



IADI

International Association of Deposit Insurers

General Guidance for Effective Deposit Insurance Mandate

Presentation by Dr. Al-Jafari / Executive Council Meetings

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General Guidance for Effective Deposit Insurance Mandate

I. Introduction

II. Systems' Mandate and Classification Considerations

III. Pay box systems

IV. Pay box with extended powers systems

V. Risk minimizing systems

VI. Important consideration for effective implementation

- Roles of other safety net participants
- Resources availability
- Membership policy

VII. General guidance points for designing an effective deposit insurance mandate

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I: Introduction

The objective of the research project is to develop a **general guidance for the effective mandate of deposit insurance schemes.**

The research project attempts to:

- Examine and analyze the mandate of a large sample of different deposit insurance schemes;
- Reflect the most widely adopted mandates;
- Examine the consistency of DI's roles, responsibilities, powers and authorities with each system's objectives.

II) Systems' Mandate and Classification Considerations:

- The mandate of an organization, in general, refers to the legal duties it has to undertake in performing the tasks necessary to achieve its public policy objectives.
- The mandate defines the **roles and responsibilities** of the organization and identifies the **powers and authorities** conferred on the organization to carry out its roles and responsibilities in its endeavor to achieve its **public policy objectives**.
- To enhance the effectiveness of the deposit insurance system's mandate, roles and responsibilities should be **consistent** with the powers and authorities on one hand and the public policy objectives on the other hand.

II) Systems' Mandate and Classification Considerations:

The mandatory roles of existing deposit insurance systems vary significantly among different systems; they depend on:

- Public policy objectives of the system;
- Roles of other financial safety net participants;
- Overall financial system structure.

Authorities granted to deposit insurers should be aligned with the system's roles to enable the deposit insurance system to accomplish its public policy objectives efficiently and effectively.

II) Systems' Mandate and Classification Considerations:

Three basic types of deposit insurance systems are:

- Pay box systems: restricted to the role of reimbursing depositors;
- Pay box systems with extended powers;
- Risk Minimizing systems: play a wider role in enhancing financial stability.

The analysis in this study identifies the characteristics of systems with effective consistent mandates following the aforementioned classification.

II) Systems' Mandate and Classification Considerations:

The research classification has three major limitations:

- There are no accurate and widely adopted definitions for the three aforementioned categories.
- Some of the deposit insurance systems may not fit easily into these broad categories according to their roles, responsibilities and powers.
- The classification does not identify clearly the set of powers granted solely to risk minimizing institutions and accordingly the limited set of powers left in hand of the middle category organizations.

Given the need to develop a comprehensive guidance and the importance for classification for this guidance, the study builds on the existing classification and follows the individual insurers' classification for their systems.

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II) Systems' Mandate and Classification Considerations:

The guidance utilizes the data available from:

- The “International Deposit Insurance Survey (IDIS) [2002]” conducted by the CDIC (Canada), and from the “Questionnaires for Developing General Guidance to Promote Effective Interrelationships among financial Safety Net Participant.
- Resolution of Bank Failures Survey [2004] ” conducted by the IADI and led by the Central Deposit Insurance Corporation of Taiwan.

The results of the questionnaires have been completed by accessing the relevant systems websites and by the direct contact with them in other cases. The analysis is also supported by the relevant practical experience of the subcommittee members.

The classification of the deposit insurance systems included in the analysis is based on each system's response to Resolution of Bank Failures Survey [2004]. Three exceptions were made to this criterion:

1. Bulgarian Deposit Insurance Fund;
2. Kazakhstan Deposit Insurance Fund, and
3. National Deposit Insurance Fund of Hungary.

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III) Pay Box Deposit Insurance Systems

- The main responsibility of those systems is to reimburse depositors using different reimbursement methods.
- The main public policy objectives shared among the pay box deposit insurance systems are to pay off depositors of failed insured institutions and to contribute to the stability of the financial system by protecting less-financially-sophisticated depositors.
- Most of the pay boxes have access to liquid resources through borrowing, perhaps under temporary and specific limits. However, seven pay box systems have the authority to resolve the way the system funds itself by determining the terms and conditions of premiums or levies. Two thirds of respondents have the authority to enter into contracts or to set their own business regulations.

