer. However, in all of the countries surveyed, premiums initially were set on a flat-rate basis after the consideration of the availability and quality of information,

the risk-management culture, the degree of stability of the financial system, and the availability of expertise, among other factors.

### ***Legal and regulatory frameworks***

A limited-coverage deposit insurance system must be well defined, whether by voluntary agreements or by law. To be effective, voluntary agreements underlying deposit insurance arrangements must be enforceable. For example, the failure to adhere to the terms of the voluntary agreement may lead to the withdrawal of deposit insurance and/or revocation of the banking license. In either case, if the limited-coverage system is to be effective, the participation of depository institutions, especially strong institutions, must be ensured. This is accomplished in many countries by making participation in the deposit protection scheme mandatory.

In most of the countries surveyed, changes that accompanied the transition have taken the form of a decree, a parliamentary resolution, or a law “protecting” the deposit insurer against later institutional or governmental changes. Similarly, the establishment of a clear and adequate regulatory and supervisory framework was noted as being crucial for the effective transition to a limited-coverage deposit insurance system. In countries with pre-existing limited-coverage systems, the regulatory framework has to be adapted to accommodate first a blanket guarantee and then, the transition to limited coverage. Countries with no experience in limited-coverage deposit insurance may require a more comprehensive regulatory change. Moreover, transparency in regulation and its enforcement, are integral to an effective transition.

### ***Condition of the banking system***

The condition of the banking system is a key factor in the determination of when and how to transition to limited coverage. If implemented while the financial system is weak or unstable, the transition can be a destabilising element that will increase the overall cost to the system:

“After a country has suffered a financial crisis, it is best to ensure that most of the major problems relating to the financial crisis have been adequately addressed before transitioning to limited-coverage deposit insurance. However, if governments wait for all deficiencies in an economy or financial system to be addressed or the system to be reformed, blanket guarantees could become entrenched.”<sup>8</sup>

Thus, it is important to ensure that during the transition all the necessary issues are addressed to prepare the financial system for limited coverage. The ability to ensure that failed depository institutions are dealt with adequately, whether by the deposit insurer or another entity, is among these issues.

In the countries surveyed, some degree of stability was achieved before initiating the transition. The elements that usually were present during the transition included tighter banking regulations in line with international practices, including accounting, regulatory, supervisory and auditing standards. In addition, a more-open disclosure regime to improve the flow of information and more-stringent risk-management regulations were important elements.

The quality and quantity of information are crucial to an effective transition; adequate information will facilitate a correct assessment of the state of the financial system and its strengthening process. In this sense, the information requirements of a limited-coverage system might be viewed as much higher than under a blanket guarantee. Some of the countries surveyed still have a blanket guarantee or very high coverage levels in place until the health of the financial system is adequate and reliable information is available.

### ***Timing***

The issue of timing was most frequently mentioned as crucial for an effective transition, from inception to completion. The first decision relates to the desirability of a “fast track” approach *versus* a more gradual process. The advantages and disadvantages

of a gradual approach are shown in table 1, below. Experience shows that in most cases, a financial system is not ready for a fast-track transition when coming out of a crisis. Thus, gradualism is a more appropriate policy choice. It allows the transition to start, avoids an entrenchment of the blanket guarantee, and provides depository institutions, regulators, and supervisors with adequate time to prepare for limited coverage and all its implications.

Most of the transitions analysed for this paper included a specific goal regarding when the ultimate level of coverage would be reached and a detailed timeline that described how the system would reach that goal. In some cases, deposits guaranteed under the blanket guarantee were grandfathered and coverage on new liabilities was reduced gradually. In other cases, a fixed schedule included in the law specified the qualitative and quantitative reduction of coverage over a number of years. For example, every year, coverage on certain deposits is to be reduced or eliminated, or the amount of the guarantee per individual or institution is to be reduced further.

In most cases, specific deliverables were included in the transition plan. These included the desired coverage goal, as well as the institutional arrangements and advances needed to strengthen the banking system. Integral to an effective transition

is a clear “tracking mechanism” designed to monitor whether all the necessary financial, regulatory, institutional, and legal changes are occurring on time. Policymakers should specify the factors on which to base progress as clearly as possible.

Some countries underscored the importance of providing for “correction mechanisms” during the transition process to allow changes to be made as necessary. However, such corrections need to be well understood by the market. Otherwise, they may negatively affect incentives for market discipline, or call into question the credibility of the government’s commitment to the transition.

Countries that initially set up a blanket guarantee system, but had to extend its duration, suggested that rather than specifying a time-frame for the removal of the guarantee, it may be more appropriate to specify the conditions that first need to be satisfied. For example, such conditions would include specific regulatory changes and/or the capitalisation levels of depository institutions. Under this approach, the government can signal its commitment to the transition process and the cost of the crisis may be reduced. In the case of one country, the timing of the transition was contingent on the financial condition and stability of the banking sector.

**Table 1: Some advantages and disadvantages of a gradual approach**

Advantages	Disadvantages
<p>Depository institutions can adjust smoothly toward the new standards, especially when fresh capital is scarce.</p> <p>Managers of depository institutions can be trained in a risk-management culture.</p> <p>Depositors need time to adjust to the new scheme, especially after years of a blanket guarantee.</p>	<p>The transition period might be perceived as too long, thus raising doubts among depositors, regulators and/or policymakers about the government’s commitment.</p> <p>The potential for moral hazard may decrease more slowly than in a more rapid transition to limited coverage.</p>

### **Public awareness**

Given that public confidence is a critical element of any deposit insurance system, it is important that the transition plan be communicated clearly to all affected parties. A transition to limited coverage can be perceived as “taking away something from the public.” However, it is in the interest of depositors, creditors, and supervisors to increase market discipline through a limited guarantee. A transition should be accompanied by a widespread public-awareness campaign to inform the public about the details of the coverage reduction in order to avoid misconceptions.

## **Lessons Learned**

Lessons learned by countries that have undergone or begun a transition to a limited-coverage deposit insurance system include the need to build the right incentives for the parties involved during the different stages of the transition process. In particular, the timing of the transition, the need to provide for corrections along the way, and the need for close coordination among the regulatory/supervisory agencies and the deposit insurer were mentioned as key to an effective transition to limited coverage. The transition process should emphasise the appropriate sequencing of events. For example, the introduction of a limited-coverage scheme is more feasible after the banking sector begins to consolidate and the economy shows evidence of stabilisation.

To enhance credibility, the reforms should reflect a consensus among representatives of the owners of depository institutions, depositors, debtors, public policymakers and government officials. Equally important, the limited-coverage deposit insurance system should be clearly defined, whether by voluntary agreements or law. Depositors might be particularly concerned about the strength of the banking sector at the time the new scheme enters into effect. Therefore, close tracking of the performance of depository institutions is highly important.

The countries surveyed indicated that it is advisable to transition to a limited-coverage deposit insurance system gradually. A gradual approach gives the owners of depository institutions and other stakeholders sufficient time to make the changes necessary for a successful transition.

The principal roadblock perceived by countries was insufficient coordination among financial authorities and difficulties in negotiations with public policymakers. Other limitations noted were a lack of resources to handle insolvent depository institutions. These problems were overcome through actions such as lobbying legislators and the granting of special powers to the deposit insurance system to issue government-backed debt.

## **Conclusions**

Even though many of the topics in this paper are the subject of other Working Group papers, it is important to note that, when considering a transition from a blanket guarantee to an effective, limited-coverage deposit insurance system, certain factors need to be addressed. The experience of different countries suggests that it is desirable to have some degree of stability in the banking sector before initiating a transition to limited coverage. However, many of the changes necessary for a system to function effectively with a limited guarantee can be implemented during the transition period. Realistic timing, clear deliverables and an adequate tracking process are essential elements for an effective transition, regardless of the structure of a deposit insurance system. Table 2 below depicts various changes that can increase the potential for a successful transition.



**Table 2: Examples of changes recommended by countries to increase the potential for a successful transition**

<b>Legal</b>	<p>Enactment of a law or voluntary agreements to establish the deposit insurance system. The deposit insurance system should have autonomy, but should be accountable for its actions.</p> <p>Provisions should be made to fund the deposit insurance system.</p> <p>The deposit insurance system or another entity should be empowered to sell assets of failed institutions and to refinance its debt, if necessary.</p>
<b>Regulatory</b>	<p>Depository institutions should be required to comply with internationally accepted standards.</p>
<b>Supervisory</b>	<p>Adequate compliance and disclosure regulation should be enacted.</p>
<b>Institutional</b>	<p>Transparency in the operation of the institution managing the transition and insured institutions should exist.</p>
<b>Financial</b>	<p>Adequate funding to restructure the banking system and to start-up the deposit insurance system should be provided via private capital markets and/or the public sector.</p>
<b>Political</b>	<p>The enactment of the law or voluntary agreements that established the deposit insurance system should be discussed thoroughly with public policymakers in order to gain consensus.</p>

## Endnotes

- 1 The Subgroup members were Mexico (coordinator), Hungary, Japan, and the International Monetary Fund.
- 2 As part of its consultative process, the Financial Stability Forum's Working Group requested comment on transition issues and other topics included in its Research Plan on its official Web site. In response to this request, the experiences of several countries that had successfully transitioned from a blanket guarantee to a limited-coverage deposit insurance system were shared with the Subgroup. The experiences of other countries that are in the process of such a transition also were considered. The countries that responded included: Finland, Hungary, Japan, Korea, Mexico and Sweden.
- 3 Public-policy objectives and situational analysis are the subjects of other papers by the FSF Working Group.
- 4 This issue is addressed in the paper on cross-border issues.
- 5 Financial Stability Forum Working Group on Deposit Insurance, *A Consultative Process and Background Paper*, June 2000, p. 11.
- 6 Moral hazard is the subject of a separate paper.
- 7 The topic of funding a limited-coverage deposit insurance system is addressed in the paper of funding.
- 8 Financial Stability Forum Working Group on Deposit Insurance, *A Consultative Process and Background Paper*, June 2000, p. 12.

# Discussion Papers

## Membership

### *Abstract:*

Decisions about membership in a deposit insurance system are ultimately based on a country's public-policy objectives. Major conclusions about membership are: (1) membership regimes should be consistent with the deposit insurer's public-policy objectives and mandate; (2) deposit insurance should normally be compulsory to avoid adverse selection and because deposit insurance tends to work best when there is a large number of members to share risks and costs; (3) moral hazard concerns suggest that membership should be extended only to institutions that are subject to effective supervision and regulation; (4) generally, membership criteria and financial requirements must be met by institutions before they become members of the deposit insurance system.

This paper represents the work of the Subgroup on Membership.<sup>1</sup> The paper focuses on: (1) identifying which kinds of deposit-taking institutions typically are members of deposit insurance schemes; (2) whether membership should be compulsory; and (3) the basis for granting eligible institutions membership. The paper also reaches a number of conclusions about membership in a deposit insurance scheme.

### **Background**

The choices relating to membership in a deposit insurance system are influenced strongly by the institutional setting countries choose for their financial system. Countries have diverse methods for determining which types of deposit-taking institutions are eligible, or mandated to become, members of their deposit insurance system. Countries also look at the nature of the deposits to be included, or excluded, from coverage. How a deposit is defined and which institutions may offer those deposits often is specified in law.

Increasingly, determining what qualifies as a deposit is becoming a complex task. Traditionally, deposits were monies placed by individuals or entities with depository institutions for the purpose of investment, safety, or storage. Deposits usually fell into two categories: those that were payable on demand, which may be used for transaction purposes in lieu of currency, and longer-term deposits that were payable at fixed dates and primarily served investment purposes. Previously, it was relatively simple to identify which financial institutions offered deposits and thereby qualified for membership in a deposit insurance system. The distinction between insured deposit-taking institutions and other financial firms was defined by law.

Given current trends, the distinction between insured deposit-taking institutions and other financial firms has become problematic. For example, technological developments are allowing a variety of financial and non-financial entities to offer products that have the same characteristics as traditional deposits placed with depository institutions. Financial firms such as insurance

companies and mutual-fund companies are able to join the payments system in certain countries, which allows such companies to offer products with the characteristics of traditional deposits. As part of the globalisation trend in the financial-services industry, depository institutions are increasingly expanding their operations into foreign jurisdictions. As a result, membership in the deposit insurance system becomes a complex issue that requires careful consideration by policymakers.

Countries have taken a number of factors into consideration in order to determine the rules by which membership is granted in the deposit insurance system. These include:

- The existence of effective regulatory and supervisory arrangements to oversee the operations of member institutions.
- The degree of competition among financial institutions.
- Diversification of membership to spread risk to the deposit insurance system.
- The institutions' importance to the country's financial system.
- The threat of contagion.
- Constitutional or jurisdictional considerations that may limit the scope of a deposit insurer's powers and responsibility for particular institutions.
- The nature of individual and household financial activity, such as where checking and savings accounts are held.

These considerations may constitute grounds for including or excluding certain financial institutions from a country's deposit insurance system. Membership decisions ultimately should be based upon national circumstances and the public-policy objectives a country chooses for its deposit insurance scheme. Separate insurance systems for institutions with other characteristics also may be created depending upon a country's public-policy objectives.

## Which Financial Institutions Typically Are Members of Deposit Insurance Systems?

### *Domestic banks*

Domestic banks form the membership base for most deposit insurance systems for a number of reasons.<sup>2</sup> First, domestic banks play a central role in domestic financial markets. Second, such institutions hold the bulk of the deposits of small savers. In addition, domestic banks are normally subject to prudential supervision and regulation.

### *Foreign-bank branches and subsidiaries*

Countries treat foreign-bank branches and foreign-bank subsidiaries in different ways with respect to membership in their deposit insurance systems.<sup>3</sup> Some countries require all foreign-bank branches and subsidiaries to participate in their deposit insurance system, while others permit foreign banks to remain outside the system.<sup>4</sup> Arguments in favour of including the onshore operations of foreign banks tend to focus on: (1) the notion that foreign banks benefit from a stable financial system and should therefore regard participation in a deposit insurance system as part of doing business in a host country; (2) the belief that wider membership may be needed to diversify the deposit insurance system's exposures and perhaps its funding base; and (3) the desire to minimise competitive advantages or disadvantages by according foreign banks comparable treatment to domestic banks.

On the other hand, the inclusion of foreign institutions may expose the deposit insurer to risks that it or some other authority has a limited capacity to mitigate. The inclusion of foreign banks also may complicate the claims and recovery process because many of their assets may be located offshore and subject to another country's insolvency regime.

## ***Deposit insurance systems and the European Union***

A special situation prevails in Europe where the harmonisation of banking regulations in the European Union (EU) has led to the creation of the European passport. Included among the features of the passport is the fact that banks, including their branches in other member states, are supervised only by their home authority. According to the deposit protection directive adopted by the EU, the deposit protection scheme in a bank's home state also has to cover deposits of branches in host member states. This coverage may be enlarged—or topped up—by the statutory deposit protection scheme of the host member state.<sup>5</sup>

### ***Non-bank financial institutions***

Countries take different approaches toward the issue of membership for non-bank financial companies—finance companies, credit unions and cooperatives, for example—that offer deposits and deposit-like products and are subject to an appropriate level of prudential supervision. The rationale for expanding membership to non-bank financial institutions includes, the desire to accord similar treatment to institutions that offer similar deposit-like products and the desire to enhance financial stability by expanding the safety net to include those institutions that offer deposit-like products.

On the other hand, there are many cases where non-bank financial institutions are not eligible for membership. The most common reason for excluding these institutions is that they are subject to less stringent supervisory standards. For some countries, a different governmental authority licenses non-bank financial institutions. In such cases, extending membership may lead to constitutional or political issues that are difficult to overcome. Some countries have addressed this problem by establishing a separate insurance system or fund.

### ***State-owned banks***

State-owned banks present unique issues for deposit insurance schemes. Because state-owned banks are normally the beneficiaries of an implicit, full

government guarantee, their inclusion in a deposit insurance system may appear to be unnecessary.

However, some countries have chosen to include state-owned banks in their deposit insurance systems. Some of the reasons cited for inclusion are: to replace the implicit guarantee of the state-owned bank with explicit, limited coverage, thereby levelling the playing field for all deposit-taking institutions; to diversify the risks and revenue base of the deposit insurer; to facilitate the privatisation of state-owned banks; and to introduce an enhanced supervisory regime.

## **Should Membership Be Compulsory?**

Experience has shown that voluntary deposit insurance systems have been more prone to crisis than compulsory ones because of problems such as adverse selection, among others.<sup>6</sup> Compulsory membership allows a deposit insurance system to avoid this problem. Moreover, all banks—even the safest and soundest—benefit from the existence of a well-designed deposit insurance system.

In some cases depository institutions have demonstrated their commitment to join a deposit insurance system without the necessity of statutory obligation. The commitment of banks to participate in deposit protection schemes, without being legally obligated to do so, may be driven by the strong desire of depositors for such coverage. On the other hand, if depositors are less concerned about the availability of deposit protection or are not aware that coverage may be limited to certain financial institutions, then depository institutions may opt-out of participation in the deposit insurance system. Their decision to do so may have implications for the financial solvency of the deposit insurance system or its ability to meet a country's public-policy objectives.

Incentives for eligible institutions to join a voluntary deposit insurance system may be enhanced if the system is privately organised and operated through a private contract.<sup>7</sup> Membership criteria

for voluntary private systems may encompass members' viability and financial strength, thus reducing the potential cost of membership for participants. Members that do not meet the criteria or do not want to participate for other reasons—for example, they may have reservations about possible examinations conducted on behalf of the system—may in fact be signalling to their depositors an adverse standing, which will have consequences in their marketplace. Such a “benchmark function” of voluntary systems should enhance the effectiveness of the deposit insurance system.

## Granting Membership When the Deposit Insurance System Is Established

When a deposit insurance system is created, policymakers are faced with the difficult task of integrating it into the country's financial system and financial safety net, while simultaneously trying to minimise the risks to the deposit insurer.<sup>8</sup> Two distinct approaches generally are utilised. First, eligible institutions automatically can be granted membership in the deposit insurance system. This is the simplest option available from an administrative and political standpoint. However, the deposit insurer may be faced with the difficulty of having to insure institutions that may pose inordinate risks to the system. For this to be a viable option, provisions would have to be made to minimise losses to the deposit insurance scheme in the event of a newly insured institution's failure.

A second option is to require institutions to apply for membership in the deposit insurance system. This option may provide the deposit insurer with a degree of flexibility to control the risks it is assuming. This option also may provide a mechanism for bringing eligible institutions into compliance with prudential regulatory standards. However, reviewing all eligible institutions at the outset will be time-consuming and requires a substantial commitment of administrative resources on the part of the deposit insurer.

The ability of the deposit insurer to function may be called into question if a sufficient number of institutions that have applied for membership do not qualify. A transition period may be necessary to give institutions time to satisfy the necessary membership requirements. In this case, an appropriate transition plan should be in place that details the process and time frame for attaining membership.

## Granting Membership to New Institutions in a Functioning Deposit Insurance System

In cases where the financial safety-net functions reside within one agency, the steps required for determining membership tend to be relatively straightforward. Eligible institutions usually are required to meet basic entry requirements such as minimum capital, appropriate business plans, and effective governance structure, among others. Institutions meeting established standards may be granted a license or charter to operate and membership in the deposit insurance scheme simultaneously.

When responsibility for the financial safety net is shared by different agencies, the process may be more complex. Some countries with separate agencies grant deposit insurance membership automatically when a depository institution receives its license or charter to operate. This method ensures that only one set of entry standards is applied and that only one approval is required, thus streamlining the process. Automatic membership in the deposit insurance system, however, may limit the deposit insurer's ability to manage its risk exposure and effectively meet the requirements of its mandate.

Some countries require that eligible institutions receive two approvals before commencing operations, first from the supervisory authority or government; and then a separate membership approval from the deposit insurer. In such cases, the deposit insurer is granted an enhanced ability to control its exposure to risk because it can determine which institutions it will insure. However,



mechanisms should be in place to ensure effective coordination by financial safety-net participants.

The way a country grants membership in its deposit insurance system should be consistent with the country's public-policy objectives and the deposit insurer's mandate—whether paybox or risk-minimisation. In all cases, appropriate mechanisms to encourage coordination and dialogue are necessary to ensure that the approval process transpires smoothly, and that eligible institutions meet minimum prudential standards and entry requirements.

## Should Institutions Reapply for Membership?

Generally, countries do not require member institutions to reapply for membership as long as they are subject to periodic or continuous examination by a regulatory or supervisory authority. Reapplication requires a significant commitment of resources from the deposit insurer and may also create a certain amount of uncertainty regarding an institution's operations. In any case, the application procedure should be consistent with a country's regulatory or supervisory activities.

## Conclusions

Membership requirements should be consistent with the deposit insurer's public-policy objectives and mandate. Determining which institutions are allowed to join the system and the basis for their inclusion will have a significant effect on the effectiveness and overall risk profile of the deposit insurance system.

A deposit insurance system tends to work best when there are a large number of members to share risks and costs. It is generally agreed that deposit-taking institutions benefit from the positive effects of a well-designed deposit insurance system and that adverse selection should be avoided. For these reasons, most deposit insurance systems require that membership be compulsory.

Decisions must be made on which type of institution to include. Although country-specific issues will play a large role in these decisions, moral-hazard concerns suggest that membership should be extended only to institutions that are subject to effective supervision and regulation.

Generally, institutions must meet membership criteria and financial requirements in order to join the deposit insurance system. Whether a country's public-policy objectives favour a paybox or a risk-minimising system, experience shows that conditions of membership are required to make deposit insurance effective.

## Endnotes

- 1 The Subgroup is comprised of representatives from Argentina (coordinator), Germany, Italy, and The World Bank.
- 2 Whether a bank is considered to be domestic may depend on a number of factors including ownership, where the institution is licensed, and where the institution transacts most of its business.
- 3 Foreign-bank branches and foreign-bank subsidiaries are different legal entities. A foreign-bank subsidiary is incorporated as a unique entity in the host country. A foreign-bank branch, on the other hand, is a direct extension of the foreign bank into a host country. Foreign-bank branches and foreign-bank subsidiaries may be subject to different rules and supervised differently by a host country. The difference between a branch and a subsidiary relates primarily to the degree of "separateness" from the parent bank.
- 4 This subject, as well as membership in the European Union, is covered in greater detail in the paper on cross-border issues.
- 5 Countries considering the transition into the EU framework should consult the relevant directive.
- 6 Other issues such as weak legal and regulatory or supervisory regimes and financial instability are dealt with in the papers on situational analysis and structure and organisation.

- 7 A limited-coverage deposit insurance system must be well defined whether by voluntary agreements or by law. To be effective, voluntary agreements underlying deposit insurance arrangements must be enforceable.
- 8 This issue is primarily relevant to countries undertaking the transition to an explicit, limited-coverage deposit insurance system. See the paper on transitioning for more information.

# Discussion Papers

## Coverage

### *Abstract:*

To be effective, the scope of deposit insurance coverage and its level must be set to meet the objectives of the deposit insurance system while mitigating the deposit insurer's exposure to potential costs, including those arising from moral hazard. Deciding what to cover and where to set the level of coverage involves trade-offs. Coverage that is set at a low level and with a narrow definition of what is covered, may not meet the deposit insurer's objectives. In turn, coverage that is set at a high level and that uses a broad definition of what is covered, may reduce any potential incentive depositors have for monitoring bank risk-taking and may increase the funding requirements for providing deposit insurance. In addition, for a credible deposit insurance system to exist, the public needs a well-defined and enforceable specification of what is covered by deposit insurance. Coverage needs to be specified in advance and should not be subject to interpretation after failures have occurred.

This paper represents the work of the Subgroup on Coverage Issues.<sup>1</sup> The scope of deposit insurance coverage and its level depend on a country's willingness and ability to balance the achievement of the deposit insurer's objectives with the introduction of incentives for depositors to exercise some discipline. Deciding what to cover and where to set the limits involves trade-offs between these objectives. Coverage that is set too narrowly and levels that are set too low may fail to prevent runs, while coverage that is set too broadly and levels that are set too high may eliminate incentives for depositors to monitor risk-taking.

The question of coverage is intertwined with issues that are covered in various other papers.<sup>2</sup> The scope and level of deposit insurance coverage vary considerably across countries. This paper will explore these variations and the considerations that go into selecting them. It will identify issues, describe trade-offs, and make recommendations on appropriate guidance for deposit insurance systems.

### **Setting Coverage Limits**

Establishment of coverage limits should take into consideration the scope and level of coverage needed to fulfil the public-policy objectives of the system, as well as the potential costs that different coverage limits may imply. Whatever scope and level of coverage is selected, it must be credible and must be internally consistent with other features of the deposit insurance system, including its funding arrangements.

The potential costs of coverage take two forms. First, there is the possibility that moral hazard may arise with high levels of coverage. This will depend on practices that govern the financial sector in each country. There are practices that can curtail the moral-hazard problem. Countries that have adopted these practices may opt for high levels of coverage without much cost.<sup>3</sup>

The second potential cost is the additional funding requirement that higher levels of coverage may bring. Since a higher coverage level does not affect the recovery rate of assets, the deposit insurance system will require a larger amount of funds when coverage is increased, other things being equal. However, practices can be adopted to counteract the need for more funding. In particular, the adoption of early-warning systems and prompt corrective action can minimise the expected loss in case of failure and counteract partially, or even totally, the increase in funding needs.

The outcome of this process will be a combination of instruments to be covered—the scope of coverage—and their coverage levels. This combination will vary from country to country, depending upon the objective(s) of the deposit insurer. For example, if the public-policy objective is to protect small depositors, the type of financial instruments held by these depositors should be determined. Such instruments may include savings deposits, term deposits, demand deposits, or other instruments. Availability, tradition, and tax treatment likely will be factors that will determine the set of instruments in each country.

Once the scope of instruments is determined, the level of coverage must be set. To determine the level of coverage, data on the financial instruments held by the population must be gathered. A useful set of information are data that describe the relative importance of holdings of different financial instruments in terms of both the number of accounts and their size distribution. Such data will allow policymakers to determine the fraction of the number of accounts and the fraction of total deposits that will be covered under alternative coverage levels. This could provide an objective measure of the appropriateness of a given scope and level of coverage. Such information could be obtained without imposing a heavy burden on individual insured institutions. For example, a representative sample of deposit accounts across different institutions can produce the necessary information at relatively low cost.

Depositors often hold multiple accounts at a given depository institution. Gathering data for depositors—which would, in effect, aggregate multiple accounts for individual depositors—would require additional effort. The necessary information, in principle, could be obtained from the banks or through a survey of the population. Whether such a survey is feasible and would produce accurate data may vary from country to country. The gathering of such information could be repeated every few years in order to track changes in the holdings of financial instruments by the population.

Some commentators have suggested that the adequacy of a country's coverage level should be judged by how closely it conforms to a uniform measure across countries—such as the oft-cited level of twice per capita gross domestic product (GDP). However, this approach fails to consider that countries do not share the same characteristics with respect to their financial systems or the same objective(s) for their deposit insurance system.

The process for making choices regarding coverage limits is country-specific. For example, a coverage level of twice per capita GDP may prove adequate in a country that desires to provide deposit insurance to small depositors. However, in a country with a similar level of GDP, but a different income distribution, the same criteria could produce different results. Moreover, what is considered a “small depositor” depends on the particular situation of a country and may not be captured by a single parameter such as the level of GDP. Additionally, objectives of the system may differ among countries. Therefore, countries that are otherwise identical may end up with different levels of coverage with respect to GDP if they have different objectives for their systems

## Exceptions to the Coverage Limit

Once the scope and level of coverage are set, consideration can be given to treating certain deposits and/or depositors as special cases. For instance,

many countries exclude from coverage the financial instruments of depositors who are deemed capable of ascertaining the condition of an insured institution and of exerting market discipline. Examples include deposits held by other banks—interbank deposits—or other professional investors, such as investment funds. Similarly, the deposits of government departments and of regional, provincial, and municipal governments and other public bodies also may be excluded. In some cases, the deposits of individuals who are regarded as bearing responsibility for the deterioration of an institution are excluded. These may include deposits belonging to the directors, managers, large shareholders, and auditors of banks.

In other countries, by contrast, the process of assessing the public-policy objectives and the conditions within the country may lead to the opposite conclusion with regard to the coverage of certain instruments. For example, if the public-policy objective is to promote stability in the payments system and if the distribution of banks is such that there are a number of small banks that hold accounts in a few large banks for clearing purposes, then it may be desirable to extend coverage to include interbank deposits—possibly up to a limit.

Likewise, there may be cases in which the public-policy objectives imply varying coverage limits according to the legal status of the depositor. For example, some countries provide coverage only to natural persons while in other countries coverage is extended to entities such as small businesses. The later coverage may be justified because small businesses, like small-unsophisticated depositors, may not be able to assess the risks of financial institutions. In such cases, a system would have to be designed such that the personal funds of the small-business owner are not co-mingled with the business-related funds. In other cases, countries have opted to give separate coverage to deposits held in trust and joint ownership.

In some countries, the public-policy objectives lead to the exclusion of deposits that carry excessively high interest rates. These deposits may be excluded

in order to discourage weak institutions from being able to bid away deposits from stronger, more prudently managed institutions. In addition, countries that provide per-depositor coverage generally exclude those deposits that are not registered to a particular owner—bearer deposits—since there is no way of calculating the coverage limit or proving eligibility when the depositor is unknown. Some countries exclude deposits that are associated with money-laundering activities.

## Application of the Coverage Limit

After it is determined which financial instruments will be covered, and for how much, the issue of how to apply the coverage limit must be addressed. In general, there are three possibilities to consider. The first is that the coverage limit may be applied per deposit, per member institution. This limit easily could be circumvented by opening multiple deposits of an amount equal to or below the maximum covered limit.<sup>4</sup> If a country wants to enforce a maximum coverage limit, then this approach is not advisable.

The second possibility is to apply the coverage limit per depositor, per institution. In this case, a depositor cannot increase his or her level of coverage by opening multiple accounts in one institution. Information requirements in this case are higher than in the previous case. If this approach is chosen, there has to be a method for identifying deposit holders. The additional costs to implement this requirement are likely to be quite low, particularly in countries that require a standardised identification form or a general-purpose ID number in order to open a deposit account.<sup>5</sup>

A third possibility is that in a country with multiple insured institutions, the coverage limit may be applied per depositor across all institutions. In this case, it is highly unlikely that the depositor will be able to increase coverage beyond the stated limit, but the costs of administering such a system could be high. This type of coverage limit tends to be



very difficult to administer as it requires not only a great deal of information regarding ownership of the instruments in the failed institutions, but also a process for determining when to combine accounts at different institutions. To manage this system effectively, a time element would have to be attached to the coverage limit—such as per calendar year—and there would have to be a mechanism to track depositor reimbursements to determine when a particular depositor had reached the coverage limit. This option is seldom used because of the high information and reporting requirements it entails.

## Coinsurance

To foster market discipline and limit the costs of deposit insurance associated with moral hazard, some countries have adopted a system of coinsurance whereby depositors bear a pre-specified share of the resultant loss from the failure of an insured institution.<sup>6</sup> There are drawbacks to such systems, however. One drawback is that it is possible that small-unsophisticated depositors would not monitor insured institutions or exert sufficient market discipline because the costs of doing so exceed the benefits. In this case, coinsurance would inflict a cost on certain depositors without increasing market discipline. As a result, these depositors may opt to stay out of the financial system. To be effective, coinsurance requires that adequate information be provided to the public regarding the condition of insured institutions than otherwise might be the case. Such information, however, may not be forthcoming.

One way to protect against some of the potentially adverse effects of coinsurance is to apply coinsurance only above a certain amount. Under such a system, small-unsophisticated depositors would be protected against the risk of loss. This, in turn, would presumably lower the risk of runs. At the same time, such a system could maintain the incentive for larger depositors to monitor insured institutions.

## Adjusting Coverage Limits

Over time, inflation can diminish the real value of deposit insurance. In addition, changes in the composition and the size of deposits, and the development of new financial instruments may make the current coverage structure irrelevant. As the real value of deposit insurance declines and the percentage of deposits covered by deposit insurance decreases, it may become more difficult for the deposit insurer to carry out its mandate. Periodic adjustments to the scope and level of coverage may therefore be necessary. However, a trade-off exists between the objective of maintaining the level of deposit insurance constant for a sufficiently long period of time so that depositors can know the coverage limit with certainty and the objective of preserving the real value of deposit insurance coverage. This problem is especially acute for high-inflation countries.

Adjustments to the scope and level of deposit insurance coverage may take place either on an *ad hoc* basis or they may be made systematically, such as through indexing. When adjustments are made on an *ad hoc* basis, policymakers are in control of the process. This may be viewed as either desirable or not, depending on the circumstances within the country. Alternatively, indexation of coverage levels may be viewed as a way to “de-politicise” the coverage question.

Indexed adjustments may be implemented automatically, which would require care in choosing the frequency and amount of adjustments. If adjustments occur too often or for odd amounts, this could lead to confusion among the public as to the insurance limit. It also could be expensive to implement such adjustments, as the public would have to be informed about the new limits. On the other hand, if adjustments occur too infrequently, this could produce large increases in uninsured deposits and significant declines in the number and amount of deposits insured over time.

A number of countries with histories of high inflation define coverage limits in terms of indexing units to maintain the real value of their deposit insurance coverage.<sup>7</sup> This provides for automatic adjustment of the coverage level for insured deposits without the need to change the information available to public—coverage in terms of the indexing units is constant.

Even within a system of indexing, the limit in real terms should be reviewed periodically in order to confirm that the objectives set for the deposit insurer are being met. Changes in the size of financial markets, expansion of the access to financial markets among households, and the growth of real income are likely to necessitate changes in the real value of deposit insurance.

## Foreign-Currency Deposits

The decision of whether to cover deposits denominated in foreign currencies depends basically on the public-policy objectives of the deposit insurer and the country-specific circumstances. In particular, the decision to cover these deposits and its ramifications depend heavily on the country's usage of foreign currency—as represented by the amount of deposits denominated in foreign currencies as a percentage of the total amount of deposits in the country. When this ratio is high, it would be of little value to institute a deposit insurance system without covering these deposits. On the other hand, providing credible coverage for deposits denominated in a foreign currency requires the deposit insurer to be protected against foreign-currency risk.

When foreign-currency deposits are covered, two decisions have to be made. The first is whether deposits will be repaid in the foreign or local currency. At a minimum, a deposit insurance system that offers to repay depositors in a foreign currency must have access to sufficient foreign assets or other sources of foreign-currency funding to make this commitment credible. Alternatively, a deposit insurer may repay foreign-currency

deposits in the local currency. Under this option, the rules should be clear with respect to which exchange rate will be used to calculate the repayment, in order for the public to understand the risks that they may face. If, for example, the rate prevailing on the date of failure is used to convert the foreign-currency deposit into the local currency, then the risk of devaluation between the date of failure and the date of repayment is borne by the depositor. If the conversion of the foreign-currency deposit into the local currency is not made until the day of repayment, the risk of devaluation is borne by the deposit insurer.<sup>8</sup>

The second decision is whether to express the coverage limit in the local or a foreign currency. If the limit is expressed in local currency, its devaluation effectively will diminish the limit for foreign-currency deposits. If the limit is expressed in foreign currency, devaluation does not affect the effective coverage level. Whichever approach is chosen, country officials have to be aware that changes in the exchange rate can introduce changes in the relative coverage of local- and foreign-currency-denominated deposits. Also, country officials should specify which exchange rate will be used to make the conversions when necessary.

## Conclusions

Setting the scope and level of coverage requires striking a balance between the public-policy objectives, the need to limit moral hazard, and funding requirements. As a result, coverage limits are country-specific.

Each country must assess its unique situation in setting coverage limits, considering: the public-policy objectives of the deposit insurance system, the state of its financial system, the distribution of deposits among depositors, and the nature and quality of the supervisory and regulatory system in its country.

The selected coverage level must be credible and must be internally consistent with other features of the deposit insurance system, including its

funding arrangements. Limits to coverage should be applied per depositor, per financial institution. This reduces the possibility that depositors will be able to circumvent the coverage limits without imposing excessive administrative costs on the deposit insurer.

The scope and level of coverage should be revised periodically. Adjustments should be made as necessary in light of changes in the financial sector.

A deposit insurance system must take a pro-active approach to determining what is and what is not insured and must communicate this effectively to insured institutions and the general public.

## Endnotes

- 1 The Subgroup on Coverage is comprised of representatives from Chile (coordinator), Germany, Hungary, Italy, the United States and the International Monetary Fund. Members of the Subgroup on Coverage contributed information on their deposit insurance systems for this paper. Comments received from the Working Group's consultative process also were considered in the preparation of this paper.
- 2 See the papers on public-policy objectives, moral hazard, situational analysis, transitioning, membership, funding, depositor priority, depositor reimbursement and cross-border issues for in-depth discussions of these issues.
- 3 The practices to curtail moral hazard are discussed at length in the paper on moral hazard.
- 4 The opening of multiple accounts in order to increase deposit insurance coverage is referred to as "deposit stacking."
- 5 There may be other variations on how the coverage limit is applied. For example, the coverage limit may be applied per depositor, but a depositor may be able to increase his or her coverage limit by holding deposits under different rights and capacities. See the paper on reimbursing depositors.
- 6 See the paper on moral hazard for a description of the mechanisms that countries may use to limit the exposure of their deposit insurance system.
- 7 Some countries have used indexing units as a means to protect contracting parties from the effects of inflation.
- 8 To illustrate, suppose that a depositor has a foreign-currency-denominated deposit of \$10 and the local currency is the Peso. On the day of failure the exchange rate is 1 Peso = \$1. By the day of repayment, however, the exchange rate is 2 Pesos = \$1. If the deposit is valued at the prevailing exchange rate on the day of failure, then the depositor will receive 10 Pesos on the date of repayment, which can then be converted to \$5. If, however, the deposit is paid at the exchange rate prevailing on the date of repayment, then the depositor will receive 20 Pesos, which can be converted to \$10. Under the first scenario, the depositor bears the risk of devaluation; under the second scenario, the deposit insurer bears that risk.

# Discussion Papers

## Funding

### *Abstract:*

Sound funding arrangements are critical to the design and operation of an effective deposit insurance system and the maintenance of public confidence. To be effective, a deposit insurance system should include the mechanisms necessary to ensure that adequate funds are available to reimburse depositors promptly if an insured depository institution fails and to cover the system's operating expenses. Inadequate funding can delay the resolution of failed institutions and significantly increase costs. The design of a deposit insurance system's funding arrangements also will affect when and by whom the costs of deposit insurance are borne.

Funding for a deposit insurance system can be obtained on an *ex-ante* or an *ex-post* basis, or through a combination of these approaches. Whether one method is preferred over another will depend, in part, on how the advantages and disadvantages associated with each approach are viewed in the context of the deposit insurance system's design and public-policy objectives. This paper examines these approaches and additional funding issues that should be considered by policymakers.

To be effective, a deposit insurance system must have access to adequate sources of funding to meet its obligations when they come due. The alternative methods or options for funding, their associated trade-offs, and related issues are explored in this paper.<sup>1</sup>

Sound funding arrangements are critical to the design and operation of an effective deposit insurance system and the maintenance of public confidence. A well-designed deposit insurance system should include the mechanisms necessary to ensure that adequate funds are available to reimburse depositors promptly in the case of an insured institution's failure and to cover the operating expenses of the system. As the experiences of several countries have

shown, inadequate funding can lead to delay in resolving failed institutions and to significant increases in costs.<sup>2</sup> The design of a deposit insurance system's funding arrangements also will affect when and by whom the costs of deposit insurance are borne.

Regardless of how it is funded, a deposit insurance system is not designed to withstand, on its own, a systemic crisis—especially when a large proportion of insured depository institutions are in severe trouble at the same time. Nor should it be assigned the responsibility of funding such a crisis. It is important, therefore, that policymakers consider how failures will be handled, both in normal times and in times of stress.

The methods for funding a deposit insurance system include *ex-ante* funding, *ex-post* funding, or some combination of the two approaches. Whether one method is preferred over another will depend, in part, on how the advantages and disadvantages associated with each approach are viewed in the context of the deposit insurance system's public-policy objectives and design.<sup>3</sup>

Beyond the decision to fund a deposit insurance system on an *ex-ante* or an *ex-post* basis, additional funding issues should be considered by policymakers. Among these are the following: the determination of the source(s) of initial funding for newly established and transitional deposit insurance systems, and the source(s) of ongoing funding for established deposit insurance systems, including borrowing; and how deposit insurance assessments should be determined, assessed, and collected. In the case of *ex-ante* funding, policymakers should consider whether a deposit insurance fund should be established, how related issues concerning the size of the fund and investment policies for the fund should be determined, and whether it is appropriate to establish separate deposit insurance funds for different types of depository institutions.

## Deposit Insurance Funding Methods: *Ex-ante* or *Ex-post* Funding

Funding for deposit insurance purposes can be obtained by building a reserve or a fund on an *ex-ante* basis, or by having the power to obtain funds when needed on an *ex-post* basis. Deposit insurers also use a combination of these approaches, notably when the deposit insurer has the ability to supplement *ex-ante* funding with an *ex-post* call on public or private funds.

### **Ex-ante funding**

The accumulation of a safe-and-liquid pool of funds is possible when *ex-ante* funding is chosen. These accumulated funds, in turn, are available for the prompt reimbursement of insured deposits in the

event of a failure of an insured depository institution. Funding also can be available readily to cover the operating expenses of the deposit insurer. When funding is obtained on an *ex-ante* basis, all insured depository institutions contribute to building and maintaining a deposit insurance fund. As a result, insured depository institutions that subsequently fail will have contributed to the cost of reimbursing their insured depositors.

As discussed below, an *ex-ante* funding system may be designed to incorporate risk-based or differential premiums, whereby the deposit insurance assessments of individual depository institutions are linked in some manner to the risks posed to the deposit insurer. Whether deposit insurance premiums are assessed on a risk-based or a flat-rate basis, *ex-ante* funding provides an opportunity to smooth the premiums paid by depository institutions over the course of the business cycle. As a result, the costs of deposit insurance may be borne when the industry and economy are healthy, as opposed to when problems are being experienced. On an operational basis, depository institutions have the opportunity to include prospective deposit insurance assessments in their financial planning process. However, such *ex-ante* funding has been criticised as a potential drain on the liquidity of the banking system, because premiums paid to the deposit insurer cannot be utilised for other purposes.

The establishment of an *ex-ante* deposit insurance fund can contribute to public confidence in the functioning of the deposit insurance system, if depositors know that funds are available for reimbursement and that the fund is well managed. The uses of the fund should be clearly defined and limited.

If a deposit insurance fund is established, policymakers should address a number of related issues. An appropriate investment policy for the fund must be developed and implemented. Without an appropriate policy, it may be difficult to maintain the value of the fund over time, especially during periods of inflation. Issues relating to the size of the fund and the level and type of insurance premiums



also must be addressed. Conflicts between the deposit insurer and the member depository institutions over these and other issues also can present a problem. For example, charging depository institutions for deposit insurance when there are no failures can cause the institutions to question the need for deposit insurance.

### **Ex-post funding**

By contrast, *ex-post* funding requires depository institutions to pay only when failures occur. *Ex-post* funding also may provide incentives for depository institutions to monitor each other in order to avoid the costs associated with the failure of a member institution. This is particularly the case in banking systems characterised by a small number of large depository institutions.

Under an *ex-post* system, when the industry and economy are healthy, contributions are minimised and the operating expenses of the deposit insurance system may be low. However, because the calculation and collection of assessments occur post-failure, prompt reimbursement of insured depositors may be more difficult than under an *ex-ante* system. Moreover, under an *ex-post* system, depository institutions that fail are not assessed for the losses they create.

There are other issues that arise under an *ex-post* funding system. Because *ex-post* levies, by their nature, are collected after the failure of an institution, they may be less effective in influencing behaviour than *ex-ante* assessments. *Ex-post* funding could be destabilising because of the point-in-time charge. If failures occur during an economic downturn, there may be an incentive for regulators and deposit insurers to forbear, given the weakened ability of member institutions to pay. There is an incentive for surviving depository institutions to make demands on the deposit insurer and other regulators in exchange for providing the requisite funds to cover the costs associated with the failure of one or more depository institutions. This may weaken the bargaining position of the deposit insurer.

### **Hybrid funding methods**

In practice, deposit insurance systems often are funded on a combined *ex-ante* and *ex-post* basis. Reliance on *ex-ante* funding sources—typically from insured depository institutions—is supplemented by access to public or private funding, including *ex-post* levies on depository institutions and draws on government lines of credit, especially in the case of a large failure or wave of failures. In designing a hybrid scheme, policymakers need to be aware of the disadvantages inherent in each of these approaches.

## **Sources of Funds**

In most countries depository institutions bear most, if not all, of the costs associated with deposit insurance. There are a number of ways in which this is done. The most common method is to levy premiums, whether *ex-ante* or *ex-post*. An alternative method is for depository institutions to set aside reserves.

### **Public funding**

It may be appropriate for the government to play a role in funding a deposit insurance system, either as the source of the initial funds for the system or as a source of supplementary funding during a wave of failures. The government also may play an indirect role in funding by providing a guarantee to support private borrowing by the deposit insurer. For example, some countries have used government funds for the initial capital needed to establish their deposit insurance systems. In certain cases, these public funds have been repaid in full over time, through the use of premium assessments and income generated by the investment of liquid funds. Alternatively, the government could offer contingent financing while a deposit insurance fund is being accumulated.

Provisions for obtaining public funding for dealing with failures also have been included in the design of deposit insurance systems. For example, some deposit insurers have access to lines of credit with

their central bank or government. Generally, it is less expensive to borrow from the government than private sources. As well, funds may be more readily available from the government than the private sector. However, some countries disallow public funding except in exceptional circumstances because it is considered a competitive distortion.

In deciding how to fund the deposit insurance system, attention should be paid to whether there are tax and/or budgetary implications for the country. There may be fiscal implications related to the budgetary treatment of premium revenues paid to the deposit insurer and expenditures from fund balances for failure-resolution purposes. When deposit insurance assessments are tax deductible for the paying depository institution, the burden of deposit insurance is shifted partially from insured depository institutions to taxpayers. Moreover, if insured depository institutions are treated differently for tax purposes than other providers of financial services, there may be competitive implications.

### ***Borrowing***

Although recoveries constitute a significant source of funding in the case of failures, they cannot be used for timely reimbursement of depositors. If the deposit insurer has insufficient funds to cover losses, it may be necessary to borrow funds. Such borrowings may have debt-management implications. Two types of borrowing can be distinguished—borrowing for working-capital purposes and borrowing against future premiums to cover any projected shortfall. In the case of the former, it may be necessary to borrow to bridge any gap between the reimbursement of depositors and the subsequent recoveries received from the disposition of the failed institution's assets. In effect, this borrowing would be secured by the value of these assets. Borrowing imposes costs that must be paid through future assessments and the value of recovered assets. Because deposit insurers do not have an unlimited call on these resources, borrowing imposes discipline on the funding process. That is, unlimited borrowing is not a feasible long-term funding option.

## **Uses of Funds**

The funds available for deposit insurance are used for several purposes. First, funds must be available to compensate insured depositors when institutions fail. Equally important, operating funds must be available to attract and retain competent staff and otherwise meet the obligations that any insurer faces in the course of normal operations.

### ***Investment policies***

When a deposit insurance system is funded on an *ex-ante* basis, policymakers need to consider which investment policy will effectively utilise the funds available for deposit insurance purposes. On one extreme, policymakers may choose to pursue a policy where funds are held in low-risk, highly liquid assets. Alternatively, policymakers might pursue an investment strategy that elevates higher rates of return above other considerations. Both of these approaches have drawbacks. If a conservative approach is adopted, the opportunity cost is the foregone return to the deposit insurance funds. The pursuit of a higher-return policy may result in funds not being available for insurance purposes when they are needed and/or a loss of principal. This, in turn, may erode public confidence in the deposit insurance system.

A more-balanced approach would be an investment strategy that balances higher rates of return against the certainty that funds will be available when needed and guards against loss of principal. For some countries, such an investment policy may include investments in different currencies or foreign jurisdictions. Regardless of the investment approach selected, policymakers should ensure that funds are protected from fraud and defalcation.

### ***Disbursement of funds to depository institutions***

A related issue is whether depository institutions should be able to receive disbursements or rebates from past premiums collected. This issue hinges on how policymakers view the respective roles of

depository institutions and government. If deposit insurance assessments paid by depository institutions are viewed as payments for the credit enhancement provided by government or as user fees—that is, government bears the risks associated with depository institution failures—then it is difficult to claim that the depository institutions should have a draw on the deposit insurance fund. On the other hand, if government is viewed as providing a potential back-stop for catastrophic losses alone, then depository institutions may be viewed as having a claim on past deposit insurance assessments paid to the fund.<sup>4</sup> Various funding arrangements are consistent with this approach. For example, rebates may be tied to the deposit insurance fund's reserve ratio, depository institutions may hold a claim on the deposit insurance fund, or the private sector may be incorporated into the provision of deposit insurance—for example, through private reinsurance contracts.

## Issues Related to a Deposit Insurance Fund

Issues of concern to policymakers include: how to assess depository institutions for the purposes of building a deposit insurance fund, and whether there is an optimal size for the fund.

### ***Approaches to building a deposit insurance fund***

How should depository institutions be assessed for the purposes of building a deposit insurance fund? One approach is to build an *ex-ante* deposit insurance fund through the use of premium rates that provide a steady stream of funds for the deposit insurance system over the long term. The fund balance will fluctuate in response to insurance losses, and changes in premium rates will not occur unless losses are excessive. As a result, the costs of deposit insurance may be smoothed over time. Policymakers should balance the need to set premium rates that are consistent with the funding needs of the deposit insurer against the ability of insured depository institutions to fund the system.

