WIDENING THE NET: DEPOSIT INSURANCE FOR DFIs

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Presentation outline

I. Benefits of deposit insurance

II. Overview of IADI

III. Best practices in deposit insurance: the Core Principles for Effective Deposit Insurance Systems

IV. Deposit insurance and Developmental Financial Institutions - considerations
Financial Consumer Protection
- To protect unsophisticated, retail and/or small-scale depositors in case of a bank failure.

Confidence and Stability
- Depositors are far less likely to ‘runs’ on banks in the event of a failure.

More orderly resolution
- Provides for the orderly closure/resolution of banks and mechanism(s) to recover costs from the industry.

Greater Certainty
- Limits 100% implicit guarantees common in many jurisdictions with no explicit deposit insurance.
I. IADI OVERVIEW

Mission
- To contribute to the enhancement of deposit insurance system effectiveness by promoting guidance and international cooperation

History
- Established in Basel in 2002 with 25 Founding Members
- Membership in 2017 – 84 Members, 8 Associates and 14 Partners

Key Advancements
- IADI Core Principles for Effective Deposit Insurance Systems (CPs) – issued in 2009 and revised in 2014
- CPs have been incorporated into IMF/WB FSAPs and FSB Peer Reviews

Research & Guidance
- Guidance under development in areas such as: funding; financial inclusion, crisis management and asset recoveries
- IADI Biennial Research Conference in Basel – June 2017
- IADI Annual survey and database

Training & Capacity Building
- Global/Regional conferences, seminars and technical workshops
- Joint FSI-IADI conferences and policy implementation meetings
- Website and on-line tutorials
II. IADI CORE PRINCIPLES FOR EFFECTIVE DEPOSIT INSURANCE SYSTEMS

Key Characteristics

- Developed in 2009 and revised in 2014.
- Incorporates best practices of deposit insurers and views of organizations such as the BIS, IMF, World Bank and European Forum of Deposit Insurance.
- Reflects lessons learned in past financial crises.
- Are being utilized in deposit insurer self-assessments, IMF-WB FSAPs and FSB peer reviews.

16 Core Principles

1. Public policy objectives
2. Mandate and powers
3. Governance
4. Relationships
5. Cross-border issues
6. Crisis management
7. Membership
8. Coverage
9. Sources and uses of funds
10. Public awareness
11. Legal protection
12. Dealing with parties at fault
13. Early detection and intervention
14. Failure resolution
15. Reimbursing depositors
16. Recoveries
III. IADI Core Principles – more detail

**CP1. Public Policy Objectives**
- Clearly defined and formally specified – emphasizing depositor protection and contributing to financial stability.
- Review of the extent to which a deposit insurance system meets policy objectives conducted on a regular basis.

**CP2/3. Mandates, Powers and Governance**
- Recognizes deposit insurer mandates vary from “paybox” to “risk minimizers”. Mandate clarifies roles and responsibilities of deposit insurer and is aligned with the mandates of the other safety-net participants.
- Deposit insurer is operationally independent, accountable and transparent. Powers support mandate.
CP4. Relationships with safety-net players

- Formal ongoing information sharing and coordination in place among deposit insurers and other safety-net participants. Rules ensure confidentiality.

CP5. Cross-border Issues

- Where there is a material presence of foreign banks in a jurisdiction, formal information sharing coordination arrangements in place among deposit insurers.

CP6. Crisis Preparedness and Management

- Deposit insurer should have effective contingency planning/crisis management policies to ensure it is able to effectively respond to bank failures.
- Deposit insurer a member of institutional framework for coordination involving system-wide crisis preparedness and management.
- Deposit insurer participates in the development of pre / post crisis management communication plans involving all safety-net participants.
CP7/8. Membership and Coverage

- Membership compulsory for all banks.
- Vast majority of individual depositors to be covered but majority of the value of deposits exposed to market discipline.

CP9. Funding

- Banks pay for deposit insurance.
- Deposit insurer must have ex-ante funding and assured access to emergency liquidity.
- Sound fund investment and management needs to be in place. Deposit insurer must authorize any use of its funds by other safety-net participants.

CP10. Public Awareness

- The public should be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.
- The deposit insurer is responsible for promoting public awareness about the deposit insurance system.
CP11/12. Legal issues

- The deposit insurer and all those working on its behalf are protected from liability arising from actions taken in good faith.

CP13. Early detection and timely intervention

- The deposit insurer is part of the framework within the financial safety net that provides for the early detection of, and timely intervention in, troubled banks.
- The framework provides for intervention before non-viability.

CP14. Failure resolution

- An effective failure resolution regime should enable the deposit insurer to provide for the protection of depositors and contribute to financial stability.
- Legal framework includes special resolution regime.
  - Resolution regimes follow FSB Key Attributes key features
CP15. Reimbursing depositors

- Majority of insured depositors to be reimbursed within seven working days utilizing a variety of reimbursement options.
- Provisions to be made for making advance, interim or partial payments.
- Access to depositor records at all times; authority to undertake advance or preparatory exams.
- Scenario planning and simulations mandated.

CP16. Recoveries

- The deposit insurer should by law have the right to recover its claims in accordance with the statutory creditor hierarchy.
- Management and disposition of the assets of failed banks is guided by commercial and economic considerations.
IV. Deposit insurance and Development Financial Institutions (DFIs) – Considerations

DFI definition...

... defined as a bank or financial institution with a proportion of state-owned equity that has been given an explicit legal mandate to reach socioeconomic goals in a region, sector or particular market segment...

Membership in deposit insurance systems typically determined by factors such as...

- The extent to which DFIs accept deposits from the general public.
- The extent to which DFIs play a complementary role to private banks (e.g. they do not compete directly with the private banks).
- IADI CPs clear that all deposit-taking institutions should be members of a Deposit Insurance System (DIS).
—While not widespread, a number of IADI Members provide coverage to DFIs (e.g. Nigeria, Kenya).

—While other Members provide different coverage limits to different types of institutions (e.g. multiple deposit insurance systems in Canada, Germany and Japan).

—The extent to which DFIs are regulated and supervised to a similar standard as other deposit-taking institutions.

  » Evidence from past surveys suggest that a significant portion of DFIs which accept deposits from the public looking to improve risk-management, transparency and corporate governance.

  » Some jurisdictions have reduced supervisory and regulatory requirements for small DFIs, citing need to alleviate “regulatory burdens” on small institutions and to promote innovation and inclusion.
Coverage

— Should DFIs depositors be given similar coverage to those of commercial banks?

  » IADI guidance says deposit-taking institutions covering similar types of institutions should have similar coverage...
  » Nigeria has different coverage levels for DFIs -- Kenya has similar limits

— If not what are the consequences (will this create a competitive disadvantage or not)?

Sources and uses of funds

— IADI CPs stress that deposit insurance should be paid by the banks.
— Premium rates (whether flat or differentiated) should reflect funding needs of the system. At present 37% of DIS use differentiated premiums (IADI 2016 Survey).
— If differential premiums applied should reflect risk profile of DFIs.
Some challenges and questions to extending similar protection to DFIs

1) What are the key challenges or concerns on extending similar protection to DFIs depositors?

» Some depositors may not require higher coverage.
» Deposit characteristics of many small banks suggest a “standard” coverage rate can lead to almost complete effective coverage of most depositors.

2) Would higher premiums be justifiable as DFIs are expected to serve its mandated role which commonly poses higher risk coupled with overall objectives in operating sustainably, as opposed to maximising return to shareholders (profitability driven)?

> IADI guidance points to matching premium rates to risk exposure.
Thank You

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