III) Pay Box Deposit Insurance Systems

- Some pay box systems assume the responsibility of liquidation or even receivership. The powers of some of those systems however might not be consistent with their responsibilities, particularly for failure resolution methods and ability to provide financial assistance. Other set of pay boxes have the authority to provide financial assistance or to guarantee loans to (or deposits at) the insured institution without the responsibility of receivership or liquidation.
- Only four pay box systems have direct and indirect access (through the supervisory authorities) to depositors' information (one third). Most pay boxes studied obtain member banks information through the supervisory authorities rather than directly from the member institutions. But no clear distinction, in this respect, was observed among different systems with different mandates.
- Finally, powers related to enforcement and intervention, failure resolutions and optimization of recoveries are almost non-existent.

IV) Pay Box with Extended Powers Deposit Insurance systems

- In general, the powers and public objectives of most of the deposit insurers belonging to “pay box with extended powers” category are consistent.
- The public objectives mainly include protecting depositors and maintaining financial stability. Other public objectives include promoting savings and facilitating economic development.
- Authorities on reimbursement and resolving failed banks of these deposit insurers could pretty much match their needs to fulfill their public policy objectives.
- Some inconsistencies exist in the cases of certain deposit insurance systems who are required to manage a failed bank at the least possible cost, as they lack proper risk management tools and adequate powers to decide on resolution methods.

IV) Pay Box with Extended Powers Deposit Insurance systems

- Most of the surveyed pay box with extended powers systems are found to assume certain direct roles in risk assessment, monitoring and resolution of bank failures. However, the powers of limited numbers of these systems may not reflect the roles and the scope of responsibilities they are mandated with.
- Deposit insurers in this category have diversified channels for funding with government guarantees, but only limited number of them has clearly set up fund target ratio. For the sake of ensuring adequate deposit insurance fund level that is crucial for an effective deposit insurance system, an explicit target ratio is beneficial for a deposit insurer to fulfill its mandates.

IV) Pay Box with Extended Powers Deposit Insurance systems

- All surveyed pay box with extended powers deposit insurers administer their systems under compulsory basis, which help avoiding adverse selection, and in most cases the deposit insurers do not have the authority to determine entry and exit of member institutions.
- Most of the deposit insurers in this category do not have intervention power or the authority to provide financial assistance to troubled institutions. These limited authorities may reflect inconsistencies between the deposit insurance function and the supervisory actions which require mandatory coordination channels to tie up the membership policy with the supervisory roles.
- Efficiency and effectiveness of banks' resolution seriously influence the depositors' right and the financial stability. In most of the cases, the authority over deciding viability and resolution methods of a troubled bank belongs to supervisors or central banks. However, for the purpose of lowering the loss of a deposit insurance system, this authority should also be provided to (or shared with) the deposit insurer. If not, a formal coordination mechanism among financial safety net players needs to be established and the accountability of each member should be specified.

V) Risk Minimizing Deposit Insurance Systems

- There is a general consistency between mandates and powers of risk minimizing deposit insurance systems.
- The Systems have been accorded extensive intervention and supervisory powers.
- The stated public policy objectives for some systems under this category are very general and actually quite similar to those of some pay box systems (e.g. to contribute to financial system stability and to protect depositors).
- All surveyed risk minimizers are found to assume direct roles in risk assessment and monitoring, and resolution of bank failures.
- In general, the powers of these systems reflect the roles and the scope of responsibilities they are mandated with.

V) Risk Minimizing Deposit Insurance Systems

- Funding channels for deposit insurers in this category are similar to those for other systems.
- The four risk minimizing institutions in the study sample invest the accumulated funds in the bond market, mainly in the government bonds and in the government guaranteed securities.
- Unlike other types of deposit insurers, they all have the authority to determine their sources of funds, borrowing limits and the levels of premiums or levies. This reflects a clear consistency in this respect, as ensuring flexible funding policies and adequate deposit insurance fund levels are crucial for an effective deposit insurance system.

V) Risk Minimizing Deposit Insurance Systems

- The systems also are managed on compulsory basis, which help avoiding adverse selection.
- Unlike other types of deposit insurers, most of the risk minimizers have the authority to control entry and exit of member institutions and all of them have the power to terminate the license or the insured status of any member institution. That reflects again a clear consistency between deposit insurance function and related authorities.
- Finally, in the four surveyed cases, the responsibility of deciding the resolution method of a troubled institution belongs to the deposit insurer, and they usually have the needed powers and authorities to carry out this responsibility. The analysis shows further that the analyzed risk minimizing deposit insurers follow the least cost approach and utilize a wide set of failure resolution methods.