Alternatively, an assessment system can be designed so that a targeted fund ratio is maintained, such as the ratio of the deposit insurance fund to estimated insured deposits or another measure of the deposit insurer's loss exposure. This approach, however, can lead to a *de facto ex-post* system once the deposit insurance fund has achieved its target ratio. Depository institutions are then asked to pay little in good economic times and to fund deposit insurance losses after they have occurred. The resultant increased variability in premiums may be addressed by setting assessment rates on the basis of a moving average after the target ratio is attained. Because assessment rates would be determined by a predetermined formula, the premium-setting process could be insulated from political factors and would become more predictable.

Where the government ultimately is responsible for losses, it can be argued that a deposit insurance fund is not necessary. However, there are practical reasons for the government to maintain an explicit deposit insurance fund. A deposit insurance fund helps to protect taxpayers from deposit insurance losses by creating a buffer paid for by depository institutions. It also can be viewed as a budgeting mechanism through which resources can be sequestered from the country's normal appropriations process. This can help to ensure that adequate resources are available readily when problems arise, and help to smooth the costs of deposit insurance over time.

### ***Size of the deposit insurance fund***

In principle, a deposit insurance fund should be large enough to reduce the probability of the fund's insolvency to an acceptable minimum, given the inherent constraints faced by the deposit insurer. One constraint is the difficulty of estimating probabilities of loss, which may be low in the immediate future when the economy and depository institutions are healthy. However, when economic conditions deteriorate, the incidence of failures can increase significantly. Other constraints relate to the finite capacity of the industry to pay, and the

fact that the deposit insurance fund alone cannot handle system-wide crises.

An approach to determining the optimal size for a deposit insurance fund is to balance the degree of risk that the deposit insurance fund takes against the ability of depository institutions to fund the system. Factors that should be considered include the composition, size and liability structure of the depository institutions that are insured by the deposit insurance fund, as well as the associated failure probabilities and loss rates. Differences in the failure and loss rates between large and small institutions have been identified. These differences reflect the fact that large banks enjoy economies of scale, more flexibility in funding sources, better diversification of risks, and a smaller likelihood of fraud of sufficient size to cause failure. However, because of its attendant costs, the failure of one large bank, while a lower-probability event, may have a more serious effect on the banking industry and the deposit insurer, as well as on the economy. The choice of fund size should balance these factors.

### **Multiple deposit insurance funds**

An ancillary issue is whether multiple deposit insurance funds should be established. A case can be made for establishing and maintaining separate deposit insurance funds for different types of insured depository institutions. Under such circumstances it is important to ensure that the integrity of the funds is maintained and that distinctions among the institutions and their funds are real and do not distort competition among different types of institutions.

## **Deposit Insurance Assessments**

Deposit insurance assessments serve a variety of functions: they can be pooled to build a deposit insurance fund, thereby spreading the burden of maintaining a deposit insurance system among all covered depository institutions; they can be used as an incentive for prudent risk management; and

they can be available to cover operating costs of the deposit insurer. The level of assessments, whether *ex-ante* or *ex-post*, should balance the needs of the deposit insurance system against the capacity of depository institutions to pay. While many deposit insurance systems rely on annual deposit insurance assessments, other deposit insurance systems have chosen to raise funds as needed in lieu of regular assessments.

### **Flat-rate versus risk-based/differential premiums**

When deposit insurance systems are funded through assessments on their members, the choice must be made between a flat-rate premium or premiums that are differentiated on the basis of an individual institution's risk profile. The primary advantage of a flat-rate premium is the ease with which assessments can be levied and collected. Most newly established or transitional deposit insurance systems initially have adopted flat-rate deposit insurance assessments. This often is appropriate, given the potential difficulties associated with the design and implementation of a risk-adjusted/differential premium system, as discussed below.

Because flat-rate deposit insurance premiums do not reflect the level of risk that a depository institution poses to the deposit insurance system, depository institutions can increase the risk to their portfolios without incurring any additional insurance expense. As a result, flat-rate premium systems are criticised for encouraging excessive risk-taking by insured depository institutions.<sup>5</sup> Another criticism is that in a flat-rate system where the deposit insurer receives sufficient funds to cover its insurance costs, low-risk depository institutions effectively pay for part of the benefit received by high-risk institutions. The burden of insurance losses, therefore, can be distributed inequitably among insured depository institutions under a flat-rate premium system.

By contrast, risk-based/differential premiums can be designed to mitigate these criticisms. Deposit insurance premiums can be designed to reflect the

risk posed by an individual institution to the deposit insurer, or to differentiate among institutions' risk profiles in some manner. Although there is general agreement that relating deposit insurance premiums to the risk an institution poses to the insurance fund is a good idea, the information-intensive nature of the intermediation process in which banks specialise makes risk measurement a difficult task. The potential difficulties involved in the design and implementation of a risk-based premium system include: finding appropriate and acceptable methods of differentiating institutional risk, obtaining reliable and appropriate data, ensuring transparency, and examining the potential destabilising effects of imposing high premiums on already troubled banks.

As countries choose to adopt risk-adjusted deposit insurance assessments, they must address the need for adequate resources to implement such a system successfully. This includes the need for sufficient information on the risk profile of depository institutions and the need for skilled staff and analytical tools. Often the supervisory authority of the country is relied upon for information on the risk profiles of depository institutions. In these cases, a good working relationship and the exchange of information between the deposit insurer and the supervisory authority are essential to establishing an effective risk-adjusted/differential system.<sup>6</sup> Moreover, careful consideration should be given to the balance between risk-based capital standards and risk-based/differential insurance premiums so that they do not operate at cross-purposes.

### ***The design of a risk-based/differentiated pricing system***

The most straightforward conceptual approach is to charge a depository institution an amount equal to the expected loss the deposit insurer faces from providing deposit insurance to that institution. This approach would reflect the differences in risk across banks and would generate revenue sufficient to pay for the costs of insuring deposits. The expected-loss price for a depository institution

would depend on the probability of default for that institution, the exposure of the deposit insurer to that institution, and the size of the loss that the deposit insurer might incur should the depository institution fail. Setting deposit insurance premiums on the basis of expected loss may minimise over the long term the distortions and moral-hazard problems associated with deposit insurance, and minimise the cross subsidisation of high-risk depository institutions by low-risk institutions.

Several broad approaches for developing expected-loss pricing or otherwise differentiating among the risk profiles of depository institutions are in use by deposit insurers. One approach relies on the use of supervisory information, which is generated through on-site examination of depository institutions, and the use of off-site monitoring tools by the supervisor or deposit insurer. Information such as composite examination ratings and the ratings of their component parts are among the supervisory tools that could be used to develop risk-based/differential pricing. Although supervisory information often is the most in-depth information available about a depository institution, it also may be subjective in nature.

Another approach involves the use of objective factors that are factual or data-driven. Bank reports of condition, non-public bank-specific information, and market information, are examples of objective factors that could be of use in differentiating among the risk profiles of individual depository institutions. Although this approach may minimise the reliance on subjective supervisory judgment, care must be taken to avoid imposing an excessive regulatory burden on depository institutions. The combined use of both subjective and objective factors to differentiate among risk profiles of depository institutions also is found in practice.

Ideally, risk-based premiums should be forward-looking rather than based on past performance, but this is difficult to accomplish. In practice, policymakers would not choose to affect adversely already weak institutions—particularly in the case of *ex-post* funding. Because of the difficulties in



assessing risk, it is likely that differences in premiums will be smaller than warranted by differences in risks.

### ***The deposit insurance assessment base***

In order to ensure the stability of a deposit insurance funding system, deposit insurance premium assessments should adequately cover the deposit insurer's risk exposure. The deposit insurance premium rate and the base against which the premium rate is assessed may determine these revenues. Policymakers may wish to consider an assessment base that corresponds to the maximum exposure or legal liability of the deposit insurance system. Thus, one choice for the assessment base is insured deposits. Alternatively, some deposit insurers have based their assessments on a broader measure of the institution's total deposit liabilities.<sup>7</sup>

### ***Assessment and collection issues***

Depository institutions have an incentive to minimise their funding obligations. One way in which this is done is to minimise their assessable liabilities. When the assessment base is measured at a finite point in time, say the end of the quarter, there is an incentive for depository institutions to “sweep” deposits out of their accounts on that day. This practice would be discouraged if the assessment base was defined in terms of average daily deposits or some similar measure. For example, assessments could be determined on the basis of year-end audited financial statements. As a result, the assessment base would be correlated more closely with the risk exposure of the deposit insurer.

Similar issues exist with regard to the collection of assessments. Features such as the automatic debit of a depository institution's account can help ensure the timely collection of assessments. Non-payment of assessments may be addressed through the same mechanisms that ensure compliance with other norms, such as assessing fines, publishing non-compliance or revoking the institution's banking license. Non-payment of assessments also may be addressed by legislating that premium

assessments have priority over other creditors or ensuring that unpaid assessments have the same status as amounts owed to the government.

## **Conclusions**

Sound funding arrangements are critical to the design and operation of an effective deposit insurance system and the maintenance of public confidence. Inadequate funding can lead to significant increases in the costs associated with resolving failed depository institutions and erode public confidence. When policymakers design a funding system—whether an *ex-ante*, *ex-post* or hybrid system—they should consider the advantages and disadvantages in the context of their public-policy objectives and structure the system accordingly.

## **Endnotes**

- 1 The Subgroup is comprised of representatives from France (coordinator), Canada, Chile, Hungary, Italy, Mexico and the United States. Members of the Subgroup contributed information on their deposit insurance systems for this paper. Comments received from the Working Group's consultative process also were considered in the drafting process.
- 2 The experience of the United States in resolving the savings-and-loan crisis during the 1980s and early 1990s provides such an example. It is discussed in Federal Deposit Insurance Corporation, *History of the Eighties: Lessons for the Future*, (1997).
- 3 Public-policy objectives for deposit insurance systems are examined in another paper.
- 4 This delineation between “user fees” or “mutual arrangement” is discussed in the Federal Deposit Insurance Corporation's *Deposit Insurance Options Paper*, (August 2000).
- 5 There are factors apart from the pricing of deposit insurance that can limit the degree of risk-taking by insured depository institutions, including market and depositor discipline. These are discussed in the paper on moral hazard.

- 6 The importance of interrelationships among safety-net participants, including the deposit insurer, is discussed in the paper on that topic.
- 7 In the United States, the assessment base is defined as total domestic deposits, adjusted for factors such as deposit float. When an individual depositor is able to hold deposits in excess of the insurance limit in one depository institution through the use of joint or trust accounts, insured deposits are difficult to measure.

# Discussion Papers

## Reimbursing Depositors

### *Abstract:*

A basic function of all deposit insurance systems is to reimburse depositors promptly for the losses they otherwise would suffer in the event of an insured financial institution's closure. As a result, depositors are relieved of both the recovery-rate and time risks of a liquidation process up to the insured level of their deposits. Reimbursements to depositors—including the speed and convenience of such—vary across countries, and can affect public confidence in the deposit insurance system. This paper addresses the factors related to the reimbursement process, discusses the advantages and disadvantages of various approaches, and makes recommendations on appropriate guidance for deposit insurance systems.

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### **Conditions Necessary for an Efficient Reimbursement Process**

A number of conditions, including those involving legal and financial issues, must be in place for a deposit insurer to accomplish its reimbursement function efficiently—that is, to reduce the recovery-rate and time risks for depositors with insured

deposits. Specifically, depositors need to know when and under what conditions the deposit insurer will start the reimbursement process.<sup>2</sup> Additionally, depositors need to know the coverage limits. Finally, the deposit insurer needs to have available adequate funding to fulfil its obligation to reimburse insured depositors.

#### ***Starting the reimbursement process***

A deposit insurer needs to know as soon as possible when an institution with insured deposits will be closed and whether depositors will need to be reimbursed. In many cases, the decision to close an institution rests with the supervisory authority, which will either suspend or withdraw the institution's license or charter. In other cases, the process to close an institution may be commenced by the supervisor or deposit insurer, but must be approved by a court.

#### ***Separating the reimbursement from the liquidation process***

It is advisable to separate the reimbursement process from the disposition of the assets of the closed institution even in cases where the deposit insurer

also handles the liquidation of the institution. A clear separation of responsibilities can improve the speed and efficiency with which depositors are reimbursed and ensure that the appropriate focus is given to the necessary tasks. However, in many cases this will not be possible. For example, if no funds are available for reimbursement other than from the disposition of the failed institution's assets, the deposit insurer will not be able to separate its task from the work of the liquidator. In these cases, the deposit insurer will need additional authorities—for example, the ability to borrow for working-capital purposes—in order to proceed with a timely reimbursement process.<sup>3</sup> The longer the period between the closure of an institution and the beginning of the reimbursement process, the greater is the likelihood that the public will lose confidence in the ability of the deposit insurer to meet its obligations.

### ***Early access to data***

In addition, the longer the period between a closure and the start of the reimbursement process, the greater the risk that manipulation of the institution's data might occur. This could result in the inability of the deposit insurer to sort out depositors with legitimate claims from those seeking protection of funds that would otherwise not be insured. Granting a deposit insurer the authority to have access to, or control of, deposit data before closure would lessen the risk of manipulation. Legislative provisions in a number of countries allow the deposit insurer to prepare for closure and possible reimbursement at institutions that appear likely to fail.<sup>4</sup> In other countries the deposit insurer is restricted from doing this by strict secrecy rules. The deposit insurer also needs to have sufficient experience and advance information about the institution's data system(s) so as to speed up the reimbursement process.

### ***Time frame for the reimbursement process***

Regardless of how a closure is handled, a deposit insurer needs a clear delineation of when to start and when to complete the reimbursement process.

Depositors, too, need to know when they can expect to receive their funds.<sup>5</sup> If insured deposits will not be available immediately after an institution is closed, depositors need to know the time frame over which reimbursement will take place. This will help to reduce the loss of public confidence.

### ***Reconciliation of accounts***

Determining who should be reimbursed and ensuring that insurance limits are respected are the most crucial and time-consuming steps in the deposit-reimbursement process. In order to carry out this function in a timely manner, the deposit insurer needs to have a clear understanding of the legal environment in which it operates, who is eligible for deposit insurance coverage, what products are covered, and the limits of that coverage. For example, the law has to define clearly the eligible persons—natural or legal, the trustee's rights to proceed depending on whether the authorisation is given before or after the closure, and the beneficiary's rights. The scope and level of coverage will vary, depending upon a country's decisions consistent with its public-policy objectives, and should be defined clearly in the law.<sup>6</sup>

Once the deposit insurer determines which depositors and what products are covered, it must determine the amount that should be reimbursed to each depositor. The deposit insurer needs to assess the amount in each deposit account at the time of the closure of the failed institution, determine whether the accounts are within the deposit insurance limit, and reimburse the depositors. The mechanics of this process are discussed below. However, there are a number of issues that must be determined before this process can begin.

### ***Ownership rights and capacities***

In order to determine the amount that each depositor is owed and whether the amount falls within the coverage limit, the deposit insurer must understand the different ownership rights and capacities, if there are any, with respect to single accounts, joint accounts, business accounts, retirement

accounts, and fiduciary accounts and how deposit insurance coverage is applied in these instances. In many countries the coverage limit is applied to the combined account statement of depositors with multiple deposits, regardless of the number of deposits, the currency, or the location.<sup>7</sup> In others, deposits held in different rights and capacities are insured separately.<sup>8</sup>

### ***Interest payment***

In most countries interest on deposits is calculated up to the point of closure and paid first, along with the principal, up to the coverage limit. However, in many countries the interest payments on deposits considered to have “high” yields may be repudiated and reimbursement made only for the principal with some “reasonable” rate of interest. In addition, some countries exclude from coverage deposits considered to have extremely high yields.

### ***Items in transit***

A complex issue involves the problem of incoming transfers and items in transit—monies received by the insured institution during the period after the withdrawal of its license or charter, but before the declaration of the unavailability of the deposits or the institution’s closure. Before calculation of the amount to be reimbursed can take place, the deposit insurer must process these, preferably in accordance with some established rules that will minimise any disruption to the payments system caused by the institution’s closure.

### ***Rules regarding set-off and collateral***

Two other important issues affecting the determination of the amount of reimbursement are the rules regarding set-off and collateral.<sup>9</sup> First, it must be decided whether the right of set-off applies. In this context, set-off refers to the right to reduce the amount of a deposit by the amount of a loan. Second, regulations regarding the status of deposit accounts used as collateral must be formulated. It generally is preferable to suspend payout of such deposits until their collateral status is cancelled.

If the reimbursement and liquidation proceed separately, which they do in most countries, then close cooperation between the deposit insurer and the liquidator is necessary to handle the offsetting and collateral cases.

### ***Funding the reimbursement process***<sup>10</sup>

As discussed above, in order to carry out its mandate to reimburse depositors of failed institutions efficiently, a deposit insurer needs a source of funding. Access to funding varies widely around the world. In some countries, a fund is built up from the premiums paid by the institutions covered by deposit insurance. In other countries, a special assessment is made on the institutions covered by deposit insurance when a member of the group fails. Whatever the case, a deposit insurer must have funds available to meet its obligations.

## **Reimbursing Depositors— Elements and Procedures**

The payment of insured depositors in a deposit reimbursement is generally a time-consuming, labour-intensive, methodical process. To speed this process and enhance its efficiency, it is advisable for the deposit insurer to establish consistent administrative practices and procedures, which are readily accessible and can be followed by subcontractors as well as in-house staff. These practices and procedures should be set out in a manual, periodically reviewed and updated, and supported by adequate computer capabilities.

In developing its administrative practices and procedures a deposit insurer should strive to set operational priorities, focus on depositors’ expectations, and emphasise structure over individual functions. The operational priorities need to be aligned with the public-policy objectives of the deposit insurance system, taking into account the particular legal, economic, and cultural aspects of the country. In designing the reimbursement process, the needs and expectations of depositors should be taken into



account. Each part of the reimbursement process must work together in a seamless fashion to ensure an efficient reimbursement process.

### ***Administrative regulation of the reimbursement procedure***

The administrative practices and procedures should specify the necessary steps to ensure accuracy in the reimbursement of depositors. To determine the proper reimbursement amount, a deposit insurer has to review all the deposit-account records, apply the proper laws and regulations to each account, and prepare a combined account statement for depositors with multiple accounts. The account statements must then be balanced with the general ledger to ensure that they are accurate. Finally, a record must be kept of all reimbursements made to depositors for verification and auditing purposes.

### ***Submission of claims by depositors***

When the verification and reconciliation of accounts cannot be accomplished through the failed institution's own records, submission of a claim form by the depositors may be required. This is an important consideration when designing the reimbursement process. In a number of countries, depositors must submit a claim—effectively proving ownership of an account—before the deposit insurer can process a reimbursement. This may be necessitated by the generally poor quality of data available at the time of an institution's closure, or by other considerations—such as bank-secrecy laws that may prevent a deposit insurer from being able to identify depositors and their accounts accurately.<sup>11</sup>

In general, requiring the submission of claims is inconvenient to depositors, can delay the payout process, and may generate negative publicity for the deposit insurer. On the other hand, proceeding with the reimbursement process on the basis of poor-quality data may result in inaccuracy, a large number of complaints and additional losses for the deposit insurer.

### ***Timing of reimbursement to depositors***

Coincident with the verification process is the decision regarding the timing of depositor reimbursement. This decision should reflect the objectives of the deposit insurer as well as the results of a comprehensive situational analysis, especially regarding the ability of the deposit insurer to gain access to the data necessary for deposit verification. In general, the deposit insurer will have the option of either a quick payout or a payout only after verification is completed.

A quick payout ensures that the time risk to depositors associated with an institution's closure is minimised, but it has the potential for inaccuracy, especially if the records are in poor condition. This option may generate complaints by depositors regarding the amount of reimbursement and may increase losses to the deposit insurer. To manage a quick payout efficiently, a high degree of cooperation between the deposit insurer and the supervisory authority is fundamental. The deposit insurer should have advance notice of an impending closure and should have access to the deposit records of the failed institution. The deposit insurer also must have the funds to reimburse depositors.

Alternatively, the deposit insurer may choose to make payment only after extensive deposit verification and proof of ownership. This option requires that all cheques, reconciliation tasks, and adjustments be completed before depositor reimbursement is made. This option can minimise the risk of error by the deposit insurer, but generally results in a protracted procedure that may result in the public's loss of confidence in the ability of the deposit insurer to meet its objectives on a timely basis.

A possible solution to the above dilemma might be to advance a partial payment to insured depositors before all the steps necessary to ensure an accurate payout are completed.<sup>12</sup> Of course, this option presents trade-offs as well. Although an advance partial payment can mitigate panic and other disruptive effects—especially if a great number of

the frozen accounts are used to pay wages or pensions—the procedure may require extraordinary measures and could increase the risk of making inaccurate payments. If this option is chosen, it is imperative to have a plan of action and systematic processes in place. Further, if this option is not properly integrated into the overall payout process, it may delay the normal reimbursement process. The approach selected must be country-specific and should take into account the tolerance levels and expectations of the public. A reasonable position on this issue would be to issue payments after best efforts to ensure accuracy and completeness are made.

### ***Preparatory tasks for the reimbursement***

The actual reimbursement to depositors should occur after the deposit records or claims of depositors have been reconciled.<sup>13</sup> To begin, the deposit insurer must determine the end point of the institution's operations and reject any transactions after that point. Then the deposit insurer must identify depositors, determine insured and uninsured amounts, produce lists of deposits, and issue cheques or implement other means of payment.

The reimbursement procedure generally starts by downloading the institution's deposit information into the deposit insurer's processing systems.<sup>14</sup> Incoming transfers must be reviewed and a determination made of whether they arrived before or after the institution's closure. Transfers arriving after an institution's closure generally should be rejected and returned to the originating institution.

Next, the deposit insurer should draw up individual deposit statements showing principal and interest as of the closing date and then sort them to determine ownership. For depositors with multiple accounts, a combined account statement will need to be prepared. If the deposit insurance laws allow a depositor to increase the level of coverage by holding deposits in different rights and capacities, the combined statement will have to reflect any deposits held in a different right or capacity. Thereafter, the deposit insurer will have to sort out

the excluded depositors, verify the rights of trustees and beneficiaries, and clarify any fiduciary relationships. The deposit insurer also will have to perform the interest calculations on deposits according to the statutory provisions. Once these steps are completed, the account statements should be posted to the general ledger and balanced to ensure accuracy.

Next, it must be determined if any deposits are to be set-off against outstanding loans or if any deposits are used either as collateral or backed up by collateral. These accounts will require special treatment according to the laws and regulations in effect.

A subsequent consideration at this point is whether any insured deposits are held in foreign currencies. Again, depending on the laws and regulations of the deposit insurer, appropriate adjustments will have to be made. In many cases, this requires the deposit insurer to convert a deposit held in a foreign currency to the domestic currency at the appropriate exchange rate. In other cases, the deposit insurer will have to be prepared to pay the depositor in the foreign currency.

At this point the deposit insurer is prepared to reimburse insured depositors. The last step before reimbursement is the preparation of a settlements claim specifying the amount to be paid by the deposit insurer and to be claimed from the liquidator.

## **Reimbursement**

The reimbursement procedure can be simplified substantially if a healthy institution can be found to take over the insured-deposit accounts. Depositors benefit if the receiving bank's network overlaps that of the failed bank. If such an institution is not available, the deposit insurer must select a method of payment, such as employing a reimbursement agent that will issue cheques, cash or some other means of payment to insured depositors; mailing cheques; transferring funds to another institution designated by the depositor; issuing a debit card to insured depositors; or making a postal transfer.<sup>15</sup>

### ***Communication and complaints***

Communication is crucial to the reimbursement process. Immediately following an institution's closure, the public should receive practical and accurate information about: when and how depositors can expect to receive their money (the reimbursement schedule), what depositors are expected to do in order to receive their reimbursement, and who depositors can contact for further information or clarification.

Frequent and regular updates regarding the proceedings, the latest reimbursement statistics, and any problems that would delay the process are advisable. Information can be disseminated through direct communication with depositors, press releases, the news media, advertisements, posters, the Internet, or any other available means. Direct communication through letters or telephone calls may be necessary in order to notify depositors about the availability of their money, to request further documentation to qualify for insurance coverage, or to answer depositors' questions or complaints. In the experience of many deposit insurers, there generally are two types of complaints—those regarding coverage and those regarding the quality of service. Coverage questions must be dealt with through a legal investigation to decide whether the dispute is valid. Complaints regarding the quality of service should be handled expeditiously and with the utmost empathy. Handling such complaints may be easier and more efficient if the deposit insurer already has established service standards.

### ***Monitoring and follow-up***

Continuous monitoring of the reimbursement process is advisable so that adjustments may be made if necessary. For example, if the reimbursement process will take weeks or months to complete, special care should be taken so that the deposit insurer is not accused of giving some depositors or group of depositors favourable treatment.

Some follow-up tasks should be noted. Submitting the reimbursement process to an independent

auditor may be advisable, especially if the regulations and supporting software did not undergo an audit before application. In some cases, the deposit insurer also will need to submit its claim as creditor of the closed institution to the liquidator in compliance with the subrogation rules specifying the amounts reimbursed and the indemnification obligation not yet settled. Finally, the deposit insurer may need to undertake some efforts to locate depositors whose reimbursement was unsuccessful during the normal process.

## **Preparations for the Reimbursement Process**

The reimbursement process will benefit not only from having adequate legal and financial elements in place, but also from undertaking preparations to ensure that information systems are in place and that human resources are identified who can handle the task.

### ***Legal provisions***

Review of the experiences of past reimbursement cases are an important task and should include consideration of the adequacy of legal provisions. If such provisions are found to be lacking, then initiation of amendments to the law is advisable.

### ***Improving the quality of bank records***

To facilitate the determination of the proper amount of insurance coverage, the implementation and enforcement of a requirement for high-quality standards in bank record keeping is very important. As long as the quality of a closed institution's records is sufficiently good, it is possible, in a reasonable period of time, to obtain a clear picture of the deposit insurer's obligations. In a number of countries, it is the role of the supervisory authority—as the proxy for the deposit insurer—to monitor the adequacy of the institutions' information systems. In other countries, this is the role of the deposit insurer. Regardless, it is important that the deposit insurer and the

supervisory authority maintain a cooperative working relationship to ensure that the deposit insurer is aware of the need to take action, and that when the need arises the deposit insurer will be able to meet its objectives. If conditions are favourable for the revision of banking law, the imposition of standardised requirements might be appropriate. Such requirements might include a minimum list of identifiers—such as name and address—for depositors, trustees, beneficiaries, and other appropriate parties, and regular reconciliation of the information.

### ***Developing information systems***

In a reimbursement scenario, deposit insurers may process many thousands of accounts. This must be done according to strict legal and administrative procedures and within very tight time frames. Information technology (IT) support is indispensable. Manual processing is not only slow, but also error-prone and resource-intensive. Proper IT support, however, must reflect the objectives of the deposit insurer and comply with the adopted priorities and special conditions of the country.

Newly established deposit insurance schemes can benefit from the accumulated experience of established deposit insurers. However, caution should be taken in applying other deposit insurers' technology, especially application software, as it may not directly relate to the legal environment or public-policy objectives of the country's deposit insurance scheme. Although lessons can be learned from how other deposit insurers developed their approaches, each deposit insurer requires a reimbursement process and an IT system that reflects the conditions in its country.

As noted above, part of the reimbursement process can involve downloading data from a closed institution into the deposit insurer's IT system. Regular and comprehensive examination of an insured institution's deposit-record-keeping system is important. Enforcement of record-keeping standards should be part of the supervisor's authority.

### ***Human resources***

A deposit insurer will need to review whether it has adequate, experienced in-house staff to handle a deposit reimbursement. In many cases, the number of staff needed for a reimbursement will exceed the number of staff the deposit insurer needs to manage its day-to-day operations. The deposit insurer will need to decide whether to maintain a staff sufficient for what it considers a normal workload or whether it will outsource the function by employing independent contractors to handle reimbursements as they arise.

Recent technological developments have made reliance on internal staff an increasingly cost-efficient alternative. However, independent contractors may be able to provide a depth of expertise and quality of resources that would otherwise be unavailable to a deposit insurer.

### ***Public awareness***<sup>16</sup>

Public confidence in the reimbursement process can be promoted by continuously disseminating information about how deposits are protected. Dissemination of such information in an easily understandable brochure and establishment of an unambiguous deposit register system, which lists protected products for each member institution, may contribute significantly to a smooth and efficient reimbursement process.

## **Conclusions**

On the basis of the experience of many deposit insurers a number of elements are necessary to achieve a successful reimbursement process. First, the deposit insurer needs to review its policies, practices and processes to ensure that they are up-to-date and can effect accurate reimbursements. Second, information systems and human and other resources need to be monitored and continually enhanced so that they can deal with the changing environment. Third, the public needs to be educated so that they understand how the reimbursement process works, including what is and what is not

insured. Fourth, the expectations of depositors need to be managed to ensure that bank runs are reduced—the expectations of depositors should mirror what the deposit insurer is capable of delivering.

In addition, there should be a high degree of coordination between the supervisory authority and the deposit insurer to ensure that the deposit insurer will be prepared to handle the closure of an insured institution.<sup>17</sup> This includes development of a process to ensure that the quality of bank records is monitored and that record-keeping standards are enforced. Above all, a deposit insurer should design a country-specific system that depositors can rely upon.

## Endnotes

- 1 The Subgroup on Reimbursing Depositors is comprised of representatives from Hungary (coordinator), Canada, Italy, Philippines, and the United States.
- 2 Typically, the reimbursement process starts when deposits became frozen because of the unavailability of liquid assets or when the decision is made to close an insured institution.
- 3 See the paper on funding for a discussion of the various sources of funding a deposit insurer may use to accomplish a timely reimbursement. See the paper on powers for a discussion of what authority a deposit insurer needs in order to accomplish a timely reimbursement of depositors.
- 4 For example, in the United States, the Federal Deposit Insurance Corporation (FDIC), which insures bank and thrift deposits, generally is given at least 90 days' notice before the closure of a bank. If no financial institution can be found to assume the deposits during this period, the FDIC makes plans to pay depositors the full amount of their insured deposits. In Hungary the deposit insurer is authorised to examine the books of a bank if it appears likely to fail.
- 5 For example, the European Union Directive requires that deposit guarantee schemes of member countries must be in a position to pay duly verified claims by depositors within three months of the date of an institution's failure.
- 6 A separate paper addresses the issue of scope and level of coverage.
- 7 For example, the European Union directive establishes that the coverage limit must apply to the aggregate of all deposits held by an individual at the same institution. With respect to jointly owned accounts, the Directive prescribes that the share of each depositor must be taken into consideration when determining the aggregate amount held by an individual.
- 8 In the United States, for depositors who are individuals, the different rights and capacities—or categories of accounts—are single-ownership accounts, joint accounts, revocable trust accounts, irrevocable trust accounts, and retirement accounts.
- 9 Depositor priority and set-off are discussed in a separate discussion paper.
- 10 See the paper on funding for a more detailed discussion.
- 11 For example, because of the bank-secrecy laws in the Philippines, the deposit insurer requires the filing of claims for verification purposes.
- 12 For example, the Philippine Deposit Insurance Corporation may make advance payments for emergency needs.
- 13 As discussed above, final verification may not be complete at this point if the decision has been made to go with a quick or a partial reimbursement of claims.
- 14 This may require conversion of systems to ensure compatibility between computers. Paper-based records must be entered into the deposit insurer's system manually.
- 15 Another reason for asking depositors to contact the deposit insurer might be to support the selected method of reimbursement. For example, money can only be transferred to a requested deposit account, or a debit card must be handed over to the depositor, which is the case in Hungary.
- 16 Public awareness is discussed in greater depth in the paper on that topic.
- 17 It is assumed that the supervisory authority has the power to direct the closure of a troubled institution. If another authority handles this function, then there must be a high degree of coordination with that authority also.



# Discussion Papers

## *Depositor Priority and Rights of Set-Off (Netting)*

### *Abstract:*

The ranking of depositors among the creditors of insolvent deposit-taking institutions, rights of set-off, and the collateralisation of claims vary between countries because of different legal traditions and different public-policy objectives. These factors can influence significantly the behaviour of the deposit insurer and other financial safety-net participants, deposit-taking institutions, and depositors and other creditors, and may affect the cost of providing deposit insurance or resolving troubled institutions.

The ranking of depositors among the creditors of insolvent deposit-taking institutions, rights of set-off, and the collateralisation of claims vary between countries because of different legal traditions and different public-policy objectives. These factors can influence significantly the behaviour of the deposit insurer and other financial safety-net participants, deposit-taking institutions, and depositors and other creditors, and may affect the cost of providing deposit insurance or resolving troubled institutions.

This paper, which was prepared by the Subgroup on Depositor Priority and Rights of Set-Off, discusses issues for deposit insurance systems that are associated with depositor priority, rights of set-off and collateralisation.<sup>1</sup> It is based primarily on the judgment of the members of the Working Group and the experience of various countries that have addressed depositor priority, rights of set-off, or collateralisation issues for deposit insurance systems. The paper also makes use of relevant literature on the subject.

## **Background**

Frequently, the failure of a deposit-taking institution will result in a formal liquidation under the auspices of an official. In some cases that role is assumed by

a deposit insurer or some governmental body, while in other cases an independent outside party, for example, a licensed professional, is appointed. A liquidator (by whatever title described) usually is charged with turning the insolvent entity's assets into cash and distributing the proceeds among claimants according to their ranking as determined by a country's statutory or decisional law.<sup>2</sup>

For the purposes of this paper, depositor priority describes the phenomenon of giving a particular category of depositor claims some superior right to share in the distribution of the proceeds of liquidation of the assets of an insolvent entity. Sometimes elevated ranking attaches to the nature or quality of the claim and sometimes it turns on the identity or status of the claimant.<sup>3</sup>

Collateralisation is defined to be the taking of a mortgage, pledge, charge or other form of security by a creditor over one or more assets of a debtor. Generally, whether a claim is collateralised will be a function of private bargaining, although that may take place in the context of statutory limits or requirements. Collateralisation can affect both the assets and the liabilities of a bank.<sup>4</sup>

The term set-off is used to refer to the situation where the claim of a creditor against an insolvent entity is to be deducted from a claim of that entity



against the creditor. Typically, the effect of set-off is to extinguish the cross-obligations to the extent that they are in matching amounts. Set-off is, by nature, a form of netting, but the latter term frequently is used to describe arrangements where obligations are off-set in circumstances, or by means, that fall outside of the bounds of the law of set-off as traditionally understood.<sup>5</sup>

The laws regarding depositor priority, rights of set-off, and collateralisation can affect recoveries in the event of insolvency. In countries where the deposit insurer becomes subrogated to the rights of the insured depositors against the failed institution, the rules governing the allocation of assets in an insolvency can influence the behaviour of the deposit insurer significantly, as well as the financial safety-net participants, deposit-taking institutions, depositors and other creditors, and they may have a significant effect on the costs associated with providing deposit insurance.<sup>6</sup>

Although collateralisation, depositor priority, and rights of set-off may not operate on the same basis and may have different sources, their economic effects may prove to be the same. In the simplest legal systems, the race between competing creditors may go to the swift. However, the state may intervene only so far as to adopt legislation placing all claimants against an insolvent entity on an equal footing in the distribution of assets. In other legal systems, determining the ranking of a particular claim or a particular creditor may be a matter of extremely fine discrimination, and perhaps considerable complexity.<sup>7</sup>

## Depositor Priority: Approaches and Implications

Depending on the specific arrangement, the relative ranking of depositors can affect the behaviour, incentives and costs affecting a deposit insurer. For instance, a system that gives depositors high priority can allow depositors (and a deposit insurer if it is subrogated to the rights of depositors) to recover in full before other claimants are compensated.

However, depositor priority may not always reduce costs to depositors and deposit insurers. When depositors are given a higher ranking than other creditors, the potential loss exposure of the lower-ranking creditors may be increased. This, in turn, may increase the incentives for lower-ranking creditors to exercise more market discipline than otherwise would be the case. Non-deposit creditors can take actions to better protect themselves, including collateralising their claims, shortening their terms of maturity, or imposing additional charges.<sup>8</sup> However, much will depend on the types of non-deposit creditors, the actual ability of these creditors to collateralise their claims, and what is allowed in individual countries.<sup>9</sup> It is probably safe to say that only very large creditors of a bank would be in a position to collateralise their claims effectively in most cases.

As a means of mitigating expected losses, non-deposit creditors may exercise early withdrawal. Early withdrawal can drain liquidity and exacerbate pre-existing problems. Given these considerations, a troubled institution's liability structure (and the changes it can undergo during times of financial stress) would play a role in determining the degree to which depositor priority lowers a deposit insurer's costs.

Depositor preference could lessen the incentives for depositors to exercise market discipline if they believe that the priority accorded to their deposits in insolvency would prevent them from experiencing any losses. It also could lessen incentives for the deposit insurer or the supervisor to act promptly in dealing with problem banks, thereby potentially raising the costs associated with resolving a troubled institution. It has been suggested that depositor preference legislation in place in some countries has created incentives to liquidate rather than pursue other strategies, such as sales or mergers of troubled banks. However, although there may be some incentives pushing deposit insurers in these directions, it also has been observed that strong governance and accountability frameworks can offset these incentives.

Depositor priority arrangements also may have implications for financial-system stability. Some argue that giving depositors priority over key payments-system creditors, such as central banks or commercial banks, can raise the costs of capital (for example, unsecured debt may have to be priced at higher rates) and may lead to a higher risk of contagion. Others take the view that depositor priority has limited implications for capital costs and stability issues.

All of these actions potentially can offset the original benefit of priority for both depositors and the deposit insurance system. Empirical studies of the effect of such behaviour have been limited and there does not appear to be any clear evidence that depositor priority reduces or raises net resolution costs.<sup>10</sup> The final outcome of depositor priority on costs and the behaviour of stakeholders appear to rest on a wide variety of country-specific legal and economic factors.

## Collateralisation: Approaches and Implications

The extent to which collateralisation is permitted or required can affect the ability of depositors to recover in the event of a bank failure, and, thus, can affect the incentives, behaviour, and costs of a deposit insurer. Some countries give depositors a priority that supercedes even the rights of secured creditors of a failed institution. In other countries, depositors, along with all other unsecured claimants, share only in the unencumbered assets of the insolvent entity.

There are trade-offs in allowing or requiring deposit-taking financial institutions to give security. Where there are limits on institutions doing so, there are implicit trade-offs in the choice of the types of creditors to whom, or the purposes for which, institutions are permitted or compelled to collateralise their obligations.

Collateralisation is used to facilitate commercial transactions, such as in the derivatives markets. If

a financial institution is unable to collateralise its obligations, it may be forced either to pay risk premiums or be excluded from participation in a given market. In the simplest sense, unsecured creditors face diminished recoveries if a failed institution's assets have been encumbered. Further, there may be beneficial effects from a supervisory perspective, such as when a regulator would prefer the institution to hedge certain of its exposures with derivatives products. In many instances collateralisation is a two-way street—that is, party A must put up assets in favour of party B in order to receive security for party B's obligation to party A. If party A is financially strong there will be no harm to its unsecured creditors. It also may benefit from being able to transact on favourable terms with party B, while mitigating its credit risk.

Collateralisation also is used to provide assistance for transaction arrangements that carry significant systemic risk. For example, deposit-taking financial institutions may be required to post collateral in order to participate in payment clearing and settlement systems and the like. Countries that encourage, or even require, participants to collateralise their obligations in these types of arrangements, have effectively decided that the value of eliminating, or at least minimising, credit risk to the other participants is worthwhile. Finally, collateralisation frequently is required as a condition for obtaining government accounts, such as tax, social benefit and other such claims.

When collateralisation is extensive, unsecured creditors have greater incentive to effect early withdrawals, shorten maturities or impose additional charges as a means of mitigating expected losses. Extensive collateralisation of a financial institution's assets also may impinge on the ability of a deposit insurer or a supervisory authority to assist a troubled depository institution. The ability of secured creditors to withdraw large blocks of assets from the control of a troubled institution could impede the ability of an institution to address its problems.

## Rights of Set-off: Approaches and Implications

When rights of set-off are available or imposed in an insolvency proceeding, the net recoveries of creditors who also are debtors of the failed institution may be improved significantly. This, in turn, may diminish the recoveries of other unsecured creditors. Allowing or imposing set-off can reduce the number of individual creditors and debtors of the insolvent entity that will have to be dealt with in the liquidation. The subsequent reduction in administrative costs may provide some benefit to other creditors.

Various arrangements for the netting of claims increasingly are being used and being given legislative protection in the belief that doing so provides systemic benefits. For example, allowing the cross-obligations of the participants in systems for the clearing and settlement of payments to be netted, lessens the credit risk of the other participants in the event of the insolvency of one participant. This reduces the possibility of one participant's insolvency having a contagious effect on other participants.<sup>11</sup> Furthermore, a number of jurisdictions (including those generally opposed to set-off) have adopted laws to protect the operation of the closeout netting provisions found in the prevailing standard documentation for derivatives transactions. This enables participants in derivatives markets to effect transactions that might not be available to them if the contemplated netting was not assured, or at least to effect transactions on more-favourable pricing than would be the case if counter parties exacted risk premiums because of uncertainty over the availability of set-off in insolvency. The cost of netting by participants in derivatives markets are borne by the other creditors if an institution fails.

Additional issues to consider regarding set-off include whether it should apply regardless of the status of the loan or whether it should apply only when the loan is due or in default. Set-off against a performing loan could result in a “call” on the

loan to a viable business. As a result, many countries restrict set-off to cases where the loan is in default or has matured. Even in jurisdictions where set-off generally is accepted, there may be issues surrounding the extent to which set-off should apply. For example, if a liquidator is permitted, or required, to set the failed institution's obligations off against loans due to the institution that are in good standing, the result may be to diminish the value of that portfolio of loans as a realisable asset. As well, while the focus of insolvency law tends to be on the creditors of the failed entity, in the case of a deposit-taking institution there may be as many, or even more, borrowers whose arrangements might be disrupted.

For example, suppose that an individual has a \$10,000 deposit with the bank and a \$100,000 residential mortgage from the bank payable in blended monthly instalments over five years. If the \$10,000 deposit is to be set-off against the mortgage debt, is it to apply to the first \$10,000 owing on the mortgage after the date of failure, or the last \$10,000 owing at maturity of the mortgage, or spread in some fashion over the monthly payments falling due between the date of the failure and the maturity of the mortgage? If the deposit is not insured, the borrower in this example may place far more value on being able to effectively “recover” his \$10,000 deposit in full than on having his mortgage loan paid in accordance with the contractual schedule. On the other hand, if the \$10,000 is insured, the borrower may well prefer his or her loan payments to remain on the original schedule.

The latter example illustrates that co-ordination issues can arise between the rules of set-off and the operation of a deposit insurance system. For example, suppose that a depositor with \$100,000 of deposit insurance coverage has a deposit of \$150,000 and a loan of \$75,000 from a troubled bank. If set-off is not available, the depositor will receive \$100,000 from the insurer, will have to pay his or her \$75,000 loan in full and will obtain on the \$50,000 uninsured portion of the deposit only

such fractional dividend as may be paid by the liquidator. Both the depositor, for his or her \$50,000 claim, and the deposit insurance organisation, for its \$100,000 claim, will share, along with all other creditors of the failed institution, in the value of the asset represented by the depositor's \$75,000 loan.

Suppose, instead, on the same facts, that set-off is available. The issue will then arise whether set-off ought to be effected before or after calculating the deposit insurance payment. To put the same matter another way, there will be an issue whether the deposit insurance is to be paid on the gross amount of the deposit or only on the net amount remaining after set-off. So, if the deposit insurance system requires the insurer to pay \$100,000 to the depositor as a gross basis, he or she will be left with a \$50,000 uninsured balance and a \$75,000 claim for set-off against that balance. In the end result, the depositor will obtain full recovery of his or her \$150,000 deposit and be left owing a \$25,000 loan balance to the failed institution. On the other hand, if set-off is taken first, then the \$75,000 loan will reduce the \$150,000 deposit to a net \$75,000 and the deposit insurer then will pay \$75,000. In this example, the depositor will achieve complete recovery of his or her deposit and complete satisfaction of their obligation as a borrower. The deposit insurer will pay less than under the first variant—although the difference is not entirely black and white, since under the first variant, while paying \$100,000 instead of \$75,000, the deposit insurer would share, along with other creditors, in the asset represented by the depositor's \$25,000 loan balance owing to the liquidator. One might say that in the first variant the deposit insurance applies to the “first” \$100,000 of the deposit and in the second variant it applies to the “last” \$75,000.

This example illustrates that countries setting out to design a deposit insurance system must consider the effects of netting. Policymakers must decide either how to tailor the coverage to achieve whatever might be the desired effect, in light of the degree to which rights of set-off operate on the

insolvency of deposit-taking institutions, or whether to give the deposit insurer a somewhat different position than creditors generally enjoy.

## Conclusions

There is a great deal of variation between countries in the ranking of depositors among the creditors of failed institutions. These differences can be attributed to different legal traditions as well as different public-policy objectives. The particular ranking of depositors, along with the rules governing the availability of set-off or collateralisation, as established by a country's legal system, usually are not subject to change by the deposit insurance system. The ranking of depositors can influence the incentives and costs affecting a deposit insurer. Systems providing for depositor priority in the event of insolvency have the potential to lower costs for a deposit insurer. However, this may be offset to a large extent, depending on the ability of other creditors to obtain collateral for their claims, initiate early withdrawal of funds and take other measures. There also may be reductions in incentives to exert market discipline from those receiving the benefit of priority.

Depositor priority arrangements also may have implications for the stability of the payments system and the financial system, although it is not clear the extent to which they can influence capital costs, the effectiveness of payment systems, or the risk of contagion.

Rights of set-off can vary significantly from one country to another. Some countries stress the importance of set-off, while others take a less favourable view, believing that it can contribute to unequal treatment.

If set-off is to be allowed in the case of depositor claims, restricting the set-off application to instances when the loan or other obligation owed by the depositor to the failed institution is due or in default may provide better conditions for the resolution of the failed institution.

## Endnotes

- 1 The Subgroup is comprised of representatives from Canada (coordinator), Germany, the International Monetary Fund and the United States.
- 2 The failure of a deposit-taking institution does not always involve liquidation. A restructuring of the institution or its balance sheet may protect its creditors fully or at least provide them with more than they would receive in a formal liquidation.
- 3 Priority is usually not something that creditors and debtors can create by private bargain but is a function of statutory law (for example, the priority afforded to domestic depositors in the United States) or decisional law (for example, the priority given to claims of “the Crown” by the common law of England and a number of countries that have inherited the English tradition). Parties can at times bargain to choose the form of their transaction so it will result in a type of claim that enjoys priority or, in the negative sense, they can bargain for subordination, so that the claim ends up with a lesser ranking than it otherwise would enjoy. Some countries allow “equitable subordination,” under which a court may, for one or another of a variety of reasons (for example, to sanction perceived wrongdoing), move a creditor’s claim down to a lower ranking than it otherwise would enjoy.
- 4 Legislation may restrict the persons to whom, the purposes for which, or the extent to which an institution is permitted to collateralise its obligations, or it may require that certain obligations be collateralised. Sometimes collateralisation arises from statute and sometimes collateralisation is mimicked as a means of providing priority (for example, where a statute provides that a certain class of creditors or claims is to be paid on a first-recourse basis out of a particular category of assets). In some countries, a claim against somebody can be a deposit with a bank that can be collateralised by taking security over the deposit, which can affect eligibility for deposit insurance coverage. The claimant can be the bank itself, in which case this can be viewed as a special form of set-off.
- 5 For example, many arrangements for the clearing and settlement of claims among multiple participants (such as the exchange between banks of customer cheques) rely on multilateral netting to reduce the

number of payments required to be made at the end of a settlement cycle, so that A may satisfy an obligation that it owes to B by paying an obligation that B owes to C. There tends to be different views between common law and civil law systems over the issue of set-off. Common law jurisdictions generally regard it as “unfair” to require a party to pay its debt to an insolvent entity in full and receive only a fractional dividend on the insolvent’s debt to them. Many civil law jurisdictions view it as “unfair” to allow a debtor of the insolvent to avoid paying its debt by deducting the amount of a claim against the insolvent that is not fully recoverable. In practice, many jurisdictions that have historically barred rights of set-off in insolvency have adopted special rules permitting netting arrangements and the like for particular purposes, such as derivatives transactions.

- 6 Subrogation of the insurance entity to the rights of insured depositors (or an equivalent arrangement, such as a requirement that depositors assign their claims in order to receive insurance payments) is an important feature of many deposit insurance systems. Subrogation allows the deposit insurer to “stand in the shoes” of the depositor when dealing with the liquidation of the deposit-taking institution. Under traditional legal principles in many jurisdictions, an insurer is not entitled to take over the rights of the insured unless and until the insured has been fully indemnified for their loss. Consequently, in jurisdictions with explicit, limited-coverage deposit insurance that principle usually is overridden by legislation enabling the deposit insurer to take over a depositor’s claim to the extent of the insured portion. In some cases, the insurer will rank equally with any remaining (uninsured) claim of the depositor. In contrast, in some systems the deposit insurer is entitled to use the depositor’s claim to recover the insurance payment before the depositor may recover on his uninsured balance (thus effectively placing the insured portion of the total deposit ahead of the uninsured portion). In most cases, the rights of the insurer as subrogee of the insured depositors against the failed institution rank no higher than the claims of the depositors would rank if they were not insured. An additional implication of subrogation is that the deposit insurer often will end up being a primary creditor in the liquidation, and so will enjoy a degree of influence or control over the conduct of the liquidator, which the depositors would be less



likely to achieve by individual or collective action, given the comparatively small stake that each would have compared to the aggregate position of the insurance organisation.

- 7 The degree of clarity in a nation's statutory or decisional law may influence significantly the bargaining power and behaviour of creditors and debtors. Precisely because there are "not enough assets to go around" in an insolvency, the decision to give particular creditors or types of claims priority, or to permit (or not) collateralisation, may produce an opposite (but not necessarily equal) reaction. In some countries, the law provides for specific time limits associated with the pursuit of claims by creditors, which can affect eligibility for deposit insurance coverage.
- 8 Nevertheless, many countries impose limitations on the extent to which a bank can provide collateral for liabilities. Public-entity depositors often require highly marketable securities for collateral, even though these typically make up only a small portion of the assets of many large banks.
- 9 It should be noted that in the case of many small banks, groups such as trade creditors could make up a sizeable portion of non-deposit creditors. These types of creditors may not be in a position to collateralise their claims.
- 10 See James A Marino and Rosalind L. Bennett, "The Consequences of National Depositor Preference," *FDIC Banking Review* 12, no. 2: 19–38, 1999.
- 11 Although set-off can be regarded as a tool to help reduce credit risk, it carries with it some legal risk in that netting contracts may not be legally enforceable in all the countries in which an institution operates and each type of netting has differing degrees of enforceability in the case of default. See, International Monetary Fund, *Orderly and Effective Insolvency Procedures*, (1999).



## *S*tructure and Organisation

### *Abstract:*

Whether a deposit insurance system will be effective in meeting its public-policy objectives will be determined, in part, by how the system is structured and organised.

Structure and organisation encompasses a deposit insurance system's mandate, roles and responsibilities; its governance arrangements; and its human resources and other operational considerations. Mandates, roles and responsibilities vary widely among deposit insurance systems. It is critical that they be well defined and consistent with the stated public-policy objectives of the scheme. In order to discharge its mandate effectively, a deposit insurer should have access to requisite information on its member institutions. The choice of the governing structure for the deposit insurance system usually is influenced by the mandate and the degree to which the deposit insurer is legally separate from the other safety-net participants or those having an interest in deposit protection and financial-sector stability.

Governance systems can be enhanced through the use of sound strategic- and risk-management processes and good internal-control and audit systems. Arrangements should be made to ensure that the governing structure is accountable and transparent. Human resources and other operational issues are critical elements of the structure and organisation of a successful deposit insurance system. Key issues are: attracting and retaining qualified employees, determining the appropriate mix between dedicated staffing and outsourcing, ensuring the confidentiality of information supplied to employees, and guaranteeing that employees receive legal protection against lawsuits for their action in the normal course of their activities.

The ability of a deposit insurance system to fulfil its public-policy objectives is greatly influenced by its structure and organisation. The development of an appropriate structure and organisation for a deposit insurance system requires an examination of a number of factors. These include the deposit insurance system's specific mandate, its roles and responsibilities; governance arrangements; human resources; and other operational considerations. This paper will identify the relevant structural and organisational issues for deposit insurance systems, and will examine the trade-offs associated with choosing a particular structure and organisation. This paper represents the work of the Subgroup on Structure and Organisation.<sup>1</sup>

## Mandates, Roles and Responsibilities

The mandate of an organisation encompasses the set of official instructions given to an organisation to perform its task(s). Organisational roles and responsibilities generally arise from the given mandate. A number of issues should be taken into account when setting out mandates, roles and responsibilities for a deposit insurance system. These include: the linkages between the deposit insurer's mandate and its public-policy objectives and country circumstances; the degree to which mandates are defined in law or by other means; the degree of coordination with other organisations that comprise the financial safety net; and the processes in place for reviewing mandates.

Mandates, roles and responsibilities vary widely among deposit insurance systems. They can focus on the relatively limited paybox responsibilities, such as the collection of premiums and the payment of claims to depositors, or they can be broader and focus on risk-minimisation responsibilities. Such responsibilities may include risk assessment and management, supervision, and intervention and failure resolution.<sup>2</sup>

Mandates also can be influenced by the degree to which a deposit insurance system is either privately

or publicly sponsored, administered or financed. In purely private systems—those sponsored and administered by private-member associations with no government involvement or financial backing—mandates tend to reflect objectives consistent with their members' wishes.<sup>3</sup>

There are, however, some privately administered deposit insurance systems that have legislative underpinnings and significant public elements. These systems legally may be required to pay depositors' claims, may be given access to government assistance, and may include the participation of bankers and government officials on their governing bodies. In such cases, their mandates, roles and responsibilities may reflect a wider range of concerns such as promoting confidence and financial-system stability.

On the other end of the spectrum are purely public systems, which entail government sponsorship, administration and financing. Their mandates tend to emphasise objectives consistent with broader public concerns. Nevertheless, many so-called publicly sponsored and administered systems may rely on private financing from their membership and may rely on private-sector advisers and the views of member financial institutions. In practice, virtually all deposit insurance systems have some private and public characteristics. This public/private-sector mix, and resultant mandates, roles and responsibilities are country-specific.

### ***Linkages to public-policy objectives***

The public-policy objectives of the deposit insurance system and its mandate should be consistent in order to enhance the effectiveness of the system. Serious problems can result when they diverge. The issue of consistency is relevant across all deposit insurance systems.

### ***Specification of mandates, roles and responsibilities***

The degree to which mandates, roles and responsibilities are well defined is another important consideration. The advantage of a well-defined

system is that there is less ambiguity, because the rules are clear to all parties, including depositors, insured institutions, and safety-net participants. This can reinforce stability and confidence in the deposit insurance system. By making transparent information on the roles and responsibilities of the deposit insurer, and the terms and conditions of deposit insurance, incentives for greater accountability and good governance are provided.<sup>4</sup> The specification of the accountability regime, terms and conditions of insurance—such as membership, coverage, and the reimbursement process—and on the coordination and information-sharing arrangements between the deposit insurer and other safety-net participants should be well-defined.

Formal specification can be accomplished either through law or regulation, a policy statement or agreement, or by private contract. Although some private systems may not be defined in legislation, they can be defined alternatively in private contracts. Even in cases where the deposit insurer is not a separate legal entity—for example, a department of a central bank—there are benefits to having well-defined mandates and responsibilities, including improved coordination with the activities of other departments within the organisation.

### ***Coordination with other safety-net participants***

In order to discharge its mandates effectively and meet its objectives, a deposit insurer should have access to requisite information on its member institutions. The need for adequate and timely information among members of the safety net is particularly critical because few deposit insurers have broad supervisory authority. At a minimum, access to basic information about member institutions, including information on current financial condition and the existence of problems, needs to be assured. Although informal arrangements can work well in some circumstances, it is often necessary that information sharing be mandated either through legislation or by private agreements, or both, given the sensitivity of member-specific information and the challenge of maintaining

open communication channels. These should set out what is to be shared and by whom, as well as the type, level of detail, and frequency of the information to be exchanged. In all cases, the confidentiality of the information should be assured. There also should be goodwill among the heads of the agencies, indicating that they are firmly committed to information exchange.

Coordination of the activities of the safety-net participants is important for ensuring an effective deposit insurance system and for avoiding inefficiencies and conflicts between safety-net participants. The need for cooperation among safety-net participants should be taken into account when determining the mandate, roles and responsibilities of the deposit insurer. This is particularly crucial in situations when the deposit insurer is accorded a broad mandate, such as the role to intervene in member institutions' affairs or act as receiver or liquidator. Experience has shown that clarity and coordination can contribute not only to the effectiveness of a deposit insurance system but also to the effectiveness of the entire financial safety net.<sup>5</sup>

### ***Process for the periodic review of mandates***

It is important to ensure that a process exists for the periodic review of the mandate, roles and responsibilities of a deposit insurance system. Rapidly changing conditions in the overall economy, and the financial sector in particular, make it necessary to undertake a situational analysis.<sup>6</sup> The review process can include a regular assessment and report to stakeholders of the system's effectiveness in meeting its mandate, including any recommended changes.

## **Governance Arrangements**

Other important considerations relate to the structure and organisation of a deposit insurance system. These include: the structure of the governance system; the composition of the governing body and its duties and responsibilities; internal-control processes; and transparency and accountability regimes.

### ***Structure of governance***

The choice of the governing structure for the deposit insurance system usually is influenced by the mandate and the degree to which the deposit insurer is legally separate from the other safety-net participants. One option is to assign responsibilities for the insurance function to an existing entity. This option has been adopted in many cases where the insurance function is primarily public. Many countries have chosen to locate their deposit insurance function as a department within a central bank or supervisory authority. This approach can be more cost-effective from an administrative point of view than the creation of a separate entity. It also allows the deposit insurer to tap into staff resources and skills from the existing entity. This type of arrangement also may facilitate information sharing and coordination.

There are several drawbacks to not having a separate deposit insurance entity. The primary disadvantage is that the existing entity—whether it is a central bank, supervisory or other authority—may have difficulty separating its other responsibilities and interests from those of the deposit insurance function. It may be difficult to ensure that the interests of the deposit insurer are given appropriate weight in the decision-making process. In addition, it may give rise to conflicts because the objectives of the deposit insurer may conflict with those of the existing entity.

Alternatively, the deposit insurance function can be set up as a separate legal entity. In this case, a governance choice is to vest a board of directors or managing board with the responsibility to direct the affairs of the organisation and to be held responsible for the sound functioning of the deposit insurance system. Board systems appear to be the predominant choice in cases where the deposit insurer has separate legal status from other safety-net participants or, in the case of private schemes, industry members. Board systems also may be utilised when the deposit insurer is designated as an autonomous subsidiary of a central bank, industry association or other organisation.

In public systems, the board can be made responsible directly to the legislature or to the supervisory authority. In private arrangements, the board can be made responsible to its member institutions through an industry association.

There are advantages associated with a separate legal status and a board structure. In particular, the deposit insurer may be more focused and effective in carrying out its often-unique mandate, roles and responsibilities. Opportunities for conflicts are reduced compared to a departmental model. However, a board structure usually requires stronger accountability and transparency regimes as well as greater administrative resources than other alternatives. Legally separate deposit insurance systems also may face greater challenges in terms of information sharing and coordination with other safety-net participants.

### ***Composition and duties of the governing body***

The governing body of a deposit insurance organisation usually includes individuals who have decision-making authority. In addition, the input and views of other safety-net participants or relevant stakeholders are often taken into account. In order to improve effectiveness and to ensure the integrity of the deposit insurer, members of the governing body should understand the organisation's activities and the environment in which it operates. The members should be subject to some form of a “fit-and-proper” test, be free from serious conflicts of interest, and be as independent as possible from undue political or industry influence. It should be noted, however, that some of the best-qualified candidates for appointments to a governing body are the same people who may have conflicts of interests—individuals such as regulators or those affiliated with member institutions. Different systems make different judgments about who should be permitted to serve in a governing capacity and how conflicts should be managed. In general, the narrower the mandate of the deposit insurance system, the less likely is the potential for conflicts of interest.

For deposit insurance systems that are predominantly administered privately through a board arrangement, the board composition may include active member institutions. Deposit insurance systems that are jointly administered may include members affiliated with financial institutions as well as government officials on their board. However, care needs to be taken to ensure that such arrangements do not lead to conflicts of interest that can be detrimental to the deposit insurance system. A number of public systems reserve positions for independent private members—those not currently active in the affairs of member institutions—in order to obtain additional expertise and advice. Some public schemes allow for members who are actively affiliated with member institutions. However, most systems discourage this practice because the interests of such members may conflict with the interests of other stakeholders and the confidentiality of information could be compromised.

Governance systems often can be enhanced through the use of special advisory bodies or committees. Such committees can include industry representatives, particularly in systems that may exclude their direct participation in the governing body. These committees also may include industry representatives who can provide their expertise and views on certain matters, such as real estate. Once again, however, the use of outside experts should not compromise the confidentiality of information or permit conflicts of interest to arise.

The delineation of the duties and responsibilities of the governing body is a critical aspect of good corporate governance. It is important for members of the governing body—such as members of the board, management and employees—to understand and to meet their responsibilities. It also is important to evaluate regularly the board's effectiveness in fulfilling its responsibilities.

In many countries, the governing body is given authority for the selection and oversight of senior management, and the responsibility to review management, operations and the performance of the organisation. This can be extended to require that

the governing body ensure that effective strategic- and risk-management processes are in place.<sup>7</sup> The governing body's authority also may include the ability to remove any officer or employee of the organisation for cause, and to deal with confidentiality, ethical business conduct, and conflict-of-interest issues. Other approaches may provide the board with the authority, under statute, to prepare and issue rules and regulations necessary for the sound functioning of the organisation. Some systems with a focus on risk minimisation may provide extra authority, through statute, to make regulations affecting the affairs of member institutions.

### ***Internal-control processes***

Internal-control processes—by which deficiencies are identified and corrected—are important governance considerations. Sound internal-control and audit processes play a crucial role in ensuring the integrity and efficiency of operations, and they can enhance corporate standards of accountability. Internal audit programs typically involve regular compliance and accountability reviews and the monitoring of performance according to set standards and policies.<sup>8</sup> Some systems go so far as to include public-service delivery and operational quality reviews. It can be particularly helpful if the internal-control processes of the deposit insurer correspond to the general requirements for audit purposes set for financial institutions or comparable government institutions.

### ***Accountability, transparency and disclosure***

Appropriate accountability, transparency and disclosure regimes for the deposit insurer and other safety-net participants are important structure and organisation issues. It is important that the deposit insurer, regardless of its structure, be held accountable for its decisions and actions. In circumstances where deposit insurance is provided through a legally separate entity, accountability can be bolstered by ensuring that the board of directors and senior management are responsible and accountable to their primary stakeholder. In many public systems



utilising an independent board structure, the organisation is made accountable in law to the public, often via the legislature or an appropriate ministry of the government. Input from member institutions and other interested parties can be channelled through the use of special advisory bodies or committees. Achieving the right balance between accountability and independence will depend, to a large extent, on country-specific factors.

In predominantly private systems, the deposit insurance organisation often is held directly accountable to its member institutions or industry association. Where a private system is mandated by law, the deposit insurer often is made accountable to both its members and the public *via* the legislature, or to a department or ministry of the government.

Setting up an appropriate transparency and disclosure regime also can provide benefits to a deposit insurance system. Transparency refers to the process by which information on the system and its actions is made available and readily understood by the public. Ensuring that the system is transparent and disclosing information on a timely, consistent and accurate basis can enhance accountability, sound management and the functioning of the system. Typically, this involves making transparent the deposit insurer's mandate, roles and responsibilities. In addition, information should be disclosed about a deposit insurer's activities, decision-making processes, financial position (for example, disclosure of audited financial statements that adhere to generally accepted accounting principles), funding arrangements, costs associated with failure resolutions and other relevant information for the provision of deposit insurance.<sup>9</sup> A number of deposit insurance systems require a full consultative process with relevant stakeholders whenever changes are proposed to the policy or legislative framework affecting the system. This can be done as a matter of law or as a matter of administrative process. The consultative process, including the time frame, are often a function of the complexity and degree of controversy surrounding any changes.

It is important to recognise the need for confidentiality and the judicious release of information as appropriate. The extent and frequency of information disclosed by deposit insurers varies considerably among systems. Some systems regularly disclose detailed reports on their activities, financial position, performance, funding positions, and even information on the costs associated with individual failures and problem institutions. Other systems release only a limited amount of information to the public. This reflects legitimate concerns that the disclosure of too much information (particularly information on the costs associated with failures and anything related to the financial position of individual member institutions) could negatively affect public confidence and the stability of the financial system.<sup>10</sup> Ultimately, an appropriate balance should be struck between the desire to promote accountability and sound management through disclosure, and the need to ensure confidence and financial-system stability.

## Human Resources and Operational Considerations

Human resources are a critical element of the structure and organisation of a successful deposit insurance system. Issues of interest are: ensuring the availability of human resources to meet the operational objectives of the system; compensation, incentives, training and other measures to attract and retain skilled staff; and confidentiality and legal-liability issues relating to employees.

A number of approaches have been used to ensure the availability of qualified persons to meet the operational objectives of deposit insurance schemes. Some deposit insurers rely primarily on a body of dedicated staff, others emphasise the use of outsourcing, while still others utilise a combination thereof. Country-specific factors, such as the mandate and structure of the deposit insurance system, as well as the availability of skilled resources, influence staffing decisions.



Having a fully dedicated staff allows for a high level of control over the functions of the deposit insurer and its ability to maintain tight control over service standards and quality. These functions include: executive decision-making; the management of operational policies, systems and practices; the strategic- and risk-management processes; and contingency planning. However, having a large proportion of dedicated staff can lead to higher fixed costs and may reduce the flexibility of the insurer to respond to changes in staffing requirements. It should be noted that the latter concern can be addressed to some degree by cross-training employees in multiple skills.

Alternatively, the deposit insurer can assign certain tasks to outside service providers through outsourcing. Outsourcing can include borrowing staff as needed from another safety-net participant or maintaining contracts with private-sector firms to undertake certain activities. It also is possible to outsource specific tasks while maintaining ultimate responsibility and control through the use of dedicated staff. Some countries have used this approach in the case of estate administration. External service providers can be required to file detailed business plans with the insurer before commencement of their activities.

Advantages of outsourcing include flexibility to allocate staff, the ability to reduce staffing costs during idle periods, and the ability to take advantage of the efficiencies and specific expertise that service providers may offer.<sup>11</sup> Outsourcing also can create arm's-length arrangements that may benefit a deposit insurer, such as in the case of outsourcing asset-disposition duties. In some systems, the deposit insurer is the major creditor and it may be perceived that there is conflict of interest if the insurer undertakes these roles directly, particularly if the deposit insurer is a priority creditor. Outsourcing these functions also may free the deposit insurer from any rigidities in government rules, such as those regarding restrictions on negotiated sales.

Major disadvantages of outsourcing include increased difficulty in controlling events as well as difficulties in ensuring consistent quality across the organisation. Given the difficulty in predicting the incidence of troubled banks and failures, service providers may not be able to respond quickly or adequately to an increased demand for their services.<sup>12</sup> Experience suggests that the net savings associated with outsourcing may not be lower than from maintaining a dedicated staff.

Because of the trade-offs associated with staffing issues, many deposit insurance systems rely on dedicated staff and outsourcing. For example, some systems assign dedicated staff to core-management functions within their organisations, while non-core functions are assigned to outside providers. Nevertheless, care must be taken to ensure that quality standards are met.

The ability to attract and retain qualified employees and establish competitive compensation is another key human-resource challenge for deposit insurance systems. Many schemes, both public and private, have limited financial resources and often have difficulty providing competitive compensation relative to the financial-services industry—and in some cases, even relative to other safety-net participants. Furthermore, some systems may face constraints in securing adequate resources to train and develop employee skills.

A variety of approaches have been undertaken to address human-resource issues. Some have focused on efforts to ensure that salary ranges are competitive with defined markets. Another approach has been to offer opportunities for career progression through succession planning and training and development. For example, training and development can be undertaken in-house in situations where the dedicated staff of the organisation is large or if outside courses are unavailable. In other instances the deposit insurer may share training and development programs resources with other safety-net participants or industry associations. There also has been a growing recognition among

deposit insurers of the benefits to be gained from international training, assistance, and collaboration. Although such assistance and collaboration can enable deposit insurers to share their knowledge, the ability to secure necessary funding for such activities may be beyond the capabilities of some deposit insurance systems. Additional assistance may be required from stakeholders such as governments and international organisations.

Most deposit insurance systems need to rely on confidential information collected from institutions and other safety-net participants to fulfil their mandates. Thus, measures to ensure that this information remains confidential are important considerations for employees. A number of countries have introduced provisions regarding secrecy and confidentiality regarding all documents, information and records pertaining to matters dealt with by the deposit insurance entity.

In terms of legal-liability issues, situations exist in some countries where employees of deposit insurers and other safety-net participants are held personally liable for actions taken on behalf of their organisations. Although this arrangement may have been instituted in an effort to improve accountability, a number of countries noted that it has resulted in serious impediments to employee and organisational performance. The lack of legal protection can reduce incentives for employees to be vigilant in the carrying out of their mandates—particularly in cases where mandates emphasise promptness in detection, intervention and closure of troubled institutions. The Working Group recognised the importance of statutory indemnification and recommended that staff should receive legal protection against lawsuits for their official action in the normal course of deposit insurance activities or supervision.<sup>13</sup>

### ***Information technology and other issues***

Information systems and the use of technology are other important operational areas for deposit insurance systems. Although specific needs may

vary depending on the type of deposit insurance system in place and its mandate, access to timely, accurate and consistent information can be extremely beneficial.

Information management systems that process information quickly and accurately can help a deposit insurer detect and deal with problems. In some cases, this information can be generated from systems within the deposit insurer, although in other cases, it may be necessary to retrieve information from other safety-net participants.

## **Conclusions**

Mandates, roles and responsibilities can vary widely among deposit insurance systems. It is critical that the mandates, roles and responsibilities are consistent with the stated public-policy objectives of the deposit insurance system.

Formal specification of the mandates, roles and responsibilities—either in law, a formal policy statement or agreement, or by private contract—and the establishment of relationships and linkages with other safety-net participants enhance the effectiveness of a deposit insurance system. The mandates, roles and responsibilities of the deposit insurance system should be clear to all parties concerned. This will reinforce stability and confidence in the financial system. It also will contribute to greater accountability and sound governance of the deposit insurance system.

In order to discharge its mandate effectively, a deposit insurer should have access to requisite information on its member institutions. The need for adequate and timely information is particularly critical because few existing deposit insurers have broad supervisory authority.

The coordination of the activities of the safety-net participants is important for ensuring an effective deposit insurance system and for avoiding inefficiencies and conflicts between safety-net participants.

A variety of forms of governance can be utilised by a deposit insurance system. The choice of the governing structure usually is influenced by the mandate and the degree to which the deposit insurer is legally separate from the other safety-net participants.

The composition of the governing body of a deposit insurance organisation should include individuals who understand the organisation's activities and the environment in which it operates. These individuals should have decision-making authority. In addition, the input and views of the safety-net participants and/or relevant stakeholders often are taken into account by the governing body. The members should be subject to some form of a “fit-and-proper” test, be free from serious conflicts of interest, and be as independent as possible from undue political or industry influence.

Governance systems can be enhanced through the use of sound strategic- and risk-management processes and good internal-control and audit systems. Arrangements should be made to ensure that the governing structure is accountable and transparent.

Human resources are a critical element of the structure and organisation of a successful deposit insurance system. The ability to attract and retain qualified employees and establish competitive compensation are key challenges for most deposit insurers.

A number of approaches have been used to ensure the availability of qualified persons to meet the operational objectives of deposit insurance schemes. Some deposit insurers rely primarily on a body of dedicated staff, others emphasise the use of outsourcing, while still others utilise a combination thereof. Country-specific factors, such as the mandate and structure of the deposit insurance system, as well as the availability of skilled resources, influence staffing decisions.

Most deposit insurance systems need to rely on confidential information collected from institutions and other safety-net participants to fulfil

their mandates. Thus, measures to ensure that this information is made available to the deposit insurance system and remains confidential are important.

The lack of legal protection for employees can reduce incentives for deposit insurers to be vigilant in carrying out their mandates—particularly in cases where mandates emphasise early detection, intervention and closure of troubled institutions. The importance of statutory indemnification should be recognised and employees should receive legal protection against lawsuits for their action in the normal course of deposit insurance activities or supervision.

The ability to have in place information management systems to access and process information quickly and accurately is vital for a deposit insurer to detect and deal effectively with problems.

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## Endnotes

- 1 The Subgroup is comprised of representatives from Philippines (coordinator), Canada, Germany, Jamaica, and The World Bank. This paper is designed for deposit insurance practitioners and other interested parties. It is primarily based on the judgment of the Working Group members and the experiences of various countries that have addressed structure and organisation issues for deposit insurance systems. The paper also incorporates use of the available literature on the subject.
- 2 The issue of powers is discussed in another paper.
- 3 A number of privately administered systems have restricted their stated objectives and mandates to providing deposit insurance solely for protecting small and unsophisticated depositors.
- 4 There can be disadvantages associated with having too many characteristics of a system defined in law or private contracts. In some countries, operational features, such as staffing levels and budgets, are established by statute, which may diminish the flexibility of the deposit insurance system to respond to changing conditions.
- 5 For a more detailed discussion of how coordination can be accomplished please refer to the paper on interrelationships.

- <sup>6</sup> See the paper on situational analysis.
- <sup>7</sup> Effective strategic management usually incorporates an understanding of the environment in which an organisation operates, the establishment of objectives, the development of implementation plans to achieve objectives, and the capability to report and assess progress toward meeting objectives. Effective risk management typically involves having the capability to identify and assess risks inherent in an organisation's current and anticipated operations, initiate policies to deal with these risks appropriately, and regularly review and evaluate risk-management policies.
- <sup>8</sup> High-risk areas such as cash, securities, premises and assets of closed banks can be covered in separate verification processes.
- <sup>9</sup> Risk-minimisation deposit insurance systems with roles in examinations, interventions and failure resolution also may benefit from the disclosure of how these activities are set out and coordinated with those of the other safety-net participants.
- <sup>10</sup> This form of disclosure can result in a reduction in asset values and losses to the deposit insurance system. In addition, the detailed disclosure of funding arrangements, particularly in cases where a deposit insurer is unclear on how it will fund the resolution of large member institutions in difficulty, also can erode confidence in the system or lead to conclusions by the public, rightly or wrongly, of the existence of a "too-big-to-fail" policy.
- <sup>11</sup> Given the financial constraints many deposit insurance systems face in attracting and retaining highly skilled staff and experts, contracting out may provide a cost-effective alternative to access the skills of such individuals.
- <sup>12</sup> In some situations the unavailability of experts can hinder attempts to outsource and lead to functions being carried out in-house.
- <sup>13</sup> Financial Stability Forum Working Group on Deposit Insurance, *A Consultative Process and Background Paper*, June 2000.

# Discussion Papers

## *P*ublic Awareness

### *Abstract:*

Public information and awareness are factors often overlooked in deposit insurance system design. For a deposit insurance system to be effective, it is essential that the public be informed about the benefits and limitations of the system. Public awareness is particularly important for newly established deposit insurance systems. Although the costs of ensuring that the public is informed may be considerable, the need for public awareness should not be underestimated.

Many countries with established systems have widely publicised the terms and conditions of deposit insurance coverage to ensure that depositors are aware of the systems in place to limit the probability of runs in the event of the failure of an insured institution. It also is important to make sure that depositors are aware of coverage limitations in terms of amounts and types of accounts covered in order to avoid the presumption that all deposits and other financial products are protected.

Public information and awareness often are overlooked in the design of a deposit insurance system. In order for a deposit insurance system to be effective, it is essential that the public be informed about the benefits and limitations of the system. Public awareness is particularly important for newly established deposit insurance systems or when an existing system undergoes a significant change. Although the costs of ensuring that the public is informed may be considerable, the need for public awareness should not be underestimated.

This paper discusses the role that public awareness plays in contributing to an effective deposit insurance system.<sup>1</sup> It identifies the objectives of a public-awareness program and the target audiences that may need to be reached. Other features of a public-awareness program that are discussed include what information needs to be communicated, which communication techniques are effective, and what

lessons have been learned with respect to promoting public awareness.

### **Background**

The need for public information and awareness stems from the unique intermediary role played by depository institutions. Research studies that have focused on the special role of depository institutions have stressed the ability of such institutions to fund illiquid assets with highly liquid liabilities. This liquidity-transformation function, which enables depository institutions to provide useful services, however, is also the source of depository institutions' susceptibility to destructive deposit runs.

The belief that a run will occur can be self-fulfilling. If depositors are uncertain whether their funds are safe, there is a greater likelihood that they will

withdraw their funds when problems or the perception of problems develop at a depository institution. If withdrawals occur in sufficient number and scale, a run may ensue and even spread to other institutions. The result is that economic activity is affected adversely. If runs become widespread, there may be a contraction in the economy overall. As discussed below, a well-designed public-awareness program can reduce the likelihood that depositors will withdraw their funds when problems develop at an insured institution.

## Objectives of a Public-Awareness Program

The effectiveness of a public-awareness program is tested when institutions fail or there is a wave of failures. In times of financial stress, countries can least afford to discover that the public is not adequately informed about the features of the deposit insurance system. Thus, it is important to craft a public-awareness program as soon as possible after the decision is made to establish a deposit insurance system. It also should be noted that efforts to inform the public about deposit insurance should be viewed in a long-term context. As discussed below, experience has shown that the characteristics of the deposit insurance system need to be publicised regularly so that the credibility of the system is strengthened and maintained.

A public-awareness program can be designed to achieve several objectives. First, a well-designed program can disseminate information to promote and facilitate understanding of the concept of deposit insurance and the main features of a country's deposit insurance system. In this regard, the public needs to be educated about both what deposit insurance can and cannot accomplish. With respect to the latter, unrealistic expectations can undermine a deposit insurance system and contribute to financial instability.

An effective public-awareness program also can help to restore and promote confidence in the financial sector. This objective is particularly

important when countries may be experiencing waves of failures and/or when countries may be transitioning from a blanket guarantee to limited coverage of deposits. If depositors have trust in the safety of money placed in insured institutions, economic recovery can be achieved more quickly and financial stability can be enhanced.

Third, a public-awareness program can help to disseminate vital information to depositors when failures of insured institutions occur. The public should be assured that the deposit insurer, together with the bank supervisory agency, is working to resolve any such failures quickly and that insured deposits are safe. In the event an insured depository institution is closed, a public-awareness program, for example, can provide guidance to depositors as to how to file claims. The ability of a deposit insurer to provide such information has implications for how effectively it can fulfil its mandate and for how quickly depositors' funds are restored and depositor confidence is maintained.

Finally, a well-designed public-awareness program carries benefits for the officials and staff of the deposit insurer. A public-awareness program helps to put a human face on the entity that provides deposit insurance. Such a program can create an image of solidity, professionalism, public-mindedness, and efficiency for the deposit insurer. As a result, greater public acceptance may make the job of the deposit insurer easier, especially when failures of depository institutions occur.

## Target Audiences

In designing an effective public-awareness program it is critical to identify the target audiences that must be reached. Moreover, which audiences need to be targeted may change over time, depending on what goals have been identified and the stage of development of the deposit insurance program. For example, if a country characterised by stable economic conditions is considering introducing a limited-coverage deposit insurance system, the target audiences may be narrow. If a country is



experiencing some financial instability, the target audiences may need to be relatively broad.

One of the most important audiences is the staff of depository institutions, especially operations and front-line staff. Employees of depository institutions should be trained to answer questions about deposit insurance because they are most likely to be queried by depositors and others seeking information.

Present and potential depositors in insured depository institutions should be targeted separately. In this regard, small, unsophisticated depositors should receive special attention. Depository institutions should inform customers of their membership in a deposit insurance system. Information should be readily available about the terms and conditions of coverage. If an institution is able to withdraw from a deposit insurance system, this fact should be reported immediately and in writing to its customers.

In addition to the need to inform employees of insured depository institutions and depositors about the benefits and limitations of deposit insurance, there are various market segments that may need to be targeted. These special market segments might include one or more of the following groups: trade unions, professional and business associations, retirees, and students in high schools and post-secondary institutions. Because of the potential reach of these groups in shaping opinion and disseminating information, it may prove useful to prepare information on deposit insurance targeted specifically toward these groups.

If a public-policy objective of the deposit insurer is to generate savings, officials might consider preparing and disseminating information on deposit insurance to guest workers or expatriates living abroad where there is significant movement of persons into or out of a country for employment and/or other reasons. The existence of information on deposit insurance may influence decisions of individuals as to where they want to deposit their funds. Such decisions may have implications

for a given country's foreign-exchange earnings and thus its economic and financial condition.

Deposit insurance officials should not overlook the need to inform the media about the main features of a country's deposit insurance system. When problems develop in insured institutions it is especially crucial that the media have accurate information on deposit insurance and a deposit insurer's effectiveness in helping to resolve failures of these institutions, if applicable. If pertinent, accurate information is provided to the media, the latter can help to quell fears about the safety of depositors' funds, if necessary.

Finally, deposit insurance officials should strive to keep lawmakers and other public officials apprised of the features of the deposit insurance program. Educational efforts that target public officials should discuss how deposit insurance relates to the other components of a country's safety net. Moreover, if problems develop in insured institutions that strain the resources of the deposit insurer, the latter may require financial assistance from the government. Any such assistance may be more readily forthcoming if public officials have a thorough understanding of the objectives and features of the deposit insurance system.

## Communication Techniques or Strategies

A broad range of options is available to deposit insurance officials regarding how to disseminate information about deposit insurance to the various audiences discussed above. Care should be taken to select or devise communication strategies that guarantee the best returns in terms of the objectives of the public-awareness program. This decision is likely to be influenced by factors such as: demography, the level of literacy, size of the population, budgetary constraints, and the intended target audience. Deposit insurers might want to contract for the services of experts at companies that specialise in marketing, communications, or other fields. The costs of contracting for outside experts should be

weighed against the potential benefits to be gained. In general, most countries rely on both the print and electronic media in different degrees and with varied support from insured depository institutions or government information units to implement their public education or awareness programs.

### ***Educational materials***

Deposit insurers in many countries have relied heavily on the publication and dissemination of educational materials to inform target audiences about deposit insurance. Such educational materials include the following: fliers, fact sheets, pamphlets, brochures, booklets and other written documents. These materials are either distributed directly or *via* the Internet, insured institutions, and consumer advice bureaus. For example, officials in some countries have prepared comprehensive books or guides to enable employees of insured institutions to provide their depositors and others with accurate and complete information about insurance coverage. These instructional materials are designed to assist insured institutions in developing in-house training programs on deposit insurance.

### ***Print and broadcast-media coverage***

Deposit insurers have adopted different approaches with respect to print- and broadcast-media coverage. This reflects the public-service view that the print and broadcast media are excellent communication vehicles for disseminating information to a broad audience. In fact, in some countries it is mandatory that insured depository institutions indicate in advertisements that they are members of the deposit insurance system that is operating in the country. Deposit insurance systems that have developed logos and tag lines find it helpful to include or highlight the logo and/or tag line in any media advertisement.

Governments in other countries may prohibit advertisement of membership in deposit insurance systems. Such prohibitions may have been put in place to prevent insured institutions from using such membership as a competitive edge. It should be noted, however, that even in countries in which

media advertising is prohibited, insured depository institutions are expected to inform their customers about deposit insurance coverage issues. The preferred approach in these countries is for depository institutions to provide such information in written form to individual customers.

### ***Product registers***

A number of countries require insured depository institutions to provide depositors and other customers with written lists that stipulate which products offered by the institution are actually insured. Such product registers serve several purposes. First, the registers help to ensure that customers receive general information about deposit insurance. Second, such registers help to differentiate insured and uninsured products, thereby reducing possible confusion on the part of potential and actual customers. For example, deposit insurance officials in some countries review the product registers before insured depository institutions disseminate them to customers.

There is widespread agreement that materials that are made available to customers should be written so that they are readily understood. Deposit insurers in countries with multicultural populations have recognised the need to provide written materials on deposit insurance in the major languages spoken by residents.

### ***Guest lectures and presentations***

Deposit insurance officials in some countries have found it beneficial to give guest lectures and presentations to various groups in their respective countries and even abroad. These may be done in coordination with professional groups and associations. Potential audiences include, for example, consumer groups, civic associations, employers and unions, financial journalists, and trade associations. Members of such groups can often reach even broader audiences as a result of personal relationships, thereby helping officials to disseminate accurate information on deposit insurance issues. As noted earlier, officials of deposit insurance systems may want to schedule appearances

before groups of citizens who may be living abroad in certain population centres. If these efforts prove to be successful, they can have a beneficial effect on a country's foreign-exchange earnings.

### ***Public hotline/help line***

Deposit insurance officials may find it useful to establish a toll-free telephone number that can be accessed easily by both local and overseas depositors. This service can help to provide customers with answers to their questions or to refer them to the proper individual(s) who can help them with particular issues. Telephone hotlines are particularly useful when an insured institution encounters problems and members of the public are unsure about the safety of their deposits. In countries with multicultural populations, deposit insurance officials may want to provide access to the telephone hotline service in the major languages spoken in the country.

### ***Web site***

With the growth in the use of the Internet, many deposit insurers have established Web sites. These Web sites provide basic information on the features of the deposit insurance system in operation in a particular country. If information is given about coverage rules and insurance limits it can be an effective way to communicate with the populace. A well-designed Web site can be used to complement the information and personal service available through use of the public hotlines discussed above. It also is an effective venue for posting other information, such as information pertaining to employment opportunities and asset disposition. Web sites also can generate feedback from the public either on operational issues or complaints about certain banking practices.

### ***Public forums/educational-outreach seminars***

Deposit insurers in a number of countries have found it useful to hold or conduct public forums and educational-outreach seminars. In some countries, deposit insurers conduct regional seminars on a

regular basis on deposit insurance issues for bankers and other interested parties. These seminars stress the need for insured institutions to inform their employees, particularly those employed in a front-line or operational capacity, about deposit insurance coverage and other issues.

Deposit insurance officials in some countries have made seminars a fundamental part of their public-awareness program. For example, seminars may be aimed at returning residents and conducted in tandem with representatives from other departments in the government that oversee financial-services activities. Such seminars focus on the mix of measures that have been put in place by the government to protect depositors and investors in the country's financial system. These measures include the strengthening of the legislative framework, the enhanced roles and functions of the various regulatory agencies, the introduction of an explicit deposit insurance scheme, and further investment and savings opportunities in the country's money and capital markets.

Deposit insurance officials should not overlook the need to hold briefings for elected government officials and other policymakers. Deposit insurers in a number of countries have recognised the need to keep an open and ongoing dialogue with lawmakers. Open communications particularly are important when countries revamp their deposit insurance systems.

## **Operational Issues**

Deposit insurers in a number of countries have found it useful to conduct opinion surveys before mounting a public-awareness campaign. The purpose of such surveys is to identify what strategy or strategies should be employed and what audiences should be targeted. Although such surveys may be costly, the potential benefits often outweigh the initial costs that must be incurred. After the survey has been conducted, the focus of the public-awareness campaign should be refined to achieve the desired objective(s).

Subsequently, the results of the public-awareness program should be evaluated to determine its effectiveness. Experience has shown that such surveys may need to be conducted every few years. If failures are relatively rare, the public may forget about the purpose of deposit insurance. Surveys provide useful benchmark information and help to identify whether new measures are needed to keep the public informed about deposit insurance issues.

Experience has shown that the prime responsibility for the public-awareness campaign generally rests with the deposit insurer. If deposit insurers wait for others to suggest that a public-awareness campaign is warranted, such suggestions may come too late or not at all. However, in seizing the initiative, deposit insurers should solicit the views of officials of insured depository institutions. It is important that the latter be consulted in crafting the public-awareness program because their staff will be key to disseminating information on deposit insurance.

One obvious question that must be addressed is who should pay for the public-awareness campaign. The answer to this question partially rests on what type of deposit insurance system will be or has been adopted. If a purely private scheme is sought or is in place, the costs of any public-awareness campaign should be borne by the private sector. In cases where the scheme is government administered and privately funded, the costs should be borne by the private sector. In the case of a program funded by the government, the costs should be borne by the government. If funding comes from more than one source, the underwriting of costs should be a collaborative effort involving the deposit insurer, member institutions, banking associations or the government.

## Special Considerations

There are certain times when the timing and content of a public-awareness program are especially important. These include when a country is transitioning from a blanket guarantee to limited-coverage

deposit insurance and when an insured depository institution is closed.

### ***Transitioning to limited coverage***

It is vitally important that the public understand what is occurring and why once a decision has been made to lift a blanket guarantee and adopt limited coverage. Any movement to reduce coverage can be misconstrued and perceived negatively by the public if they feel that something “is being taken away from them.” In addition, efforts to scale back coverage may raise unwarranted doubts about the health of depository institutions and/or the financial system overall. Thus, it is crucial to explain to the public why limited coverage is being adopted and what benefits will accrue to the populace.

In transitioning to limited coverage, it is important that the proposed timetable, whether on a fast-track or gradual basis, be communicated to the public. If the timetable cannot be met as the transition proceeds, the public should be informed about what changes have occurred to alter the initial timetable. Subsequently, the revised timetable must be widely publicised.

### ***Failures of insured institutions***

When insured depository institutions are closed, it is important that depositors be reassured that their claims will be settled promptly and that they know how to proceed in order to receive payment. Failure situations may be localised or they may encompass an entire country or even cross borders. Deposit insurance officials need to have plans already prepared detailing how they will inform depositors and other creditors about their rights and the procedures for seeking reimbursement.

There are numerous methods that can be employed to inform the public. In some countries, deposit insurers provide on-site information services to assist depositors in the filing of claims and advertise in major newspapers when failures occur. Other methods utilised include television and radio spots informing depositors about the failure(s) and how to proceed with the filing of claims. Press

conferences convened by the deposit insurer also can be an effective means to inform the public. As noted earlier, it is important to establish and maintain contacts with the media when the decision is made to establish a deposit insurance system. Such contacts can prove invaluable when failures occur and may need to be enlisted to help allay the fears of the public.

A public-awareness plan to address issues related to closures of insured depository institutions should be carefully conceived before it is needed, not hastily prepared after a closure has occurred. A well-designed public-awareness program can help to counteract the potentially disruptive effects of failures of insured institutions.

## Conclusions

In order for a deposit insurance system to be effective, it is essential that the public be informed about the benefits and limitations of the scheme. Although the costs of ensuring that the public is informed may be considerable, the need for public awareness should not be underestimated. It is important to craft a public-awareness program as soon as possible after the decision is made to establish a deposit insurance program. Experience has shown that subsequently the characteristics of the deposit insurance system need to be publicised regularly so that the credibility of the system is strengthened and maintained.

In designing an effective public-awareness program it is critical to identify the target audiences that must be reached. One of the most important audiences is the staff of depository institutions, especially operations and front-line staff. The primary responsibility for the public-awareness campaign generally rests with the deposit insurer. Care should be taken

to select or devise communication strategies that guarantee the best returns in terms of the objectives of the public-awareness program.

There are certain times when the timing and content of a public-awareness program are especially important. When a country is transitioning from a blanket guarantee it is important to keep the public well informed. The public must understand what is occurring and why after the decision has been made to lift a blanket guarantee and adopt limited coverage. In particular, the proposed timetable, whether on a fast-track or gradual basis, should be communicated to the public. A well-crafted program can help to bring about financial recovery.

Similarly, the timing and content of a public-awareness program are important when insured institutions are closed. Depositors must be reassured that their claims will be settled promptly. They also need to know how to proceed in order to receive payment. A public-awareness plan to address issues related to actual failures should be carefully conceived before it is needed. A well-designed public-awareness program can help to counteract the potentially disruptive effects of failures of insured institutions.

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## Endnotes

- <sup>1</sup> The Subgroup includes representatives from Jamaica (coordinator), Hungary, Japan, Mexico, and Philippines.



# Discussion Papers

## *I*nterrelationships Among Safety-Net Participants

### *Abstract:*

Deposit insurance is one component of many countries' financial safety net, which also includes prudential regulation and supervision, and the lender-of-last-resort function. In many countries, a department of the government—generally, the ministry of finance or the treasury—also plays an important role in the financial safety net. The interrelationships among these players can vary significantly and are the outgrowth of the institutional, economic and financial situation of a country, as well as of its history.

In order to design an effective deposit insurance system and to contribute to an effective financial safety net, smooth cooperation and goodwill among a country's financial safety-net participants are essential. Information sharing and coordination are particularly relevant, and explicit arrangements should be designed to avoid or minimise potential conflicts among safety-net participants. The more complex the safety-net institutional set-up is, the more relevant the “interrelationships issue” becomes. The need for coordinated actions by safety-net participants is particularly important when the need to handle bank failures arises. There also needs to be a strong accountability regime in place.

The following paper represents the work of the Subgroup on Interrelationships among Safety-Net Participants.<sup>1</sup> Every country has a safety net that underpins the financial system. This safety net usually includes the central bank, a department of the government such as the ministry of finance or the treasury, an entity responsible for prudential regulation and supervision, and, in many cases, a deposit insurer or a deposit insurance agency. The paper focuses on: 1) how the institutional set-up of a country's safety net influences the interrelationships among the various agencies involved; 2) information sharing between safety-net participants; and 3) the need for coordination among safety-net participants.

### **Interrelationships and the Institutional Set-Up of a Country's Safety Net**

Deposit insurance is one component of many countries' financial safety net, which also includes prudential regulation and supervision, and the lender-of-last-resort function. In many countries, including those countries represented in the Subgroup, a department of the government—generally, the ministry of finance or the treasury—also plays an important role in the financial safety net. For example, officials from the ministry of finance or treasury are key players when a crisis-management situation may necessitate the use of government resources.



The interrelationships among the safety-net participants can vary significantly. These interrelationships are the outgrowth of the institutional, economic and financial situation of a country, and of its history. Irrespective of the specific structure of a country's financial safety net, however, smooth cooperation and goodwill among the various components are key to an effective deposit insurance system. A well-designed safety net is integral to a smooth-functioning financial system and contributes to economic stability.

A need for coordination exists in any institutional set-up, as three different instruments—deposit insurance, lender of last resort and supervision—are used, each with its own criteria, to achieve the common objective of banking-system stability. However, the nature and the extent of the problem vary with the specific institutional set-up a country has adopted.

When a single agent—generally the central bank—acts simultaneously as lender of last resort, banking supervisor and deposit insurer, the interrelationships issue is an internal matter and thus should be capable of being dealt with and resolved relatively simply. The smooth resolution of potential conflicts is dependent on an adequate accountability regime among the departments that are responsible for each mandate.

When, however, the functions of lender of last resort, banking supervisor and deposit insurer are allocated to separate agencies, the interrelationships issue may be more complex, as each agency is held accountable for discharging its own mandate.<sup>2</sup> As a consequence, various issues related to information sharing, allocation of powers and responsibilities, and coordination among the different functions need to be clearly and explicitly addressed in order to promote and maintain the credibility of the safety net.

There are no specific rules or guidelines to address and, possibly, resolve the interrelationships issue described above. Possible solutions by their very nature must be country-specific. Moreover, even

within the same country, the safety-net institutional set-up and, therefore, the characteristics of the relationships among the various agencies evolve in response to changes in the country's financial system.

When a country decides to implement an independent deposit insurance system, or to reform an existing deposit insurance system, it is important that any “interrelationships issues” that may arise should be addressed.<sup>3</sup> This task is made easier if policymakers consider and are guided by what would be in the best interest of the general public.

## Information Sharing: Interrelationships and the Deposit Insurer's Information Needs

Information sharing among safety-net participants is essential to an effective deposit insurance system. Indeed, in order to discharge their mandates effectively, deposit insurers and other safety-net participants should have access to an adequate flow of information.

The need for information on the part of the deposit insurer varies significantly according to its institutional mandate and its powers. In a simple paybox system, for example, the deposit insurer should have the necessary information to be able to reimburse depositors whenever necessary, including information on the amount of insured deposits held by individual depositors.

For its part, a risk-minimising deposit insurer has greater needs for information because of its broader mandate. It must be able to assess the financial condition both of the industry and of individual insured institutions, as well as to anticipate the financial troubles of individual institutions and to deal with them effectively when they arise. Thus, depending on its mandate, a risk-minimising deposit insurer may need macro-level—industry information—and micro-level information—

information on individual institutions. Industry information encompasses macroeconomic conditions, main financial trends, as well as information about important policy consultations that may have a significant effect on insured institutions. In turn, information on individual institutions is crucial in order for the deposit insurer to evaluate the soundness of each member institution.

In the case of failing institutions, a deposit insurer should have access as soon as possible to specific information, including the amount of insured deposits and their size distribution at the institution so that the deposit insurer can estimate its liquidity requirements, resource needs and possible risk exposure. The deposit insurer also needs information regarding the estimated total value of the institution's assets and the time frame for the liquidation process, given that the value of the institution's assets depends on the time necessary to liquidate them. This kind of information, however, often is difficult to collect and evaluate even by the supervisor, especially when a strong disclosure regime is not in place or institutions' records and accounting rules are not transparent.

The supervisory authority is usually the primary source of information for the deposit insurer for several reasons. First, and most important, the supervisory authority in most countries has the authority to examine depository institutions. Second, laws in many countries normally require depository institutions to submit periodic, accurate prudential reports to the supervisory authority. Moreover, supervisors often are allowed to obtain any additional information necessary to carry out their institutional mandate. Because of its specific powers and responsibilities, the supervisory authority often is the only safety-net agency able to assess accurately and ensure the quality of the information provided by financial institutions. High-quality information is fundamental for the deposit insurer if it is to carry out its institutional mandate effectively.

Depending on the breadth of their individual mandates, deposit insurers may need to supplement

information provided by supervisors with information directly collected from insured institutions. For example, if a deposit insurance system has an *ex-ante* fund, information must be received on the level of insured deposits on which premiums are based. In order to ensure that the deposit insurer obtains the information it needs to fulfil its mandate while minimising reporting requirements on its membership, it is important to coordinate effectively the collection and sharing of information between the deposit insurer and the other safety-net participants. One approach is to have the supervisory authority act as the primary collector of information required for supervisory and deposit-insurance purposes. However, the deposit insurer should still be able to access supplemental information from its members as the deposit insurer will need, from time to time, information directly pertaining to its operations and not related to safety-and-soundness issues.<sup>4</sup>

Obviously, deposit insurers should be able to access easily all the information publicly disclosed by member institutions. The effectiveness of a deposit insurance system is clearly enhanced if laws and regulation provide for a strong information-disclosure regime, which is characterised by a high degree of transparency of banks' financial statements and accounting rules.

It is important that deposit insurers on a timely basis access information, in order to ensure that an effective system of ongoing evaluation both of the industry and of individual institutions is in place. It is essential to have early warning of problem banks, so that in case of a failure the resolution can be implemented in a very short time. The experience of various deposit insurance systems around the world shows that strong coordination, information sharing and exchange arrangements are essential. In some cases, however, the effectiveness of the arrangements actually can be enhanced when high-level officials from the different safety-net participants establish formal arrangements for sharing information as well as analyses and views on the state of the financial system.<sup>5</sup> All confidential information should remain so.