VI) Important Considerations in the Design of an Effective Mandate

1. Interrelationships with other safety net participants

- Several factors shape the interrelationship's architecture:
 1. Complexity of a country's economic and financial structure;
 2. Composition of regulation and supervision functions;
 3. Mandates and responsibilities of the deposit insurer relative to the mandates and responsibilities of other safety net members;
 4. Individual countries experience.
- The analysis shows that each type of deposit insurance schemes necessitates different arrangements and interrelationships among safety net members.

VI) Important Considerations in the Design of an Effective Mandate

1. Interrelationships with other safety net participants

	Pay-box	Pay-box extended powers	Risk minimizer
Scope of Information sharing	Limited	Considerable	Extensive
Amount of insured deposits from member institutions	Typical	Typical	Typical
Financial statements of member institutions directly or through the supervisory authority	Considerable	Typical	Typical
Detailed information of bank's financial situation from Supervisory Authority	Not typical	Typical	Typical
Macroeconomic information from Central Bank (from CB)	Not typical	Typical	Typical
Role in resolving bank failure	Limited	Significant	Significant
Role in decision to close failed banks	Not typical	Not typical	Significant
Conducting examinations	Not typical	Considerable	Typical
Enforcement Actions.	Not typical	considerable	typical

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VI) Important Considerations in the Design of an Effective Mandate

2. Organizational considerations and resources availability

a. Organizational and operational issues

- Deposit insurer's legal and physical independence is a crucial element of a well functioning safety-net system.
- Banks in countries where the deposit insurer has the responsibility of intervening failed banks and the power to revoke membership in the deposit insurance scheme are more stable and less likely to become insolvent.
- Involvement of the deposit insurer in bank failure resolution dampens the negative effect that deposit insurance has on banks' risk taking .
- Deposit insurers having no physical independence and housed by the Central Bank or the Supervisory Authority belong to the category of Pay-box. On the contrary, those institutions which are fully operational and staffed well in order to fulfill all core deposit insurance functions in house belong to the category of pay-box with extended powers or risk minimizers .

VI) Important Considerations in the Design of an Effective Mandate

2. Organizational considerations and resources availability

b. Funding

- Funding is the basic resource consideration. The cost that the members and/or the authorities are ready to absorb is a major factor in determining the type of the deposit insurance system.
- The possible medium and long-term costs of maintaining a deposit insurance system have direct influence on all resource elements.
- Funding is subject to different debates during sound financial conditions.
- Deposit insurers face pressure to cut premiums and expenses during stable financial conditions.
- Stable economic conditions and sound financial position of member banks bring about changes in the roles and responsibilities of the deposit insurance system.
- This can establish an unsound imbalance within the safety-net of the respective country and can also have repercussions for the stability of the system, especially in the event of economic downturn.

VI) Important Considerations in the Design of an Effective Mandate

2. Organizational considerations and resources availability

c. Human resources & staff training

•The effective mandates should enable deposit insurers to:

- Attract and retain qualified employees;
- Determine the appropriate mix between dedicated staffing and outsourcing;
- Ensure the confidentiality of information supplied to employees;
- Guarantee that employees receive the legal protection against lawsuits for actions taken in the normal course of activities.

•Accordingly, all types of deposit insurance should have the authority to employ and retain their own workforce on a permanent or temporary basis in order to be able to adjust their staff requirements according to their needs.

•In order to meet these personnel requirements and retain qualified people on a long term basis a fair compensation package and incentives should be introduced and maintained. Competitive salaries and other benefits should be aligned with comparable packages offered by the financial industry.

•The responses to the aforementioned questionnaire show only a slight majority (55%) of the respondents who felt that the compensation and incentives given to them are competitive and sufficient to attract and retain skilled people.

VI) Important Considerations in the Design of an Effective Mandate

2. Organizational considerations and resources availability

c. Human resources & staff training

The analysis shows noticeable differences among different types of deposit insurers that are reflected as follows table:

	Pay-box systems	Pay-box with Extended Powers	Risk-minimizers
Authority to employ staff	No (in most case)	Yes	Yes
Staff requirement	Very low, only a few part- or full-time employees for care-taking purposes, seconded by the host authority	Each functional areas need at least one staff	More complex functionalities require more staff and even substitutes
Skillful and dedicated staff	Not prioritized	Dedicated staff, reliance on private sector in some cases	Dedicated staff, reliance on private sector in some cases
Specialized knowledge in key areas	Not prioritized	Increasingly important	Very important
Multiple accountability	Not prioritized	Very important	Important
Fixed costs	Very low	Low/medium	High

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VI) Important Considerations in the Design of an Effective Mandate

2. Organizational considerations and resources availability

d. Information technology

- Information technology (hardware and software applications) should be in place in all deposit insurance systems
- Deposit insurance systems need some sort of IT support in all functional areas, which should take into consideration precisely the roles and responsibilities of the deposit insurance system.
- The quality of information technology also plays a crucial role in the successful fulfillment of the system's mandate.
- IT requirements and their cost and implications vary across the three analyzed types of deposit insurance.