## Coordination among Safety-Net Participants

The need for coordination and goodwill among the various safety-net participants is directly related to the possibility of conflicting mandates. When dealing with bank crises, for example, it is particularly important to establish precisely which safety-net participant(s) has the power to formally declare an institution to be insolvent (or formally initiate the liquidation procedure of a failed institution).<sup>6</sup>

Tensions may arise between the deposit insurer and the lender of last resort with respect to financial assistance to troubled institutions. Indeed, the granting of funds to a troubled institution may create problems if the use of those funds by the troubled insured institution is not properly monitored or even conditioned by the central bank. Indeed, troubled institutions could use the financial assistance provided by the lender of last resort to engage in risky activities (“gambling for resurrection”), significantly increasing the deposit insurer’s risk exposure and potential losses.<sup>7</sup>

Potential tensions between the supervisory authority and the deposit insurer may arise if the supervisor, who is generally in charge of closing a bank, is viewed to be delaying or even avoiding such an action altogether (forbearance). As long as failures of insured institutions are thought to somehow represent supervisory failures, there could be a tendency to give troubled institutions “the last chance” in order to avoid a potential crisis and its attendant effect on the supervisor’s reputation; this, in turn, could create an incentive for troubled institutions to engage in riskier activities.

This is obviously not the case when failures of individual institutions are viewed to be a “natural” result of competition among financial institutions. Indeed, the primary objective of bank supervision is to avoid systemic banking crises; the pursuit of this objective generally is compatible with accepting failures of some insured institutions.

An important and effective way to promote smooth coordination on the part of safety-net participants is a clear division of powers and responsibilities. Although this clear division can be considered as a minimum requirement when addressing coordination issues, provision for prompt-corrective-action rules could be an additional requirement in order to promote smooth coordination among safety-net participants.

In the case of deposit insurers with broader mandates, it is important that the insurer has sufficient control of the risks it actually faces. This objective also can be achieved by coordinating the powers of the different safety-net participants so that they do not operate at cross-purposes. Although the precise mechanisms of the coordination obviously will depend on each country’s institutional set-up, efforts should be made, for example, to ensure that the powers to revoke deposit insurance are coordinated with licensing requirements.

Finally, a clear division of powers and responsibilities is particularly important with respect to the closure and liquidation of insured institutions. This division should be spelled out beforehand, for example, in legislation. Indeed, when failures occur, it could be very hard for the participants in the safety net to fulfil their responsibilities without a clear ex-ante mandate. In such cases, events may unfold quickly and time becomes of the essence. Reconciliation of potential conflicting mandates requires prior discussion and a high degree of transparency when setting the “rules of the game.”

## Formal Mechanisms to Ensure Coordination and Information Sharing

Although informal arrangements for information sharing and coordination can work well in certain circumstances, given the sensitivity of institution-specific information and the challenge of maintaining open communication channels, it may be useful to formalise these agreements either through

legislation, memoranda of understanding, formal agreements or a combination of these techniques.

If formal information-sharing arrangements are relied on, they should clearly acknowledge the roles and responsibilities of the respective parties, set out what is to be shared and by whom, as well as the type, level of detail and frequency of information to be exchanged. Confidentiality of information exchanged between parties also should be respected at all times.

Apart from these specifics, formal agreements also may be useful in providing a general framework for safety-net participants to coordinate their related operational and policy-making activities by promoting regular meetings and opportunities for consultation.

## Conclusions

The main conclusions of this paper are as follows:

When considering the creation of a deposit insurance system, a country should address effectively the issues related to the deposit insurer's relationships with the other safety-net participants. Depending on the institutional, economic and financial situation of a country, and its history, the characteristics of the relationships among the central bank, the ministry of finance or the treasury, the supervisory agency, and the deposit insurer can vary substantially. Irrespective of the specific structure of a country's financial safety net, however, smooth cooperation and goodwill between the components are key to an effective deposit insurance system.

Information sharing among safety-net participants is essential for an effective deposit insurance system. Indeed, in order to discharge their mandates, deposit insurers should have access to an adequate flow of relevant information. Ideally, information should be timely, accurate and relevant; a strong disclosure regime is based on these elements. The effectiveness of a deposit insurance system is clearly enhanced if laws and regulations provide for a

strong information disclosure regime, which is characterised by a high degree of transparency of institutions' balance sheets and accounting rules.

The need for coordination and goodwill among the various safety-net participants is directly related to the emergence of potential conflicts between them. The most important and effective way to promote smooth coordination on the part of safety-net participants is to provide for a clear division of powers and responsibilities among them and appropriate mechanisms to ensure coordination and information sharing.

## Endnotes

- 1 The Subgroup is comprised of representatives from Italy (coordinator), Argentina, Chile, France, Jamaica and Japan.
- 2 The different functions of the safety net are not necessarily allocated to three or more separate agencies. For instance, in Italy and in Jamaica the financial institutions' supervisory authority is a separate department of the central bank; in Chile the central bank is also the authority responsible for paying-off depositors when a bank fails. Argentina's institutional set-up evolved from a single-agent framework to the current framework of three separate agencies.
- 3 For example, the paper on powers discusses that the roles and responsibilities of the deposit insurer *vis-a-vis* other safety-net participants could be spelled out in legislation before the establishment or the reform of the deposit insurance system. The objectives of such legislation include ensuring that adequate information sharing among safety-net participants occurs and all parties are held accountable for their actions.
- 4 This information could include, for purposes of verification, the level of deposits held for premium assessments and information on specific products and their insurability.
- 5 In some countries, information-sharing arrangements are mainly informal, and the bank supervisory authorities provide the deposit insurers with the necessary information on a regular basis. In other countries, a formal memorandum of understanding is used to manage relationships.

- <sup>6</sup> As stated above, the distribution of powers among safety-net participants is discussed in the paper on powers.
- <sup>7</sup> At least in principle, there could be cases in which the resources provided by the central bank, whose repayment is usually guaranteed by the troubled institution's best assets, are actually used to repay uninsured, rather than insured, liabilities or to invest in riskier assets. In this case, the deposit insurer could find that its losses are higher than they otherwise would be.

# Discussion Papers

## Powers

### *Abstract:*

As a preliminary matter, a deposit insurer needs only those powers and authorities necessary to fulfil its public-policy objectives effectively. Consequently, one must first determine the specific mandate, roles and responsibilities of the organisation responsible for deposit insurance. Is the deposit insurer's role limited to reimbursing depositors after an insured institution is closed or does it have a broader function? If it has a broader function, does it include intervention and resolution responsibilities, or the liquidation of assets of failed institutions? Finally, is the deposit insurer charged with directly supervising or regulating the institutions that it insures, or does it have some input into the supervisory and regulatory processes? These questions must be answered before it is possible to determine the necessary powers for a deposit insurer to operate effectively. In addition, it is necessary to consider the assigned responsibilities of other safety-net participants so as to avoid overlapping or conflicting responsibilities.

This paper discusses those powers that are necessary for a deposit insurer to fulfil its public-policy objectives. In addition, the paper discusses the fundamental powers related to deposit insurance systems and examines factors and considerations that can influence decisions on the granting of specific powers to deposit insurers. The full panoply of powers that can be provided to deposit insurers will be explored briefly.



As a preliminary matter, a deposit insurer needs only those powers and authorities necessary to fulfil its public-policy objectives effectively. Consequently, one must first determine the specific mandate, roles and responsibilities of the organisation responsible for deposit insurance.<sup>1</sup> Is the deposit insurer's role limited to reimbursing depositors after the supervisory authorities close an insured institution or does it have a broader function? If it has a broader function, does it include intervention and resolution responsibilities, or the liquidation of assets of failed institutions? Finally, does the deposit insurer directly supervise or regulate the institutions that it insures, or does it have some input into the supervisory and regulatory processes? These questions must be answered before determining the powers necessary for a deposit insurer to operate effectively. It also is necessary to consider the assigned responsibilities of other safety-net participants so as to avoid overlapping or conflicting responsibilities.

This paper, which was prepared by the Subgroup on Powers,<sup>2</sup> discusses those powers that are necessary for a deposit insurer to fulfil its public-policy objectives effectively. It examines the factors and considerations that can influence decisions on the granting of specific powers to deposit insurers. The full panoply of powers that can be provided to deposit insurers will be explored briefly. Much of the material presented here is covered in greater detail in the other papers prepared by the Working Group on Deposit Insurance; where appropriate, those papers are cross-referenced.

## Basic Powers and Legal Authorities

The responsibilities and associated powers of deposit insurers vary greatly and depend, to a large extent, on the public-policy objectives established for them by law or contract. Some deposit insurers serve only to reimburse depositors once an insured institution has been closed (“paybox” systems), while others serve as the receiver and liquidator of the assets of failed institutions. Still others have the role of

minimising risk to the deposit insurer (“risk minimisers”) and, in a few cases, some directly supervise the institutions they insure. As a result, there is no single set of optimal powers or authorities suitable for all deposit insurers.

At a minimum, however, all deposit insurers need certain basic powers and legal authorities to ensure that they can meet their obligations to depositors in a timely fashion and thus help to maintain public confidence in the financial system. A paybox system requires appropriate authority, including, access to deposit information and access to funding, for efficient reimbursement of depositors when an institution fails. In addition to these authorities, a risk minimiser requires the authority to gather information—either directly from insured institutions or from the supervisory authority—to assess risks, the authority to limit risks through various means, and the flexibility to access needed funding sources. The deposit insurer may exercise these authorities directly, or, alternatively, mechanisms may be instituted to ensure that the supervisor is responsive to the deposit insurer's needs.

### **Operational issues**

#### **Organisational structure**

Regardless of the scope of a deposit insurer's responsibilities, there are certain fundamental operational issues that must be addressed in any law creating a deposit insurer. First, it must be determined whether the deposit insurer should be established as a separate governmental entity, a department of another government entity, a private entity with government backing, or as a completely private entity. In determining the entity's basic structure, it is important to maintain an appropriate balance between the need for the deposit insurer to be independent and for the insurer to be accountable for its actions. Second, it is important to stipulate the duties and responsibilities of the deposit insurer *vis-a-vis* the central bank and any other financial institution supervisors or regulators. Particularly in times of crisis, it is essential that the roles and responsibilities of all parties be clearly defined to

avoid misunderstandings and duplicative efforts on the part of officials responsible for the financial sector.<sup>3</sup>

### ***Operating procedures***

As a basic operating guide, the deposit insurer may consider developing bylaws or some similar document to specify its corporate governance rules clearly. Such a document should specify the manner in which the deposit insurer's general business will be conducted and how the authorities granted to it by law may be exercised.

### ***Operating powers***

In order to function efficiently and effectively, a deposit insurer must be vested with certain legal authorities. The deposit insurer should have the ability to employ staff on a permanent and temporary basis so that it can adjust staffing levels quickly to address rapid changes in the level of failures of insured institutions. Another issue is whether the employees of the deposit insurer should be held personally liable for the results of their official actions. Holding employees personally liable for their official actions may cause the employees to be reluctant to perform their official duties. Therefore, some deposit insurance schemes provide indemnification for their employees.

In addition, the ability to enter into contracts to obtain goods and services is an essential power that should be vested in the deposit insurer. Undue restrictions on a deposit insurer's ability to enter into contracts can make it difficult for the deposit insurer to fulfil its responsibilities properly. Finally, the law creating the insurer should specify whether the deposit insurer can sue and be sued on its own behalf. This is a fundamental power that can be used to protect the interests of the deposit insurer.

## ***Powers needed to perform the basic deposit insurance function***

### ***Control over entry and exit***

In setting up a deposit insurance system, it is necessary to determine what types of institutions should be insured.<sup>4</sup> That determination must be made after taking into account the types of existing institutions and considering the objectives of the deposit insurance system. In addition, the rules for entry and exit should be clear and transparent and should establish eligibility criteria for deposit insurance.

In a paybox system, decisions regarding membership in the deposit insurance scheme usually are made solely by the financial supervisory authority. In a risk-minimising system, the deposit insurer should have a role in determining which institutions are insured since the deposit insurance system bears the risk of loss when a member institution fails. A number of countries require that applications for deposit insurance be filed concurrently with the primary supervisor and the deposit insurer. Thus, institutions cannot gain deposit insurance without the approval of both entities. Alternatively, some countries require that the primary supervisor provide copies of the relevant application materials to the deposit insurer. The deposit insurer is then permitted to add its input to the application process.

In order to maintain a high level of confidence in the deposit insurance system, the rules for closing an insured institution also should be clearly specified to avoid confusion over who has the authority to act. However, consideration should be given to providing the deposit insurer with the opportunity to provide input into the decision-making process. In many countries the primary supervisor has the sole power to close an insured institution.<sup>5</sup> In some countries, the decision to close an institution is subject to judicial review, either before an institution can be closed or subsequent to the institution being closed.

As an alternative to providing the deposit insurer with the opportunity to provide input into the decision-making process on bank closings, the deposit insurer could be permitted to terminate an institution's deposit insurance. In some countries, where authorities have been slow or reluctant to close insolvent institutions, the ultimate costs to the deposit insurance system have been quite high. Granting the deposit insurer the power to terminate deposit insurance independently may facilitate timely closure and reduce costs to the insurance fund. Termination of insurance does not always cause an institution to lose its license or charter to operate. In countries where an institution can continue to operate without deposit insurance, it is important to specify a process for phasing out deposit insurance and informing depositors about the status of the institution, so as to protect them from potential losses.

### ***Funding***

In order to reimburse depositors and cover its day-to-day operating expenses, every deposit insurer needs the authority to obtain adequate funding, regardless of whether there is an existing insurance fund or an *ex-post* funding scheme.<sup>6</sup> In addition, ancillary sources of funding must be identified as insurance losses quickly can exceed available funds. In these cases, it is important that the deposit insurer have the authority to obtain additional resources quickly in order to maintain public confidence.

In some countries, the deposit insurer has the authority to determine the appropriate regular and special assessment amounts collected from insured institutions, while in other countries, the primary supervisor either determines those amounts or approves the amounts proposed by the deposit insurer. In collecting assessments, the deposit insurer should be granted broad authority to determine the manner and means of collection, which may include determining the frequency of payments. Although the base upon which the assessment is levied and the rate to be applied may be specified in the law, there are often many practical issues about how the actual amounts are to be

collected and the deposit insurer generally would be in the best position to make the necessary determinations. If an insured institution should fail to make a required payment, either by nonpayment or underpaying the amount due, the deposit insurer or the primary supervisory authority should have the legal authority to pursue payment by the institution.

If there is no deposit insurance fund, then the deposit insurer needs a mechanism by which it can obtain funds in order to facilitate the timely reimbursement of depositors at failed institutions. In addition, at some point there is a limit to the amount of money that insured institutions reasonably can be expected to contribute without causing additional insolvencies and burdening the deposit insurance system. Thus, the deposit insurer should have the authority to borrow funds when necessary to cover its expenses and meet its obligations. Possible sources for borrowing funds include the government, the central bank, private banks and the capital markets. It is often deemed prudent to place limits on such borrowings and to specify in the law the terms and conditions under which funds can be borrowed. If there is a government guarantee that stands behind the deposit insurer, then the procedures for invoking that guarantee should be clear to prevent uncertainty.

### ***Managing a fund***

If there is an insurance fund, then it is necessary to determine how the fund can be invested. Many countries limit the investment authority of the deposit insurer. Generally, the requirement is to invest in only the safest and most highly liquid instruments to ensure that funds are available to fulfil the deposit insurer's responsibilities.

### ***Reimbursement***

The most basic and common function of deposit insurers around the world is to reimburse depositors for losses they would otherwise suffer when an insured institution is closed.<sup>7</sup> The law creating the deposit insurance system should specify the amount of insurance coverage provided for each

depositor, who is eligible for deposit insurance, and the types of bank liabilities that are to be covered by the scheme. The deposit insurer should have broad authority to administer the deposit insurance rules. In order to perform the reimbursement function quickly and efficiently, the deposit insurer should be able to perform the payout function through various means such as cash disbursements, checks, electronic transfers, or other means, as appropriate.

### ***Information requirements***

The type and amount of information required by a deposit insurer to fulfil its mandate is directly related to the scope of the insurer's responsibilities. In the simplest case—that of a paybox system—the insurer needs to have access to the names and deposit account balances of all depositors in the insured institution before it can reimburse depositors. This information should be provided as of the date and time of failure and should include information about transactions that occurred before the failure, but which were not included in the account balances. Information may come from the institution itself or from the primary supervisor. It is often easier and more efficient to convey the information in an electronic format. That information should be obtained as quickly as possible from the failed institution to enable the deposit insurer to begin the deposit payout.

As the scope of the deposit insurer's responsibilities is broadened—for example, if it is responsible for setting assessments—it will need additional powers. In order to determine the appropriate assessment amounts, the deposit insurer must have the information necessary to calculate the assessments. In a number of countries, assessments are calculated on the basis of an institution's total deposits, total insured deposits, or total assets, and may vary with an institution's risk. The depositor insurer must have the ability to obtain that information, on a regular and timely basis, either from

the insured institutions directly or from the supervisory authority. In addition, the deposit insurer should have the ability to verify the information. This can be done through either targeted or random audits performed by the deposit insurer, the primary supervisor or an outside audit firm.

If the deposit insurer is involved in resolving failed institutions, then it must have detailed and accurate information not only about the institution's deposit liabilities, but also about its assets. This information could come from either the institution itself or through the primary supervisor. The insurer also needs the best possible information about potential acquirers of the institution so that only those entities that have the requisite financial resources and qualified management can acquire failed institutions. Finally, the deposit insurer needs information about contractual obligations, other agreements, and potential litigation to estimate least-cost solutions.

Deposit insurers that also act as receivers or liquidators of failed institutions need even more detailed information about the assets and liabilities of the institutions under their control to manage the receiverships properly. In addition, the deposit insurer would have to be aware of all contractual obligations and other agreements of the failed institution as well as any pending litigation. In such cases, the deposit insurer often succeeds to the rights, titles, powers and privileges of the insured institution and therefore must carefully identify every obligation and all of the rights and interests that the insured institution had before it failed.

In addition to the powers discussed above, deposit insurers that have supervisory and/or regulatory responsibilities have expanded information needs, including specific information about each individual institution as well as industry and macroeconomic data. Such information can enable the deposit insurer to spot trends and anticipate problem areas before they develop into substantial losses. All information should be current and specific.

## Additional Powers and Authorities

### *Intervention*

Often when the financial condition of an insured institution begins to deteriorate there are steps that can be taken to try to prevent or limit its further deterioration.<sup>8</sup> Such steps may prevent the failure of the institution or can limit the losses to the insurance system should the institution fail. In most countries, these actions generally are taken by the primary supervisor of the insured institution. However, if the deposit insurer has broad responsibilities, then, as the entity most directly concerned with limiting losses to the insurance system, it should be granted the authority—either indirectly or directly—to participate in an intervention involving a troubled insured institution. For example, if the deposit insurer has no supervisory or regulatory responsibilities, it could be granted the authority to make recommendations to the primary supervisor. By contrast, if the deposit insurer is involved actively in the supervision and regulation of insured institutions, it could be granted independent authority to take appropriate actions against the insured institutions to prevent or limit losses to the insurance system. A middle ground would be to allow the deposit insurer to take such actions with the consent of the primary supervisor.

A number of countries have adopted, or are considering adopting, certain corrective measures that automatically take effect as the condition of an insured institution deteriorates.<sup>9</sup> Such measures, frequently known as “prompt corrective action,” become progressively more severe as the condition of the institution continues to deteriorate. Although the use of automatic corrective measures tends to limit the flexibility to intervene in a troubled institution, they can limit losses to the insurance system.

Another issue that should be considered carefully in establishing any deposit insurance scheme is whether, and under what circumstances, the deposit insurer should intervene or participate in the

restructuring of a troubled institution. In some circumstances, it may be desirable to restructure a troubled institution with direct financial assistance from the deposit insurer in order to prevent the institution from failing. Such financial assistance might take the form of loans or loan guarantees from the deposit insurer to the troubled institution. Alternatively, the deposit insurer could be granted the authority to make direct equity investments in an insured institution that is in need of financial assistance. If the deposit insurer is a government agency, such assistance could be viewed as the government assisting one private-sector enterprise at the expense of others and spreading protection beyond deposits. Moreover, the deposit insurer may find it difficult subsequently to determine the best possible time and price at which to sell the equity investment, assuming the institution recovers.

### *Resolutions*

If the deposit insurer has responsibility for arranging resolution transactions, it will need a number of powers in addition to the information requirements discussed above.<sup>10</sup> Specifically, it will need the legal authority to engage in the most appropriate resolution method, including implementing purchase-and-assumption transactions, establishing bridge banks, and facilitating open-bank assistance. Since every financial institution is different, the deposit insurer should be granted considerable flexibility in structuring resolution transactions. Ideally, in such cases, the deposit insurer should be granted on-site access to the records of the failing institution before its closure so that the deposit insurer can become familiar with, and properly estimate the value of, the assets and liabilities involved.

### *Receivership and liquidation*

A deposit insurer that has responsibility for serving as a receiver or liquidator of a failed institution has a fiduciary duty to try to obtain as much value as possible from that institution. In order to maximise recoveries on claims held in a failed institution, a deposit insurer needs broad authority to acquire, manage and dispose of assets. In these cases, the



deposit insurer should have the authority to collect all obligations due to the failed institution, sell or otherwise dispose of its assets, administer the claims notification and review and determination process, and deal with all contractual obligations and pending litigation. In order to accomplish this, the law should provide that the deposit insurer succeeds to all of the rights, titles, powers and privileges of the institution. The deposit insurer also should be able to hire outside experts whenever it lacks the expertise or resources to manage or dispose of assets properly or otherwise carry out its responsibilities as a receiver or liquidator.

### ***Supervision and regulation***

Few deposit insurers have direct supervisory and regulatory responsibilities over insured institutions, although some have input into the supervisory process. If, however, such responsibility is vested in the deposit insurer, then it will need to have the authority to set and enforce standards through regulations, policy statements, guidelines and other similar pronouncements for the institutions it insures. Examples of such standards include minimum capital standards, limitations on loans to insiders, internal or external audit requirements, as well as other prudential standards to maintain the safety and soundness of insured institutions. In order to supervise insured institutions properly, the deposit insurer should have the authority to request and obtain detailed and timely information on any aspect of their operations through either regular or special examinations or audits as well as from reports filed by the institutions.

A deposit insurer that serves as a supervisor and regulator of insured institutions must have sufficient authority to enforce any rules setting forth standards for insured institutions. For instance, if an institution does not meet its minimum capital requirements or fails to provide information requested promptly, the deposit insurer must have an adequate mechanism to force compliance. This could be accomplished through an informal administrative proceeding or through a more formal

judicial proceeding, although the latter is usually more time-consuming and expensive. Vesting the deposit insurer with the authority to impose monetary penalties, or to remove directors and officers of an insured institution, under certain circumstances, may provide adequate incentives for institutions to comply with any rules or directives issued by the deposit insurer.

## **Conclusions**

A deposit insurer must be vested with adequate powers and sufficient legal authority to fulfil its public-policy objectives. There are certain basic powers and legal authorities that all deposit insurers need to ensure that they can meet their obligations to depositors in a timely fashion and thus help maintain public confidence. Beyond these, a deposit insurer needs all of the powers and legal authorities required to meet its assigned responsibilities efficiently and effectively.

As noted above, deposit insurers have widely varying mandates and responsibilities. Consequently, there is no single set of optimal powers or authorities for all deposit insurers. Deposit insurers that function as paybox systems do not need extensive powers. By contrast, deposit insurers that directly supervise and regulate the institutions they insure need a wide range of powers. Between these extremes are deposit insurers that participate in the resolution process and/or serve as the receiver and liquidator of the assets of failed institutions. To perform these functions effectively, deposit insurers need more powers than those of a paybox system, but fewer than those of a full-fledged bank supervisor or regulator. Providing the optimal legal framework and powers for a new deposit insurer will help to ensure the stability of a country's financial system.



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## Endnotes

- <sup>1</sup> See discussion of the varying mandates, roles and responsibilities of deposit insurers in the paper on structure and organisation.
- <sup>2</sup> The Subgroup on Powers is comprised of representatives from the United States (coordinator), Argentina, France, Hungary, Italy, Japan, and the International Monetary Fund. Members of the Subgroup contributed information on their deposit insurance systems for this paper.
- <sup>3</sup> See paper on structure and organisation.
- <sup>4</sup> Many different types of companies act as financial intermediaries throughout the world, including banks, savings associations, credit unions, finance companies, industrial loan companies, and postal savings institutions, among others. This issue is covered in the paper on membership.
- <sup>5</sup> In 1991, in the United States, the U.S. Congress granted the deposit insurer independent authority to close any insured institution when certain conditions, as specified in the law, are satisfied. However, this authority is expected to be used rarely and only in very unusual circumstances.
- <sup>6</sup> For a full discussion of this issue, see the paper on funding.
- <sup>7</sup> See the paper on reimbursing depositors for a full discussion of the conditions necessary to establish an efficient reimbursement process.
- <sup>8</sup> Examples of such steps include setting restrictions on asset growth and payment of dividends, and requiring changes in management or additional capital.
- <sup>9</sup> Such corrective measures can include provisions that prevent institutions from taking certain actions without the express consent of the supervisor or the deposit insurer.
- <sup>10</sup> In some countries, the deposit insurer is required to select the least-costly transaction method for resolving failed or failing institutions so as to minimise the losses to the insurance system.

## *R*esolution of Failed Institutions

### *Abstract:*

The timely and effective resolution of failed insured institutions is an important element in financial safety-net arrangements. Different exit strategies for such institutions may have considerably different cost implications for the deposit insurer and implications for other safety-net participants, the government, public, banking industry, and economy. Cooperation among the various safety-net participants, both before and after failure, is essential if timely and effective resolutions of failed institutions, particularly large insured institutions, are to be accomplished.

This paper was prepared in response to requests from representatives of numerous countries that participated in the Working Group's outreach programs. The purpose of the paper is to describe the main issues relating to the resolution of troubled institutions. The paper is not concerned with any questions relating to where in the financial safety net the authority for resolutions should reside. The responsibilities of deposit insurers for various aspects of resolution activity are likely to be country-specific, reflecting their particular mandates. However, regardless of the specific responsibilities of the deposit insurer in any particular country, the manner in which troubled institutions are resolved can have a major effect on the funding requirements and other aspects of the deposit insurer's operations.

The timely and effective resolution of failed insured institutions is an important element in financial safety-net arrangements. Different exit strategies for such institutions may have considerably different cost implications for the deposit insurer and implications for other safety-net participants, the government, public, banking industry, and economy. Cooperation among the various safety-net participants, both before and after failure, is essential if timely and effective resolutions of failed institutions, particularly large institutions, are to be accomplished.

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## Pre-Resolution Activity

Before a troubled financial institution reaches the point where resolution is necessary, it generally has been the object of various efforts to strengthen its operations. Such actions may have included restructuring efforts that, in broad outline, are similar to resolution transactions, in that they involve a merger with, or acquisition by, a healthy institution. These efforts frequently are described as "private-sector" solutions and do not impose a cost on the deposit insurer or the government.

## *Private-sector solutions*

Healthy institutions may be willing to combine with weaker ones in a number of situations. However, if financial inducements are required to attract an acquirer, such inducements in a private-sector transaction generally result from concessions made by creditors or owners of the troubled institution, rather than from outlays by the deposit insurer. As a result, successful private-sector solutions may be viewed essentially as "no-cost resolutions" from the standpoint of the deposit insurer.

Owners and creditors of a troubled institution often have strong incentives to accomplish a merger or acquisition, because their losses generally will be greater if the institution continues to deteriorate and fails. On the other hand, they may be slow to acknowledge the seriousness of the institution's condition and reluctant to yield control of the institution, or make the concessions necessary for it to be an attractive acquisition or merger partner for a healthy institution. Owners of troubled institutions may have little incentive to explore private-sector solutions unless they perceive that the authorities may close the institution if such solutions cannot be arranged. As a result, private-sector solutions cannot always be accomplished without the active participation of the relevant safety-net participants even though the deposit insurer bears no cost.

The legal authority of the responsible safety-net participants differs among countries and, in some countries, limits their ability to play a role in private-sector solutions for troubled institutions. In other cases, the safety-net participants may bear significant legal exposure to creditors dissatisfied by the terms of the merger or acquisition. In some countries, owners of troubled institutions may have taken legal action against the resolution authority for closing an institution and officials of the authority faced personal liability.<sup>3</sup> Such a legal environment may have the effect of permitting troubled institutions to continue to operate for

lengthy periods of time and, therefore, may reduce incentives of owners of such institutions to find private-sector solutions.

In such cases, the responsible authority may only encourage or exert pressure on the troubled institution to initiate its own attempted solution. (Monitoring of the efforts of the bank is necessary to ensure that any “solution” does not include increased risk-taking.) In other countries, the legal authority is broader and may permit the appointment of administrators to replace the directors of the troubled institution and take over its operations. In some situations, credit may be advanced on a secured basis to meet the liquidity needs of the troubled institution while a solution is being sought.

Private-sector solutions require that action be taken early while acquirers are still willing to take over the troubled institution. They presuppose the existence of healthy institutions, which have the financial and managerial capabilities to combine with weaker ones and are acceptable to the authorities. Whether, and to what extent, foreign-owned banks are eligible to serve as acquirers are important factors in some countries. Well-developed arrangements for monitoring and overseeing such solutions are necessary. Also needed is a legal environment that balances creditor and shareholder rights with the authority of the safety-net participants to participate constructively in private-sector solutions.

In countries where legal and other conditions are not conducive to private-sector solutions, troubled banks may continue to deteriorate and eventually will have to be resolved by the responsible authority, with deposit insurers bearing the cost.<sup>4</sup>

### ***Timing of action***

Private-sector solutions depend on early action to prevent further deterioration in the condition of the troubled bank; otherwise, healthy institutions may refuse to participate. Early action also may reduce resolution costs if the private-sector effort is unsuccessful and the institution has to be resolved. The experience of many countries has been that delay in addressing the problems of troubled

institutions may make the avoidance of failure more difficult and may increase significantly the ultimate cost to the deposit insurer.

Some countries have adopted statutory provisions requiring early intervention or prompt corrective action for troubled institutions. Such provisions may be based on the capital position of the troubled institution or on other criteria, and require the responsible authority to restrict the activities of the institution and ultimately to terminate its operations according to some objective measure. In many cases these provisions were adopted to prevent the responsible authority from delaying action in the hope that external events would bring about an improvement in the institution's condition or for other reasons. Statutory prompt-corrective-action provisions that require certain actions by safety-net participants may make those actions less politically contestable.

On the other hand, some countries have concluded that such statutory provisions limit the discretionary authority of safety-net participants, which may be needed in periods of financial instability when a significant portion of the banking industry has been weakened, and actions taken with respect to one institution may destabilise other institutions. The trade-off between rules and discretion is a difficult issue, to which there appears to be no universal solution that is applicable to all countries.

### ***Information needs***

Another pre-resolution activity of major importance to deposit insurers is the maintenance of accessible asset and liability information in order to expedite the resolution of the institution and help ensure that depositors have prompt access to insured funds. This includes information that will identify the owners of deposit accounts and permit the aggregation of balances for purposes of determining the amount covered by insurance. It also includes asset information needed by the resolution and liquidation authorities for the valuation of assets, least-cost calculations, and formulation of asset disposition plans.

Maintaining such information in accessible form involves a cost to the institution. As the financial viability of the institution diminishes, the accuracy of its records also may diminish. As a result, enforcement of record-keeping requirements may be needed.

Finally, deposit insurers and resolution authorities need to be notified promptly of an impending failure if the commitment to insured depositors is to be met expeditiously. Ideally, the deposit insurer should be notified well in advance of the date of failure so that preparatory work can proceed on a timely basis.

## Resolution Options for Failed Institutions

If private-sector solutions have not been successful, a determination is typically made that an institution has failed. This determination should be made on the basis of well-defined criteria by a safety-net participant with the authority to act for this purpose. Criteria used in different countries include determinations that an institution is insolvent, has capital below some critical level, is operating in an unsafe-and-unsound manner or fails to meet some other established standard that defines failure. With respect to the latter, some countries require action by safety-net participants when the institution is unable to repay funds received from the public according to the legal, regulatory and contractual conditions governing their payback.<sup>5</sup> Such determinations may be made by the chartering or licensing authority, the court system, through action to terminate deposit insurance, by the governing bodies of the institution, or by a general meeting of shareholders. These procedures are generally followed by some type of resolution transaction that usually involves a financial loss to the deposit insurer.<sup>6</sup>

This section of the paper will examine: (1) the objectives that guide resolution strategy; (2) types of resolution transactions; (3) procedures for

selecting resolution methods and acquirers of failed institutions; and (4) the staffing of resolution activities.

### *Guiding objectives*

A general objective that guides resolution strategies in most countries is to act quickly so that insured depositors have prompt access to their funds and the value of the failed institution's assets is preserved to the extent possible. More-specific objectives generally can be grouped under three headings. First, resolution activity may take as its primary objective the disposition of failed institutions in a manner that minimises resolution costs. Second, in particular situations, resolution strategies may be designed to avoid problems associated with failures of large and complex institutions. Third, resolution strategies may seek to avoid interruptions in the provision of banking services in particular markets or regions.

Which of these objectives is primary in any particular situation is spelled out in the statutes of some countries. For example, the statute may require that all resolution transactions must meet a least-cost test, except in specified types of situations where certain other considerations may prevail. Such statutory provisions are generally designed to set boundaries on the discretion of resolution authorities to choose among resolution methods.

### *Least cost*

As used in this paper and applied in the resolution policies of many countries, the term "least cost" refers to the cost of meeting the deposit insurer's commitment to the depositors of an individual failed institution, taking into account the projected proceeds from the disposition of the institution's assets. Countries that utilise cost tests in resolution activity generally do so in order to provide an objective means of choosing among resolution methods and to foster transparency and accountability in the resolution process. As noted later in this paper, however, resolution activity may be guided by other considerations in some situations.

A least-cost resolution is one that results in the lowest cost to the deposit insurer and/or the government.<sup>7</sup> In general, only insured depositors are fully reimbursed or protected under a strict least-cost resolution.<sup>8</sup>

A less-stringent cost test that has been used in some countries is that the resolution cost associated with a particular resolution method must be less than the cost of a liquidation and reimbursement of depositors' claims (also referred to as a deposit payout). This test often permits resolution methods that fully reimburse or protect uninsured depositors and other creditors.

The difference between the two tests bears emphasis. Least cost means literally that the chosen resolution method must be the *least expensive to the deposit insurer of all possible resolution methods*. The less-stringent cost test means that the chosen method merely has to be *less expensive than the cost of a liquidation and reimbursement of depositors' claims*.

Resolution costs generally are measurable on an estimated basis, although in some countries the necessary information may not be readily available. The chief information necessary to make least-cost calculations includes: the amount of insured deposits, estimated net recoveries on assets, off-balance-sheet assets and liabilities, claims of uninsured depositors and other creditors (including claims arising from litigation and off-balance-sheet liabilities), and any premium that may be offered by a potential acquirer of the failed bank. Essentially the same information is required to meet either of the two cost tests. Using appropriate rates to discount future cash flows to present values takes account of variations in risk and timing among different resolution and asset disposition methods.<sup>9</sup>

An implicit assumption in cost-test calculations is that the resolution of one failed institution will not affect the cost of subsequently resolving other institutions. This is most likely to be true in countries where occasional bank failures are regarded as a normal occurrence and the failed bank does not represent a major proportion of the banking

industry. The cost test also may not adequately take into account potential non-financial costs such as the legal exposure of the resolution authority in certain resolution transactions.

### ***Large-bank failures***

Large institutions often have been resolved in ways that are not designed primarily to minimise resolution costs, as defined in this paper, because of their perceived special significance from the standpoint of maintaining financial stability or for other reasons. In such cases, the safety-net participants sometimes have protected uninsured depositors, other creditors, and even shareholders. As noted in the paper on moral hazard, some of these practices may weaken market discipline and increase moral hazard. Providing more generous protection to particular institutions also may be perceived to be unfair to shareholders of banks that are resolved by least-cost methods. As is frequently the case, a trade-off exists between the discipline provided by the least-cost objective and efforts to avoid the effects of large-institution failures.

Failures of large banks often have been treated differently than failures of small banks in a variety of economic and financial scenarios. In some countries, the statutes specify the circumstances under which the objective of avoiding the potential destabilising effects of large-bank failures may override least-cost considerations. In this regard, the report of the Study Group on Deposit Insurance stated “deposit insurance systems are not designed to cope with systemic financial crises by themselves. The resolution of systemic crises requires broad, coordinated government action.”<sup>10</sup>

### ***Avoiding interruptions in banking services in particular markets or regions***

Safety-net participants may seek to avoid interruptions in the provision of banking services in particular markets or regions. Such an interruption may occur where alternative banking facilities are not readily available and if the institution is resolved through a deposit payout—generally because a merger with, or acquisition by, a healthy



institution cannot be arranged. The failing institution may have little franchise or “going-concern” value, its market area may be economically unattractive to potential acquirers or merger partners, the institution may pose unusual risks that acquirers are reluctant to assume, or there may be institutional or legal barriers to potential acquirers or merger partners. Accommodating customers of such institutions through the resolution process may require more-costly resolution methods than otherwise would be undertaken.<sup>11</sup> Once again, the resolution authorities may be confronted by a trade-off between competing objectives and choices among these objectives may be governed by statute.

### ***Types of resolution transactions***

Once it is determined that an institution has failed, or is in danger of failing, and private-sector solutions have not been successful, there are basically three options for its resolution. The institution can be liquidated, sold, or assisted to prevent its failure.

The relevant terminology may differ among countries, and there are many variations of these basic resolution options. For example, an institution in one country is currently being resolved through a deposit payout in an open-bank scenario, with liquidity support provided on a secured basis from the deposit insurer. In this paper, the various resolution methods are grouped under three headings: liquidation and reimbursement of depositors’ claims; purchase-and-assumption transactions (sales); and open-bank financial assistance. Existing bankruptcy/insolvency and other laws may influence heavily the choice of resolution methods. Such laws vary considerably among countries and, in some cases, may make a particular resolution method difficult to implement. Because of the special significance of banks and bank failures, countries may wish to review bankruptcy/insolvency laws from the standpoint of whether such laws facilitate the orderly exit of troubled institutions.

### ***Liquidation and reimbursement of depositors’ claims (deposit payout)***

Reimbursement of depositors’ claims may be accomplished by the deposit insurer directly paying depositors their insured balances or by transferring the accounts to another institution that makes the insured balances available to the depositors.<sup>12</sup> The institution is closed (license or charter extinguished) and the assets and uninsured claims are transferred to a receiver for liquidation and settlement.<sup>13</sup> As suggested above, liquidation generally is selected as the resolution method because an acquisition of, or merger with, the failed bank is unattractive to other parties.

### ***Purchase-and-assumption transactions (sales)***

In a purchase-and-assumption (P&A) transaction, a healthy institution<sup>14</sup> assumes some or all of the obligations, and purchases some or all of the assets, of the failed institution. P&As can be structured so that the acquirer assumes all deposits, insured deposits, or is offered an opportunity to bid for both. Where discretion exists, the decision whether to protect uninsured as well as insured depositors is perhaps the most crucial decision to be made in a P&A transaction.<sup>15</sup>

A number of other decisions also have to be made in structuring a P&A. First, the eligibility of various potential acquirers must be determined, as is the case in any other acquisitions. Clearly, acquirers must be healthy institutions or a group of investors with sufficient resources to acquire and operate the failed institution and qualified management. In addition, whether and to what extent foreign institutions are eligible, are important questions in some countries, and may involve issues of control, competition with domestic lenders, as well as funding considerations.

Second, decisions have to be made regarding the assets to be offered to the acquirer. Typically, these include performing loans and other good-quality investments. Whether nonperforming and other

risky investments are included depends frequently on the capability of the acquirer and whether loss-sharing or other financial inducements are offered, as discussed below. Assets not sold to the acquirer at resolution are usually passed on to the receiver for liquidation.

Variants of a purchase-and-assumption transaction include the “bridge bank” or other interim arrangement, which have been used primarily for failures of large and complex institutions. In a bridge bank or similar interim transaction, the responsible safety-net participant takes ownership or control of the failed institution and operates it for a period of time. Control may be exercised directly through outright ownership of the failed institution by the resolution authority, or indirectly through a separate body or organisation.<sup>16</sup>

The chief objectives of a bridge or similar interim arrangement are to prevent further deterioration of the institution, give the safety-net participants more time to seek a permanent resolution, and provide potential acquirers a greater opportunity to review the loan portfolio and other operations of the institution. As a result, acquirers may offer higher bids, leading to lower resolution costs, than if the institution were resolved immediately after failure. A bridge bank may be used for transactions that fully protect only insured depositors or in transactions that provide various degrees of protection to other depositors and creditors.

Provisions for maintaining the liquidity of the institution during the bridge-bank period may be necessary. If the institution remains too long under official control it may lose value as customers seek alternative providers of banking services and important operations wind down. In some cases, the authorities may be tempted to put the resolution process “on hold” once they have control of the institution. The vehicle potentially could be used to postpone a permanent solution unduly, with the likely results that the value of the institution might deteriorate further and the cost of a permanent solution might increase. As a result, some countries have limited the length of time that a bridge bank may remain in operation.

### *Open-bank assistance*

Assistance may be provided to an operating institution that is in danger of failing. This assistance may take the form of a direct capital infusion, purchase of troubled assets, loans to the institution, or loss-sharing arrangements. The deposit insurer or other authority that provides the assistance may (in some countries must) retain ownership rights in the restructured institution. Additional capital from outside investors and replacement of managers and directors may be required. Uninsured depositors and certain other creditors generally are fully protected, although shareholders may bear significant losses. Subordinated debt holders also may suffer losses, although in some countries such a result might expose the deposit insurer to significant legal exposure from dissatisfied creditors. Open-bank assistance has been provided mainly to large institutions when it was believed that closing the institution and imposing losses on uninsured depositors and other creditors would pose significant risks for financial markets and the economy.

Open-bank assistance has certain consequences deemed to be undesirable in some countries. The institution’s bondholders and shareholders retain some bargaining power in dealing with the authorities, which could cause undue delay in completing the transaction. In some countries, assistance to an operating institution is regarded as a subsidy.<sup>17</sup> Deposit insurers or the resolution authorities in some countries may be empowered and expected to recover any financial assistance they have provided. In other countries, it is expected that open-bank transactions will involve a cost; the resolution authority may recover part of the assistance that it provided if it retains ownership rights and the assisted institution prospers.

In a closed-bank transaction, claims of bondholders and shareholders typically pass to the receiver. Depending on the legal system, closed-bank transactions also may have other advantages over open-bank assistance.<sup>18</sup> Finally, small institutions that may be ineligible for open-bank assistance, may believe they are treated unfairly.

### ***Procedures for selecting and implementing resolution methods***

The procedures for selecting and implementing resolution methods vary among different countries. For example, the procedures that may be used effectively in a particular country are likely to depend on the number of potential acquirers, the frequency of bank failures, public attitudes toward bank failures, the stage of development of asset markets, and other matters. This section discusses only those issues that are likely to be common among a number of countries.

#### ***Assets offered for sale***

When a financial institution fails and is offered for sale, various decisions must be made with respect to the nature and amount of the assets offered. These may include the failed institution's total assets, high-quality assets, or pools of similar assets. If low-quality assets are offered for sale, consideration may be given to loss-sharing arrangements between the acquirer and the resolution authority, or to put-back provisions that allow the acquirer to return assets within specified periods at specified prices. Branch systems may be offered in their entirety, in clusters of branches, or as individual offices.

Although the theoretical range of possibilities is wide, practical considerations may limit the choices in many countries. Some alternatives are highly labour-intensive and may not be feasible where the deposit insurer or other responsible authority has a limited staff. Countries that have undeveloped markets for troubled assets may seek to pass such assets to the acquirer of the failed institution and may have to offer substantial inducements to compensate for the risk undertaken by the acquirer. On the other hand, some countries have established centralised asset-liquidation agencies that purchase risky assets from failing and other institutions for subsequent disposition. Countries with a small number of insured institutions and infrequent failures may not have first-hand experience in choosing among complex alternatives.

### ***Competitive bidding versus negotiated sales***

Selections among alternative resolution methods and, if the failed institution is sold, among potential acquirers may be made through a competitive auction process or by private negotiation with the acquirers. Competitive bidding has the advantage of greater transparency and higher prices in some cases, but may not be necessary or useful if there is only a small number of potential acquirers. In such countries, direct negotiations between the responsible safety-net participant and the few eligible acquirers may produce the best results.

#### ***Providing information to potential acquires***

In principle, the greater the information available to potential acquirers, the less expensive the resolution is likely to be to the deposit insurer. Absence of relevant information may induce potential acquirers to offer very low bids in order to protect themselves against risks that they are unable to evaluate properly. Although maximum availability of information may be advantageous to the deposit insurer, there may be a conflict with bank-secrecy laws that protect the confidentiality of information before the actual closing of the institution. In some countries, potential acquirers must enter into confidentiality agreements in order to have access to such information.

#### ***Marketing failed institutions***

A failed institution may be marketed publicly or privately. Widespread marketing makes the process more transparent and may increase the number of bidders. However, in countries with only a limited number of eligible domestic acquirers and/or restrictions on entry by foreign banks, public marketing may not serve a useful purpose. Moreover, if the public is not prepared for bank failures, widespread marketing may have unfavourable public reactions. Marketing an institution before failure may also cause liquidity problems. Once again, country-specific circumstances are likely to shape marketing efforts.

### **Staffing considerations**

When financial-institution failures occur in waves, the deposit insurer and other safety-net participants face staffing challenges. Government work rules may preclude the hiring of temporary employees to handle peak workloads. In such situations, outside contractors may be engaged. Alternatively, another financial institution may assume the deposit-payout and asset-liquidation functions for a particular failure for a fixed period on a fee basis. If outside contractors or agents are used extensively, provisions should be made for their oversight to ensure that the activities of the contractor or agent are closely aligned with the objectives of the deposit insurer and conflict-of-interest rules are in place and enforced.

### **Conclusions**

The timely and effective resolution of failed institutions is an important element in financial safety-net arrangements. Different strategies for resolving failures may have considerably different cost implications to the deposit insurer and different implications for other safety-net participants, the government, public, banking industry, and economy. Cooperation among the various safety-net participants, both before and after failure, is necessary if timely and effective resolutions of failed banks, particularly large banks, are to be accomplished.

In some situations private-sector solutions may be used to accomplish mergers and acquisitions of troubled institutions, although often with the involvement of the responsible safety-net participant. If such solutions are not feasible or successful, resolution of the institution is necessary, generally at a cost to the deposit insurer. Resolution strategies are guided by a number of objectives: minimise costs, address large-bank failures, and avoid interruptions of financial services. Which objective is primary in particular situations is governed by statute in some countries.

Three main resolution options are available: the troubled institution may be liquidated, sold, or assisted to prevent its failure. Numerous variations of these main options are used in different countries. Procedures for resolving troubled banks and staffing requirements also are likely to differ in various countries, depending on the frequency of failures, the number of qualified acquirers, the availability of developed markets for assets, public attitudes toward bank failures, and other factors.

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### **Endnotes**

- <sup>1</sup> This paper represents the work of the Subgroup on Failure Resolution, which is comprised of representatives from the United States (coordinator), France, Hungary, Italy, Japan, and the International Monetary Fund.
- <sup>2</sup> The mandates of deposit insurance systems and the linkages of these mandates to the public-policy objectives, roles and responsibilities, and legal powers of the systems are discussed in the papers on structure and organisation and powers.
- <sup>3</sup> The report of the Study Group on Deposit Insurance indicated that holding employees of deposit insurers or other agencies liable for actions taken on behalf of their organisations was “a serious impediment to performance and to fulfilling mandates.” The Study Group “recognised the advantages of statutory indemnification against legal liability that has been provided in some countries.” Financial Stability Forum Working Group on Deposit Insurance, *A Consultative Process and Background Paper*, June 2000.
- <sup>4</sup> A resolution may be defined as a disposition plan for a failed institution, which is directed by the responsible safety-net authority, and is generally designed to reimburse fully or protect insured depositors while minimising costs to the deposit insurer. In most cases (other than open-bank assistance transactions), the troubled institution is closed and its license or charter is extinguished. Typically, resolutions involve costs to the insurer because the insurer’s obligation to insured depositors

- exceeds net recoveries on the institution's assets. Private-sector solutions, as the term is used in this paper, involve no cost to the deposit insurer or government. Depending on the legal situation and other circumstances in the country, private-sector solutions are likely to be directed by, or have the significant participation of, owners or creditors of the troubled institution.
- 5 This is, in general, the standard used by the European Community to trigger intervention by the deposit-guarantee scheme. In some countries, a similar rule triggers a deposit payout. See the paper on depositor reimbursement.
  - 6 If an institution is resolved while it still has positive equity on a market-value basis, the deposit insurer may be able to avoid a loss.
  - 7 The cost of resolving failed institutions is borne in the first instance by the deposit insurer. However, the deposit insurer must be reimbursed if it is to stay in business, generally through premiums paid by insured institutions. The insured institutions may pass on part of the cost—for example, through lower interest rates to depositors. In general, it may be concluded that, for the most part, the public ultimately bears the cost of resolving failed institutions.
  - 8 In rare cases, a strict least-cost requirement may result in the reimbursement or protection of uninsured depositors if the acquirer of a failed institution makes a bid high enough to compensate, or more than compensate, the deposit insurer for absorbing losses that would otherwise be borne by the uninsured depositors.
  - 9 See the paper on claims and recoveries. Discounting future cash flows to present values is useful particularly because of differences in the timing of recoveries and expenses associated with asset disposition and because of differences in risk among asset types.
  - 10 Financial Stability Forum Working Group on Deposit Insurance, *A Consultative Process and Background Paper*, June 2000, page 16.
  - 11 For example, open-bank assistance may be used to keep the institution operating and thereby avoid an interruption in the provision of banking services and undue inconvenience or hardship for customers of the failed institution.
  - 12 Another alternative that has been used in some countries is to charter a new, limited-life bank to handle the reimbursement of depositors. Deposit payouts are discussed in detail in the paper on depositor reimbursement.
  - 13 The receiver may be a separate public or private entity or may be the deposit insurer in some countries. See the paper on powers.
  - 14 Rather than an operating institution, the acquirer may be a group of investors with a bank license or charter.
  - 15 The bid offered in a P&A represents the difference between the obligations assumed by the acquirer and the value of the assets purchased and the amount of cash provided by the deposit insurer. Because the difference between the obligations and the value of the assets may be considerable, the deposit insurer must offer cash or a loan to fill the “hole.” The winning bidder is the one willing to accept the least amount of cash or loans from the deposit insurer. In general, the same procedure applies in insured-deposit transactions as well as total-deposit P&As, with the obvious difference that the amounts of obligations assumed by the acquirer are different. If a strict least-cost test, as defined in the text, applies, and bidders may bid for both insured and total deposits, the bid for total deposits will win only if it is sufficient to cover the loss that would otherwise be borne by the uninsured depositors and also exceeds bids for only insured deposits.
  - 16 In some countries a bridge-bank transaction is a type of closed-bank P&A transaction, in which the responsible authority becomes the temporary owner of the institution, pending a permanent solution. In at least one country, on the other hand, the bridge bank is controlled by an independent board of directors that adheres to corporate-governance principles in order to ensure the preservation of the institution's value.
  - 17 The subsidy element is most apparent in open-bank transactions that provide some degree of protection for shareholders. At the other extreme, least-cost resolutions fully reimburse only insured depositors. Uninsured depositors and other stakeholders are reimbursed only to the extent of net-asset recoveries applied according to the priority ranking established by statute. (See the paper on depositor priority.)

- <sup>18</sup> Depending on the legal situation in different countries, open-bank transactions may have certain other disadvantages compared with a closed-bank transaction. In the open-bank case, certain contingent liabilities may be retained by the assisted institution and become potentially payable in cash; in a closed-bank transaction such liabilities would pass to the receiver and be payable as a non-deposit creditor claim. Furthermore, in some countries, certain burdensome leases and contracts may be abrogated without penalty in a closed-bank transaction.



# Discussion Papers

## Claims and Recoveries

### Abstract:

The capacity to manage the assets and liabilities of a failed bank is an essential part of all effective safety-net systems. In the broadest sense, it involves disposing of the bank's assets and resolving the bank's liabilities for the benefit of creditors with *bona fide* claims against the bank. This paper considers the major objectives, organisational and resource requirements, and strategies of the claims-and-recoveries function that arise after a failure-resolution strategy has been adopted.

The optimal strategy for effectively and efficiently managing the claims-and-recoveries function is situational, and reflects different economies, safety-net structures, insolvency regimes, and financial, legal and political systems. However, the claims-and-recoveries function is subject to common management processes. These include a feedback loop of analysis, planning, and execution. In addition, effectiveness and efficiency likely are best achieved through decisive control and commercial practice rather than reliance upon legal rights or bureaucratic procedures.

The capacity to manage the assets and liabilities of a failed bank is an essential part of all effective safety-net systems.<sup>1</sup> In the broadest sense, it involves disposing of the bank's assets and resolving the bank's liabilities for the benefit of creditors with *bona fide* claims against the bank. This paper, which was prepared by the Subgroup on Claims and Recoveries, considers the major objectives, organisational and resource requirements, and strategies of the claims-and-recoveries function that arise after a failure-resolution strategy has been adopted.<sup>2</sup>

In bank failures, claims take several forms.<sup>3</sup> In the context of insolvency proceedings, for example, creditors file claims. Claims also may encompass matters such as legal actions by or against the insolvent bank, or costs and outlays from financial

assistance provided to the bank by the deposit insurer or another safety-net participant. Recoveries on these claims are typically derived from the disposition of the bank's assets, payments by borrowers, and proceeds from legal actions, including claims against directors, officers, auditors and other third parties.

The organisation (s) that actually performs the claims-and-recoveries function varies across jurisdictions, and reflects country-specific developments beyond the scope of this paper. In most cases, the deposit insurer will have, at a minimum, a mandate to advance its claims to recover on deposit insurance payments and possibly other costs. Thus, irrespective of whether a deposit insurer is responsible for resolving claims or disposing of the failed bank's assets, it is likely to have an interest in

understanding and possibly influencing the claims-and-recoveries process in order to achieve its goals.<sup>4</sup>

The optimal strategy for effectively and efficiently managing the claims-and-recoveries function is situational, and reflects different economies, safety-net structures, insolvency regimes, and financial, legal and political systems. However, the claims-and-recoveries function is subject to common management processes. These include a feedback loop of analysis, planning, and execution. In addition, effectiveness and efficiency likely are achieved best through decisive control and commercial practice rather than reliance upon legal rights or bureaucratic procedures.

## Objectives of the Claims-and-Recoveries Function

In most countries, claims and recoveries typically involve at least some of the following objectives: (i) maximisation of recoveries from the assets of the failed bank; (ii) minimisation of the costs associated with the failed bank's liabilities and those arising from the failure resolution; (iii) determination of the most cost-effective strategies; (iv) contribution to financial-system stability; (v) timely and equitable payment to creditors; and (vi) contribution to system discipline by such measures as instituting legal action against errant officers, directors, auditors, and other parties.

Some objectives may conflict with other objectives. For example, a mandate to return assets to market promptly may be conditional upon minimising adverse economic effects. Similarly, pursuing professional-liability actions for system discipline may be subject to considerations regarding the financial benefits of reaching early compromise. Ideally, such trade-offs are considered and agreed upon in the development of the claims-and-recoveries function in order to facilitate consensus and coordination on, and commitment to, the necessary action steps and priorities involved in dealing with a failed bank.

## Conditions Precedent

A number of factors affect the performance of the claims-and-recoveries function. As with any bankruptcy process, bank-insolvency resolution requires clear and enforceable priority-of-claim rules. These establish seniority of various classes of claimants, including depositors' claims. Also important are bank-liquidation and asset-disposition procedures, open-marketing and effective conveyance processes, and an effective and transparent judiciary with expertise in the liquidation of banks.

The powers provided to the organisations responsible for performing the claims-and-recoveries function also have considerable effect on overall performance. These powers include control over the assets, contract rights, and privileges of the failed bank. The ability to allow or disallow claims, stay litigation, enforce or repudiate certain contractual obligations, and challenge fraudulent transfers, affect the performance of the claims-and-recoveries function. Finally, fiduciary responsibilities may limit the ability of those performing the claims-and-recoveries function to fulfil other responsibilities and goals.

## Strategies for Management of the Failed Institution's Assets and Liabilities

Although the precise nature of the claims-and-recoveries strategies vary from country to country, in each case the strategies should be consistent with (i) the objectives of the safety net, (ii) the economic and legal environment in which claims-and-recoveries activities are conducted, and (iii) the organisational form and resources available. In the absence of a country-wide political consensus on the steps to be undertaken, claims-and-recoveries activities may be lengthy, inefficient and ineffective.

The benefits of explicit rules and procedures for handling various aspects of the claims-and-recoveries function may be particularly significant

in enhancing credibility, increasing market discipline, prompting action, and thereby minimising costs arising from delay. For example, regularly updated memoranda of understanding among participants in the financial safety net help protect the claims-and-recoveries function from political interference.<sup>5</sup> In the event of a failure, explicit policy statements that authorities will not protect creditors and shareholders beyond pre-specified commitments, also may help manage expectations.

By contrast, discretion may be beneficial in certain circumstances in order to achieve public-policy objectives, such as financial-system stability. Discretion also may be useful in providing a degree of flexibility that otherwise may be lost when too many aspects of the claims-and-recoveries function are made explicit.

## Organisation and Resources for the Claims-and-Recoveries Functions

The determination of whether the claims-and-recoveries function should be performed by public, private, or hybrid organisation(s) is country-specific. However, it may be guided by an evaluation of which form is expected to be more efficient and effective in handling claims and recoveries, and by rigorous application of commercial criteria with incentives for efficiency. Likewise, the choice of outsourcing or developing the internal capacity to fulfil the functions of the claims-and-recoveries function may be facilitated by a consideration of the frequency, scale, and cyclical nature of projected failures, and the mandates and objectives of the deposit insurer and other safety-net participants.<sup>6</sup>

The identification and development of the capabilities and skills involved in claims-and-recoveries activities are ongoing processes. In most countries, professionals are drawn from the insolvency, accounting, banking, real-estate, information-technology and legal professions. Although projecting staffing requirements for future failures is

problematic, it is important that those responsible for the claims-and-recoveries function have both the funding to remunerate and access—internally or through standby arrangements with external suppliers—to professionals capable of dealing with projected failures. Inadequate funding will lead to delay and increased costs.

## Planning Claims-and-Recoveries Activities

Business plans are a key element of the claims-and-recoveries process. They provide a strategic framework within which financial and non-financial performance information is developed and evaluated. Plans articulate the strategy for maximising the recovery of assets (including litigation) on a net present-value basis; for employing effective resources in the liquidation; and for establishing benchmarks for assessing performance. The goal is efficiency and consistency, with reliable estimates based on timely, verifiable information and assumptions.

Ideally, business plans should be updated regularly and cover all major areas of the claims-and-recoveries function, including claims processing, asset management and disposition, and forensic-litigation management. To address large failures and/or multiple failures, it also is essential to develop contingency plans that mobilise the resources of internal staff and contractors, as well as coordinate activities of the safety-net participants.<sup>7</sup>

## Maximising Recoveries from Asset Management and Disposition

Asset management and disposition is typically the most visible and the most expensive activity of the claims-and-recoveries function, and usually has the greatest effect on recoveries. To ensure that appropriate strategies are adopted, it is important to evaluate the assets, in much the same manner as

the medical procedures of a hospital emergency ward, where victims are first classified for treatment on a priority basis.

On this basis, healthy or performing (“good-bank”) assets may be separated from nonperforming (“bad-bank”) assets. The good bank may be retained as part of a “going-concern” solution, or otherwise marketed as soon as possible, as they have no “upside” potential. The disposition of the bad bank may be more problematic in the event of a large overhang of similar assets, such as unsold real estate, held by other banks and market participants. In such circumstances, the bad bank may be “worked out” under professional management with a mandate to maximise recoveries, after operational and financial costs, precisely because there is an “upside.”

Efficient and effective asset-management strategies reflect the type and quality of assets being realised, and include tools to validate valuation assumptions employed in the asset valuation/appraisal process and business plans. Risks relating to interest rates, market fluctuations, particular asset-disposition strategies, and asset-specific and legal issues need to be identified, evaluated, quantified, managed or hedged. Use of discounted cash-flow analysis or another appropriate valuation technique is required to ensure that approaches to claims and recoveries recognise the time value of money, as well as the risks associated with hold *versus* sell decisions. Consideration also might be given to the estimated value of the assets to potential purchasers, each of whom values the assets differently because of different plans and different financing costs.

Once the assets have been examined and categorised, the timing and method of disposition may be considered in light of the nature of the assets being disposed of and the condition of the markets into which they are being sold, with a view to such objectives as maximisation of recoveries on a net present-value basis. Other considerations may have to be balanced against such objectives, including environmental implications or legislatively mandated policy requirements.

Selling assets at resolution or immediately thereafter has the advantage of returning assets to the market quickly, as well as replenishing the deposit insurance fund and minimising government involvement with the assets. These advantages should be considered against the risk of lower recoveries and potential resistance from creditors who stand to benefit from a more lengthy realisation process.

It is vital to maintain the value of those assets that cannot be sold immediately, or that have been selected for longer-term workout, through clear asset-management procedures. Even performing loans tend to lose value unless managed actively. Clearly, the risks of holding for later sale and the availability of skilled asset-management practitioners need to be factored into any application of this approach. As well, internal information and operations systems and procedures will be required to catalogue and track the assets.

Transparency and access to information are key factors in asset management and disposition, since marketing the assets to qualified and interested potential purchasers is likely to stimulate competition and thereby increase recoveries. The quality of information available to potential purchasers has an important bearing on prices, so effort is needed to arrange information in as orderly and complete as possible a manner to generate greater buyer interest and thereby maximise value.

## Marketing Methods

There is a wide range of methods for marketing the assets of failed banks, including (i) asset-by-asset sales on a commercial basis; (ii) auctions; (iii) portfolio sales; (iv) securitisation; (v) workout/restructuring; and (vi) equity partnerships:

On the premise that retail prices are higher than wholesale, it may be better to sell certain assets individually, particularly nonperforming assets where the security interest has been realised. This

permits their sale as appropriate with a marketing program tailored to the asset in question. The purchaser may be the end user who is often more willing to pay a higher price than the “middleman” in a bulk sale. One potential downside to an asset-by-asset sale is higher transaction costs.

Auctions by outcry or sealed written bids—including tender bids and expressions of interest—have been utilised to facilitate bulk or individual-asset sales, sometimes with enhancements such as seller financing, representations and warranties. The advantages of auctions, which can significantly accelerate the speed of recoveries, should be considered against the risks of few bidders and low bids.

Marketing assets that have been combined into pools may facilitate quick sale, generate market-value returns, and significantly reduce both the assets under administration and the resources required to manage the assets. As is the case with auctions, consideration should be given to the risks of few bidders and low bids.

Securitisation involves packaging similar assets and selling portions with rights to cash flows identified by contract, in some cases with credit enhancements. As is the case with portfolio sales, securitisation may be advantageous in enhancing asset recovery values and expediting asset sales. To date, the application of securitisation has been most effective in well-developed markets with existing markets for asset-backed securities.

Asset-management companies can serve as rapid asset-disposition vehicles for bundling and securitising or portfolio sales, and as longer-term restructuring or workout agencies to deal with nonperforming assets. They also enable a consolidation of skills, resources, and uniform workout practices within one agency, thereby providing efficiencies in recovering maximum possible value.

Equity partnerships have been an effective method of disposing of portfolios of underperforming, nonperforming, and owned real estate. In these joint ventures, the agency responsible for recoveries

provides the assets and financing, and the partners/investors contribute equity and assume responsibility for management and disposition of the partnership’s assets.

In some instances, the method of marketing may be enhanced with vendor take-back (seller) financing and limited guarantees. Seller financing may be particularly advantageous in dealing with hard-to-sell assets, but should be part of a well-thought-out exit strategy. Guarantees against loss—as well as related put agreements by which a buyer has the option of returning assets for a refund within a specified period of time—may be of assistance in completing a transaction. Although guarantees have the disadvantage of creating contingent liabilities, such disadvantages can be mitigated by limiting their duration and total value.

Factors affecting asset management and disposition performance include general economic conditions, the quality of the assets of the failed bank, depth of secondary markets, assets subject to competing creditor claims, and litigation or other proceedings that complicate realisations. Similarly, the ability to market assets promptly may be problematic where a failure is sudden, such as failure caused by a rapid lack of liquidity, where failure occurs across multiple jurisdictions, or where an asset-valuation review and pricing of assets cannot be accomplished in advance of failure.

The absence of specialised human resources for the handling of insolvency issues, including distressed assets, is a challenge for many countries. Contracting out tasks relating to claims and recoveries raises the “principal-agent” risk that the agent will not act in the principal’s interest, resulting in below-expectation returns. Where practical, this risk may be addressed explicitly with measures to align the interests of the agents with those of the deposit insurer or other relevant safety-net participant.

Measures designed to align interests include negotiating incentive plans with receivers or other entities to increase the probability that net realisations will be in the upper range of projections, measured on



a net present-value basis. Other measures may specify that the liquidation of assets will be completed by a specific date, that the liquidation management will focus on the need to minimise costs, and that existing management expertise will be retained to completion of the plan.

## Maximising Recoveries from Claims and Litigation

Claims and litigation advanced against other parties by the failed bank or relevant safety-net participants represent a potentially important asset on which recoveries may be realised. In some cases, these activities also are an important tool in fostering greater discipline in the financial-services sector. For these reasons, potential claims should be identified and investigated carefully to determine the appropriateness and potential for recovery (cost/benefit) before being pursued. Consideration of whether to pursue an action might include an analysis of the possible defenses, counterclaims, or claims-over that may be made by the defendants. Once commenced, activities may be refined or curtailed at appropriate times.

Among the more important claims pursued are professional-liability claims. These arise in circumstances where the deposit insurer, failed bank, or another safety-net participant has suffered damages, and there is information that raises a reasonable case of negligent or wilful misconduct or wrongdoing by directors, officers, or auditors, or by other relevant parties. In cases of fraudulent or otherwise patently egregious behaviour, the results of an investigation also may raise the possibility of potential criminal proceedings—typically pursued by the state as opposed to a deposit insurer or other safety-net participants.

## Minimisation of Liabilities

In addition to depositor claims, failed banks typically have a number of liabilities, such as environmental problems associated with real estate or

businesses owned by the bank, indemnifications or other guarantees, off-balance-sheet liabilities, and claims against the failed bank.

The claims-and-recoveries function likely will require that claims against the failed bank are resolved in a fair and cost-effective manner. This will involve notifying potential claimants of the claims process, reviewing and resolving asserted claims, distributing dividends to proven claimants, and transferring unclaimed dividends to the appropriate state authority.

The resolution of claims against a failed bank can add significantly to the cost and duration of a liquidation. Such claims may involve a creditor taking security before failure of a bank; higher ranking or priority claims;<sup>8</sup> multi-jurisdictional insolvency issues; complications arising from a parent/affiliate pursuing significant claims; and reviewable transactions entered into before failure resolution.

A particularly important source of cost and delay arises from litigation instituted by creditors, shareholders, or other claimants and plaintiffs against the failed bank or the agency that performs the claims-and-recoveries function. This is the negative side of the possibility of realising recoveries from litigation, and a crucial aspect of liability management for those charged with handling claims and recoveries. For this reason, it is advisable to conduct regular evaluation of the claims in order to quantify appropriate reserves, estimate the potential liability exposure, and consider alternative means for resolution.

## Measuring Performance and Managing Knowledge

One of the key strategies to be applied to the claims-and-recoveries function is the creation of a framework to measure and credibly demonstrate performance, as well as promote continuous learning. Performance measurement is likely to focus on such criteria as the least-cost criteria of resolution, as well as on the quality of management



processes, including performance against management's plans, and performance against quantitative and qualitative industry standards.<sup>9</sup>

To be meaningful, performance measures reflect the country-specific claims and recoveries' objectives, the institutional framework, and characteristics of the bank failures. Moreover, precisely because the claims-and-recoveries function is country-specific, it is important to ensure that the knowledge and experience gained be both captured and disseminated. In particular, an analysis of each bank failure may be beneficial in providing guidance for future liquidations and thereby potentially reducing costs to both the safety net and other creditors.

## Conclusions

The effectiveness of the claims-and-recoveries function depends on understanding the problems, matching appropriate strategies with goals and country-specific conditions, and the level of commitment to achieve such goals. Above all, careful planning and analysis need to be complemented by decisive action and the discipline of commercial practice.

The claims-and-recoveries function benefits from clear and enforceable priority-of-claim rules, and well-developed bank liquidation and asset-disposition procedures supported by the legal system. Uncertainty or inequality of treatment of creditor groups may jeopardise confidence in the financial system, with attendant costs.

Coordination among safety-net participants plays an important role in contributing to the efficiency and effectiveness of the claims-and-recoveries function. Where those functions are not consolidated in the hands of the deposit insurer, memoranda of understanding among financial safety-net participants becomes even more critical in facilitating coordination.

Once a bank has failed, liquidation of its assets should be pursued on the basis of the economic merits. Other considerations—such as concern for

system-wide stability, or a determination to pursue professional-liability actions to enhance business standards of conduct—may introduce conflicting objectives and pose trade-offs that will need to be addressed.

Success depends upon sufficient organisational, funding, and human resources to conduct efficient and effective claims-and-recoveries activities. These resources should be consistent with the structure of the financial-services sector, and with the frequency and cyclical nature of failures. Inadequate funding can lead to delay in completing asset dispositions or claims-resolution activities, and to a significant extent increases in costs.

Plans are a key element of the claims-and-recoveries process. Plans articulate the strategy for maximising the net present-value recovery of assets; ensure the employment of effective resources in the liquidation; and establish benchmarks for assessing progress and performance.

Regular review and reporting to stakeholders on the efficiency and effectiveness of claims-and-recoveries activities provide a feedback loop for identifying steps to strengthen supervision and standards of bank management, and, to validate or revise practices relating to claims and recoveries as well as failure-resolution methodologies.

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## Endnotes

- <sup>1</sup> The Subgroup is comprised of representatives from Canada (coordinator), Hungary, Mexico, Philippines, and the United States.
- <sup>2</sup> See the paper on failure resolution, which describes the main issues relating to the resolution of troubled banks.
- <sup>3</sup> Definitions of bank failure tend to be country-specific. In this paper, bank failure may be considered to have occurred when one or more of the following circumstances obtain: the institution's liabilities exceed its assets, it has been placed in administration or liquidation, or it has voluntarily sought to wind-up its affairs.

- 4 There is considerable variation in the claims-and-recoveries role played by deposit insurers and other safety-net participants. Where deposit insurance payments are made upon the liquidation of a bank, the deposit insurer usually is subrogated to the rights of the insured depositors, and is likely to file and actively manage the claim arising from the deposit insurance payment. In some instances, deposit insurers have broader roles in risk-minimisation or recovery processes, for example as lender, creditor, or possibly as receiver. In other cases, these functions are the responsibility of other entities, including central banks.
- 5 Coordination between safety-net participants is the subject of a paper on interrelationships.
- 6 A more comprehensive review of this subject, as it pertains to deposit insurance systems, may be found in the paper on structure and organisation.
- 7 For an elaboration on this point, see the paper on interrelationships.
- 8 Creditor ranking is discussed more fully in the paper on depositor priority.
- 9 Qualitative benchmarks might include performance in closure of the bank, management of cash, claims processing, and litigation. Quantitative benchmarks likely would focus on such issues as speed of asset disposition, yield on asset realisations, overhead costs, and the net present value of recoveries/losses.

# Discussion Papers

## Cross-Border and Regional Issues

### *Abstract:*

In general, relevant laws, regulations, and other provisions applicable to banks, their customers, and deposit insurers, are that of the bank's country of charter or incorporation. Circumstances change if a bank operates branches in other jurisdictions, or provides services on a cross-border basis to customers located abroad. Depending on the volume of these activities, the implementation of appropriately adapted policies by home- and host-country deposit protection schemes can be crucial for the effective operation of deposit protection arrangements and for the achievement of public-policy goals.

Issues that require particular consideration from a cross-border and regional perspective are: membership, coverage, funding, interrelationships between safety-net participants and, in the case of failures, the process of reimbursing depositors and the recovery of assets. This paper identifies relevant cross-border and regional issues from the perspective of deposit protection, and will examine the trade-offs associated with a variety of approaches. It also includes considerations with regard to the process of accession to the European Union (EU) by candidate countries.

In general, relevant laws, regulations, and other provisions applicable to banks, their customers, and deposit insurers, are that of the bank's country of charter or incorporation. Circumstances change if a bank operates branches in other jurisdictions, or provides services on a cross-border basis to customers located abroad. Depending on the volume of these activities, the implementation of appropriately adapted policies by home- and host-country deposit protection schemes can be crucial for the effective operation of deposit protection arrangements and for the achievement of public-policy goals.<sup>1</sup>

Issues that require particular consideration from a cross-border and regional perspective are: membership, coverage, funding, interrelationships between safety-net participants and, in the case

of failures, the process of reimbursing depositors and the recovery of assets. This paper identifies relevant cross-border and regional issues from the perspective of deposit protection, and will examine the trade-offs associated with a variety of approaches. It also includes considerations with regard to the process of accession to the European Union (EU) by candidate countries.<sup>2</sup>

In most countries, deposit taking is primarily a domestic business. However, cross-border aspects of this business are increasing in many jurisdictions (for example, e-finance developments). In some countries, cross-border aspects play a considerable role in the design of deposit insurance arrangements. This is the case, for example, if a banking system is characterised by a strong presence of foreign-bank

branches. In weak banking systems, especially after a crisis, the outflow of deposits to foreign countries may have to be taken into account when establishing or reforming deposit insurance arrangements. Special considerations may apply in regions where economies are closely related—for example, North America—or closely integrated—for example, the EU.

The considerations presented in this paper regarding cross-border claims and recoveries of foreign branches also are applicable to domestic banks with foreign subsidiaries and domestically chartered foreign-bank subsidiaries, but these are not the focus of this paper.<sup>3</sup>

## Membership Issues

Policy approaches with regard to the membership of banks from foreign countries in deposit protection schemes vary widely. Foreign branches could be included in or excluded from a host-country deposit protection scheme. Host countries also could choose to prohibit foreign branches from accepting deposits that are covered by the host-country deposit protection scheme unless the branches participate in this scheme and comply with entry criteria. Another approach is to waive or limit protection to supplementary coverage in circumstances where the deposit protection scheme of the bank's home country is recognised by the host country. Finally, countries may require banks from foreign jurisdictions to set up legally separate subsidiaries if they wish to accept covered deposits.

It may not be necessary to include foreign-bank branches in host-country deposit protection schemes to achieve public-policy objectives when foreign banks play a limited role in a country's financial system. Excluding foreign-bank branches may facilitate the administration of the scheme and prevent it from covering deposits at banks that it may not be able to supervise adequately. A drawback of this policy is that consumer protection may be weakened because depositors may be uncertain about the coverage provided for their deposits.

Some countries choose to include all foreign branches in their deposit insurance scheme. In countries where foreign-bank branches have a large market share, the inclusion of foreign branches may be considered necessary to achieve stated public-policy objectives. The mandatory inclusion of foreign branches in the host-country deposit protection scheme ensures that all eligible depositors benefit from deposit protection. However, this strategy could threaten the viability of the host-country deposit protection system, if the respective bank and its foreign branches are not subject to an adequate supervisory regime. To ensure adequate supervision and the financial strength of foreign branches, supervisors may require foreign banks to pledge assets as a capital substitute, and to conform with capital adequacy and other regulatory requirements of the host country.

If special membership or entry criteria for deposit protection schemes exist, foreign branches should comply with them in order to preserve the financial strength of the system and competitive equity. Accession criteria could include supervisory capacity to carry out audits at the branch- or head-office level, and the possibility of receiving information from the head office or the home country's supervisor.

It may be appropriate to recognise the coverage already provided through membership in a home-country scheme, if this scheme also covers deposits collected by foreign branches. In such cases, the relevant host-country authorities (generally banking supervisors) would have to be informed about the level of coverage provided by the branch's home-country scheme during the licensing or chartering process, if the coverage of deposits is mandatory. Authorities should be given the ability to not recognise the branch's home-country deposit protection scheme, if they conclude that the protection policies of the home-country scheme are inadequate. Membership in a deposit insurance scheme for banks that only collect deposits directly from customers abroad without having established a branch or a subsidiary (that is, a physical presence) in the foreign jurisdiction generally is not appropriate.

Cross-border deposits generally are protected by the bank's home-country scheme (in cases where one exists), since deposits are booked in the home country where the bank is physically located and licensed to operate. In all cases, depositors should be appropriately informed of whether the home-country deposit protection scheme, the host-country deposit protection scheme or a combination of both is applied.

## Coverage Issues

Deposits that are collected by a bank directly from depositors in other countries (for example, *via* the Internet) may or may not be covered by the bank's deposit protection scheme. If a bank has established a branch in a foreign country, a wide spectrum of coverage arrangements for the branch's deposits may apply.

The coverage of deposits of foreign branches that only participate in the host-country deposit protection scheme is, in general, determined according to that scheme's regulations. This does not rule out that the scope and level of coverage may be fixed with a view to the coverage provided in other countries, so that, in addition to domestic factors, external aspects are taken into account. Coverage that is comparable to that in competitor countries may be one element of an overall strategy to strengthen the financial system and to stop the outflow of deposits, especially in weak banking systems and banking systems that have experienced a recent crisis. However, it is important to avoid a competitive process by which national deposit insurance schemes adapt to the ones with the most encompassing features and the lowest premiums or levies without taking due regard of the country's domestic situation. Such a process may have negative implications for the viability of the protection scheme and could jeopardise financial stability.

The determination of an appropriate coverage policy could become more complex if the bank's home-country scheme also covers deposits raised by foreign branches in foreign jurisdictions. The coverage of deposits at foreign branches may be

appropriate because the branch is a legal part of the bank and its solvency and liquidity cannot be separated from the soundness of the bank itself. Furthermore, domestic customers of the bank doing business with its foreign branches might expect to be protected in the same manner as that provided when they deal with the bank's head office. If the coverage of the home-country scheme is lower or less encompassing than the coverage provided by the host-country scheme, the branch could be given the opportunity to top-up the home-country coverage; this supplementary coverage could be provided by the home- or by the host-country deposit protection scheme. On the other hand, if the coverage of the home-country scheme of the branch is higher or of broader scope, the branch's customers would benefit from more-encompassing protection than that provided by the host-country scheme. Limitations may run counter to policies that allow free provision of financial services on a cross-border basis.

If a branch that already benefits from coverage by its home-country scheme is obliged, or granted the right, to join a host-country scheme, care should be taken to ensure that insured deposits are not covered twice. This might require appropriate provisions in contracts, statutes and laws, and possibly mutual agreements between the deposit protection schemes concerned.

In the EU, the home-country deposit protection scheme of a bank also covers deposits of the bank's branches in other EU jurisdictions according to the deposit protection directive.<sup>4</sup> This directive specifies minimum features for deposit protection schemes in member countries and supplements the overall harmonisation of banking supervisory regulations in the EU. As the minimum coverage in the EU already is provided by the branch's home-country scheme, the branch cannot be obliged to join the host-country deposit protection scheme. If the coverage of a host-country deposit protection scheme is higher or of broader scope, branches may choose supplementary coverage by this scheme, provided that they accept the membership conditions of the host-country scheme.

For candidate countries preparing for accession to the EU, transitional arrangements with lower initial coverage are under consideration. With lower initial coverage there may be a risk that if an accession country were allowed to export its lower deposit guarantee coverage to another member state with higher coverage, depositors could be insufficiently protected. To solve this problem, branches of banks from accession countries could be requested by the host country to top-up to the minimum level of the home-country scheme during the transition period. This arrangement could be a safety device to ensure that an adequate, minimum deposit guarantee level is offered in all member states.

On the other hand, there may be requests for a limited export prohibition ban in the EU toward certain accession countries. This means that an accession country may request EU branches operating in its territory to not exceed the lower initial minimum EU deposit guarantee during the transitional period. Implementation of this approach could be difficult if the transitional export ban would have to be altered by amending the law in the branch's home-member state. Furthermore, it should be taken into account that the freedom of establishment only may be restricted in the EU for a limited period and on exceptional grounds.

## Funding Issues

If deposits at foreign branches are covered by the bank's home-country deposit protection scheme, the same funding mechanisms as for the head office of the bank could apply to its foreign branches. If deposits at foreign branches are not covered by the bank's home-country scheme, but the foreign branch belongs to the deposit protection scheme of the host country, the branch could be considered for funding purposes as a separate legal entity; levies or premiums could be collected according to balance-sheet data, the level of business and deposits, or other relevant branch-specific information. Special adaptations could be necessary if premiums are assessed *ex-ante* on a differential (risk-adjusted) basis. As the financial condition of the branch can

not be separated from the situation of its head office, in principle the risk profile of the whole bank would have to be taken into account for the calculation of differential levies and premiums. If there is a lack of adequate data for a differential premium system, the branch could be assessed under criteria consistent with that applied to domestic banks. This could be an appropriate approach if the branch is required to have endowment capital or to pledge assets as a substitute for its own funds. More-complex approaches may be necessary if the basic coverage of the bank's head office is provided by the home-country scheme, and supplementary coverage would be granted by a host-country scheme. In this case, the calculation of funding requirements for the supplementary coverage often could not follow the standard approach for domestic banks. It could be necessary to develop special funding formulas for supplementary coverage, possibly adapted to the financing approach of the home-country scheme (especially *ex-post* or *ex-ante* financing; flat-rate or differential (risk-adjusted) premiums). Regardless of the concrete formula developed, the protection already provided by the home-country scheme should be recognised in the determination of levies and premiums to avoid double charging.

## Interrelationship Issues

Cross-border deposit taking may require close interrelationships among safety-net participants in different jurisdictions. In general, information received by safety-net participants in other jurisdictions should be subject to strict confidentiality rules that comply with international standards and that are not more lenient than the rules for information received by other domestic safety-net participants. If this is assured, all relevant information could be exchanged between deposit insurers in different jurisdictions. In addition, it may be helpful if deposit insurers were able to benefit from information channels established between supervisory authorities in different jurisdictions. Relevant information concerning banks and branches in other countries could, where appropriate,



be requested by contacting the deposit insurer. In some cases, it also could be useful to exchange information directly between deposit insurers and other safety-net participants in foreign jurisdictions. In any case, foreign deposit insurers should receive all information necessary to enable a prompt reimbursement of depositors.

If a foreign branch belongs to the deposit protection scheme of the host country—possibly only for supplementary coverage—it could be appropriate to establish information channels between this scheme and the home-country deposit protection scheme. If the host-country scheme is a risk minimiser, and has the power to audit banks belonging to its scheme, including foreign branches, it may detect facts that also are material from a supervisory point of view. Such information could be made available to the supervisory authority, even if it is located in a different jurisdiction under information-sharing agreements. To fulfil its task as a risk minimiser, it also may be appropriate for the deposit insurer to require the provision of relevant information concerning the whole bank and to verify such information with the home country's supervisory authority.<sup>5</sup> If a crisis occurs at the bank or the branch, the information sharing between safety-net participants also could include the host-country deposit insurer. In any case, the host-country deposit insurer should be informed early when a bank fails.

If the foreign branch belongs to the host-country deposit protection scheme only for supplementary coverage, while basic coverage is provided by the home-country deposit protection scheme, regular contacts between the home- and the host-country deposit protection scheme also might be useful. Close cooperation may be necessary during the reimbursement process after a failure has occurred. Moreover, if bankruptcy proceedings were to be initiated, all relevant deposit insurers would have to be informed immediately about the closure of the bank, including its foreign branches.

Also in the case of the accumulation of cross-border deposits without the establishment of a branch, communication between the home-country deposit

insurer and the supervisory authority of the depositors jurisdiction may be appropriate. This issue could be especially important in a crisis, if the bank has a strong position in the foreign market.

## Claims and Recovery Issues

In general, the determination of claims and the recovery of assets are more complex for foreign branches than for domestic banks. As foreign branches are a legal part of a bank chartered in a different jurisdiction, cross-border transfers of assets and liabilities can be easily executed and occur during the normal course of a bank's business. If such a bank fails, and deposits at foreign branches have to be reimbursed by the relevant home- or host-country deposit protection scheme, the proper recognition of rights of set-off and collateral arrangements may complicate the determination of the depositors' claims. Furthermore, subrogation may imply that assets have to be recovered by the deposit protection scheme in foreign jurisdictions. The issue becomes even more complex when the branch's home-country deposit protection scheme provides the basic coverage and the host-country scheme provides supplementary coverage.

Deposit protection schemes should analyse cross-border legal issues and develop solutions from a cost-benefit perspective for potentially major legal disputes before failures occur. In some cases, memoranda of understanding between deposit protection schemes might contribute to the resolution of complex legal issues related to bank failures. Deposit protection schemes should have quick access to legal advice and try to avoid unresolved legal issues and disputes, which may lead to delays in the reimbursement of depositors.

## Conclusions

Funds collected from depositors located in other countries where a bank has not established a branch or subsidiary normally are covered by the deposit protection scheme of the bank's home country. Deposits at foreign branches may be protected by

the bank's home-country deposit protection scheme, by the host-country protection scheme, a combination of both schemes, or not protected at all. In the case where protection is provided by both the home- and host-country protection schemes, the home-country scheme may provide basic coverage that is supplemented by the host country. Foreign branches participating in a host-country deposit protection scheme should conform to the membership criteria of the host-country scheme, which may possibly include the application of supervisory requirements on a stand-alone basis. If the host-country scheme provides supplementary coverage, double reimbursement of insured depositors should be avoided. The protection already provided by the home-country scheme should be recognised in the determination of levies and premiums.

In general, information received by safety-net participants in other jurisdictions should be subject to the same strict confidentiality rules applicable to information received by other domestic safety-net participants. Confidentiality rules should comply with international standards. If this is assured, 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 any case, foreign deposit insurers should receive all information necessary to enable a prompt reimbursement of depositors.

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## Endnotes

- <sup>1</sup> This paper represents the work of the Subgroup on Cross-Border and Regional Issues. The Subgroup is comprised of representatives from Germany (coordinator), Canada, Hungary, Mexico and the United States. For the purposes of this paper, the home country is the jurisdiction of the bank's head office; the host country is the jurisdiction where the foreign branch is located.
- <sup>2</sup> The EU minimum requirements for deposit insurance and other regulatory aspects are harmonised and the responsibilities for deposit protection lie primarily with the home country.
- <sup>3</sup> A bank's foreign subsidiary is in general separately chartered, and supervised in the same way as domestic banks. The only differences are that its shareholder is a bank located in a different country and that the parent bank should be subject to consolidated supervision by the parent bank's supervisory authority. For deposit protection purposes, the subsidiary is treated like domestic banks. Cross-border issues arise if the subsidiary has transferred assets and liabilities to foreign jurisdictions or otherwise established business relationships, for example in derivative markets that may produce claims and obligations with counter parties in other countries.
- <sup>4</sup> The EU Directive on Deposit Guarantee Schemes (Directive 94/19/EEC) is available in the Internet under the following address: [http://europa.eu.int/eur-lex/en/lif/dat/1994/en\\_394L0019.html](http://europa.eu.int/eur-lex/en/lif/dat/1994/en_394L0019.html)
- <sup>5</sup> See Annex II (a) of the EU Directive on Deposit-Guarantee Schemes (Directive 94/19/EC).

# II

## Outreach



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# Process

Thirteen outreach sessions and conferences were held around the world. The Working Group held meetings in Switzerland, the United States of America, Mexico, Hungary, Malaysia, Argentina, Italy and Chile. It also provided a number of *fora* for people interested in deposit insurance issues to exchange ideas and benefit from the experience of others. The Group met with over 400 people from over 100 countries. In addition to the presentations by Working Group members, there were over 90 presentations delivered at the conferences and seminars from individuals who were not directly associated with the Working Group.

The format consisted of a two-day Working Group meeting, followed by an outreach session hosted by one of the members and a two-day conference on specific guidance topics. Outreach sessions and conferences were supported financially and otherwise by the Working Group members, other organisations and, in some cases, the Financial Stability Institute (FSI). As well, the Working Group cooperated with a number of the regional development banks.

The remainder of this part contains the list of the activities of the Working Group and the programs for each outreach session, conference and seminar.

# Activities

## 2000

- April 10, 2000 Meeting at the European Bank for Reconstruction and Development (EBRD) with country specialists.
- May 9-12, 2000 Working Group meeting in Basel, outreach session and FSI and FDIC seminar.
- June 5-9, 2000 Working Group meeting in Washington, “brown bag” session at The World Bank and deposit insurance conference organized by The World Bank.
- July 25, 2000 Outreach session at the Inter-American Development Bank
- Oct 2-5, 2000 Working Group meeting in Mexico, including an outreach session with the Inter-American Development Bank and FSI, seminar hosted by Instituto para la Protección al Ahorro Bancario (IPAB) and meeting with Mexican legislators.
- Oct 30, 2000 Tele Seminar at The World Bank – Designing Financial Safety Nets: what have we learned about Deposit Insurance.
- Nov 13-17, 2000 Working Group meeting in Hungary, outreach session with deposit insurers from central and eastern Europe and seminar organized by the FSI.
- Dec 12, 2000 Conference at the Federal Reserve Bank of Chicago.

## 2001

- Jan. 15-19, 2001 Working Group meeting in Kuala Lumpur and seminar organized by the FSI, SEACEN and the Asian Development Bank.
- March 7, 2001 Outreach session in Berlin with countries from European Economic Area and Switzerland.
- March 9, 2001 Presentation at the Fifth OECD Conference on Financial Sector Development in the Central Asian Countries.
- March 13-15, 2001 Working Group meeting in Buenos Aires and outreach session in advance of The Third Symposium on Deposit Insurance organized by Seguro de Depositos Sociedad Anonima (SEDESA).
- April 17-20, 2001 Working Group meeting in Rome and outreach session with African and Middle East countries.
- April 28-30, 2001 Outreach session in Lusaka, Zambia at the First Meeting of Bank Supervisors in the COMESA Region.
- June 18-22, 2001 Working Group Meeting in Santiago, Chile.

# Outreach Sessions

## Basel, Switzerland

### Meeting with Participants at the FSI Seminar for Newly Established Deposit Insurers

May 10, 2000

Meeting Location:  
Meeting Room "B", 1st Floor  
Bank for International Settlements  
Financial Stability Forum  
Centralbahnplatz 2  
CH-4002 Basel  
Switzerland

### Agenda

- Chairman: J.P. Sabourin  
*Chairman, FSF Working Group on Deposit Insurance and  
President and Chief Executive Officer, Canada Deposit Insurance Corporation*
- 2:00 p.m. Call to Order and Welcoming Remarks by the Chairman  
(Mr. Sabourin)
- 2:10 p.m. Presentation on Study Group Report on Deposit Insurance  
(Ms. Cerwinka)
- 2:40 p.m. Working Group on Deposit Insurance  
(Mr. Sabourin)
- 2:45 p.m. Questions
- 3:00 p.m. **Group Discussion** (participants will be given 5 minutes to provide their individual perspectives on important issues for countries wanting to establish effective deposit insurance systems and to provide comments on the subject matter of the type of guidance that could be developed).
- 4:15 p.m. **List of Possible Guidance/Guideline Subjects**  
(Mr. Sabourin)
- 4:30 p.m. Meeting Ends



## Objectives of deposit insurance

- Conditions for establishing deposit insurance and key attributes and important elements of an effective deposit insurance system.
- Recent experiences with deposit insurance and lessons learned.
- Moving from blanket guarantees to limited-coverage deposit insurance.
- Possible areas for further work in developing international guidance.
- Issues for Discussion
- Individual perspectives and issues for newly established deposit insurance systems and those considering establishing a deposit insurance system.

# Establishing a Deposit Insurance System

## *A Seminar for Newly Established Deposit Insurers and Those Considering Establishing a Deposit Insurance System*

May 11-12, 2000

Basel, Switzerland

Financial Stability Institute  
Bank for International Settlements  
Federal Deposit Insurance Corporation

### May 11: *Building a successful deposit insurance system*

*Financial crises around the world have focused attention on the role government should play in ensuring financial-system stability and in providing a safe savings mechanism for small depositors. In response, numerous countries have adopted, or are actively exploring the adoption of, an explicit system of deposit insurance. However, deposit insurance alone cannot provide financial stability or even protect small depositors from loss. Certain political, economic, and legal conditions must be in place for a deposit insurance system to work. The deposit insurer, as well, must have access to information about the condition of the entities it insures, and must be able to take action against those entities on a timely basis. The system must be sustainable—it cannot fail because banks fail. The following workshops will focus on these issues and discuss how deposit insurance can play an integral role in a nation's financial system.*

9:00 - 9:15 a.m.

#### **Welcoming Remarks**

John Heimann, Chairman, Financial Stability Institute

9:15 - 10:45 a.m.

#### **Workshop I: The necessary political and economic steps**

This workshop will discuss the objectives of deposit insurance and outline the political and economic conditions necessary for establishing a successful deposit insurance system to meet those objectives.

##### *Moderator:*

George Hanc, Associate Director, Division of Research and Statistics, Federal Deposit Insurance Corporation (Accepted)

##### *Panelists:*

Carl-Johan Lindgren, Senior Advisor, Systemic Banking Issues Division, International Monetary Fund (Accepted)

Jean Pierre Sabourin, President & CEO, Canada Deposit Insurance Corporation (Accepted)

10:45 - 11:00 a.m.

#### **Coffee Break**

- 11:00 - 12:30 p.m. **Workshop II: Legal infrastructure, independence, and succession planning**
- To create a well-functioning deposit insurance system, the necessary legal structure must be in place and there must be support for the system within the government and the financial community. This workshop will discuss the legal infrastructure and the powers necessary for developing a deposit insurance system. It will explore the issue of independence, including the need for a clear delineation of the roles and responsibilities of the deposit insurer. It also will include a discussion of succession planning—how to sustain a system after the immediate crisis has passed. And, it will discuss the prominent features of a deposit insurance system, including the development of deposit insurance laws and regulations.
- Moderator:*  
William Kroener, General Counsel, Legal Division, Federal Deposit Insurance Corporation (Accepted)
- Panelists:*  
Winston Carr, Chief Executive Officer, Jamaica Deposit Insurance Corporation (Accepted)  
Van B. Jorstad, Associate Director, and Lawrence Connell, Senior Advisor-Budapest, Office of Technical Assistance, U.S. Department of the Treasury (Accepted)
- 12:30 - 2:00 p.m. **Luncheon**
- 2:00 - 3:30 p.m. **Workshop III: Information sharing**
- All deposit insurers, regardless of organizational structure, require access to timely and accurate information to carry out their mandate. This workshop will explore how various deposit insurers have solved the problem of obtaining information necessary to perform their duties.
- Moderator:*  
Christie Sciacca, Associate Director, Division of Supervision, Federal Deposit Insurance Corporation (Accepted)
- Panelists:*  
Ingrid Cerwinka, Assistant General Director, Mexico Deposit Insurance Institute (Accepted)  
Constantinos Liakopoulos, Director, Deposit Guarantee Fund, Greece (Accepted)
- 3:30 - 3:45 p.m. **Coffee Break**
- 3:45 - 5:15 p.m. **Workshop IV: Dealing with troubled financial institutions**
- Troubled financial institutions throughout the world during the 1980s and 1990s created challenges for many financial systems. Governments have utilized a variety of resolution strategies ranging from forbearance to open-bank assistance to liquidation, all with an eye toward maintaining public confidence and financial stability. The question for deposit insurers is when and how the decision to close a bank is reached and what becomes of the failed institution and its assets.

*Moderator:*

Stan Ivie, Assistant Director, Division of Resolutions and Receiverships, Federal Deposit Insurance Corporation (Accepted)

*Panelists:*

Thomas Norling, Administrative Director, Deposit Guarantee Board, Sweden (Accepted)

Guy L. Saint-Pierre, Senior Vice President, Insurance and Risk Assessment, Canada Deposit Insurance Corporation (Accepted)

## May 12: *Basic issues facing a deposit insurance system*

*After necessary preconditions have been met, certain basic issues must be addressed before a deposit insurance system can become operational. Among these issues are deposit insurance coverage and the funding of the deposit insurance system.*

9:00 - 10:30 a.m.

### Workshop V: Coverage

An explicit system of deposit insurance must establish the limits of the coverage to be provided. These limits must be consistent with the objectives of the deposit insurance system. Too much coverage may make the system unsustainable; too little coverage and the system may not meet its objectives. Issues to be discussed in this workshop include: the liabilities to be insured and the extent of the coverage to be provided; problems of transitioning—going from a system of blanket coverage to one of limited coverage; coinsurance; coverage of deposits denominated in a foreign currency; and whether to insure deposits at branches of foreign banks.

*Moderator:*

Claude Rollin, Senior Counsel, Legal Division, Federal Deposit Insurance Corporation (Accepted)

*Panelists:*

Andras Fekete-Gyor, Deputy Managing Director, National Deposit Insurance Fund of Hungary (Accepted)

Roberto Moretti, Managing Director and Giuseppe Vulpes, Director of Research, Fondo Interbancario di Tutela dei Depositi (Accepted)

10:30 - 10:45 a.m.

### Coffee Break

10:45 - 12:15 p.m.

### Workshop VI: Funding

As countries establish systems of explicit deposit insurance they must identify a source of funding. Issues include: whether to establish a fund or rely on a pay-as-you-go system; how much funding is necessary to meet the objectives of the deposit insurance system; how to invest a fund if one is established; and the ability of the deposit insurer to borrow from the government (through back-up lines of credit) or to directly raise funds in the capital markets.

*Moderator:*

Jean Pierre Sabourin, President & CEO, Canada Deposit Insurance Corporation  
(Accepted)

*Panelists:*

Thomas P. Briggs, Senior Advisor, Office of Technical Assistance, U.S.  
Department of the Treasury (Accepted)

Jose Carlos Jaime, Chairman, Seguro de Depositos Sociedad Anonima, Argentina  
(Accepted)

12:15 - 2:00 p.m.

**Luncheon and Concluding Remarks**

John Heimann, Chairman, Financial Stability Institute

# Outreach Sessions

Washington, U.S.A.