VI) Important Considerations in the Design of an Effective Mandate

2. Organizational considerations and resources availability

d. Information technology

	Pay-box	Pay-box with Extended Powers	Risk-minimizers
Pay-out system application	Yes	Yes	Yes
Additional complex systems requirement	No need	Need MIS only	Need complex systems
Shared IT systems	Yes	No	No
Outsourcing	No	Yes	Yes
IT platform for data sharing with supervisor	No	Yes	Yes
IT budget	Negligible (1-2% of yearly operational budget)	Medium (5-6% of yearly operational budget)	High (6-10% of yearly operational budget)

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Lumpur, Sept. 2006

VI) Important Considerations in the Design of an Effective Mandate

3. Membership policy

a. Compulsory or voluntary membership

- **Membership should be compulsory to avoid adverse selection.**
- Depositors' awareness of voluntary deposit insurance system can create strong incentives for banks to participate in the system.
- The weakness of such incentive for stronger banks may leave the deposit insurance for the weaker ones.
- **The financial solvency and effectiveness of the voluntary-membership system may be affected and it may not be able to meet its public-policy objectives.**

VI) Important Considerations in the Design of an Effective Mandate

3. Membership policy

b. Membership umbrella

- Different approaches exist in respect to which institutions should be eligible for membership in the deposit insurance system.
- **Moral hazard concerns suggest that membership should be extended only to institutions that are subject to effective supervision and regulation.**

VI) Important Considerations in the Design of an Effective Mandate

3. Membership policy

c. Membership granting

- The analysis reveals that membership granting varies across deposit insurance systems.
- In general there are two different mechanisms:
 - Membership is granted automatically.
 - Eligible institutions are required to apply for membership.
- Membership criteria and financial requirements must be met by institutions before they become members of the deposit insurance system.
- The criteria and process should be transparent.

VI) Important Considerations in the Design of an Effective Mandate

3. Membership policy

d. Membership Termination

- In most countries, the membership of an institution in the deposit insurance system is terminated automatically when its operating license is revoked or the institution is closed down.
- Institutions may be excluded from membership only by risk minimizing deposit insurance institutions in the sample.
- Deposit insurers may have the sole authority to exclude institutions from membership or share this authority with other regulatory bodies.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

Mandate of Deposit Insurance Systems:

- Effective deposit insurance mandate should define clearly the roles and responsibilities of the deposit insurer and identify the powers and authorities conferred on the system to carry out its roles and responsibilities in its endeavor to achieve its public policy objectives.
- Public policy objectives of an effective deposit insurance system should be specific and stated in law, in order that they could serve as policy direction of the deposit insurance system.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

Mandate of Deposit Insurance Systems:

- Effective deposit insurance mandate should define clearly the roles and responsibilities of the deposit insurer and identify the powers and authorities conferred on the system to carry out its roles and responsibilities in its endeavor to achieve its public policy objectives.
- Public policy objectives of an effective deposit insurance system should be specific and stated in law, in order that they could serve as policy direction of the deposit insurance system.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

- To enhance the effectiveness of the deposit insurance system's mandate, roles and responsibilities should be consistent with the powers and authorities on one hand and the public policy objectives on the other. Deposit insurers need the powers and authorities necessary to assume their responsibilities and to achieve their public-policy objectives effectively.
- All deposit insurers must be empowered with direct access to depositors' information and with the authority to access depositors' records through the supervisory authority for verification and cross examination. Other Types of information depend on the responsibilities of the deposit insurer beyond depositors' reimbursement.
- Providing a deposit insurer with the powers over collecting premium from its members and borrowing for liquidity purpose is prerequisites for any type of deposit insurers to be effective. Collecting premium and reimbursing depositors are the basic mandates of any type of deposit insurers. In order to fulfill these mandates, a deposit insurer should be vested necessary powers, such as the authorities of assessing premium from its members based on its estimated cost/loss and borrowing fund for liquidity purpose.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