## The World Bank “Brown Bag” Session

June 7, 2000

### Agenda

- Chairman: J.P. Sabourin  
*Chairman, FSF Working Group on Deposit Insurance and  
President and Chief Executive Officer, Canada Deposit Insurance Corporation*
- 12:45 p.m. Call to Order and Welcoming Remarks by the Chairman  
(Mr. Sabourin)
- 12:50 p.m. Presentation on Study Group Report on Deposit Insurance  
(Ms. Mathérat)
- 1:15 p.m. Working Group on Deposit Insurance  
(Mr. Sabourin)
- 1:25 p.m. List of Guidance Subjects  
(Mr. Hanc)
- 1:30 p.m. Group Discussion
- 2:30 p.m. Meeting Ends



# Deposit Insurance Conference

June 8-9, 2000

World Bank, MC13-121

## Agenda

### Thursday, June 8

- 9:00 - 10:50 am      **Session I: Facts and Principles**  
*Chair:* Kemal Dervis
- 9:00 - 9:30 am      **Opening remarks: Manuel Conthe**
- 9:30 - 10:50      **Adjusting Financial Safety Nets to Country Circumstances** Edward Kane  
*Discussants:* Geoffrey Miller and Gillian Garcia
- 10:50 - 11:10 am      **Coffee break**
- 11:10 - 12:30 pm      **Session II: Deposit Insurance and Banking Crises**  
*Chair:* Jo Ritzen
- Does Deposit Insurance Increase Banking System Stability? An Empirical Investigation**  
Asli Demirguc-Kunt and Enrica Detragiache  
*Discussant:* Mark Flannery
- Deposit Insurance Design and Bailout Costs**  
John Boyd and Bruce Smith  
*Discussant:* Anthony Santomero
- 12:30 - 2:00 pm      **Lunch**
- 2:00 - 3:20 pm      **Session III: Deposit Insurance and Market Discipline**  
*Chair:* Manuel Conthe
- Market Discipline and Financial Safety Net Design**  
Asli Demirguc-Kunt and Harry Huizinga  
*Discussant:* Randall Kroszner
- Can Emerging Market Bank Regulators Establish Credible Discipline? The Case of Argentina**  
Charles Calomiris  
*Discussants:* Augusto de la Torre and David Scott
- 3:30 - 4:10 pm      **Coffee break**

- 4:10 - 5:30 pm      **Session IV: Deposit Insurance and Market Discipline (con't)**  
*Chair:* Thomas Rose
- Do Depositors Punish Banks for “Bad” Behavior? Market Discipline, Deposit Insurance, and Banking Crises**  
 Maria Soledad Martinez Peria and Sergio Schmukler  
*Discussant:* George Pennacchi
- Deposit Insurance as Private Club: The Case of Germany**  
 Thorsten Beck  
*Discussant:* Haluk Unal

## Friday, June 9

- 10:00 am - 12:30 pm      **Session V: Deposit Insurance and Financial Development**  
*Chair:* Franco Passacantando
- Deposit Insurance and Financial Development**  
 Robert Cull, Lemma Senbet and Marco Sorge  
*Discussant:* Charles Okeahallam
- Evidence of Safety-Net Support for Banks During Economic Development in Canada, the U.K., and the U.S.: A Progress Report**  
 Edward Kane and Berry Wilson  
*Discussant:* Ross Levine
- Quantifying the Cost of Blanket Deposit Insurance and Other *Ex-Post* Rescue Strategies**  
 Patrick Honohan and Daniela Klingebiel  
*Discussant:* Danny Leipziger
- 12:30 - 2:00 pm      **Lunch**
- 2:00 - 4:00 pm      **Session VI: Panel Discussion**  
**What Did We Learn?**  
*Chair:* Jerry Caprio  
*Panel:* Jerry Caprio, Stijn Claessens, Edward Kane, Jose Carlos Jaime, J.P. Sabourin

For more information contact: Asli Demirgüç-Kuntt ([ademirguckunt@worldbank.org](mailto:ademirguckunt@worldbank.org))

# Outreach Sessions

Washington, U.S.A.

## The Inter-American Development Bank

July 25, 2000

### Agenda

- Chairman: J.P. Sabourin  
*Chairman, FSF Working Group on Deposit Insurance and  
President and Chief Executive Officer, Canada Deposit Insurance Corporation*
- 12:45 p.m. Call to Order and Welcoming Remarks by the Chairman  
(Mr. Sabourin)
- 12:50 p.m. Presentation on Study Group Report on Deposit Insurance  
(Mr. LaBrosse)
- 1:15 p.m. Working Group on Deposit Insurance  
(Mr. Sabourin)
- 1:25 p.m. List of Guidance Subjects  
(Mr. Hanc)
- 1:30 p.m. Group Discussion
- 2:30 p.m. Meeting Ends

# Outreach Sessions

## Cancun, Mexico

### Outreach Session

October 4, 2000

### Agenda

Wednesday, October 4, 2000

Chairman:	J.P. Sabourin <i>Chairman, FSF Working Group on Deposit Insurance</i>
9:00 a.m.	<b>Call to Order and Welcoming Remarks by the Chairman</b> (Mr. Sabourin)
9:15 a.m.	<b>Round Table Discussion</b> (participants will be given 5 minutes to provide their individual perspectives on important issues for countries wanting to establish effective deposit insurance systems and to provide comments on the subject matter of the type of guidance that is being developed by the Working Group)
9:45 a.m.	<b>Presentation on Working Group on Deposit Insurance</b> (Mr. Rodrigo Cifuentes)
10:00 a.m.	<b>Public Policy Objectives</b> (Mr. Saint-Pierre and Mr. Carr followed by Roundtable Discussion)
10:45 a.m.	<b>Moral Hazard</b> (Mr. Hanc and Mr. Franke followed by Roundtable Discussion)
11:15 a.m.	<b>Situational Analysis</b> (Mr. Hoelscher and Dr. Jaime followed by Roundtable Discussion)
11:45 p.m.	<b>Transition Issues</b> (Ms. Cerwinka and Mr. Honma followed by Roundtable Discussion)
12:15 p.m.	<b>Q and A Session</b>
3:00 p.m.	<b>Review of Other Sub-group Business Plans</b>
3:30 p.m.	<b>Feedback Session</b>
4:15 p.m.	<b>Chairman's Sum up</b>
4:15 p.m. - 5:00 p.m.	<b>Potential One on One meetings</b>
5:00 p.m.	<b>Meeting ends</b>



## Deposit Insurance Seminar

October 5, 2000

Cancun, Mexico

### Agenda

- 9 a.m. **Welcoming remarks**  
*Julio César Méndez, Chief Executive Officer, IPAB*
- 9:15 a.m. - 11:00 am **I. Panel Topic: Transitioning from Unlimited Coverage to Limited Deposit Guarantee**  
*Moderator: Patricia Armendáriz*  
 Associate Director, Financial Stability Institute, BIS  
*Individual Presentations:*  
 a) **Preconditions; Dealing with an Adverse Economic Environment**  
*Speaker: Rodrigo Cifuentes, Senior Economist Analysis, Banco Central de Chile*  
 b) **Lessons Learned; the Need for a Continuous Improvement Process**  
*Speaker: John Raymond LaBrosse, Adviser to the President and CEO, Canada Deposit Insurance Corporation*  
 c) **Transitioning Gradually: What to Cover and When to Uncover**  
*Speaker: Julio César Méndez, Chief Executive Officer Instituto para la Protección al Ahorro Bancario, Mexico and Daniel Janossy, Managing Director, National Deposit Insurance Fund of Hungary*
- 11 30 a.m. - 1:30 p.m. **II. Panel Topic: Interventions of Financial Institutions: The Role of Deposit Insurers**  
*Moderator: Norberto Nazareno, President, Philippine Deposit Insurance Corporation*  
*Individual Presentations:*  
 a) **Maintaining a Going Concern**  
*Speaker: Adalberto Palma, Member of the Board, Instituto para la Protección al Ahorro Bancario, Mexico*  
 b) **Risk Minimization and Liquidation; What Does Canada Do?**  
*Speaker: Guy Saint-Pierre, Senior Vice President, Insurance and Risk Assessment, Canada Deposit Insurance Corporation*  
 c) **Asset Disposition Methods**  
*Speaker: James Wigand, Deputy Director, Resolution and Receiverships, Federal Deposit Insurance Corporation, USA*
- 2:30 p.m. **Remarks by J.P. Sabourin**  
 President and Chief Executive Officer, Canada Deposit Insurance Corporation

3 p.m. to 5 p.m.

### III. Panel Topic: Funding the Deposit Insurance System

*Moderator:* Edgardo DeMaestri, IADB (TBC)

#### *Individual Presentations:*

##### **a) *Ex-ante* vs. *Ex-post* Systems**

*Speaker:* Udo Franke, Advisor to the Ministry of Finance, Germany

##### **b) Fees: How to Set them and When to Risk-Adjust**

*Speakers:* Winston Carr, Chief Executive Officer Jamaica Deposit Insurance Corporation and Jose Carlos Jaime, Chairman, Seguro de Depositos S.A. Argentina

##### **c) Alternative Funding Sources: the Market**

*Speaker:* Carlos Vara, Chief Financial Office, Instituto para la Proteccion al Ahorro Bancario, Mexico





## Meeting with Mexican Legislators

October 6, 2000

Cancun, Mexico

### Agenda

#### Friday, October 6

- 9:00 a.m.                    **Welcoming Remarks**  
*Julio César Méndez, Chief Executive Officer, Instituto para la Protección al Ahorro Bancario*
- 9:15 a.m.                    **The FSF Working Group on Deposit Insurance and Relevant International Issues**  
*J.P. Sabourin, President and Chief Executive Officer, Canada Deposit Insurance Corporation*
- 9:45 a.m.                    **Interrelation Among Members of the Financial Safety Net: Cooperation and Tension**  
*George Hanc, Associate Director, Federal Deposit Insurance Corporation*
- 10:00 a.m.                   **Discussion on the Previous Topic**  
*Moderator: Humberto Murrieta, Member of the Board, Institute for the Protection of Bank Savings*
- 11:15 a.m.                   **Establishing Bank Fees after a Financial Crisis: The Cost of the Crisis vs. the Cost of Deposit Insurance**  
*Rodrigo Cifuentes, Senior Economist, Banco Central de Chile*
- 11:30                         **Discussion on the Previous Topics**  
*Moderator: Alejandro Creel, Member of the Board, Instituto para la Protección al Ahorro Bancario*
- 12:30 p.m.                   **General Topics**

# Outreach Sessions

Washington, D.C.

## Designing Financial Safety Nets: What Have We Learned on Deposit Insurance?

October 30, 2000

World Bank

Washington, D.C.

### Agenda

Mr. Asli Demirgüç-Kunt	Summary of the findings of the research work and report from the past Conference on Deposit Insurance
Mr. Edward J. Kane	Design and support of Safety Nets, what have we learned?
Q&A Session	Brief illustration of a country case with problems they've faced in designing their system
Presenters	Panel discussion on the case
Mr. J.P. Sabourin	Overview of the FSF Working Group on Deposit Insurance
Q&A Session	
Mr. Asli Demirgüç-Kunt	Closing Remarks

# Outreach Sessions

## Budapest, Hungary

### Round Table Session with Deposit Insurers from Central and Eastern Europe

November 15, 2000

Location:  
Anjou Room  
Budapest Hilton Hotel

### Agenda

Wednesday, November 15, 2000

Host:	Mr. Jánossy, <i>Managing Director, National Deposit Insurance Fund of Hungary</i>
9:00 a.m.	Welcoming Remarks (Mr. Jánossy)  Overview on FSF Working Group on Deposit Insurance (Mr. Sabourin)
9:20 to 11:30 a.m.	Feedback from the CEE deposit insurers on the Working Group Business Plans/Issue Papers. Comments have been requested on the following topics: membership, coverage, funding, reimbursement, public awareness, inter-relationship/information sharing between safety-net players.
9:20-9:35 a.m.	Bulgaria
9:40-9:55 a.m.	Croatia
10:00-10:15 a.m.	Lithuania
10:20-10:35 a.m.	Poland
10:40-10:55 a.m.	Romania
11:00-11:15 a.m.	Slovakia
11:20-11:35 a.m.	Ukraine
2:30 p.m.	Discussion on the Working Group's Business Plans/Issue Papers (moderated by the co-ordinator of the subgroup):

- 2:30 p.m.            **Membership** (Argentina)
- 2:50 p.m.            **Coverage** (Chile)
- 3:10 p.m.            **Funding** (France)
- 3:30 p.m.            **Reimbursement** (Hungary)
- 3:50 p.m.            **Public Awareness** (Jamaica)
- 4:10 p.m.            **Interrelationship/information sharing** (Italy)
- 4:30 p.m.            **Concluding Remarks by Mr. Hanc** (*Chairman of the Research Committee of the Working Group*) and Mr Sabourin
- 5:00 p.m.            **End of the Roundtable Session**
- 6:30 p.m.            **Reception hosted by Ambassador Peter F. Tufo, U. S. Ambassador to Hungary**

## Seminar on Deposit Insurance

15-17 November 15-17, 2000

Hess A. tér 1-3, 1014 Budapest

### Agenda

#### Thursday, November 16

- 09:00 - 09:15 a.m.      **Welcoming remarks**  
 Mr. Daniel Jánossy, *Managing Director, National Deposit Insurance Fund of Hungary.*
- Session 1: Theory and Practice of Successful systems*
- 09:15 - 10:00 a.m.      **Opening Seminar to session 1: “Elements of a Successful Deposit Insurance Organisation”**  
*Speaker:* Ms Ingrid Cerwinka, Instituto para la proteccion al Ahorro Bancario (IPAB), Mexico
- 10:00 - 10:45 a.m.      **Breakout Session: “Deposit Insurance in the Real World: Problems of Implementation”**  
**Public Awareness** (moderated by Mr Winston Carr, Jamaica Deposit Insurance Corporation)  
**Funding** (moderated by Ms Sylvie Mathérat, Commission Bancaire, France)  
**Relationships with other Safety Net Players** (moderated by Mr Alessio De Vincenzo, Banca d’Italia)
- 11:00 - 11:45 a.m.      **Reports from the break-out session** (moderated by Mr George Hanc, Federal Deposit Insurance Corporation (FDIC), USA)
- 11:45 - 12:30 p.m.      **Seminar: “Comparative analysis: The Experience of Latin America and Central and Eastern Europe”**  
*Speaker:* Ms Gillian G. H. García, Consultant
- 12:30 - 14:00 p.m.      **Lunch**  
*Keynote speaker:* Mr Kurt Geiger, Business Group Director, Financial Institutions, European Bank for Reconstruction and Development (EBRD)

**Session 2: Coverage and Pay-out**

- 14:00-14:45 p.m. **Seminar: “Coverage: Theory and Practical Solutions”**  
*Speakers:* Ms Ma?gorzata Iwanicz-Drozdowska, Ms Monika Szymonska,  
 Mr Tomadz Obal, Bank Guarantee Fund of Poland
- 14:45 - 15:45 p.m. **Seminar: “Preconditions and Administration of an Efficient PayOut”**  
*Speakers:* Mr Daniel Jánossy, National Deposit Insurance Fund of Hungary,  
 Mr Wayne Acton, CDIC
- 16:00 - 16:45 p.m. **Breakout Session: “Pay-out experience of Busy Deposit Insurers”**  
*Moderators:* Mrs Rose Casiguran, Philippines Deposit Insurance Corporation,  
 Mr Milan Horvath, Slovak Deposit Protection Fund, Mr Mileti Mladenov,  
 Bulgarian Deposit Insurance Fund
- 16:45 - 17:30 p.m. **Reports from the break out session**  
 Moderated by Mr Wayne Acton, CDIC
- 19:00 p.m. **Dinner**  
*Keynote Speaker:* Mr John G. Heimann, Chairman, FSI

**Friday, November 17****Session 3: Resolution and Liquidation**

- 09:00 - 09:45 a.m. **Opening Seminar to session 3: “Elements of Efficient Resolution”**  
*Speaker:* Mr. Aristóbulo de Juan, Aristóbulo de Juan Asociados
- 09:45 – 11:00 a.m. **Panel: Case studies on Legislative Challenges and Bank Assistance.**  
 Chaired by Mrs. Patricia Armendáriz, FSI  
*Speakers:* Ms Agnieszka Kujda, Bank Guarantee Fund of Poland, Mr Mileti Mladenov, Bulgarian Deposit Insurance Fund, Mr Ihor Yushko, People’s Deputy,  
 Ukrainian Parliamentary Financial and Banking Committee
- 11:15 - 12:45 p.m. **Seminar: “Liquidating a Financial Institution”**  
 Chaired by Mr Jean Pierre Sabourin, President and CEO, CDIC  
**Case Study: “Canada, A Partnership Arrangement”**  
*Speakers:* Mr Wayne Acton, Canada Deposit Insurance Corporation, Mr Frank Brown, Partner, Deloitte & Touche
- 12:45 - 13:15 p.m. **Keynote Closing Remarks:**  
 Mr Jean Pierre Sabourin, Chairman, FSF Working Group on Deposit Insurance
- 13:15 p.m. **End of Program**



# Outreach Sessions

## Chicago, IL

### Designing an Effective Deposit Insurance Structure: An International Perspective

December 12, 2000

Sponsored by:

Financial Stability Forum (<http://www.fsforum.org>) and  
Federal Reserve Bank of Chicago (<http://www.chicagofed.org/>)

Location:

Federal Reserve Bank of Chicago  
230 South LaSalle  
Chicago, Illinois

### *Symposium Announcement:*

On the afternoon of Tuesday, December 12, the Federal Reserve Bank of Chicago and the Working Group on Deposit Insurance of the Financial Stability Forum (Basel) will cosponsor a symposium on deposit insurance:

*“Designing an Effective Deposit Insurance Structure: An International Perspective”*

The symposium is part of the Forum’s outreach program to generate informed feedback on its ongoing research and proposed recommendations on deposit insurance and safety-net provisions. The program presenters are from a number of different countries, providing for an international perspective, and the discussants are all leading financial and banking academics and economists. This should make for an interesting discussion.

A copy of the program is attached, as is a more complete description of the Forum, its mission and activities. Scholars interested in participating in the symposium are invited to contact the sponsors listed below. Admission to the symposium is free, but seating is limited. Please inform Ms. Portia Jackson at the Chicago Federal Reserve Bank by mail, telephone (312-322-5775) or email ([portia.jackson@chi.frb.org](mailto:portia.jackson@chi.frb.org)) if you plan to attend as soon as possible, but no later than December 7, 2000.

Conference proceedings can be downloaded from the following hyperlink:  
[http://www.cdic.ca/international/meetingdocs/Final\\_Version.doc.pdf](http://www.cdic.ca/international/meetingdocs/Final_Version.doc.pdf)

## Agenda

- 12:45 p.m.      **Registration**
- 1:15 p.m.      **Welcoming Remarks**  
*Michael H. Moskow, President, Federal Reserve Bank of Chicago*  
*William C. Hunter, Senior Vice President and Director of Research, Federal Reserve Bank of Chicago*
- 1:30 p.m.      **Keynote Speaker**  
 J.P. Sabourin, President and Chief Executive Officer, Canada Deposit Insurance Corporation, and Chairman, Financial Stability Forum, Working Group on Deposit Insurance
- 1:50 p.m.      **Panel I: Deposit Insurance Objectives and Infrastructure Requirements**  
*Chair: Douglas D. Evanoff, Vice President and Senior Financial Economist, Federal Reserve Bank of Chicago*
- Public Policy Objectives for Deposit Insurance Schemes**  
 Guy Saint-Pierre, Senior Vice President, Canada Deposit Insurance Corporation
- Ensuring a Country's Readiness for Deposit Insurance**  
 Jose Carlos Jaime, Chairman, Seguro de Depositos Sociedad, Argentina
- Discussants: Randall S. Kroszner, University of Chicago, Gordon S. Roberts, York University, Canada, Carl Tannenbaum, First Vice President, ABN Amro*
- 3:15 p.m.      **Coffee Break**
- 3:30 p.m.      **Panel II: Issues in Implementing Deposit Insurance Systems**  
*Chair: John Raymond LaBrosse, Director, International Affairs, Canada Deposit Insurance Corporation*
- Moral Hazard: Is Not Prohibitive and Can Be Contained**  
 George Hanc, Associate Director, Federal Deposit Insurance Corporation
- Transitioning from Blanket Guarantees to Limited Deposit Protection**  
 Carlos Isoard, Member of the Board of Governors, Instituto para la proteccion al Ahorro Bancario
- Discussants: Robert Eisenbeis Federal Reserve Bank of Atlanta, George Kaufman, Loyola University Chicago, George Pennacchi, University of Illinois at Urbana-Champaign*
- 5:00 p.m.      **Panel III: Where Do We Go From Here?**  
*Chair: George Kaufman, Loyola University Chicago*
- What are the Academics Saying?**  
 William C. Hunter, Federal Reserve Bank of Chicago
- What is the Working Group Hearing?**  
 George Hanc, Associate Director, Federal Deposit Insurance Corporation

- 5:20 p.m.                    **Closing Remarks: The Role of the FSF in Promoting Stability**  
Svein Andresen, Head of the Secretariat,  
Financial Stability Forum, Basel
- Rapporteur:                Gillian G.H. Garcia
- Location:                    Federal Reserve Bank of Chicago  
3rd Floor Conference Center  
230 South LaSalle Street  
Chicago, IL 60604-1413
- Conference Organizers: Douglas D. Evanoff  
William C. Hunter  
George G. Kaufman  
John Raymond LaBrosse

## Conference Background:

The Financial Stability Forum (FSF) was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. It seeks to coordinate the efforts of various bodies in order to promote international financial stability, improve the functioning of markets, and reduce systemic risk. A study group was created a year ago to examine the contribution that deposit insurance can make to financial stability. The study group became a FSF working group in April of this year. Together with the Federal Reserve Bank of Chicago, the working group will hold a conference in Chicago on December 12, 2000.

Working group members includes experts on deposit insurance from twelve countries,<sup>1</sup> the International Monetary Fund and the World Bank. Recently the group has begun a series of outreach meetings in different regions of the world with people and organizations interested in deposit insurance issues. The December meeting will include academic experts on deposit insurance. In Chicago, members of the working group will present their current thinking which will focus on (1) the public policy objectives for deposit insurance, (2) moral hazard, (3) ensuring a country's readiness for deposit insurance and (4) the transition from blanket coverage to limited protection.

The working group wants to benefit from a discussion of these issues with the academic community. Such input will facilitate the preparation of the guidance on deposit insurance that the working group that will be delivering to the FSF in September 2001.

Additional information on the FSF Working Group on Deposit Insurance can be found at <http://www.cdic.ca/international>

<sup>1</sup> Including Argentina, Canada, Chile, France, Germany, Hungary, Italy, Jamaica, Japan, Mexico, the Philippines, and the United States of America

## *Conference Proceedings*

# Designing an Effective Deposit Insurance Structure: An International Perspective

Prepared by:  
Gillian G. H. Garcia

February 2001

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Executive Summary

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Panel I: Deposit Insurance Objectives and Infrastructure Requirements

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Gregory Cowper for Guy Saint-Pierre  
Jose Carlos Jaime  
Randall S. Kroszner  
Robert Bliss for Gordon S. Roberts  
Carl Tannenbaum

Panel II: Issues in Implementing Deposit Insurance Systems

John Raymond LaBrosse, Chair  
George Hanc  
Carlos Isoard  
Robert A. Eisenbeis  
George G. Kaufman  
George G. Pennacchi

Panel III: Where Do We Go From Here?

George G. Kaufman, Chair  
William C. Hunter/Douglas D. Evanoff  
George Hanc

Closing Remarks

Svein Andresen and Pierre Cailleteau  
William C. Hunter

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- I: Conference Program
- II: Bibliographical Notes on Speakers
- III: List of Conference Participants

## Foreword

A distinguished group of deposit insurance practitioners, academics, and bankers came together at the Federal Reserve Bank of Chicago on December 12, 2000 to provide an international perspective on the design of an effective deposit insurance structure. The conference, organized by Douglas D. Evanoff, William C. Hunter, George G. Kaufman, and John Raymond LaBrosse, was sponsored jointly by the Federal Reserve Bank of Chicago and the Financial Stability Forum.

The Financial Stability Forum (FSF) established a Working Group on Deposit Insurance (WGDI) that is charged with setting out guidance on deposit insurance for countries that are considering the initiation or reform of a system of depositor protection. The sixteen-member group consists of the Chairman, Mr. Jean Pierre Sabourin, and representatives from 12 member countries (Argentina, Canada, Chile, France, Germany, Hungary, Italy, Jamaica, Japan, Mexico, the Philippines, and the United States) and from the Financial Stability Forum, the International Monetary Fund and The World Bank. In order to develop guidance the group has held a number of internal meetings and is in the process of reaching out, on a regional basis, to groups of deposit insurance practitioners, incipient practitioners, and other interested parties around the world.

This conference provided an opportunity for academics and practitioners to discuss guidance that will improve the design of new systems of deposit protection and the reform of existing systems. The dialog was valuable and will be continued.

The author thanks Professors Kaufman, Kroszner, Pennacchi, and Roberts, and Messrs. Andresen, Bliss, Cailleteau, Diz (for Dr. Jaime), Eisenbeis, Evanoff, Hanc, Isoard, and LaBrosse for their comments on a draft of this report, which helped to ensure a faithful reporting of the proceedings.

A video recording of the conference is available on the worldwide web at <http://www.cdic.ca/international/meetingdocs.cfm?Id=44&conf=conf>. Scroll to the bottom of the screen to view the video.

## Executive Summary

The conference brought together practitioners of deposit insurance who were also members of the Working Group on Deposit Insurance (WGDI) of the Financial Stability Forum (FSF) and a distinguished panel of academic, regulatory and industry discussants. The WGDI presented four draft issue papers that it regards as crucial to the determination of the guidance that it had committed to offer to the FSF by late summer 2001 to aid countries that were considering initiating or revising a system of deposit protection. The papers discussed (1) public policy objectives for deposit insurance, (2) situational analysis of a country's readiness for deposit insurance, (3) options for containing moral hazard, and (4) issues relating to the transition from blanket guarantees to limited coverage.

In their comments, the discussants lauded the WGDI on its willingness to take on an important, but extremely complex, subject. The discussants noted that the development of guidance on deposit insurance was made more difficult by the many tradeoffs involved and by the interface between related economic and political constraints. The discussants complimented the presenters on their comprehensive listing of relevant issues in each of the four papers, but particularly in the paper on identifying deposit insurance objectives and the one on options for containing moral hazard.

The discussants made a number of suggestions for improving the papers. First, several panel members questioned the WGDI's interpretation of two aspects of its mandate. First, the Working Group stated that it did not intend to set standards or develop best practices. It asserted that each country's circumstances were unique and that countries must choose their own path toward setting and achieving their deposit insurance objectives. Messrs. Eisenbeis and Evanoff disagreed and suggested that the WGDI needed to do more than offer a list of alternatives for countries to choose from at will. Instead, more specific guidance was needed in the form of a blueprint for one or more integrated deposit insurance systems.

In addition, Mr. Eisenbeis and Professor Roberts, through Mr. Bliss, were concerned about the charge that the Working Group was working under—to give guidance only on how to fashion an explicit system of deposit insurance. The three discussants considered that it was essential to ask first whether explicit coverage was optimal and to question whether implicit insurance would be preferable when necessary preconditions for successful explicit coverage had not been met.<sup>1</sup>

Messrs. Eisenbeis, Evanoff, and Hunter, and Professors Kaufman, Kroszner, and Pennacchi observed that the Working Group's recommendations were very general and they urged it to give more emphasis to concrete and definitive advice so that those putting a deposit insurance system in place would know specifically what features might suit their country's needs. Messrs. Eisenbeis and Evanoff also called on the group to identify the key elements that would guide a country in selecting among the many paths to deposit protection that were available. Professor Kaufman observed that giving specific advice would become easier if it were grounded more on academic research, both theoretical and empirical. Professors Kroszner and Roberts and Messrs. Bliss and Evanoff agreed with Professor Kaufman that the WGDI needed to pay more attention to previous research findings on deposit insurance.

Professors Kaufman, Kroszner, Pennacchi and Roberts and Messrs. Bliss and Tannenbaum called on the Working Group to give greater emphasis to private market forces in disciplining the markets and replacing the government's role in achieving the objectives attributed to deposit insurance, particularly in protecting small depositors and promoting financial stability.



A number of discussants referred to the political dimensions of making choices on deposit insurance objectives and design. Messrs. Eisenbeis and Tannenbaum cautioned country authorities not to overreach in setting objectives for deposit protection and suggested that the Working Group could usefully give guidance on the advisability of selecting certain objectives and the feasibility of achieving them. Professor Kaufman noted that time inconsistency was a problem in that politicians could readily foresee the short-term advantages to deposit insurance while overlooking its longer run pitfalls. Both Mr. Bliss and Professor Roberts (in his prepared remarks) noted that decisions on deposit insurance could be path-dependent, i.e. the right choice might depend on the starting position.

Conference participants felt that the exchange of views between practitioners and academics had been worthwhile and should continue.

## Welcoming Remarks

The President of the Federal Reserve Bank of Chicago, Michael H. Moskow, welcomed conference participants, on behalf of the Chicago Fed and its co-sponsor, the Financial Stability Forum, and thanked them for braving the notorious Chicago weather. He said that, despite the snow, there were good reasons for holding the conference in Chicago. The city, he noted, was home of many of the world's top analysts and researchers in finance and banking issues and a number of them were attending the conference. They would give cutting edge critiques of the four issue papers being presented by the WGDI. These papers discussed (1) public policy objectives for deposit insurance, (2) ensuring a country's readiness for deposit insurance ("situational analysis"), (3) options for containing moral hazard, and (4) issues associated with transitioning from blanket guarantees to limited coverage.

Mr. Moskow observed that the FSF's mandate—to support cooperation and information exchange among countries in order to foster international financial stability, improve the functioning of markets and reduce systemic risk—paralleled in a number of ways the objectives of the Federal Reserve at the domestic level. He said that the conference was consistent with the Chicago Fed's wish to fulfill its own mandate by seeking feedback from its customers and stakeholders in order to increase its customer focus. In this quest, it understood the importance of learning from experts in order to achieve its goals.

Mr. Moskow then introduced Mr. J. P. Sabourin, who, he said, had led the Canada Deposit Insurance Corporation since 1990. He noted that the CDIC insured over \$315 billion in deposits at 109 member institutions and observed that Mr. Sabourin had unparalleled expertise in resolving claims and international deposit insurance issues and had helped to establish the deposit insurance systems in Hungary in 1993 and Jamaica in 1998. He had also advised the deposit insurance systems in Taiwan and the Philippines. Hoping to capitalize on his expertise, the FSF had asked Mr. Sabourin to assemble and chair the Working Group on Deposit Insurance.

## Keynote Speaker

**Mr. J. P. Sabourin, President** and Chief Executive Officer of the Canada Deposit Insurance Corporation (CDIC) and Chairman of the Financial Stability Forum's Working Group on Deposit Insurance, gave the keynote address. He began by thanking the Federal Reserve Bank of Chicago for hosting the conference and his colleagues from the Working Group who had traveled from around the world to participate in the event. This conference, he said, provided an important opportunity for a dialogue between deposit insurance practitioners and those in the academic community who had given considerable thought to deposit insurance issues.

The Working Group's Chairman said that the Asian crisis and Russian meltdown had emphasized the interdependence of financial markets around the world and had removed any doubts about the need for global mechanisms to foster financial stability. While globalization had been driven by the private sector, there was a role for the public sector to ensure that economic growth was durable and stable. In response, the G7 finance ministers and central bankers had established the Financial Stability Forum in February 1999. Among its other activities, the FSF set up a Study Group on Deposit Insurance in November 1999. That Group was now the Working Group on Deposit Insurance, which included deposit insurers, central bankers, and supervisors from 12 countries, plus representatives of the FSF, IMF and World Bank.

Mr. Sabourin stated that, while the group was charged with developing practical guidance on deposit insurance, it would *not* set standards or best practices to be imposed on emerging markets nor would it question whether a country should initiate a system of deposit insurance—"that was for others to decide." He observed that the group's goal was to provide guidance to newly established systems and to act as a clearinghouse for information, viewpoints, experiences, and lessons learned. The group had held meetings for its members and, through the European Bank for Reconstruction and Development, the Inter-American Development Bank, the Financial Stability Institute, and the Bank for International Settlements, it had also held outreach sessions attended by over 200 senior executives from more than 95 countries. The group's research team, headed by George Hanc of the FDIC, planned to write 16 issue papers on guidance topics. Four of the issue papers were on the conference agenda and were open to public comment.<sup>2</sup> While guidance would be developed by August 2001, deposit insurers, no doubt, would continue to meet afterwards, to exchange ideas and experiences, and to face new challenges.

Mr. Sabourin regretted the separation between the academic world concerned with theoretical, long-term issues facing countries with sophisticated markets operating in a developed framework and the imperfect world facing deposit insurance practitioners. He invited the academic community to look again at what is actually happening in countries around the world and he called on practitioners to learn from those who had studied financial systems and safety nets. Mr. Sabourin said that he looked forward to hearing academic views on containing moral hazard, the rationale behind the issuance of subordinated debt, designing risk-based premiums, and funding deposit insurance coverage. He also anticipated hearing recommendations to consider market value accounting and minimize reliance on the safety net. He called for additional academic research that would help developing countries contain moral hazard, provide an analytical and an empirical base for setting risk-based insurance premiums, and choose among their funding options.

## Panel I: Deposit Insurance Objectives and Infrastructure Requirements

The panel was moderated by [Mr. Douglas Evanoff](#), Vice President and Senior Financial Economist at the Federal Reserve Bank of Chicago. Mr. Evanoff introduced the paper-presenters: CDIC's Mr. Gregory Cowper (standing in for Mr. Guy Saint-Pierre, who was prevented from attending the conference by a blizzard), and Dr. José Carlos Jaime, Chairman of Argentina's Seguro de Depositos Sociedad Anonima. Mr. Evanoff also introduced the discussants: Professor Randall S. Kroszner of the University of Chicago, Mr. Robert Bliss of the Federal Reserve Bank of Chicago, who was standing in for another blizzard absentee—Professor Gordon S. Roberts of York University— and Mr. Carl Tannenbaum, the Director of Treasury Research at ABN AMRO Bank in North America.

The presentation delivered by [Mr. Cowper](#) on behalf of Mr. [Saint-Pierre](#), closely followed the WGDI's issue paper on deposit insurance objectives.<sup>3</sup> Mr. Cowper stated that the paper is still very much work in progress. It sought to determine what were countries' objectives, whether they were expressed explicitly, what processes were used to determine those objectives, how the chosen objectives had affected the design of countries' systems, what tradeoffs existed among objectives, and whether some goals could be accomplished more readily than others. The subgroup, consisting of officials from Canada, Jamaica, the Philippines, and the IMF, had first conducted a review of relevant literature and had also studied materials submitted to it by Working Group members and others interested in deposit insurance issues.

The Working Group had divided the many surveyed objectives for deposit insurance systems into three groups: (1) those that promoted financial stability, (2) those that protected the small depositor, and (3) a collection of additional objectives. Objectives that favor financial stability included creating formal mechanisms for resolving failed banks,

contributing to an orderly payment system, and avoiding or resolving a financial crisis. The team allocated such objectives as enhancing competition, increasing banks' contributions toward covering the cost of bank failures, replacing a blanket guarantee by limited coverage, facilitating the enactment of needed financial legislation, encouraging economic growth, and reducing the impact of a recession to the catch-all group of "other objectives."

So far, the team working on this issue paper had concluded that public policy objectives varied according to a country's national goals and circumstances. The team had perceived that objectives influence the design of a deposit insurance scheme and that the goals chosen must harmonize with the structure of the deposit insurance system. He said that, in a changing environment, many countries periodically reviewed the objectives set for their system. The team recommended that policymakers identify the public-policy objectives for the scheme before designing it. The subgroup believed that public policy objectives must address a country's needs and conditions and that the structure chosen must be consistent with its goals. In practice, Mr. Cowper said, policymakers in each country should present their objectives in a policy paper, and periodically review the objectives and structure of the deposit insurance system.

[Dr. José Carlos Jaime](#), spoke on, "Ensuring a Country's Readiness for Deposit Insurance" provided interesting supplementary insights into the issues raised in the Working Group's paper on "Situational Analysis". Dr. Jaime started from the premise that a state had already decided to establish an explicit and limited system of deposit insurance. That system must then function as an integral part of the financial safety net, which the speaker characterized typically as a triangle consisting of three agencies—the supervisor, the deposit insurer and the lender of last resort.

Dr. Jaime noted that deposit insurance could definitely *not* prevent the spread of systemic risk. However, it could prevent spillover from an isolated bank failure to the rest of the financial system.

That action, he said, involved a cost that, under modern legislation, would be paid for by the members and users of the financial system. The supervisor could reduce that cost by taking prompt action to detect and remedy problems in the banking system.

Permissive action by the lender of last resort could harm the deposit insurance fund, said Dr. Jaime. A troubled bank requesting lender-of-last-resort assistance would give its best assets as collateral for this assistance, which would go to benefit the weak bank's most restless depositors—those who were not guaranteed and thus sought to withdraw their funds. Such action would increase the final cost to the insurer. Dr. Jaime set out how each of the three components of the financial safety net should behave. The lender of last resort should (1) limit spillover by lending funds that would be quickly recovered because they were paid only to illiquid but solvent banks, (2) provide assistance without expanding the monetary base, and (3) have an asset base that enabled it to sterilize assistance. He stated that, despite popular belief, even central banks in countries with a currency board were able to act as lenders of last resort if they had the appropriate assets on their balance sheets.

The speaker observed that the supervisor required a legal/prudential framework that strengthened banks' solvency and liquidity without hindering the work of markets. Thus, the Basel Committee's Core Principles must be followed. In practice, the supervisor must be preventive and do more than just monitor *ex post* compliance with prudential regulations. The deposit insurer protected insured depositors when a bank failed so there should be no excuse for delayed supervisory action. No banker should benefit from, or be protected during, the winding up of his bank. Resolutions that in fact covered all liabilities at a "too-big-to-fail" bank violated this principle and led to ambiguity that was in no way constructive. Such resolutions also raised costs to the surviving banks.

A sound government budget, absence of inflation, strong supervision, and politicians who did not

meddle were all prerequisites for the establishment of a system of deposit insurance and for the better functioning of the financial system. Further, the safety net needed to function as a virtuous triangle with its three components acting in harmony.

In its turn, the deposit insurer should resolve problem banks with a minimum commitment of funds and a maximum recovery of those expended. Moreover, the deposit insurer should not act as payer of last resort to the lender of last resort.

**Mr. Carl Tannenbaum** of ABN AMRO (a large, Dutch, international bank holding company) spoke first for the discussants. In introducing him, Mr. Evanoff pointed out that Mr. Tannenbaum was the only practicing banker on the program—his bank paid deposit insurance premiums and footed the bill for others' mistakes. Mr. Tannenbaum said that, while he was aware that there were alternatives to deposit insurance, he nevertheless was supportive of its aims to stabilize markets and assure the interests of small depositors. From a banker's perspective, it reduced volatility, lowered the cost of capital, and built a stronger currency. He regretted, however, that private suppliers of deposit protection had insufficient funds and credibility to take over the government's role.

Mr. Tannenbaum doubted the ability of deposit insurance to achieve the objectives attributed to it in the paper on public policy objectives. Achieving financial stability, for example, would require 100 percent coverage, because the flight of large pools of uninsured money would be destabilizing. There was a danger that protection would extend beyond banks—for example, even commercial firms might be backstopped by the deposit insurance system under Holland's universal banking system. One impediment to deposit insurance's success was poor processing of information. Here he stressed the role that private rating agencies for banks played in providing information to the markets and the sophisticated public in the United States.

Mr. Tannenbaum observed that reliance on supervision, regulation, capital requirements, and disclosure to thwart moral hazard, as recommended

in the issue paper on moral hazard, raised banks' cost of capital, especially where there were multiple regulators, as in the United States. Moreover, supervisors needed information, skills, and salaries commensurate with that paid by the banks they supervised. He would have preferred to see greater reliance placed in the paper on risk-adjusted premiums. Where banks faced flat-rate premiums they dangerously choose risky assets that earned enough to cover the premiums. He considered that having supervisors require banks to hold subordinated debt instruments, another possibility raised in the paper, was an unwarranted intrusion on banks' ability to determine their own capital structure. Mr. Tannenbaum spoke in opposition to capping the amount of money that could be held in a deposit insurance fund, especially where zero premiums were charged once the fund had hit its target.

**Professor Kroszner** spoke as the next discussant. He noted that the papers contained good ideas, but that they were very general and would *not* provide sufficient guidance to countries wishing to institute or revise a system of deposit protection. Recommending that staff revising the papers should make them more specific and concrete, he developed four topics that he thought could enhance the papers. The first topic examined the interrelationship between a deposit insurance system and financial stability. The second topic concerned the avoidance, in the first place, of bank failures that required the deposit insurer to intervene. The third emphasized the importance of liquidity while the fourth examined constraints on deposit insurance design and implementation that derived from political economy.

Professor Kroszner observed that more private market discipline was the answer to the first two questions. Private insurers, for example, typically work toward reducing risk *ex ante*. For example, customers who installed sprinklers paid a reduced rate for fire insurance. He said that the two issue papers in Panel I discussed supervision and regulation extensively, but needed to pay more attention

to discipline from the private markets. In this context, his research on corporate governance and liability structures was relevant, showing how market discipline could be encouraged. Boards of Directors of banks in the United States had more outside members than the Boards of other firms, which encouraged input from the markets. He called for an incentive structure that would make Board members more responsible for their bank's performance. The Boards of large banks in Japan, and particularly in Germany, had more members than those in the United States and they had fewer inside directors, which also fostered greater market discipline.

He noted that, with regard to closing failed banks, the banking system needed to continue to provide liquidity and transmit payments despite closures. History in the United States had demonstrated that closure policies must not impair market liquidity. The financial crisis in the United States in 1907, for example, was less serious than that in 1933 because the bank holiday in 1907 was only partial—bank customers could continue to conduct some transactions and checks cleared. In 1933, however, in some states the entire banking system, including both good and bad banks, was completely shut down. For depositors and the state of the economy, however, prompt recovery of depositors' funds was *always* a key issue.

Professor Kroszner also recommended that any revision of the papers pay more attention to issues of political economy. Political pressures from favored groups could impair the design of a deposit insurance system and thwart the implementation of even a well-designed system. Above all, the papers needed to be more concrete and specific.

**Mr. Robert Bliss** delivered **Professor Gordon Robert's** presentation because the latter was trapped in Toronto by the blizzard. He began with a medical analogy—deposit insurance, like medical treatment, could have unintended consequences. But at least the deposit insurer (the doctor in the analogy) should do no harm. He likened explicit deposit



insurance to mainstream medicine, implicit guarantees to alternative medicine, market discipline to natural healing, and forbearance to faith healing.

Mr. Bliss noted that the first issue paper laid out public policy objectives very well. The two papers' stated mandate to provide guidance on deposit insurance immediately raised a question as to whether implicit insurance might sometimes be optimal and referred to Professor Edward Kane's suggestion that the ambiguity associated with implicit coverage increased market discipline. He also pointed to The World Bank's research on implicit coverage and the success of Canada's implicit guarantees during the Great Depression. He asked whether introducing deposit insurance in some circumstances—for example, where legal, regulatory and accounting systems were underdeveloped—could do more harm than good. He raised the issue of minimum necessary standards for the legal, accounting and supervisory framework before deposit insurance could be effective. He pointed to 's empirical findings that lower coverage limits, coinsurance, private involvement in funding and management, and covering foreign deposits, appeared to improve market discipline. Lastly, he suggested that subsequent versions of the papers pay more attention to market discipline and to implicit guarantees.

In their responses to the discussants' comments, Mr. Cowper observed that the Working Group's mandate confined it to studying explicit systems of deposit protection and Dr. Jaime referred to his country, Argentina, as a long-term “laboratory” for deposit insurance experiments.

**In the question and answer period**, Professor Thomas Mondschean of De Paul University observed that the papers neglected questions relating to insuring state-owned banks and pointed to difficulties experienced by Poland in resolving this issue. Mr. Sabourin responded that issues relating to state-owned banks would be covered in a later paper. Another questioner pointed to the difficulties experienced by Hong Kong, Malaysia and Thailand when Japan withdrew the funds it had

lent to these and other countries and on which they relied. In response, Mr. Sabourin stated that the issue of insuring foreign banks was, in fact, dealt with in the situational analysis paper.

Mr. Tannenbaum pointed to a lack of enthusiasm by the Federal Reserve for his branch bank's contingency plans to support its Dutch parent during the recent period of market instability. Mr. Eisenbeis called for an examination of the key elements that would lead a country to chose one path for deposit protection rather than another. He expressed some frustration with the statement that the Working Group's mandate confined it to giving guidance only on explicit systems of deposit protection and prevented it from examining the alternatives. He said that this was like advising someone, who had declared his intention to commit suicide, how best to hold the gun. At this, the moderator said it was time for the coffee break!

## Panel II: Issues in Implementing Deposit Insurance Systems

**Mr. John Raymond LaBrosse**, moderator of Panel II and Director of International Affairs at CDIC, provided the context for the next two papers that were discussed. He observed that the Working Group looked forward to receiving input from the academic community on the day's papers, which were important because they addressed the four main policy issues facing deposit insurers. He complimented the next speaker—Mr. George Hanc, Associate Director at the U.S. Federal Deposit Insurance Corporation (FDIC)—on leading the Working Group's research effort. He also introduced Carlos Isoard, Member of the Board of Directors of Mexico's Instituto para la Proteccion al Ahorro Bancario (IPAB); and the three discussants—Dr. Robert Eisenbeis, Director of Research at the Federal Reserve Bank of Atlanta; Professor George Kaufman of Loyola University Chicago; and Professor George Pennacchi of the University of Illinois at Urbana-Champaign.

Mr. Hanc's presentation closely followed the options available for controlling moral hazard that were laid out in the issue paper written by the subgroup composed of officials from Chile, France, Germany, Italy, Japan, the United States and . He stated that, although moral hazard was inherent in deposit insurance, the subgroup was resisting the temptation to give advice because the choices might be "country specific." He then referred to three general strands of discipline to mitigate moral hazard—internal governance, market discipline and supervision/regulation. He pointed out that none of these strands could be achieved easily. Good corporate governance with strong internal controls and incentive structures for controlling risk, for example, might require supervisory oversight/encouragement.

The speaker said that market discipline could be encouraged by a number of measures, including coverage limits, the exclusion of certain instruments from coverage, coinsurance, mandatory subordinated debt requirements, and depositor preference. To be successful, market discipline required good information, adequate disclosure, sophisticated recipients, uniform application of rules, and supervisors and deposit insurers who responded to market signals.

Mr. Hanc observed that many countries relied principally on regulation and supervision, despite their intrusive nature, to contain moral hazard but that successful reliance required human and technical resources, legal authorities, incentives, and supervisory cooperation that were often lacking. Risk-based premiums, minimum capital requirements, prompt corrective action, legal action against those responsible for failures, and personal liability for bank officials could provide good incentives for both bankers and supervisors to keep the financial system sound. He noted that unlimited liability facing private banks in Germany restrained moral hazard in that country.

Mr. Carlos Isoard's presentation illustrated an interesting supplement to the discussion in the issue paper on transitioning from blanket to limited

coverage with particular reference to the experience of Mexico. The issue paper had been written by a subgroup that consisted of officials from Hungary, Japan, Mexico, and the IMF and which had received written submissions from Finland, Korea, and Sweden. He observed that transition issues were country-specific and involved many tradeoffs. He discussed a number of questions raised by the transition (public policy objectives, the regulatory framework, institutional arrangements, membership, coverage, funding, public awareness, timing, and corporate governance). For example, he said that Mexico explicitly included increasing public confidence as an *objective* of the new deposit protection system. The regulatory and supervisory framework needed for the transition should be transparent and embodied in law. In making institutional arrangements, he said, policy-makers needed to decide whether to retain existing institutions or establish new ones, how institutions would exchange information and cooperate and whether the system should be publicly or privately managed. In Mexico, Mr. Isoard said that IPAB would insure deposits, resolve failed banks, design and implement programs to sell assets, and actively manage its liabilities. It would be one of five components of the Mexican safety net that also includes the Ministry of Finance as the regulator, a supervisor (the National Banking and Securities Commission or CNBV), the central bank, and the National Commission for the Defense of Financial Service Users.

Mr. Isoard said that new capital rules would be fully in force in Mexico by the year 2003 and were timed to rise as insurance coverage fell. It was important, he noted, for the deposit insurance system to have mandatory membership at least during the transition—membership was compulsory for commercial banks in Mexico. He recommended that countries in transition reduce coverage gradually to a limit that had been specified earlier. Mexico aimed to reach its limit (which would be the same as that in the United States) by the beginning of 2005.

Mr. Isoard said that the choice between a system of *ex ante* and *ex post* funding would give rise to different transition issues. Mexico had chosen *ex ante* funding with contributions from banks paying flat fees, funds from the government's budget, proceeds from asset sales and from issuing debt. He observed that Mexico was conducting a public awareness campaign based on "openness and transparency." In general, a transition could be put on a fast track or a slow one—a choice that would depend on circumstances. Mexico had chosen a defined but relatively slow track. The country would limit the use of discretionary powers to adjust the declared timing in order to ensure credibility. Finally, Mexico had decided to improve corporate governance by ensuring that four of IPAB's seven-member Board of Directors were independent.

**Dr. Robert Eisenbeis** complimented Mr. Hanc on providing a comprehensive list of remedies to combat moral hazard. He also observed that some of the other presenters had provided additional and interesting material in their presentations to supplement the issue papers. He noted that the papers presumed that countries should provide deposit insurance rather than first asking whether there was not a minimal set of preconditions that should be in place before deposit insurance was considered. In particular, he would have preferred to see more emphasis placed on the need for an adequate infrastructure before deposit insurance was initiated. That infrastructure would include capital markets to impose discipline, a sound and certain legal system to reduce uncertainties over claims, a well-defined closure rule, an absence of government-owned banks, and an agency to regulate and insure deposits that is separate from the central bank and the ministry of finance.

Mr. Eisenbeis asked what deposit insurance was designed to accomplish. He doubted that it could achieve many of the goals listed by the previous panel. He observed that protecting small depositors had merit but it would not remove the principal causes of financial crises—misguided fiscal policies, runaway inflation, and/or foreign borrowing to stimulate economic growth. Moreover, he thought

it unnecessary to offer the public a risk-free asset by guaranteeing certain private-sector liabilities in a developed economy because it damaged the incentive structure. Neither did it make sense, he said, to offer deposit insurance in a developing country that lacked credibility. Instead, deposit insurance put the government on the hook for bad policies and encouraged forbearance. He maintained that the legitimate goals for deposit insurance were to make failures isolated events, to protect taxpayers and eliminate forbearance.

Mr. Eisenbeis then turned to the options listed in the moral hazard paper and asked which of them were consistent with the goals that he had identified. He observed that the issue paper offered a menu of deposit insurance features but provided little guidance on which features were substitutes and which were compliments. In this sense, it was like offering a box of parts to someone who wanted to build a car, but leaving out the assembly instructions. He offered the observation that deposit protection, when not properly priced, interferes with the market discipline that is needed to control risk-taking. Important questions, not raised in the issue paper, were what kind of discipline would be effective and how much discipline would be needed? He answered these questions by suggesting, first, that supervisors should charge banks for determining the true value of their activities so that they would voluntarily provide more realistic information. Second, he recommended that the deposit insurance agency itself, not the supervisor, be put in charge of risk monitoring and closure. There were few examples where organizations bearing risk delegate monitoring of that risk to someone else. He did not find risk-based premiums to be an effective counter to moral hazard, at least as they were currently constructed in the United States. Third, he argued that a properly implemented system of early intervention and corrective action would contain moral hazard but it would also make deposit protection unnecessary because (except in cases of fraud, measurement error, or forbearance) only equity holders would lose funds.

**Professor Kaufman** said that he enjoyed the papers but wished that they had made stronger, bolder recommendations. He advised the authors to rely more on the literature and less on anecdotes, myths, and intuition. He noted that deposit insurance had a problem of time inconsistency. Its short-term advantages made it politically popular, while its long-term disadvantages tended to be overlooked. He asked whether the WGDI were dispensing political advice, economic advice or possibly both. He asserted also that some failures among inefficient or unlucky banks were necessary and runs were not necessarily a disaster—the papers should make that clear.

He observed that moral hazard was *not* inherent in deposit insurance. He identified two types of moral hazard—excessive risk-taking by banks caused by under-pricing insurance coverage and by regulatory delay in resolving failed banks due to the well-known principal-agent problem of supervisors failing in their duty to protect the public interest. He advocated higher capital for banks and expressed dismay over the issue paper’s concern that capital requirements could be set too high. He recommended that the authorities increase reserve requirements, which are easy to monitor, in some countries as an antidote to moral hazard facilitated by weak accounting systems that made observing solvency difficult.

Professor Kaufman noted that economists were notoriously bad at handling questions that relate to transitioning from one position to another. He said that he had enjoyed the transition paper, but believed that it needed to justify the expressed preference for gradual transition and to present more details on the proper sequencing of the steps. He also called for more care in the papers’ use of technical terms. He concluded by asking why a blanket guarantee was always taken to be the answer in a crisis.

**Professor Pennacchi** said that he appreciated the opportunity to discuss the papers, which provided some sensible guidelines. He proposed to focus on

certain issues that he considered needed greater emphasis. He described how the financial safety net could be contained by placing less emphasis on restricting bank liabilities and more on controlling insured banks’ assets. For example, even a universal bank could pledge high quality assets to protect insured deposits against loss. Similarly, a financial holding company could restrict insured deposit taking to a subsidiary that held transparent assets. These asset constraints would eliminate the need for deposit protection. Then depositors could self-select by placing their funds in a transparent subsidiary if they wanted safety. He wondered also whether designing the bank structure to rely more on private covenants could lead to less intrusive regulation. He noted that coverage limits could disadvantage a retirement fund that pooled the retirement funds of financially unsophisticated workers, such as a community of nuns, if the group were not otherwise accommodated.

Professor Pennacchi supported the issue paper’s preference for making a transition gradual. He recommended that the pace of coverage reduction be made to coincide with improvements in the markets’ and the supervisors’ abilities to assess and monitor risks. He cautioned against setting a target for the deposit insurance fund that would drive the level at which premiums were set. The size of the fund reflected past mistakes, whereas premiums should be set to reflect future losses. He hoped that the private markets would take over part of the responsibility for insuring deposits and noted that coverage for deposits above the \$100,000 insurance limit was already available from the private markets in the United States.

**In the question and answer period**, Mr. Jack Tatom raised two issues. First, he opposed the proposal for a gradual removal of a blanket guarantee. He was concerned that a slow transition, in the continued presence of insolvent or weak banks, would provide additional opportunities for incurring losses. He asked whether granting full coverage in the first place were ever optimal. He considered it inadvisable to guarantee banks’ continued existence

under blanket coverage in the face of admitted excess capacity. Second, he raised the possibility of limiting small depositors' coverage across the banking system instead of setting the limit bank-by-failed-bank as is commonly done.

In response, Mr. Isoard observed that it would not be possible to close all banks when all were insolvent, so that a blanket guarantee was the best option. Mr. Tatom responded that insolvent banks need not be closed. Necessary and sound banking functions could be continued under new owners. Mr. Hanc noted that setting a system-wide coverage limit would make it difficult to estimate entitlements when a bank failed and slow the payout process. Such a change had been proposed in the United States and rejected under the first Bush Administration. Mr. Eisenbeis downplayed the importance of the size of the deposit insurance fund and claimed that government backing and *ex post* settling up by surviving banks would be sufficient where the government was financially credible. Professor Kaufman noted that funding for deposit insurance had become entirely private in the United States following the FDIC Improvement Act. Professor Pennacchi disagreed. He expressed his belief that the US government would provide financial aid in a situation where deposit insurance premiums rose so high as to threaten surviving banks.

Professor Jackie So of Southern Illinois University pointed to the difficulty of continually monitoring a bank's condition to identify and avoid sudden portfolio changes that could render it insolvent. Mr. Eisenbeis considered that the problem was broader, especially when it came to the desirability of marking the portfolio to market. Nevertheless, Mr. Eisenbeis was confident that markets could identify weak banks, such as LTCM in 1998, and that regulators now had the power to resolve them when their capital fell to two percent of assets.

## Panel III: Where Do We Go From Here?

**Professor Kaufman** moderated this panel, calling first on Mr. Hanc to explain what the Working Group had heard and then on Mr. Evanoff to summarize what the academics had been saying.

**Mr. Hanc** wondered whether the day had revealed a large measure of agreement on potentially contentious issues despite the frustration expressed by some over the approach that the WGDI was using. Nevertheless, he had heard much good advice—do no harm and possibly do some good, be bold, and design a system—not just a set of spare parts. Unfortunately, he noted, the advice given was not always consistent. He observed that the discussants suggested that (1) market discipline should be given greater attention, (2) bank failures were not all bad, and (3) analysts must distinguish between runs on good banks and runs on bad banks.

**Mr. Evanoff** observed that deposit insurance is an important, but not an easy topic, partly because it involved so many tradeoffs. He praised the WGDI for being willing to take on a difficult task. Concerning tradeoffs, for example, he observed that, while policymakers desired stability, it must be *not* achieved at the expense of stagnation: innovation must not be stifled. He recommended that the Working Group: (1) ground its recommendations more firmly in theoretical and empirical research; (2) find commonalities across countries on such things as infrastructure requirements, corporate governance, coverage limitations, closure policies, and ways to price risk; and (3) recall “the Lucas critique,” which notes that behavior may change in unexpected ways when policy changes. He noted that the issues were sufficiently important that help would be available to the group in implementing these recommendations if it requested such help.



## Closing Remarks

Mr. Svein Andresen, head of the Secretariat of the Financial Stability Forum (FSF), assisted by Mr. Pierre Cailleteau, thanked the Chicago Fed for hosting the conference and described the FSF's mandate and its activities in areas other than deposit insurance. The FSF began when the G7 finance ministers asked Mr. Hans Teitmeyer, early in 1999, to look into three areas where improvement to the international financial system was thought desirable: (1) identifying and containing incipient vulnerabilities, (2) setting international standards, and (3) coordinating supervisory activities and exchanges of information.

Mr. Andresen reported that the FSF had 41 members, including regulators, central bankers and deputy finance ministers from 11 countries—the G7, Australia, Hong Kong, the Netherlands, and Singapore, together with representatives from the Bank for International Settlements, the Basel Committee for Banking Supervision, OECD, International Monetary Fund, World Bank, the International Organization of Securities Commissioners (IOSCO), and the International Association of Insurance Systems (IAIS). The Forum's working groups had also included representatives from a large number of emerging market countries.

Mr. Andresen noted that the FSF had met four times and had already issued reports on highly leveraged institutions, offshore activities, volatile capital flows, and implementing standards. He said that there was a strategy to foster the implementation of standards and codes and that a large number of these standards and codes were already posted on the FSF's web site.<sup>4</sup>

However, the Forum had identified important gaps, including guidance on deposit insurance that the WGDI would fill. The Forum was currently also studying diminishing liquidity in the international financial markets, winding down large and complex institutions in multiple jurisdictions, and supervisory challenges posed by the development of “e-finance.” As with all issues taken up by the Forum, these topics emphasized the interface between micro and macro issues.

**Mr. Hunter** thanked the presenters and the audience for participating in the conference and observed that the event had provided an excellent opportunity for the WGDI to exchange ideas with the academic community. He congratulated the Working Group on being willing to take on a challenging and complex subject. He personally agreed with much that had heard during the afternoon on, for example, the importance of prompt corrective action, the fact that deposit insurance was not a magic elixir, and the need to make the Group's recommendations more concrete. In closing the conference he called on the participants to continue the research they had begun and the exchange of ideas that had characterized the day.



## Annex I

### *Conference Program*

## Designing An Effective Deposit Insurance Structure: An International Perspective

Sponsored by:  
Financial Stability Forum and  
Federal Reserve Bank of Chicago

December 12, 2000

Federal Reserve Bank of Chicago  
230 South LaSalle  
Chicago, Illinois

- 12:45 p.m.      **Registration**
- 1:15 p.m.      **Welcoming Remarks**  
Michael H. Moskow, President, Federal Reserve Bank of Chicago  
William C. Hunter, Senior Vice President and Director of Research, Federal Reserve Bank of Chicago
- 1:30 p.m.      **Keynote Speaker**  
J.P. Sabourin, President and Chief Executive Officer, Canada Deposit Insurance Corporation, and Chairman, Financial Stability Forum, Working Group on Deposit Insurance
- 1:50 p.m.      **Panel I: Deposit Insurance Objectives and Infrastructure Requirements**  
*Chair:* Douglas D. Evanoff, Vice President and Senior Financial Economist, Federal Reserve Bank of Chicago  
**Public Policy Objectives for Deposit Insurance Schemes**  
Guy Saint-Pierre, Senior Vice President, Canada Deposit Insurance Corporation  
**Ensuring a Country's Readiness for Deposit Insurance**  
Jose Carlos Jaime, Chairman, Seguro de Depositos Sociedad, Argentina  
*Discussants:* Randall S. Kroszner, University of Chicago, Gordon S. Roberts, York University, Canada, Carl Tannenbaum, First Vice President, ABN AMRO
- 3:15 p.m.      **Coffee Break**
- 3:30 p.m.      **Panel II: Issues in Implementing Deposit Insurance Systems**  
*Chair:* John Raymond LaBrosse, Director, International Affairs, Canada Deposit Insurance Corporation

**Moral Hazard: Is Not Prohibitive and Can Be Contained**

George Hanc, Associate Director, Federal Deposit Insurance Corporation

**Transitioning from Blanket Guarantees to Limited Deposit Protection**

Carlos Isoard, Member of the Board of Governors, Instituto para la proteccion al Ahorro Bancario

*Discussants:* Robert Eisenbeis Federal Reserve Bank of Atlanta, George Kaufman, Loyola University Chicago, George Pennacchi, University of Illinois at Urbana-Champaign

5:00 p.m.

**Panel III: Where Do We Go From Here?**

*Chair:* George Kaufman, Loyola University Chicago

**What are the Academics Saying?**

William C. Hunter, Federal Reserve Bank of Chicago

**What is the Working Group Hearing?**

George Hanc, Associate Director, Federal Deposit Insurance Corporation

5:20 p.m.

**Closing Remarks: The Role of the FSF in Promoting Stability**

Svein Andresen, Head of the Secretariat, Financial Stability Forum, Basel

5:45 p.m.

**Reception**

Rapporteur:

Gillian G. H. Garcia

Location:

Federal Reserve Bank of Chicago  
3rd Floor Conference Center  
230 South LaSalle Street  
Chicago, IL 60604-1413

Conference Organizers:

Douglas D. Evanoff  
William C. Hunter  
George G. Kaufman  
John Raymond LaBrosse

## Annex II: Biographical Notes on the Speakers

**Mr. Svein Andresen** is the Secretary General of the Financial Stability Forum, a position he has held since the Forum's establishment in 1999. Prior to this appointment, he was a Special Advisor to the General Manager of the Bank for International Settlements, from 1997 till 1999. He headed the Secretariat to the G-10 Central Banks on Financial Issues from 1995 till 1997, and was Secretary of the Committee on the Global Financial System (formerly the Euro-currency Standing Committee) from 1992 till 1997. In his capacities at the BIS and the FSE, Mr. Andresen has been involved in a variety of international efforts to strengthen the functioning and stability of financial systems. Prior to joining the BIS, Mr. Andresen was an assistant professor of economics at the University of North Carolina at Chapel Hill.

**Dr. Robert R. Bliss** is a senior financial economist and economic advisor in the Research Department of the Federal Reserve Bank of Chicago. Before joining the Bank in January 1999 he was at the Bank of England, the Federal Reserve Bank of Atlanta, and Indiana University. His research interests are modeling the term structure of interest rates, interest rate derivatives, and risk management. Mr. Bliss earned his doctorate in finance from the University of Chicago.

**Mr. Pierre Cailleteau** has been working in the secretariat of the Financial Stability Forum in Basel for more than a year, and, as part of his assignment, assists the working group on deposit insurance in the setting up of international guidance. From 1996 to 1999, he was Head of the International Capital Market Division of the Banque de France. From 1993 to 1996, he was Advisor to the French Executive Director at the IMF, and from 1990 to 1993 worked at the Banque de France on monetary integration in Europe.

**Mr. Greg S. Cowper** joined the Canada Deposit Insurance Corporation (CDIC) as its Policy Advisor in 1997. Since that time, he has worked with other federal government agencies on the development of new Canadian financial services legislation, contributed to the development of CDIC by-laws and, participated in the work of the Financial Stability Forum's Working Group on Deposit Insurance. Prior to joining CDIC, Mr. Cowper held the position of Advisor on Economic Development Policy in the Office of the Prime Minister (PMO). While in the PMO, Mr. Cowper worked closely with the Economic Policy Committee of Cabinet, which dealt with a range of economic files including financial services reform. Mr. Cowper began his career as a policy analyst with Environment Canada in 1992.

Born in Ottawa, Mr. Cowper holds an MBA in international finance and management (Ottawa University), an MA in public policy (Dalhousie University), and an Honours BA in political science (Queen's University).

**Dr. Robert Eisenbeis** is senior vice president and director of research at the Federal Reserve Bank of Atlanta. In addition to advising the Bank president on monetary policy and related matters, Dr. Eisenbeis oversees the research, public affairs, and statistical reports departments. He also serves as a member of the Bank's Management and Discount Committees.

Before joining the Atlanta Fed in May 1996, Dr. Eisenbeis was the Wachovia Professor of Banking and associate dean for research at the Kenan-Flagler Business School at the University of North Carolina at Chapel Hill. He joined the faculty in 1982 as Wachovia Professor of Banking and subsequently became coordinator of finance. In addition to his academic experience, Dr. Eisenbeis worked in the public policy arena — at the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation

(FDIC). He joined the staff of the Board of Governors as an economist in 1967. From 1968 to 1975, with the FDIC, he served as assistant director of research and chief of financial and economic research. In this capacity, he was responsible for basic research, policy analysis, and review of all proposed bank mergers. In 1976, Dr. Eisenbeis returned to the Board of Governors and over the next six years held the positions of assistant to the director, associate research division officer, and senior deputy associate director in the division of research and statistics.

Widely published in the field of banking and finance, Dr. Eisenbeis' articles have appeared in such leading publications as the *Journal of Finance*, the *Journal of Financial Services Research*, the *Journal of Money, Credit, and Banking*, the *Journal of Banking and Finance*, *Banking Law Journal* and the *Journal of Regulatory Economics*. His articles have also appeared in several Federal Reserve Bank publications, as well as the *Journal of Retail Banking Services* and other trade journals. Dr. Eisenbeis has also coauthored several books on banking and statistics and contributed chapters to other books and is the executive editor of the *Journal of Financial Services Research*. He currently serves on the editorial boards of various scholarly publications. Dr. Eisenbeis has also been active in professional organizations, particularly the Financial Management Association, and he has testified frequently before Congress. He was a founding member of the Shadow Financial Regulatory Committee and is presently a member of the Financial Economists Roundtable and the board of directors of the National Association for Business Economics. A graduate of Brown University, he received both his master's and doctorate degrees from the University of Wisconsin at Madison.

**Dr. Douglas D. Evanoff** is a senior financial economist and vice president in the Research Department of the Federal Reserve Bank of Chicago. As director of the financial studies group he oversees research on financial markets and regulation. He serves as an advisor to senior management of the Federal Reserve System on regulatory issues and is chairman of the Federal Reserve Bank of Chicago's annual Conference on Bank Structure and Competition. He is also an adjunct faculty member in the Graduate School of Business at DePaul University. Mr. Evanoff's current research interests include bank cost and merger analysis, financial sector regulatory barriers, payment system mechanisms, and accessibility to consumer credit. He has published studies in a wide array of professional journals and books including credit access, bank regulation, industry structure, bank efficiency, payment system issues, and correspondent banking. Mr. Evanoff holds a Ph.D. in economics from Southern Illinois University.

**Dr. Gillian G. H. Garcia** is currently an international consultant in banking and finance, having worked recently on deposit insurance issues for the Canada Deposit Insurance Corporation, the International Monetary Fund, and Arthur Andersen. She has also advised a number of countries on the design of an "incentive-compatible" deposit insurance system to suit their needs. She has practical experience in dealing with financial crises at home in the United States and abroad—as an Assistant Director at the U.S. General Accounting Office and on the staff of the U.S. Senate Banking Committee. In the Senate she helped to resolve the S&L debacle and write the 1991 FDIC Improvement Act. Subsequently at the IMF she was intensively involved in calming the crisis in Asia. She began her career as an academic in the Haas School of Business at the University of California at Berkeley, later as a National Fellow at the Hoover Institution at Stanford University, and a Distinguished Professorial Lecturer at Georgetown University. She is the author of five books and a number of professional articles on financial subjects including publications in the *American Economic Review* and the *Journal of Finance*.

**Dr. George Hanc** joined the FDIC as Associate Director of Research and Statistics in 1996. He also chairs the Research Committee of the Financial Stability Forum's Working Group on Deposit Insurance. From 1990 to 1995, he was with the Resolution Trust Corporation where he served as Director of the Office of

Research and Statistics. Previously, he held senior positions—including chief economist and executive vice president—in two trade associations of banks and savings institutions: the National Association of Mutual Savings Banks and the National Council of Savings Institutions. He holds a Ph.D. in economics from Columbia University in New York.

At the FDIC, he has directed policy research, including the FDIC's 1997 study *History of the Eighties: Lessons for the Future*. He has directed the evaluation of critical FDIC programs and transactions, participated in the FDIC's current deposit insurance reform study, participated in FDIC international assistance programs, and served on the Research Task Force of the Basel Committee on Banking Supervision.

**Dr. William C. (Curt) Hunter** is Senior Vice President and Director of Research at the Federal Reserve Bank of Chicago. He is a member of the Bank's Management Committee and serves as Chief Economic Adviser to the Bank President. Mr. Hunter is responsible for planning and supervising the Bank's research in the areas of monetary policy, banking and financial markets, and regional economics and programs. He also oversees the Statistical Reports functions. Mr. Hunter is an Associate Economist on the Federal Open Market Committee, the Federal Reserve System's primary monetary policy group. Previously, he was Vice President at the Federal Reserve Bank of Atlanta and has served on the faculties of the University of Georgia, Emory University, Chicago State University, and Northwestern University. He is co-editor of *Research in Banking and Finance*, serves on several editorial boards. Mr. Hunter earned a B.S. degree in 1970 from Hampton Institute (now Hampton University) and an M.B.A. in Finance in 1972 and a Ph.D. in Finance and Environment in 1978 from Northwestern University.

**Mr. Carlos Isoard** has been a member of the Board of Governors the Instituto para la Proteccion al Ahorro Bancario (IPAB), Mexico, since May 1999. Prior to his appointment, he served as CEO of the Central Bank's Commercial Development Fund from 1991 to 1999. Between 1972 and 1991 Mr. Isoard held numerous positions at Mexico's Central Bank (Banco de México): Programs Deputy Manager in the Credit and Development Division, Economic Research Deputy Manager, Fund Flows Deputy Manager, Head of the Banking Research Division, Head of the Data Integration Division and the Banking System's Financial Accounts Division, Economist and Research Economist. Mr. Isoard holds a Master's Degree in Economics from the University of Chicago, 1977.

**Dr. Jose Carlos Jaime** has served as Chairman of the Seguro de Depositos Sociedad Anonima (SEDESA) in Argentina since 1995. He also is Chairman of the Financial Studies Forum in Argentina. Previously, he was a member of the Board of IBCA Sovereign Ratings Ltd. (London), the Second Vice-Governor of the Central Bank of the Argentine Republic, Chairman of the Honorary Advisory Committee on the Reform of the Argentine Financial System and member of the Board of the Banco de la Nación Argentina.

Dr. Jaime has been an economics professor at the Universidad Católica in Argentina since 1967. He has published extensively on numerous subjects. He also has been an independent economic advisor since 1970. Dr. Jaime graduated with Distinction from the School of Economics of the National University of Buenos Aires.

**Professor George G. Kaufman** is John F. Smith Professor of Finance and Economics and Director of the Center for Financial and Policy Studies at Loyola University Chicago. Before teaching at Loyola University, Professor Kaufman was a research fellow, economist and research officer at the Federal Reserve Bank of Chicago from 1959 to 1970 and has been a consultant to the Bank since 1981. From 1970 to 1980, he was the John B. Rogers Professor of Banking and Finance and Director of the Center for Capital Market

Research in the College of Business Administration at the University of Oregon. He has been a visiting professor at the University of Southern California (1970), Stanford University (1975-76), and the University of California at Berkeley (1979), and a visiting scholar at the Federal Reserve Bank of San Francisco (1976) and the Office of the Comptroller of Currency (1978). Professor Kaufman also served as Deputy to the Assistant secretary for Economic Policy of the U.S. Treasury in 1976. He has taught at Loyola since 1981. Professor Kaufman received his B.A. from Oberlin College (1954), M.A. from the University of Michigan (1955), and Ph.D. in economics from the University of Iowa (1962).

Professor Kaufman's teaching and research interests are in financial economics, institutions, markets and regulation and in monetary policy. Most recently, he has been involved in developing ways of preventing bank crises and reforming deposit insurance in the U.S. and elsewhere. He has lectured extensively on these subjects in the U.S. and abroad. He has published extensively in the *American Economic Review*, *Journal of Finance*, *Journal of Financial and Quantitative Analysis* and other professional journals. Professor Kaufman is also the author or editor of numerous books, including *Money, the Financial System and the Economy* (third edition, Houghton-Mifflin, 1981); *The U.S. Financial System: Money, Markets, and Institutions* (sixth edition, Prentice-Hall, 1995); *Perspectives on Safe and Sound Banking: Past, Present, and Future* (MIT Press, 1986) (co-author); *Innovations in Bond Portfolio Management: Duration Analysis and Immunization* (JAI Press, 1983) (co-editor); *Deregulating Financial Services: Public Policy in Flux* (Ballinger Press, 1986) (co-editor); *Restructuring the American Financial System* (Kluwer, 1990) (editor); *Assessing Bank Reform*, (Brookings, 1993) (co-editor); *Reforming Financial Institutions and Markets in the U.S.* (Kluwer, 1994) (editor); *Preventing Bank Crises* (FRB of Chicago and World Bank, October 1998) (co-editor); *The Asian Financial Crisis* (Kluwer, 1999) (co-editor); *Global Financial Crises* (Kluwer 2000) (co-editor); and the annual *Research in Financial Services* (JAI Press) (editor). Professor Kaufman has served on the board of directors of the American Finance Association (1977-80) and as president of both the Western Finance Association (1974-75) and the Midwest Finance Association (1986-87). He is past co-editor of the *Journal of Financial Services Research* and is serving or has served on the editorial boards of a number of major professional journals, including the *Journal of Money, Credit and Banking*, *Journal of Financial and Quantitative Analysis*, *Journal of Financial Research*, *Review of Pacific Basin Financial Markets and Policies* and *Contemporary Economic Policy*. He also served on the advisory board of the International Association of Financial Engineers from 1992 through 1999.

Professor Kaufman has served as a consultant to numerous government agencies and private firms, including being a member of the Federal Savings and Loan Insurance Corporation Task Force on Reappraising Deposit Insurance (1983), the American Bankers Association Task Force on Bank Safety and Soundness (1985), the American Enterprise Institute Project on Financial Regulation (1987), and the Brookings Institution Task Force on Depository Institutions Reform, whose report was published under the title *Blueprint for Restructuring America's Financial Institutions* (1989). He is co-chair of the Shadow Financial Regulatory Committee, a group of independent banking experts who analyze and comment on economic, legislative and regulatory factors affecting the financial services industry, and executive director of Financial Economists Roundtable. He has testified before Congress and other legislative and policy groups on numerous occasions. Professor Kaufman was a director of the Rochester Community Savings Bank (New York) from 1988 through 1997 and from 1982 to 1986 he served as an elected trustee of the Teachers Insurance Annuity Association and College Retirement Equity Fund (TIAA-CREF), the largest private pension fund in the country. In 1992, he was named Loyola University's faculty member of the year.



**Professor Randall S. Kroszner** is Professor of Economics at the University of Chicago Graduate School of Business. He has been a member of the faculty since 1990. His research interests include international and domestic banking and their regulation; political economy; organization and design; corporate governance; law and economics; monetary economics. He received a Sc.B. magna cum laude (applied mathematics-economics) from Brown University, an M.A. from Harvard University, and a Ph.D. (economics) from Harvard University. He has served as a junior staff economist at the Council of Economic Advisors, an economist with the Economics Research Group, a Research Fellow at G.T. Management (Asia) Limited, a Visiting Scholar at the U.S. Securities and Exchange Commission, and a Visiting Research Scholar at the International Monetary Fund, a Visiting Professor at the Stockholm School of Economics, a Visiting Professor at the Free University of Berlin and a resident scholar at the Federal Reserve Board, a Visiting Professor, Institute for International Economic Studies at the University of Stockholm, and the Bertil Danielson Visiting Professor of Banking and Finance at the Stockholm School of Economics, and the John M. Olin Fellow in Law and Economics, University of Chicago Law School.

He is currently the Associate Director of the Joseph J. Stigler Center for the Study of the Economy and the State, 1999. He has served as a consultant to the Federal Reserve Banks of Chicago, Kansas City, New York, and St. Louis. He is a Faculty Research Fellow of the National Bureau of Economic Research an Associate Editor of *Economics of Governance*, *Journal of Economics and Business*, and *Journal of Financial Services Research*.

**Mr. John Raymond (Ray) LaBrosse** is Director, International Affairs, Canada Deposit Insurance Corporation. Before joining the CDIC in 1999, Mr. LaBrosse was the Department of Finance's representative in New York for three years. During his posting, Mr. LaBrosse developed an extensive network of contacts on Wall Street, organized two highly acclaimed international conferences on cross-border banking issues, conducted numerous visits of Canadian government officials including the Prime Minister and the Minister of Finance and he prepared several reports on international issues and developments. During his 24-year career with the Department of Finance, Mr. LaBrosse has served in numerous posts as a Policy Advisor on financial institution issues and he was the author of numerous policy papers on financial institutions issues. In 1995, Mr. LaBrosse was responsible for implementing the Canada Savings Bond program, which raised \$3.2 billion, and then he took the steps necessary to establish a specialized agency to run the federal government's retail debt program. Mr. LaBrosse joined the Canadian public service in 1972 as an officer of the Bank of Canada. He has a B.A. and a M.A. in Economics both from The University of Calgary.

**Dr. Michael H. Moskow** took office on September 1, 1994, as the eighth chief executive of the Seventh District Federal Reserve Bank, at Chicago. He is currently serving the remainder of a full term that began March 1, 1996. He received a B.A. in economics from Lafayette College in Easton, Pennsylvania, in 1959 and an M.A. in economics in 1962 and a Ph.D. in business and applied economics in 1965 from the University of Pennsylvania. Dr. Moskow began his career teaching economics, labor relations, and management at Temple University, Lafayette College, and Drexel University. From 1969 to 1977, he held a number of senior positions with the U.S. government, including senior staff economist, Council of Economic Advisors; assistant secretary for Policy Development and Research, U.S. Department of Housing and Urban Development; director, Council on Wage and Price Stability; and under secretary of Labor, U.S. Department of Labor, serving as the second ranking official in the department with responsibility for day-to-day management of its 15,000 member staff and \$20 billion budget.

Dr. Moskow joined Esmark, Inc., in Chicago in 1977 as vice president of Corporate Development and Planning and in 1980 was named executive vice president of Estronics, Inc., its wholly owned subsidiary. He later served as president and chief executive officer of Velsicol Chemical Corporation, a subsidiary of

Northwest Industries, Inc., of Chicago; vice president of Corporate Development for Dart and Kraft, Inc., of Northbrook, Illinois; and vice president of Strategy and Business Development for Premark International, Inc., of Deerfield, Illinois (a spinoff from Dart and Kraft). He received his Ph.D in Economics from the Massachusetts Institute of Technology and a Sc.B. in Applied Mathematics from Brown University. He served at the Universities of Bocconi in Milan, Illinois and Pennsylvania. He has numerous publications and awards.

**Professor George G. Pennacchi** is Professor of Economics at the University of Illinois at Urbana-Champaign. He Received his Ph.D. in Economics from the Massachusetts Institute of Technology. He has also taught at the the University of Pennthe University of Pennsylvania and Bocconi in Milan, Italy. He has served at the Pension Research Council, the University of Pennsylvania and has received numerous awards. He is the co-editor of *Advances in Futures And Options Research*, associate editor of the *Journal of Finance*, *Journal of Financial Services Research*, *Journal of Money, Credit and Banking*, *Journal of Banking and Finance*, *Management Science*, and the *Review of Financial Studies*.

He teaches courses in financial institutions and markets, and security pricing. His research interests include financial institutions, derivative securities, and bond markets. He is currently a consultant to the Office of Management and Budget, the Executive Office of the President of the United States, and a research Associate of the Federal Reserve Bank of Cleveland. He has been a consultant to Central Bank of Finland and the Federal Reserve Bank of Chicago, the International Monetary Fund, and the World Bank.

Professor Gordon S. Roberts is the CIBC Professor of Financial Services at the Schulich School of Business at York University in Canada. He received a Ph.D. in Economics and a M. A. from Boston College, and a B. A. from Oberlin College. He has received numerous academic honors and has served as the Director of the Financial Services Program at the Schulich School of Business, and has taught at Dalhousie University, Babson College, Deakin University in Melbourne, Australia, Tilburg University in the Netherlands, the Universities of Arizona, Toronto, and Victoria, Xiamen University in the People's Republic of China, and the Canadian International Development Agency.

**Mr. Jean Pierre Sabourin** is the President and Chief Executive Officer of the Canada Deposit Insurance Corporation. He has led the Canada Deposit Insurance Corporation (CDIC) since 1990. CDIC is a federal Crown corporation that insures over \$315 billion of Canadian dollar deposits in 109 member institutions. Under his leadership, CDIC has intervened successfully in more than 40 problem financial institutions and resolved claims in excess of \$25 billion. This depth of experience in all aspects of the organization provides him with unparalleled expertise in deposit insurance issues. As CDIC's Chief Executive Officer, he has also provided advice internationally. His expertise helped to form the Hungarian Deposit Insurance Fund in 1993 and the Jamaica Deposit Insurance Corporation in 1998. He also assisted the Central Deposit Insurance Corporation in Taiwan and the Philippine Deposit Insurance Corporation in improving their deposit insurance systems. In 1999, Mr. Sabourin provided technical assistance to the Household Deposit Insurance Fund of Ukraine.

In November 1999, Mr. Sabourin was asked to assemble and chair a study group on deposit insurance established by the Financial Stability Forum based in Switzerland. The study group was composed of representatives from 12 countries as well as The World Bank and the IMF. It examined recent experiences of international deposit insurance schemes and assessed the desirability of setting out international guidance on deposit insurance. At the end of March, 2000, the Financial Stability Forum asked Mr. Sabourin to chair a working group to develop international guidelines on deposit insurance. The working group has launched a broad-based international consultation process and it will complete its report in September 2001.

Mr. Sabourin holds an MBA from the University of Toronto. In 1999, and again in 2000, Mr. Sabourin was the chair of the Black & White Opera Soirée benefit concerts for the National Arts Centre Orchestra and Opera Lyra Ottawa. He has served as a Director of Christie Lake Community Center, an organization that provides summer camp and year-round activities for underprivileged children in the Ottawa region.

**Mr. Guy Saint-Pierre** joined Canada Deposit Insurance Corporation (CDIC) in 1987 and shortly thereafter was appointed Senior Vice President Insurance & Risk Assessment. He is responsible for the overall administration of the development, implementation and maintenance of policies and procedures relating to member admission; deposit insurance termination and cancellation; the policy of deposit insurance; risk-based premium administration; standards of sound business and financial practices; practices warranting premium surcharges; dissemination of information by member institutions to the public; compliance of member institutions with the CDIC Act and By-laws; and most importantly for the monitoring of member institutions and assessment of potential risk to the CDIC Deposit Insurance Fund.

During his 14 years with CDIC, Mr. Saint-Pierre has developed extensive experience in dealing with problem banks. He has been closely associated with the resolution of many bank failures, sometimes through formal liquidations, sometimes through purchase and assumption transactions. Over this period he has negotiated all CDIC's financial assistance related to purchase and assumption transactions.

Mr. Saint-Pierre has served as an instructor for SEACEN and the IMF-Singapore Training Institute in various training courses or seminars on banking supervision, failure resolutions and other deposit insurance matters. He has been a consultant to many countries (most recently to Kuwait and the Philippines) with respect to the implementation or enhancement to deposit insurance systems.

**Mr. Carl R. Tannenbaum** is Senior Vice President of ABN AMRO North America. He is the Chief Economist for the North American holdings of ABN AMRO, which include the LaSalle Bank in Chicago, Standard Federal Bank in Michigan, and EAB in New York. ABN AMRO is a Dutch institution, which is one of the world's 20 largest banks. In this capacity, Carl provides internal and external briefings for ABN AMRO's U.S. affiliates, including its LaSalle bank group. He publishes weekly, monthly, and quarterly commentary for distribution to the bank's customers, and provides commentary for CNN and other media outlets.

Mr. Tannenbaum is Chairman of the American Banker's Association's Economic Advisory Committee and a member of the *Blue Chip* panel of economic forecasters. In addition to his economic duties, Carl is also responsible for measuring the organization's interest rate risk and monitoring its investment portfolio. He is a member of the bank's Asset/Liability Management Committee.

Mr. Tannenbaum holds an M.B.A. and a B.A. in finance and economics from the University of Chicago.

## Annex III

### Conference Participants

Timothy Anderson	Consultant
Svein Andresen	Financial Stability Forum, Switzerland
Peter Barger	North Central College
William Bergman	Federal Reserve Bank of Chicago
Robert Bliss	Federal Reserve Bank of Chicago
Pierre Cailleteau	Financial Stability Forum, Switzerland
William Conrad	Federal Reserve Bank of Chicago
Gregory Cowper	Canada Deposit Insurance Corporation
Robert DeYoung	Federal Reserve Bank of Chicago
Tomothy Divis	Federal Deposit Insurance Corporation
Dr. Adolfo Diz	Seguro de Depositos Sociedad Anonima, Argentina
Robert Eisenbeis	Federal Reserve Bank of Atlanta
Douglas Evanoff	Federal Reserve Bank of Chicago
Andras Fekete-Gyor	National Deposit Insurance Fund of Hungary
Gillian Garcia	International Financial Consultant
Hesna Genay	Federal Reserve Bank of Chicago
William Hocter	DePaul University
PiTau Hsu	Illinois Housing Development
William C. Hunter	Federal Reserve Bank of Chicago
Carlos Isoard	Instituto para la Proteccion al Ahorro Bancario, Mexico
Julapa Jagtiani	Federal Reserve Bank of Chicago
Dr. Jose Carlos, Jaime	Seguro de Depositos Sociedad Anonima, Argentina
Joan Junkus	DePaul University
George Kaufman	Loyola University of Chicago
Randall Kroszner	University of Chicago
John Raymond LaBrosse	Canada Deposit Insurance Corporation
Richard Lamm	Federal Reserve Bank of Chicago
Nick Lash	Loyola University of Chicago
Cathy Lemieux	Federal Reserve Bank of Chicago
Tom Marr	Canadian Consul General

Dan McKee	Office of Thrift Supervision
John McPartland	Federal Reserve Bank of Chicago
Thomas Mondschean	DePaul University
Michael Moskow	Federal Reserve Bank of Chicago
Gabriela Nava-Campos	Northwestern University
Jim Nelson	Federal Reserve Bank of Chicago
George Pennacchi	University of Illinois
J. P. Sabourin	Canada Deposit Insurance Corporation and FSF Working Group on Deposit Insurance
Jackie So	Southern Illinois University
Robert Steigerwald	Federal Reserve Bank of Chicago
Robert Stearn	Office of Banks and Real Estate
Jack Sustman	Institute for Enterprise Finance
Jack Tatom	Consultant
Carl Tannenbaum	ABN AMRO NA
Reza Varjavand	Saint Xavier University
Alessio De Vincenzo	Bank of Italy
Carl Vander Wilt	Federal Reserve Bank of Chicago

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## Endnotes

- <sup>1</sup> Mr. Eisenbeis wondered whether the FSF had subdivided the project into parts and hoped that the broader issues, such as the go/no-go decision, were being dealt with elsewhere.
- <sup>2</sup> The issue papers can be read at <http://www.cdic.ca/international>.
- <sup>3</sup> This paper, like the others, had been issued at [www.cdic.ca/international](http://www.cdic.ca/international).
- <sup>4</sup> The rapporteur points out that the word “standard” can be broadly interpreted for two reasons. First, the FSF’s website ([www.fsforum.org](http://www.fsforum.org)) describes a standard as setting out “what are widely accepted as good principles, practices or guidance in a given area.” Second, in a letter dated April 18, 2000, the FSF’s Chairman, Mr. Andrew Crockett, invited Mr. Sabourin to lead the WGDI in order to set out “international guidance on sound deposit insurance arrangements.” The letter noted that Forum members had underscored that “guidance should be undertaken through a broad consultative process that would include other countries that are interested in deposit insurance issues, so as to ensure that the guidelines are reflective of, and adaptable to, the broadest set of circumstances, settings and sound structures.”



# Outreach Sessions

## Kuala Lumpur, Malaysia



Asian Development Bank

FSI

Financial Stability Institute



Philippine Deposit Insurance Corporation

## Asian Policy Conference on Deposit Insurance Kuala Lumpur, Malaysia

January 17-18, 2001

**Location:**

The Regent Kuala Lumpur  
160 Jalan Bukit Bintang, 55100  
Kuala Lumpur, Malaysia

## Agenda

### Wednesday, 17 January

- 8:30 a.m.                      **Registration**
- 9:00 a.m.                      **Welcoming Remarks**  
Dr. Subarjo Joyosumarto, *Executive Director, SEACEN*  
Ms. Elizabeth Roberts, *Director, Financial Stability Institute*  
Mr. Myoung-Ho Shin, *Vice President, Asian Development Bank*
- 9:15 a.m.                      **Overview of FSF Working Group**  
Introduction by Mr. Jean Pierre Sabourin, Chairman, FSF Working Group  
Presentation by Mr. Winston K. Carr, Jamaica Deposit Insurance Corporation
- 9:45 a.m.                      **Session I**  
Chaired by Mr. George Hanc, USA  
**WG Presentations on Guidance for Public Policy Objective/Moral Hazard/  
Situational Analysis** by Mr. David Walker, Canada Deposit Insurance Corporation  
**Powers** by Mr. Michael Taylor, IMF Interrelationships among Safety Net Players

- Interrelationships among Safety Net Players** by Mr. Giovanni Carosio, Banca Italia
- Structure and Organization** by Mr. Ricardo M. Tan, Philippine Deposit insurance Corporation
- 10:45 a.m. **Panel Discussion on Topics above**  
Mr. Chong Kim Tong, Hong Kong Monetary Authority, Dr. Sun Aae Chun, Korea Deposit Insurance Corporation
- 11:15 a.m. **Session II**  
Chaired by Ms. Rescina S. Bhagwani, Philippine Deposit Insurance Corporation  
**WG Presentations on Guidance for Coverage** by Mr. Rodrigo Cifuentes, Banco Central de Chile  
**Membership** by Dr. José Carlos Jaime, SEDESA, Argentina  
**Public Awareness** by Mr. Winston K. Carr, Jamaica Deposit Insurance Corporation
- 11:45 a.m. **Panel Discussion on Topics above**  
Mr. Wen-Hsian Lai Central Deposit Insurance Corporation, Taipei, Republic of China, Mr. Madan G. Srivastava, Reserve Bank of India
- 12:15 p.m. **Open Q/A Forum**  
Chaired by Mr. Ray LaBrosse, Canada Deposit Insurance Corporation
- 2:15 p.m. **Session III**  
Chaired by Ms. Elizabeth Roberts, FSI  
**WG Presentations on Guidance for Funding** by Ms. Sylvie Mathérat, Commission Bancaire, France  
**Claims and Recovery** by Mr. Wayne Acton, Canada Deposit Insurance Corporation  
**Transitioning from Blanket to Limited Guarantee** by Carlos Isoard, IPAB, Mexico
- 2:45 p.m. **Panel Discussion on Topics Above**  
Dr. Sun Aae Chun, Korea Deposit Insurance Corporation, Mr. Masaru Honma, Financial Services Agency, Japan
- 4:00 p.m. **Session IV**  
Chaired by Mr. Jean Pierre Sabourin, President and CEO, Canada Deposit Insurance Corporation  
**Seminar on Liquidating Financial Institutions**  
**Canada: A Partnership Arrangement**  
*Speakers:* Mr. Wayne Acton, Canada Deposit Insurance Corporation, Mr. Frank Brown, Partner, Deloitte & Touche
- 5:30 p.m. **Open Forum**
- 6:00 p.m. **Break**
- 7:30 p.m. **Reception at Official Residence of the Canadian High Commissioner to Malaysia**  
Hosted by: Mr. Otch von Finckenstein, Acting High Commissioner

**Thursday, 18 January**

- 9:00 a.m.                    **Session V**  
Chaired by: Mr. Charles Adams, Asian Development Bank  
**Asian Response to the 1997 Crisis**  
*Panel Discussion:* Mr. Chaktip Nitibhon, Bank of Thailand, Dr. Darmin Nasution, Ministry of Finance, Indonesia, Dr. Sun Aae Chun, Korea Deposit Insurance Corporation and Ms. Nor Shamsiah Mohd Yunus, Bank Negara Malaysia  
An analysis of how the Asian countries coped with the 1997 crisis with a focus on how bank depositors and other creditors were protected to foster systemic stability; how this was funded; who were the financial safety net players involved.
- 10:45 a.m.                    **Session VI**  
Chaired by Mr. George Hanc, Associate Director, Federal Deposit Insurance Corporation, USA  
**Seminar on Problem Bank Intervention and Resolution**  
Mr. Michael Spaid, FDIC
- 1:30 p.m.                    **Session VII**  
Chaired by Mr. Ray LaBrosse, Canada Deposit Insurance Corporation  
**WG Presentations on Guidance for Depositor Priority** by Mr. David Walker, Canada Deposit Insurance Corporation  
**Reimbursing Depositors** by Mr. Daniel Jánossy, NDIF, Hungary
- 2:00 p.m.                    **Panel Discussion on Above Topics**  
Ms. Rosalinda U. Casiguran, Philippine Deposit Insurance Corporation. Mr. Jerry Ng, Indonesia Bank Restructuring Agency  
**Closing Session**
- 2:30 p.m.                    **“What the Working Group Learned from the Conference Participants”**  
Mr. Udo Franke, Ministry of Finance, Germany
- 3:00 p.m.                    **Closing Remarks**  
Mr. Jean Pierre Sabourin, Chairman, FSF Working Group on Deposit Insurance
- 8:00 p.m.                    **Dinner** Hosted by Y .Bhg. Dato Dr. Zeti Akhtar Aziz, Governor, Bank Negara Malaysia

# Outreach Sessions

## Berlin, Germany

### Outreach Session with Countries from European Economic Area and Switzerland

March 6-7, 2001

Berlin, Germany

Ministry of Finance, Germany

## Agenda

### March 6, 2001

**Hotel Information:**

Astron Hotel Berlin-Mitte  
Leipziger Straße 106 – 111  
10117 Berlin

7:00 p.m.

**Dinner with German banking associations**

### March 7, 2001

**Meeting Location:**

Bundesministerium der Finanzen  
(Federal Ministry of Finance)  
Leipziger Straße 5 – 7  
10117 Berlin  
Euro-room

9:00 a.m.