- Pay box systems, given their limited roles and responsibilities; require appropriate authority, as well as access to deposit information and adequate funding, for the timely and efficient reimbursement of depositors when banks fail.
- The added responsibilities of the pay- box with extended powers systems necessitates closer cooperation and coordination of appropriate actions taken by safety net participants. The systems need to have some proactive powers such as access to risk assessment information and they may play a role in decisions on bank insolvency resolution. This gives the insurer more ability to address costs compared to pure pay box systems.
- To enhance the level of effectiveness and minimization of losses for the deposit insurer and the financial system, deposit insurer with risk-minimization mandate needs to be proactive in terms of taking on the risk identification, assessment and management. It needs access to timely and accurate information so it can assess the financial condition of individual insured institutions, as well as the financial industry. It also must anticipate the financial troubles of individual banks and deal with them effectively when they arise.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

- **Interrelationship with Other Safety Net Participants:**
- Deposit insurance is a critical complementary function within the financial safety net, so the mandate of the deposit insurer should be aligned with other institutional functions of other members in the safety net. The mandatory roles, responsibilities and authorities of different safety net participants have to be well coordinated and clearly defined in the relevant laws/ bylaws to prevent overlaps and to avoid delayed intervention.
- The powers, authorities and mandates of other safety net members need also to be explicitly defined in the respective laws. The clearly stated division of responsibilities improves the corporate governance in the system and enhances the decision making process and accordingly system's efficiency.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

- Although the memoranda of understanding is a flexible formal mean of information sharing, it has a major shortcoming; as the scope, frequency, timing and even continuance of information flows depend on the readiness and willingness of the regulatory bodies to cooperate with the deposit insurer. Consequently, it is preferable to stipulate the right to receive critical information in the Law or at least in the By-laws with further specification in the memoranda.
- Coordination mechanisms are particularly important in handling a systemic banking crisis. All financial safety net participants (the government, regulatory body, Central bank and deposit insurer) should join the regulation of the situation. Deposit insurer forms an integral part of the solution which depends on its mandate and the nature of the problem.
- Deposit insurance schemes have to be part of a well-designed system of regulation and supervision that makes sure banks do not go overboard with risk. Ultimately, deposit insurance does not replace supervision, but calls for its intensification: without effective supervisory system it can not, on its own, prevent depositors from losing faith in the financial system as a result of banking failures.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

Organizational Aspects:

- The integration of the deposit insurance function in one of the departments of the Central Bank or the Supervisory Authority might be cost effective and it could also result in a better access to supervisory data on member institutions. However, the analysis shows that physical independence of the deposit insurer proves to be a crucial element of a well functioning safety net system, as it supports the decision making process of different safety-net members and enhances the corporate governance in the systems by identifying practically the roles, responsibilities and authorities of the different safety-net players.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

Resources and Staff Training:

- Funding is the basic resource consideration, for the sake of ensuring adequate deposit insurance fund level that is crucial for an effective deposit insurance system; an explicit target ratio is beneficial for a deposit insurer to fulfill its mandates.
- To maintain efficient system, deposit insurers should have adequate funding to cover medium and long-term operational costs.
- The effective mandates should enable the deposit insurers to attract and retain qualified employees, determine the appropriate mix between dedicated staffing and outsourcing, ensure the confidentiality of information supplied to employees and guarantee that employees receive legal protection against lawsuits for actions taken in the normal course of activities.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

- Deposit insurer should have the right to employ its own workforce on a permanent or temporary basis in order to be able to adjust its staff requirements according to its needs. It should also provide competitive and sufficient enough financial packages to attract and retain skilled people.
- Outsourcing could be viable solution for deposit insurer particularly when dealing with resolution issues. However, core functions should be handled by permanent staff, and deposit insurer should retain the key persons for all functional aspects.
- Continuous training is critical for effective implementation of insurer's mandate. Training needs could be fulfilled through inside regular or ad hoc courses. Outside and co-shared, with other safety-net players, training is cost effective; it brings additional education and allow for wider experience-sharing benefits for the deposit insurer. Any institutional arrangements among safety net players should consider the training dimension.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

- Deposit insurers in a particular region need target-oriented training courses for employees in order to enhance their specialized knowledge in monitoring cross-border activities and their repercussions for insurance risk.
- Deposit insurers must appropriate adequate budget for IT support to fulfill their mandates. They may enhance further operational efficiency and cost effectiveness by sharing IT systems and data bases with other safety net players.

VII: General Guidance Points for Designing Effective Deposit Insurance Mandate

Membership Policy

- Membership should be compulsory to avoid adverse selection. Nevertheless, it should be granted only to institutions that are subject to supervision and regulation. Membership policy should be articulated explicitly in the deposit insurer's mandate. Moreover, membership criteria and financial requirements must be met by institutions before they become members of the deposit insurance system.

Thank You

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