**Opening Session**

**Welcoming Remarks**

(Mr. Udo Franke)

**Overview of FSF Working Group**

**Guidance on Deposit Insurance for Policy Makers** by Mr. Jean Pierre Sabourin,  
Chairman, FSF Working Group

**Discussion of Activities of the Working Group** by Mr. Udo Franke, Advisor to the  
Ministry of Finance, Germany

- 9:30 a.m.                    **Roundtable Discussion**  
(Each Country will be given 5 minutes to make a statement and/or table a question)
- 10:45 a.m.                   **EU Deposit Insurance and Accession Countries – the Transition Phase**  
(Mr. Gianluigi Campogrande, European Commission)
- 11:15 a.m.                   **Presentation on Membership**  
(Mr. Alessio De Vincenzo, Italy)
- 11:30 a.m.                   **Presentation on Coverage**  
(Mr. Udo Franke, Germany)
- 11: 50 a.m.                   **Presentation on Structure and Organization**  
(Mr. John Raymond LaBrosse, Canada)
- 1:30 p.m.                    **Presentation on Funding**  
(Mr. Olivier Jaudoin, France)
- 1:50 p.m.                    **Presentation on Reimbursing Depositors**  
(Mr. András Fekete-Gyor, Hungary)
- 2:15 p.m.                    **Presentation on Claims and Recoveries and Depositor Priority**  
(Mr. Jean Pierre Sabourin, Canada)
- 2:45 p.m.                    **Presentation on Public Awareness**  
(Mr. John Raymond LaBrosse, Canada)
- 3:00 p.m.                    **Presentation on Interrelationships**  
(Mr. Alessio De Vincenzo, Italy)
- 3:20 p.m.                    **Cross Border Issues and Regional Groupings**  
(Mr. Udo Franke, Germany)
- 4:00 p.m.                    **Open Forum (Q&As)**  
(Mr. Pierre Cailleteau, FSF Secretariat)
- 4:30 p.m.                    **Session ends**

# Outreach Sessions

Paris, France



## Fifth Conference on Financial Sector Development in the Central Asian Countries, Azerbaijan and Mongolia

March 8-9, 2001  
Paris, France

### Agenda

#### Day 1

- 09:00-09:30      **Opening Remarks by the OECD**  
Chairman: Mr. Gerard Dages, *Vice President, Federal Reserve Bank of New York*
- 09:30-10:30      **Session I: Review of Banking Sector Reform in the Region**  
*Presentations:*  
Mr. Yerkegali Yedenbayev, Head, National Bank, Kazakhstan  
Mr. Rufat Aslanov, Director, National Bank, Azerbaijan  
Mr. Donkhim Bayasgalan, Director General, Ministry of Finance and Economy, Mongolia  
Ms. Amanbibi Palvanova, First Deputy Chairman, Central Bank, Turkmenistan
- 10:30-11:00      **Coffee Break**
- 11:00-12:30      **Session I – continued**  
*Presentations:*  
Mr. Toshiharu Kitamura, Professor, Waseda University, Japan  
Ms. Shamshad Akhtar, Manager, ADB  
*Commentaries:*  
Mr. John Thompson, Counsellor, OECD  
Mr. Juraj Rencko, Advisor to Minister, MOF, Slovakia



12:30-14:30	<b>Lunch Break</b>
	<b>Session II: Development of a Sound Banking Sector</b>
14:30-16:00	<b>Part A: Establishment of an effective financial intermediation mechanism</b>
	<i>Presentations:</i>
	Dr. Grzegorz W. Kolodko, Professor and Director, Tiger, WSPiZ, Former Deputy Premier and Minister of Finance of Poland
	Dr. Martin Pontzen, Senior Advisor, Deutsche Bundesbank
	<i>Commentaries:</i>
	Mr. Hans Christiansen, Financial Markets Division, OECD
16:00-16:30	<b>Coffee Break</b>
16:30-18:00	<b>Part B: Risk Management and banking supervision</b>
	<i>Presentations:</i>
	Mr. Jean-Philippe Svoronos, BIS
	Mr. Ruslan Akmatbekov, Head, National Bank, Kyrgyzstan
	<i>Commentaries:</i>
	Mr. Robert Dzmuran, Team Leader, National Bank, Czech Republic
	Mr. Stephen Lumpkin, Financial Markets Division, OECD
18:30	<b>Cocktail</b>

## Day 2

### Session III: Crisis Management and Safety Net

09:00-10:30	<b>Part A: Crisis Management</b>
	<i>Presentations:</i>
	Mr. Jamshid Kuchkarov, Deputy Minister, Ministry of Finance, Uzbekistan
	Mr. Hiroshi Nakaso, Visiting Senior Advisor, BIS
	Ms. Liisa Halme, Chief Legal Advisor, FSA, Finland
	Mr. Martin Blavarg, Head of Division, Central Bank of Sweden
	<i>Commentaries:</i>
	Mr. Joe Ganley, Advisor, Bank of England, UK
10:30-11:00	<b>Coffee Break</b>

- 11:00-12:30 **Part B: Deposit insurance system**
- Presentations:*
- Mr. Jean-Pierre Sabourin, Chairman, FSF Working Group on Deposit Insurance, on “Guidance on Deposit Insurance for Policy Makers”
- Mr. John Raymond LaBrosse, Director, International Affairs, Canada Deposit Insurance Corporation, on “Activities of the FSF Working Group”
- Mr. Yerkegali Yedenbayev, Head, National Bank, Kazakhstan
- Commentaries:*
- Mr. George Hanc, Associate Director, FDIC, US
- Mr. Takahiro Yasui, Outreach Unit for Financial Sector Reform, OECD
- 12:30-14:30 **Lunch Break**
- 14:30-16:00 **Session IV: Policy Round Table: Future Steps and the Role of Government**
- Presentations:*
- Mr. Kazuhiko Koguchi, Director of Team, EBRD
- Mr. Tunc Uyanik, Program Team Leader, WB
- Commentaries:*
- Mr. Sharif Mulloev, First Deputy to the Minister, Ministry of Finance, Tajikistan
- Mr. Taalibek Djoumataev, Member of the Board, National Bank, Kyrgyzstan
- 16:00-16:30 **Coffee Break**
- 16:30-17:30 **Concluding Session: Future Work**
- Summary of the discussions** by Chairman
- Tour d’horizon** (5 minutes by each target country)

# Outreach Sessions

## *Buenos Aires, Argentina*

### Outreach Session with Latin America Central Bank, Buenos Aires, Argentina Seguro de Depositos Sociedad Anonima (SEDESA)

March 14, 2001

#### Agenda

- 2:30 p.m.                      **Overview of FSF Working Group**  
**Introduction and Presentation on Guidance on Deposit Insurance for Policy Makers** by Mr. Jean Pierre Sabourin, Chairman, FSF Working Group  
**Presentation on Activities of the Working Group on Deposit Insurance** by Dr. José Carlos Jaime Chairman, SEDESA (Spanish version)  
**Presentation on Transitional Issues**  
(Mr. Isoard)
- 3:45 p.m.                      **Presentation on Interrelationships**  
(Mr. De Vincenzo)
- 4:15 p.m.                      **Presentation on Public Awareness**  
(Mr. Carr)
- 4:45 p.m.                      **Presentation on Structure and Organization**  
(Ms. Castillo)
- 5:15 p.m.                      **Presentation on Cross Border**  
(Mr. Franke)
- 5:45 p.m.                      **Open Forum (Q&As)**  
(Mr. LaBrosse)
- 6:30 p.m.                      **Meeting Adjourns**

# Outreach Sessions

## Rome, Italy

### Outreach Session with African and Middle East Countries

April 19, 2001

Banca d'Italia, Rome, Italy

## Agenda

### Wednesday, April 18, 2001

7:00 - 9:00 p.m. **Welcome reception** hosted by Mr. Gary Scott, Minister Counsellor (Commercial-Economic) Embassy of Canada at: Canadian Embassy via G.B. de Rossi 27 tel: 06.44598.359

### Thursday, April 19, 2001

**Location:**

Banca d'Italia,  
Sala Conferenze Piano Terra  
Via Nazionale 91  
Rome, Italy

9:00 a.m. **Welcoming Remarks** by Mr. Bianchi, *Head, Banking and Financial Supervision, Banca d'Italia*

9:15 a.m. **Overview of FSF Working Group**  
**Introduction and Presentation on Guidance on Deposit Insurance for Policy Makers** by Mr. Jean Pierre Sabourin, Chairman, FSF Working Group  
**Presentation on Activities of the Working Group on Deposit Insurance** by Mr. Giovanni Carosio, Head of Department, Supervision of Credit Institutions, Banca d'Italia

9:45: a.m. **Roundtable Discussion**  
(Each Country will be given 5 minutes to make a statement and/or table a question)

10:30 a.m.	<b>Coffee Break</b>
11:00 a.m.	<b>Presentations on Guidance for Public Policy Objective/Moral Hazard/Situational Analysis</b> by Mr. John Raymond LaBrosse, Canada Deposit Insurance Corporation
11:30 a.m.	<b>Transitioning</b> <b>The Mexico Case:</b> Mr. Carlos Isoard, IPAB
12:00 p.m.	<b>Open Q &amp; A Session</b> Chaired by: Mr. George Hanc, FDIC
1:00 - 14:00 p.m.	<b>Lunch</b> <i>Keynote Speaker:</i> Ms. Donna A. Tanoue, Chairman, Federal Deposit Insurance Corporation, Washington, D.C. Introduction by Mr. J.P. Sabourin, President & Chief Executive Officer, Canada Deposit Insurance Corporation
2:00 p.m.	<b>Presentation on Structure and Organization</b> (Mr. David Walker, CDIC)
2:30 p.m.	<b>Presentation on Coverage</b> (Mr. Cifuentes)
3:00 p.m.	<b>Coffee Break</b>
3:30 p.m.	<b>Presentation on Funding</b> (Mme Sylvie Math�erat)
4:00 p.m.	<b>Presentation on Interrelationships</b> (Mr. Giovanni Carosio)
4:00 p.m.	<b>Open Forum (Q&amp;As)</b> (Mr. Pierre Cailleteau, FSF)
4:30 p.m.	<b>Program ends</b>
8:00 p.m.	<b>Dinner</b>

For further information please contact:  
Mr. Alessio De Vincenzo, Banca d'Italia,  
devincenzo.alessio@insedia.interbusiness.it;  
tel +39 (06) 4792 4446

# Outreach Sessions

## Lusaka, Zambia

### Outreach Session with Countries from the COMESA Region, Lusaka, Zambia

April 28-30, 2001

#### Agenda

##### Saturday, April 28, 2001

- 9:00 a.m.                      **Opening Session**  
Overview of the FSF Working Group on Deposit Insurance  
(Macro Policy Issues)  
**Guidance on Deposit Insurance for Policy Makers**  
Mr. John Raymond LaBrosse, Director, International Affairs, Canada Deposit  
Insurance Corporation  
**Discussion of Activities of the Working Group on Deposit Insurance**  
Mr. Pierre Cailleteau, Member of the FSF Secretariat
- 10:00 a.m.                      **Roundtable Discussion**  
(Each Country will be given 5 minutes to make a statement and/or table a question)
- 11:00a.m.                      **Coffee Break**  
**Terms and Conditions of an Effective Deposit Insurance Systems**
- 11:15 a.m.                      **Presentation on Membership (English)**  
(Mr. John Raymond LaBrosse)
- 11:45 a.m.                      **Presentation on Coverage (French)**  
(Mr. Pierre Cailleteau)
- 12:45 p.m.                      **Lunch Break**
- 2:00 p.m.                      **Presentation on Funding (French)**  
(Mr. Pierre Cailleteau)



**Other Design Features of Deposit Insurance Systems**

- 2:30 p.m.            **Presentation on Structure and Organization (English)**  
(Mr. John Raymond LaBrosse)
- 3:00 p.m.            **Presentation on Reimbursing Depositors (French)**  
(Mr. Pierre Cailleteau)
- 3:30 p.m.            **Presentation on Claims and Recoveries and Depositor Priority (English)**  
(Mr. John Raymond LaBrosse)
- 4:00 p.m.            **Cross Border Issues and Regional Groupings (French)**  
(Mr. Pierre Cailleteau)
- 4:30 p.m.            **Q & A Session**
- 5:00 p.m.            **Session Ends**

**Monday, April 30, 2001**

- 9:00 a.m.            **Presentation on Powers (English)**  
(Mr. John Raymond LaBrosse)
- 9:30 a.m.            **Presentation on Interrelationships (English)**  
(Mr. John Raymond LaBrosse)
- 10:00 a.m.           **Presentation on Resolution (English)**  
(Mr. John Raymond LaBrosse)
- 10:30 a.m.           **Session Ends**

# List of Participants<sup>1</sup>

**B**asel, Switzerland, May 10-12, 2000

Names of Participants		Organisations	Countries
Last Name	Name		
Syziu	Artan	Bank of Albania	Albania
Gorishti	Rudina	Bank of Albania	Albania
El-Hassar	Choaib	Bank of Algeria	Algeria
Soldano	Isabel	Seguro de Depósitos Sociedad Anónima (SEDESA)	Argentina
Jaime	José Carlos	Seguro de Depositos Sociedad Anonima	Argentina
Hambardzumyan	Karen	Central Bank of the Republic of Armenia	Armenia
Bashir	Bakri	Bahrain Monetary Agency	Bahrain, State of
Romano	Guillermo	Superintendencia de Bancos y Entidades Financieras	Bolivia
Nevjestic	Josip	Deposit Insurance Agency	Bosnia and Herzegovina
Manon	Sead	Deposit Insurance Agency	Bosnia and Herzegovina
Matic	Neda	U.S. Treasury	Bosnia and Herzegovina
Modise	Freddy	Ministry of Finance and Development Planning	Botswana
Pelaelo	Moses	Bank of Botswana	Botswana
Bueno Silva	Antonio	Fondo Garantizador de Créditos (FGC)	Brazil
Mladenov	Mileti	Deposit Insurance Fund	Bulgaria
Dimitrova	Rayna	USAID Mission to Bulgaria	Bulgaria
Sabourin	Jean Pierre	Canada Deposit Insurance Corporation	Canada
LaBrosse	John Raymond	Canada Deposit Insurance Corporation	Canada
Robertson	Ronald N.	Canada Deposit Insurance Corporation	Canada
Saint-Pierre	Guy	Canada Deposit Insurance Corporation	Canada
Walker	David	Canada Deposit Insurance Corporation	Canada
Budnevich	Carlos	Banco Central de Chile	Chile
Sun	David	The People's Bank of China	People's Republic of China
Wang	Kejin	The People's Bank of China	People's Republic of China

Names of Participants		Organisations	Countries
Last Name	Name		
Lin	Wei-Yi	Central Deposit Insurance Corporation	Taiwan
Sossouvi	Magloire	Secretaria General de la Commission Bancaire	Republic of China Côte d'Ivoire
Ognjenovic	Djurdjica	State Agency for Deposit Insurance and Bank Rehabilitation	Croatia
Georgiadou	Lenia	Central Bank of Cyprus	Cyprus
Alkidou	Maria	Ministry of Finance	Cyprus
Dedek	Oldrich	Czech National Bank	Czech Republic
Kjaer	Jorn	Danish Deposit Guarantee Fund	Denmark
Lemma	Lakew	National Bank of Ethiopia	Ethiopia
Mathérat	Sylvie	Commission bancaire	France
Liakopoulos	Constantinos	Greek Deposit Guarantee Fund (TEK)	Greece
Marr	Philip	Guernsey Financial Services Commission	Guernsey
Pierre	Roland	Banque de la République d'Haiti	Haiti
Chong	Kim T.	The Hong Kong Monetary Authority	Hong Kong
Jánossy	Dániel	National Deposit Insurance Fund of Hungary	Hungary
Fekete-Gyor	András	National Deposit Insurance Fund of Hungary	Hungary
Hafliðason	Sveinbjörn	Central Bank of Iceland	Iceland
Chandramouliswaran	Aiyaswamy	Deposit Insurance and Credit Guarantee Corporation	India
Imansyah	Iman	Bank Indonesia	Indonesia
Dalimi	Irman	Bank Indonesia	Indonesia
Joyosumarto	Subarjo	Bank Indonesia	Indonesia
Jazayeri	Mina	The Central Bank of the Islamic Republic of Iran	Iran
Arbel	Eli	Bank of Israel	Israel
Pistelli	Francesco	Fondo Interbancario di Tutela dei Depositi	Italy
Vulpes	Giuseppe	Fondo Interbancario di Tutela dei Italy Depositi	Italy
Carr	Winston K.	Jamaica Deposit Insurance Corporation	Jamaica
Kubono	Shizuharu	Ministry of Finance	Japan
Kanzaki	Yasushi	Ministry of Finance	Japan
Higgins	Michael	Jersey Financial Services Commission	Jersey
Abdel Fattah Issa	Ahmad	Central Bank of Jordan	Jordan
Mekishev	Arman	National Bank of Kazakhstan	Kazakhstan

Names of Participants		Organisations	Countries
Last Name	Name		
Kibua	Nzioki	Central Bank of Kenya	Kenya
Rhee	Byung-Hwa	Korean Financial Supervisory Service	Korea
Cerbulis	Guntis	Bank of Latvia	Latvia
Pranevskis	Gints	Bank of Latvia	Latvia
Zilinskas	Raimundas	Deposit Insurance Fund	Lithuania
Rumskiene	Lina	Ministry of Finance	Lithuania
Ciapas	Linus	The Bank of Lithuania	Lithuania
Leonoviene	Lioné	The Bank of Lithuania	Lithuania
Pun	Vai-Kuan Doreen	Monetary and Foreign Exchange Authority of Macau	Macau
Jovanovski	Zoran	National Bank of the Republic of Macedonia	Macedonia, Republic of
Ratovondrahona	Guy	Banque Centrale de Madagascar	Madagascar
Baharuddin	Ahmad Hizzad	Bank Negara Malaysia	Malaysia
Muscat	Bernadette	Central Bank of Malta	Malta
Corta	Vicente	Institute for the Protection of Bank Savings	Mexico
Cerwinka	Ingrid	Institute for the Protection of Bank Savings	Mexico
Arrigunaga	Javier	Banco de Mexico	México D.F.
Musteata	Radu	National Bank of Moldova	Moldova, Republic of
Nanzaidorj	Tuvshinjargal	Ministry of Finance	Mongolia
Bouazza	Abderrahim	Bank Al Maghrib	Morocco
Macuacua	Antonio	Banco de Mocambique	Mozambique
Ipangelwa	Lazarus	Bank of Namibia	Namibia
Tromp	Emsley	Bank van de Nederlandse Antillen	Netherlands Antilles
Karlsen	Ole-Jörgen	The Banking, Insurance and Securities Commission	Norway
Abdullah Al-Harthy	Mohammed	Ministry of Finance	Oman, Sultanate of
Crisanto	Juan Carlos	Superintendencia de Banca y Seguros	Peru
Bhagwani	Rescina	Philippine Deposit Insurance Corporation	Philippines
Lirio	Ricardo	Central Bank of the Philippines	Philippines
Iwanicz-Drozdowska	Malgorzata	Bank Guarantee Fund	Poland
Reich	Andrzej	National Bank of Poland	Poland
Bogza	Mihai	National Bank of Romania	Romania

Names of Participants		Organisations	Countries
Last Name	Name		
Blanco	Adam Anthony	Financial Services Volunteer Corps	Russia
Paramonova	Tatiana Vladimirovna	Central Bank of the Russian Federation	Russia
Voilukov	Arnold Vasilievich	Central Bank of the Russian Federation	Russia
Necheeva	Marina	Agency for Restructuring Credit Organizations	Russia
Mourytcheva	Alexandra Sergeevna	Agency for Restructuring Credit Organizations	Russia
Agaptsev	Georgy Yurievich	Agency for Restructuring Credit Organizations	Russia
Tourbanov	Alexander Vladimirovich	Agency for Restructuring Credit Organizations	Russia
Medvedev	Pavel	Russian Federation State Duma	Russia
Kantengwa	Angelique	Banque Nationale du Rwanda	Rwanda
Rutabingwa	Jean-Paul	Banque Nationale du Rwanda	Rwanda
Al-Aboodi	Khaled	Ministry of Finance and National Economy	Saudi Arabia
Alghith	Ali	Saudi Arabian Monetary Agency	Saudi Arabia
Horvath	Milan	Deposit Protection Fund	Slovakia
Hettes	Frantisek	National Bank of Slovakia	Slovakia
More	Matej	Ministry of Finance	Slovenia
Majcen	Vida	Bank of Slovenia	Slovenia
Stark	Hugo	South African Reserve Bank	South Africa
Song	Yoo Jon	Korean Deposit Insurance Corporation	South Korea
García Macarrón	Javier	Fondo de Garantía de Depósitos en Cajas de Ahorro	Spain
Nagahawatte	Manik	Central Bank of Sri Lanka	Sri Lanka
Faragalla	Hassan	Bank of Sudan	Sudan
Al Qusi	Abdul Munim	Bank of Sudan	Sudan
Norling	Thomas	Deposit Guarantee Board	Sweden
Sjöberg	Gustaf	Ministry of Finance	Sweden
Andresen	Svein	Financial Stability Forum	Switzerland
Cailleteau	Pierre	Financial Stability Forum	Switzerland
White	William	Bank for International Settlements	Switzerland
Heimann	John G.	Financial Stability Institute	Switzerland
Armendariz	Patricia	Financial Stability Institute	Switzerland
Matafu	Simon	Deposit Insurance Board, Bank of Tanzania	Tanzania

Names of Participants		Organisations	Countries
Last Name	Name		
Nitibhon	Chaktip	Bank of Thailand	Thailand
Barkia	Bareddine	Banque Central de Tunisie	Tunisia
Esen	Aydin	Central Bank of the Republic of Turkey	Turkey
Demir	Yakup	Undersecretariat of the Treasury	Turkey
Prigozhina	Angela	The World Bank	Ukraine
Le Leslé	Vanessa	European Bank for Reconstruction and Development (EBRD)	United Kingdom
Briggs	Thomas P	U.S. Department of the Treasury	USA
Connell	Lawrence	U.S. Department of the Treasury, Office of Technical Assistance	USA
Jorstad	Van B	U.S. Department of the Treasury	USA
Hanc	George	Federal Deposit Insurance Corporation	USA
Ivie	Stanley	Federal Deposit Insurance Corporation	USA
McFadyen	James	Federal Deposit Insurance Corporation	USA
Murton	Arthur	Federal Deposit Insurance Corporation	USA
Rollin	Claude	Federal Deposit Insurance Corporation	USA
Sciacca	Christie	Federal Deposit Insurance Corporation	USA
Voesar	Detta	Federal Deposit Insurance Corporation	USA
Blair	Christine	Federal Deposit Insurance Corporation	USA
Kushmeider	Rose	Federal Deposit Insurance Corporation	USA
Lindgren	Carl-Johan	International Monetary Fund	USA
Hoelscher	David	International Monetary Fund	USA
van der Vossen	Jan Willem	International Monetary Fund	USA
Majnoni	Giovanni	The World Bank	USA
De Krivoy	Ruth	Sintesis Financiera	Venezuela
Perovic	Lidija	Agency for Deposit Insurance	Yugoslavia



# List of Participants

Washington, D.C., United States of America, June 7-9, 2000

Names of Participants		Organisations	Countries
Last Name	Name		
Edetragiache	Enrica	International Monetary Fund	Argentina
Jaime	José Carlos	Seguro de Depositos Sociedad Anonima	Argentina
Diz	Adolfo	Seguro de Depositos Sociedad Anonima	Argentina
Huizinga	Harry	European Commission	Belgium
Sabourin	Jean Pierre	Canada Deposit Insurance Corporation	Canada
Robertson	Ronald N.	Canada Deposit Insurance Corporation	Canada
LaBrosse	John Raymond	Canada Deposit Insurance Corporation	Canada
Walker	David	Canada Deposit Insurance Corporation	Canada
Cowper	Greg	Canada Deposit Insurance Corporation	Canada
Budnevich	Carlos	Banco Central de Chile	Chile
Mathérat	Sylvie	Commission bancaire	France
Franke	Udo	Ministry of Finance	Germany
Jánossy	Dániel	National Deposit Insurance Fund of Hungary	Hungary
Carr	Winston K.	Jamaica Deposit Insurance Corporation	Jamaica
Cerwinka	Ingrid	Instituto para la Proteccion al Ahorro Bancario	Mexico
Ortiz	Salvador	Instituto para la Proteccion al Ahorro Bancario	Mexico
Barrera	Roberto	Instituto para la Proteccion al Ahorro Bancario	Mexico
Isoard	Carlos	Instituto para la Proteccion al Ahorro Bancario	Mexico
Bhagwani	Rescina	Philippine Deposit Insurance Corporation	Philippines
Okeahalam	Charles	University of the Witwatersrand	South Africa
Cailleteau	Pierre	Financial Stability Forum	Switzerland
Smalhout	James	EuroMoney	UK
Hanc	George	Federal Deposit Insurance Corporation	USA
Blair	Christine	Federal Deposit Insurance Corporation	USA

Names of Participants		Organisations	Countries
Last Name	Name		
Kushmeider	Rose	Federal Deposit Insurance Corporation	USA
Voesar	Detta	Federal Deposit Insurance Corporation	USA
Unal	Hunal	Robert H. Smith	USA
Wilson	Berry		USA
Calomaris	Charles	Columbia University	USA
Conthe	Manuel	The World Bank	USA
Dervis	Kemal	The World Bank	USA
Caprio	Gerard	The World Bank	USA
Passacantando	Franco	The World Bank	USA
Rose	Thomas	The World Bank	USA
Demirguc-Kunt	Asli	The World Bank	USA
Miller	Geoffrey	New York University	USA
Garcia	Gillian, G.H.		USA
Flannery	Mark	The World Bank	USA
Boyd	John	The World Bank	USA
Smith	Bruce	The World Bank	USA
De La Torre	Augusto	The World Bank	USA
Scott	David	The World Bank	USA
Peria	Maria Soledad Martinez	The World Bank	USA
Schmukler	Sergio	The World Bank	USA
Beck	Thorsten	The World Bank	USA
Cull	Robert	The World Bank	USA
Honohan	Patrick	The World Bank	USA
Klingebiel	Daniela	The World Bank	USA
Leipziger	Danny	The World Bank	USA
Claessens	Constantijn	The World Bank	USA
Labrie	Kari	The World Bank	USA
Pennachi	George	University of Illinois	USA
Wharton	Santomero	University of Pennsylvania	USA
Kroszner	Randy	University of Chicago	USA
Senbet	Lemma	University of Maryland	USA
Kane	Edward J	Boston College	USA
Levine	Ross	University of Minnesota	USA

# List of Participants

Cancun, Mexico, October 4-5, 2000

Names of Participants		Organisations	Countries
Last Name	Name		
Jaime Nuñez Camps	José Carlos Flora Claudia Amelia	Seguro de Depositos Sociedad Anonima Seguro de Depositos Sociedad Anonima Seguro de Depositos Sociedad Anonima	Argentina Argentina Argentina
Bethel Ward Romano	Philip D. Warwick Guillermo	Central Bank of the Bahamas Central Bank of Barbados Superintendencia de Bancos y Entidades Financieras	Bahamas Barbados Bolivia
Siliprandi Sabourin Labrosse	Fátima Fantíni Jean Pierre John Raymond	Fundo Garantidor de Créditos Canada Deposit Insurance Corporation Canada Deposit Insurance Corporation	Brazil Canada Canada
Morrow Saint-Pierre Walker	Claudia Guy David	Canada Deposit Insurance Corporation Canada Deposit Insurance Corporation Canada Deposit Insurance Corporation	Canada Canada Canada
Cowper Cifuentes Arbelaez	Greg Rodrigo Beatriz Elena	Canada Deposit Insurance Corporation Banco Central de Chile Fondo de Garantía de Instituciones Financieras	Canada Chile Colombia
Galvis	Carlos Andrés	Fondo de Garantía de Instituciones Financieras	Colombia
Pérez. Jaudoin	M Oscar Armando Oliver	Seguro de Garantía de Depósitos Commission bancaire	El Salvador France
Franke Jánossy	Udo Dániel	Ministry of Finance National Deposit Insurance Fund of Hungary	Germany Hungary
De Vincenzo	Alessio	Banca de Italia	Italy
Carr Honma Zilinskas	Winston K. Masaru Raimundas	Jamaica Deposit Insurance Corporation Deposit Insurance Corporation of Japan Deposit Insurance Fund of Lithuania	Jamaica Japan Lithuania
Méndez	Julio César	Instituto para la Protección al Ahorro Bancario	Mexico
Palma	Adalberto	Instituto para la Protección al Ahorro Bancario	Mexico
Creel	Alejandro	Instituto para la Protección al Ahorro Bancario	Mexico

Names of Participants		Organisations	Countries
Last Name	Name		
Isoard	Carlos	Instituto para la Protección al Ahorro Bancario	Mexico
Murrieta	Humberto	Instituto para la Protección al Ahorro Bancario	Mexico
Garza	Eugenio	Instituto para la Protección al Ahorro Bancario	Mexico
Vara	Alfredo	Instituto para la Protección al Ahorro Bancario	Mexico
González	Jaime	Instituto para la Protección al Ahorro Bancario	Mexico
Barrera	Roberto	Instituto para la Protección al Ahorro Bancario	Mexico
Ochoa	José Luis	Instituto para la Protección al Ahorro Bancario	Mexico
Cerwinka	Ingrid	Instituto para la Protección al Ahorro Bancario	Mexico
Ortiz	Salvador	Instituto para la Protección al Ahorro Bancario	Mexico
Palau	Luis	Instituto para la Protección al Ahorro Bancario	Mexico
Gómez	Gloria	Instituto para la Protección al Ahorro Bancario	Mexico
Lee	Miguel	Superintendencia de Bancos	Panama
Nazareno	Norberto	Philippine Deposit Insurance Corporation	Philippines
Okehalam	Charles	University of the Witwatersrand	South Africa
Cailleteau	Pierre	Financial Stability Forum	Switzerland
Armendariz	Patricia	Financial Stability Institute	Switzerland
Walkings	Frank	Deposit Insurance Corporation	Trinidad & Tobago
Demaestri	Edgardo	Inter-American Development Bank	USA
Hoelscher	David	International Monetary Fund	USA
Hanc	George	Federal Deposit Insurance Corporation	USA
Wigand	James	Federal Deposit Insurance Corporation	USA
Majnoni	Giovanni	The World Bank	USA
Zeman	Judith	Fondo de Garantía de Depósitos	Venezuela
Gil	Ana	Fondo de Garantía de Depósitos	Venezuela
Sol Rodríguez	Larissa	Fondo de Garantía de Depósitos	Venezuela

# List of Participants

**B**udapest, Hungary, November 15-17, 2000

Names of Participants		Organisations	Countries
Last Name	Name		
Cani	Shkelqim	Seguro de Depositos Sociedad Anonima	Albania
Angjeli	Anastas		Albania
Diz	Adolfo		Argentina
Sharifov	Samir		Azerbaijan
Prokopovich	Petr		Belarus
Bars	Zlatko		Bosnia I Herzegovina
Vilendecic	Simeon	Banking Agency of Republika Srpska	Bosnia I Herzegovina
Mladenov	Mileti	Deposit Insurance Fund	Bulgaria
Sabourin	Jean Pierre	Canada Deposit Insurance Corporation	Canada
LaBrosse	John Raymond	Canada Deposit Insurance Corporation	Canada
Walker	David	Canada Deposit Insurance Corporation	Canada
Cowper	Greg	Canada Deposit Insurance Corporation	Canada
Acton	Wayne	Canada Deposit Insurance Corporation	Canada
Ognjenovic	Durdica	State Agency for Deposit Insurance and Bank Rehabilitation	Croatia
Rohatinski	Zeljko		Croatia
Vujcic	Boris		Croatia
Racocha	Pavel		Czech Republic
Kraft	Vahur		Estonia
Mathérat	Sylvie	Commission bancaire	France
Cailleteau	Pierre	Financial Stability Forum	Switzerland
Franke	Udo	Ministry of Finance,	Germany
Jánossy	Dániel	National Deposit Insurance Fund	Hungary
Fekete-Györ	András	National Deposit Insurance Fund	Hungary
Berg	Marianna	National Deposit Insurance Fund	Hungary
De Vincenzo	Alessio	Banca d'Italia	Italy
Carr	Winston K.	Jamaica Deposit Insurance Corporation	Jamaica
Honma	Masaru	Deposit Insurance Corporation of Japan	Japan
Marchenco	Gregory		Kazakhstan
Sarbanov	Ulan K.		Kyrgyzstan
Rimsevics	Ilmars		Latvia

Names of Participants		Organisations	Countries
Last Name	Name		
Zilinkas	Raimundas	Deposit Insurance Fund of Lithuania	Lithuania
Sarkinas	Reinoldijus		Lithuania
Trpeski	Ljube		Macedonia
Cerwinka	Ingrid	Instituto para la Proteccion al Ahorro Bancario	Mexico
Isoard	Carlos	Instituto para la Proteccion al Ahorro Bancario	Mexico
Bacalu	Veronica		Moldova
Casiguran	Roslinda	Philippine Deposit Insurance Corporation	Philippines
Kawecka-Wlodarczak	Ewa		Poland
Gronkiewicz	Hanna		Poland
Bogza	Mihai	National Bank of Romania	Romania
Urdea	Decebal	Romanian Deposit Guarantee Fund	Romania
Simanovsky	Alexey Yurievich		Russian Federation
Horváth	Milan	Deposit Protection Fund	Slovakia
Arhar	France		Slovenia
Cailleteau	Pierre	Financial Stability Forum	Switzerland
Davlatov	Iskandar		Tajikistan
Mavyev	Ata		Turkmenistan
Ogyenko	Valerij	The Household Deposit Insurance Fund	Ukraine
Majnoni	Giovanni	The World Bank	USA
Hanc	George	Federal Deposit Insurance Corporation	USA
Kushmeider	Rose	Federal Deposit Insurance Corporation	USA
Taylor	Michael	International Monetary Fund	USA
Garcia	Gillian G.H.	Consultant	USA
Geiger	Kurt	EBRD	UK
Popoff	Allan	EBRD	UK
Azimov	Rustam		Uzbekistan
Mullajanov	Faizulla		Uzbekistan



# List of Participants

Chicago, IL, December 12, 2000

Names of Participants		Organisations	Countries
Last Name	Name		
Diz	Adolfo	Seguro de Depositos Sociedad Anonima	Argentina
Mondschean	Thomas	Seguro de Depositos Sociedad Anonima	Argentina
Jaime	José Carlos	Seguro de Depositos Sociedad Anonima	Argentina
Marr	Tom	Canadian Consulate General	Canada
Sabourin	Jean Pierre	Canada Deposit Insurance Corporation	Canada
LaBrosse	John Raymond	Canada Deposit Insurance Corporation	Canada
Cowper	Greg	Canada Deposit Insurance Corporation	Canada
Fekete-Györ	András	National Deposit Insurance Fund of Hungary	Hungary
De Vincenzo	Alessio	Banca d'Italia	Italy
Isoard	Carlos	Instituto para la protección al Ahorro Bancario	Mexico
Cailleteau	Pierre	Financial Stability Forum	Switzerland
Andresen	Svein	Financial Stability Forum	Switzerland
Garcia	Gillian H.	Consultant	USA
Susser	Suzannah		USA
Varjavand	Reza	MacArthur Foundation	USA
Tannenbaum	Carl	Northwestern University	USA
Kaufman	George	ABN AMRO NA	USA
Mote	Larry	OCC	USA
Barger	Peter	North Central College	USA
Sustman	Jack	Institute for Enterprise Finance	USA
Anderson	Timothy		USA
Tatom	Jack	Consultant	USA
Grown	Caren	Federal Deposit Insurance Corporation	USA
Hanc	George	Federal Deposit Insurance Corporation	USA
Madson	Susan	Federal Deposit Insurance Corporation	USA
Divis	Timothy	Federal Deposit Insurance Corporation	USA
Polakoff	Scott	Federal Deposit Insurance Corporation	USA
Siddiquee	Baker A.	Federal Deposit Insurance Corporation	USA
Rollin	Claude A.	Saint Xavier University	USA

Names of Participants		Organisations	Countries
Last Name	Name		
Pinteris	George	University of Illinois	USA
Esbitt	Milton	University of Illinois	USA
Karr	Ronald	Dominican University	USA
Rezvanian	Rasoul	OTS	USA
Urrutia	Jorge	Northeastern Illinois University	USA
Stearn	Robert	Loyola University	USA
Junkus	Joan	Office Banks & Real Estate	USA
Lash	Nick	DePaul University	USA
Hocter	William	Loyola University	USA
Kugel	Robert	DePaul University	USA
Pavelka	Debra	Illinois HD	USA
Nathan	Lionel	Roosevelt University	USA
DeLeonardis	Nicholas	Northwestern University	USA
I Moskow	Michae	DePaul University	USA
William Hunter		Federal Reserve Bank Chicago	USA
Evanoff	Douglas	Federal Reserve Bank Chicago	USA
Kroszner	Randall S.	Federal Reserve Bank Chicago	USA
Jagtiani	Julapa	Federal Reserve Bank Chicago	USA
Conrad	William	Federal Reserve Bank Chicago	USA
Lamm	Richard	Federal Reserve Bank Chicago	USA
Steigerwald	Robert	Federal Reserve Bank Chicago	USA
Bergman	William	Federal Reserve Bank Chicago	USA
Wilt	Carl Vander	Federal Reserve Bank Chicago	USA
Lemieux	Cathy	Federal Reserve Bank Chicago	USA
Moser	Jim	Federal Reserve Bank Chicago	USA
Coussens	Michelle	Federal Reserve Bank Chicago	USA
McPartland	John	Federal Reserve Bank Chicago	USA
Genay	Hesna	Federal Reserve Bank Chicago	USA
Bliss	Robert	Federal Reserve Bank Chicago	USA
Nelson	Jim	Federal Reserve Bank Chicago	USA
DeYoung	Robert	Federal Reserve Bank Chicago	USA
Nava-Campos	Gabriela	University of Chicago	USA
Pennacchi	George	University of Illinois	USA
Newton	Charles	Houston Community College	USA
Eisenbeis	Robert	Federal Reserve Bank Atlanta	USA
McDonald	John F.	University of Illinois	USA
Stanton	Thomas H.	Attorney At Law	USA
So	Jacky	Southern Illinois University	USA
Hsu	PiTao	Illinois Housing Development	USA

# List of Participants

**K**uala Lumpur, Malaysia, January 17-18, 2001

Names of Participants		Organisations	Countries
Last Name	Name		
Jaime	José Carlos	Seguro de Depositos Sociedad Anonima	Argentina
San	Eng Thay	National Bank of Cambodia	Cambodia
Ho	Phan	National Bank of Cambodia	Cambodia
Sabourin	Jean Pierre	Canada Deposit Insurance Corporation	Canada
Acton	Wayne	Canada Deposit Insurance Corporation	Canada
LaBrosse	John Raymond	Canada Deposit Insurance Corporation	Canada
Walker	David	Canada Deposit Insurance Corporation	Canada
Cowper	Greg	Canada Deposit Insurance Corporation	Canada
Brown	Frank R.	Deloitte & Touche	Canada
Cifuentes	Rodrigo	Banco Central deChile	Chile
Wang	Kejin	People's Bank of China	People's Republic of China
Mathérat	Sylvie	Commission bancaire	France
Franke	Udo	Ministry of Finance	Germany
Chong	Kim T.	Hong Kong Monetary Authority	Hong Kong SAR
Jánossy	Dániel	National Deposit Insurance Fund of Hungary	Hungary
Srivastava	G.	Reserve Bank of India	India
Ng	Jerry	Indonesian Bank Restructuring Agency (IBRA)	Indonesia
Lahino	Chris	Indonesian Bank Restructuring Agency (IBRA)	Indonesia
Saragih	Indomen	Ministry of Finance	Indonesia
Congram	David	Ministry of Finance	Indonesia
Carosio	Giovanni	Banca d'Italia	Italy
Carr	Winston K.	Jamaica Deposit Insurance Corporation	Jamaica
Honma	Masaru	Deposit Insurance Corporation of Japan	Japan
Bae	Sung Hwan	Korea Deposit Insurance Corporation	Korea
Chun	Sun Eae	Korea Deposit Insurance Fund	Korea
Ho	Antonio M.	Monetary Authority of Macau	Macau SAR
Pun	Doreen	Monetary Authority of Macau	Macau SAR

Names of Participants		Organisations	Countries
Last Name	Name		
Wong	Yoke Mei	The SEACEN Centre	Malaysia
Quah	Kanaengnid	The SEACEN Centre	Malaysia
Jaffar	Jami'ah	The SEACEN Centre	Malaysia
Mohd. Yuus	Nor Shamsiah	Bank Negara Malaysia	Malaysia
Che Din	Che Zakiah	Bank Negara Malaysia	Malaysia
Mohamed	Madelena	Bank Negara Malaysia	Malaysia
Abdul Rahman	Azizan Hj.	Bank of Negara Malaysia	Malaysia
Isoard	Carlos	Instituto Para La Proteccion Al Ahorro Bancario	Mexico
Ganbaatar	Jambal	The Bank of Mongolia	Mongolia
Tan	Ricardo M.	Philippine Deposit Insurance Corporation	Philippines
Casiguran	Rosalinda U.	Philippine Deposit Insurance Corporation	Philippines
Bhagwani	Rescina S.	Philippine Deposit Insurance Corporation	Philippines
Ramos	Flordeliza F.	Philippine Deposit Insurance Corporation	Philippines
Ho Shin	Myoung	Asian Development Bank	Philippines
Adams	Charles	Asian Development Bank	Philippines
Liepach	Werner	Asian Development Bank	Philippines
Evstratenko	Nikolay	Agency for Restructuring Credit Organizations	Russian Federation
Miroshnikov	Valery	Agency for Restructuring Credit Organisations	Russian Federation
Cailleteau	Pierre	Financial Stability Forum	Switzerland
Roberts	Elizabeth	Financial Stability Institute	Switzerland
Lai	Wen-Hsian	Central Deposit Insurance Corporation	Republic of China, Taiwan
Nitibhon	Chaktip	Bank of Thailand	Thailand
Roehrl	Pacharapan	Bank of Thailand	Thailand
Wesaratchakit	Worawut	Bank of Thailand	Thailand
Limpongpan	Sathit	Ministry of Thailand	Thailand
Udyanin	Krista	Ministry of Thailand	Thailand
Manakul	Taweesakdi	Ministry of Thailand	Thailand
Taylor	Michael	International Monetary Fund	USA
Hanc	George	Federal Deposit Insurance Corporation	USA
Spaid	Michael	Federal Deposit Insurance Corporation	USA
Dung	Nguyen Manh	Deposit Insurance of Vietnam	Vietnam

# List of Participants

*B*erlin, Germany, March 7, 2001

Names of Participants		Organisations	Countries
Last Name	Name		
Goschler-Praxmarer	Monika	Sparkassen-Haftungs AG	Austria
Hassler	Paul	Geschäftsführer/Wirtschaftsprüfer	Austria
Campogrande	Gianluigi	European Commission	Belgium
Sabourin	Jean Pierre	Canada Deposit Insurance Corporation	Canada
LaBrosse	John Raymond	Canada Deposit Insurance Corporation	Canada
Kjar	Jorn H.	Danish Guarantee Fund for Depositors and Investors	Denmark
Jaudoin	Oliver	Commission banca	France
Franke	Udo	Ministry of Finance	Germany
Bang	Jorgen	Bundesverband deutscher Banken e.V.	Germany
Cupei	Dirk	Bundesverband deutscher Banken e.V.	Germany
Dreymann	Jügen	Principal Economic Question of Banking Supervision	Germany
Frings	Hartmut	Deutscher Sparkassen-und Giroverband (DSGV)	Germany
Kollbach	Walter	Bunderverband der Deutschen Volksbanken und Raiffeisenbanken e.V.	Germany
Schoppmann	Henning	Bunderverband Öffentlicher Banken Deutschlands	Germany
Wienberg	Gerhard	Association of German Co-operative Banks	Germany
Wink	Benno	Bundesbankdirektor	Germany
Liakopoulos	Constantine	Hellenic Deposit Guarantee Fund (TEK)	Greece
Fekete-Györ	András	National Deposit Insurance Fund of Hungary	Hungary
Haflidason	Sveinbjörn	Central Bank of Iceland	Iceland
Orlygsson	Thorgeir	Ministry of Industry and Commerce	Iceland
Finneran	Dermot	Central Bank of Ireland	Ireland
De Vincenzo	Alessio	Banca d'Italia	Italy
Baduel	Ettore	Fondo di Garanzia dei Depositanti del Credito Coop. VO	Italy
Bocuzzi	Giuseppe	Banca d'Italia	Italy

Names of Participants		Organisations	Countries
Last Name	Name		
Moretti	Roberto	Fondo Interbancario di Tutela dei Depositi	Italy
Pauly	Betty	ABBL	Luxembourg
Theissen	Roel	De Nederlandsche Bank NV	Netherlands
Karlsen	Ole-Jörgen	Banking, Insurance and Securities Commission	Norway
Garcia Macarrón	Luis Javier	Sociedad Gestora de los Fondos de Garantía de Depósitos en Entidades de Credito, A.I.E	Spain
Jacobson	Hans	Deposit Guarantee Board	Sweden
Norling	Thomas	Deposit Guarantee Board	Sweden
Cailleteau	Pierre	Financial Stability Forum	Switzerland
Winzeler	Christoph, PD	Swiss Bankers Association	Switzerland
McCarthy	Suzanne	Financial Services Compensation Scheme	United Kingdom
Oddie	Julie	Deposit Protection Board	United Kingdom



# List of Participants

*P*aris, France, March 8-9, 2001

Names of Participants		Organisations	Countries
Last Name	Name		
Aslanov	Rufat	National Bank of Azerbaijan	Azerbaijan
Svartsman	Issac	National Bank of Azerbaijan	Azerbaijan
Mardanov	Mardan	Foreign Economic Relations Department	Azerbaijan
Uyanik	Tunc	Financial and Private Sector Development	Azerbaijan
Masson	Christophe	European Commission/EuropeAid	Belgium
Sabourin	Jean Pierre	Canada Deposit Insurance Corporation	Canada
LaBrosse	John Raymond	Canada Deposit Insurance Corporation	Canada
Dzmuran	Robert	Czech National Bank	Czech Republic
Halme	Liisa	The Finnish Financial Supervision Authority	Finland
Rafat	Philippe	Banking and Investment Banking	France
Pecchioli	Rinaldo	OECD	France
Thompson	John	OECD	France
Hayashi	Fujiki	OECD	France
Lumpkin	Stephen	OECD	France
Kaizuka	Masaaki	OECD	France
Yasui	Takahiro	OECD	France
Christiansen	Hans	OECD	France
Asano	Makoto	OECD	France
Saiuchi	Toshimitsu	OECD	France
Tomizawa	Katsuyuki	OECD	France
Guy	Marie-Laurence	OECD	France
Whitney	Lynn	OECD	France
Nicholas	Dina	OECD	France
Ellis	Jaimie	OECD	France
Pontzen	Martin	Deutsche Bundesbank	Germany
Kitamura	Toshiharu	Waseda University	Japan
Nakabayashi	Shinichi	Permanent Delegation of Japan to the OECD	Japan
Gabitova	Alina	Kazakhstan Institute of Management	Kazakhstan
Yedenbayev	Yerkegali	National Bank of Kazakhstan	Kazakhstan
Mynbayev	Kairat	Kazakhstan Institute of Management	Kazakhstan

Names of Participants		Organisations	Countries
Last Name	Name		
Ross	Paul	International Monetary Fund	Kazakhstan
Lee	Jung-Hwan	Permanent Delegation of the Republic of Korea	Korea
Isaev	Urakly	State Committee on Foreign Investment and Economic Development	Kyrgyz Republic
Akmatbekov	Ruslan	National Bank of the Kyrgyz Republic	Kyrgyz Republic
Djoumataev	Taalaipek	National Bank of the Kyrgyz Republic	Kyrgyz Republic
Sadycova	Churec	Ministry of Finance	Kyrgyz Republic
Bayasgalan	Donkhim	Ministry of Finance and Economy	Mongolia
Batbayar	Purevjargal	Ministry of Finance	Mongolia
Chimgee	Ochirvaani	Central Bank of Mongolia	Mongolia
Tsend	Batbuyan	Embassy of Mongolia	Mongolia
Akhtar	Shamshad	Asian Development Bank	Philippines
Kolodko	Grzegorz W.	T.I.G.E.R / W.S.P.I.Z	Poland
Ren-Ko, PhD.	Juraj	Ministry of Finance	Slovak Republic
Blavarg	Martin	Central Bank of Sweden	Sweden
Svoronos	Jean-Philippe	Bank for International Settlement	Switzerland
Nakaso	Hiroshi	Bank for International Settlement	Switzerland
Cailleteau	Pierre	Financial Stability Forum	Switzerland
Khotamov	Davlatally	Ministry of Economy and Trade	Tajikistan
Mulloev	Sharif	Ministry of Finance	Tajikistan
Özdemir	Biltekin	Banking Regulation & Supervision Agency	Turkey
Küçüözmen	Cumhur Coskun	Banking Regulation & Supervision Agency	Turkey
Ccoskun	Isa	Permanent Delegation of Turkey	Turkey
Palvanova	Amanbibibi	Central Bank of Turkmenistan	Turkmenistan
Ganley	Joe	Centre for Central Banking Studies	United Kingdom
Koguchi	Kazuhiko	European Bank for Reconstruction and Development	United Kingdom
Dages	Gerard B.	Federal Reserve Bank of NY	USA
Hanc	George	Federal Deposit Insurance Corporation	USA
McFeeters	Brian	Mission of the United States to the OECD	USA
Kuchkarov	Jamshid	Ministry of Finance	Uzbekistan
Yakubjanov	Murat	Central Bank of Uzbekistan	Uzbekistan
Asretidinov	Djamolitdin	The Uzbekistan Banking Association	Uzbekistan

# List of Participants

**B**uenos Aires, Argentina, March 14, 2001

Names of Participants		Organisations	Countries
Last Name	Name		
Jaime	José Carlos	Seguro de Depositos Sociedad Anonima	Argentina
Diz	Adolfo	Seguro de Depositos Sociedad Anonima	Argentina
Gutierrez	Eduardo	Banco Central de Bolivia	Bolivia
Ponce Garcia	Jaime	Banco Central de Bolivia	Bolivia
Bueno de Camargo	Antonio Carlos	Fundo Garantidor de Créditos (FGC)	Brazil
Silva			
Sabourin	Jean Pierre	Canada Deposit Insurance Corporation	Canada
Robertson	Ronald N.	Canada Deposit Insurance Corporation	Canada
LaBrosse	John Raymond	Canada Deposit Insurance Corporation	Canada
Walker	David	Canada Deposit Insurance Corporation	Canada
Cowper	Greg	Canada Deposit Insurance Corporation	Canada
Cadena	Hector	Fondo de Garantias de Instituciones Financieras	Colombia
Jaudoin	Olivier	Secrétariat général de la Commission bancaire	France
Franke	Udo	Ministry of Finance	Germany
Jánossy	Dániel	National Deposit Insurance Fund of Hungary	Hungary
De Vincenzo	Alessio	Banca d'Italia	Italy
Carr	Winston K.	Jamaica Deposit Insurance Corporation	Jamaica
Oka	Noriaka	Deposit Insurance Corporation of Japan	Japan
Isoard	Carlos	Instituto para la Proteccion al Ahorro Banca	Mexico
Virginia	Castillo P.	Philippine Deposit Insurance Corporation	Philippines
Cailleteau	Pierre	Financial Stability Forum	Switzerland
Bergara	Mario	Banco Central del Uruguay	Uruguay
Garat	Rosario	Banco Central del Uruguay	Uruguay
Hanc	George	FDIC	USA
Taylor	Michael	International Monetary Authority	USA
Hoelscher	Michael	International Monetary Authority	USA
Rodriguez	Sol	Fondo de Garantia de Depositos Y Proteccion Bancaria	Venezuela
Gil	Ana Larisa	Fondo de Garantia de Depositos Y Proteccion Bancaria	Venezuela

# List of Participants

Rome, Italy, April 19, 2001

Names of Participants		Organisations	Countries
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# List of Participants

*Lusaka, Zambia, April 28-30, 2001*

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Ghebresslassie			
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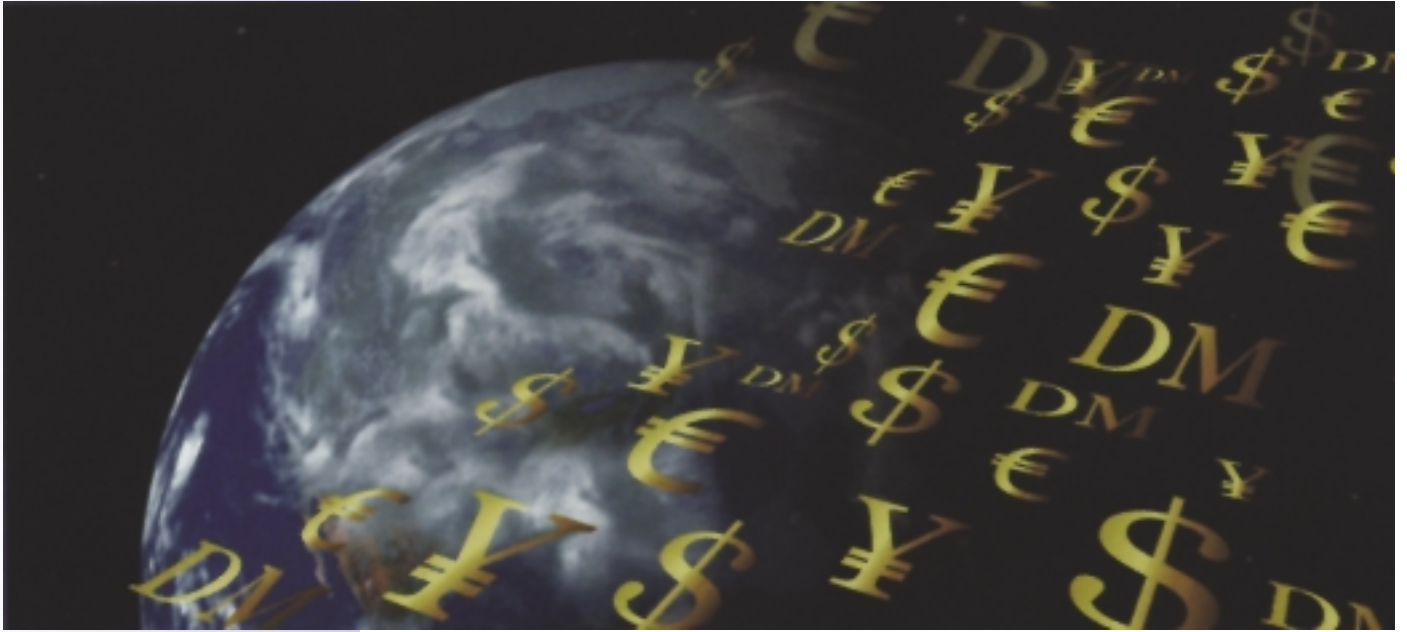
## Endnotes

- <sup>1</sup> These lists were developed on the basis of information that we had and information provided to us by other organizations. Due to various circumstances, certain names may or may not be reflected in each list. For any amendments to these lists, please contact Ms. Jackie Chartrand at Canada Deposit Insurance Corporation at <mailto:jchartrand@cdic.ca>



# III

## *Feedback*



**Feedback on the discussion papers and the draft final report was received  
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FINANCIAL STABILITY FORUM

Guidance for Developing Effective Deposit Insurance Systems

Background Documents

Working Group on Deposit Insurance

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