Current Developments in Deposit Insurance

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What is deposit insurance?

• A scheme to protect depositors against loss of their insured deposits in the event that a bank is unable to meet its obligations to its depositors.

• The main objectives of a deposit insurance scheme (DIS) is …
  • to insure the most vulnerable depositors (individuals, sometimes SMEs) and
  • to contribute to financial stability (by preventing bank runs).

• A deposit insurance scheme is part of the financial safety net, together with the central bank, the bank supervisor, the resolution authority and the MOF.
How do deposit insurance systems work?

- A DIS collects premiums from its member banks for its Deposit Insurance Fund and invests the funds.

- When a member bank is closed these funds are used to reimburse insured depositors. The DIS Law defines the scope and level of deposit insurance as well as the pay-out timeframe.

- The reimbursement can take the form of a pay-out or the transfer of insured deposit (P&A transaction).

- The DIS takes over the claims from the depositors against the failed bank (subrogation).

- Recoveries from the estate of the failed bank flow back into the Deposit Insurance Fund.
Different mandates for deposit insurers

• A “pay box” mandate, where the deposit insurer is only responsible for the reimbursement of insured deposits.

• A “pay box plus” mandate, where the deposit insurer has additional responsibilities such as certain resolution functions (e.g. financial support)

• A “loss minimizer” mandate, where the insurer actively engages in a selection from a range of least-cost resolution strategies

• A “risk minimizer” mandate, where the insurer has comprehensive risk minimization functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases, prudential oversight responsibilities.
IADI Core Principles as an international standard

• The Core Principles for Effective Deposit Insurance Systems were first issued in 2009 by the International Association of Deposit Insurers (currently 83 members out of 120 schemes worldwide).

• The Core Principles were designed to be …
  • a voluntary framework;
  • adaptable to a broad range of country circumstances, settings and structures.

• IADI Core Principles are used in IMF/WB Financial Sector Assessment Program (FSAP) and as a benchmark in technical assistance projects.
16 IADI Core Principles

**Preconditions:**
* Sound banking sector
* Prudential regulation, supervision and resolution
* Legal and judicial framework
* Accounting and disclosure framework

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IADI CP: Key changes in revised version (2016)

• Reducing overlap and duplication

• Strengthening the CPs in certain areas
  • Reimbursement in 7 days (instead of 20 days)
  • Ex-ante funding only (no longer ex-post)
  • Use of deposit insurance fund for bank resolution (new)
  • Contingency planning (new)

• Updating the CPs relating to crisis preparedness, intervention and failure resolution (FSB Key Attributes for Effective Resolution Regimes)
IADI CPs: Common Assessment Findings

Materially Non-Compliant/Non-compliant ratings can be found more often in certain Core Principles such as:

- Powers (e.g. access to depositor records)
- Relationships with other Safety-net Participants (e.g. insufficient information exchange)
- Membership (e.g. not all banks are members)
- Funding (e.g. back-up funding is not explicitly foreseen)
- Reimbursing Depositors (e.g. long timeframes to payout deposits)
Current challenges for deposit insurers

• Implementation of shorter payout timeframe of 7 days

• Need to clarify the role of deposit insurer in funding bank resolutions (least cost-rule, cap for use of funds)

• Discussions to enhance the mandate of the deposit insurer to include (certain) resolution powers

• Cooperation and coordination in bank resolution and crisis management on a national and international level

• Contingency planning for deposit insurers and the financial safety-net
How the World Bank assists deposit insurers - examples

- **Uganda**: Establishing the deposit insurer as a separate legal entity

- **Bosnia Herzegovina**: Reforming the legal framework in light of the FSAP 2014 findings

- **Nigeria**: Development of a target ratio methodology for the deposit insurance fund

- **Montenegro**: Implementation of risk-based contribution framework

- **Bulgaria**: Loan to strengthen the financial and institutional capacity of the deposit insurance fund
Annex
CP 1: Public Policy Objectives

The principal public policy objectives for deposit insurance systems are to **protect depositors** and contribute to **financial stability**. These objectives should be formally specified and publicly disclosed. The design of the deposit insurance system should reflect the system’s public policy objectives.
CP 2: Mandate and Powers

The mandate and powers of the deposit insurer should support its public policy objectives and be clearly defined and formally specified in legislation.
CP 3: Governance

The deposit insurer should be operationally independent, well-governed, transparent, accountable, and insulated from external interference.
CP 4: Relationships with Other Safety-Net Participants

In order to protect depositors and contribute to financial stability, there should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, among the deposit insurer and other financial safety-net participants.
CP 5: Cross-Border Issues

Where there is a **material presence** of foreign banks in a jurisdiction, **formal information sharing and coordination arrangements** should be in place among deposit insurers in relevant jurisdictions.
CP 6: Deposit Insurer’s Role in Contingency Planning and Crisis Management

Development of a crisis strategy and implementing crisis management policies is not the responsibility of a single agency but is the joint responsibility of all safety-net participants. A framework should be in place that includes the deposit insurer as a member of a jurisdiction’s crisis management framework.
CP 7: Membership

Membership in a deposit insurance system should be compulsory for all banks.
CP 8: Coverage

Policymakers should define clearly the level and scope of coverage. **Coverage should be limited, credible and cover the large majority of depositors while leaving a substantial amount of deposits exposed to market discipline.** Deposit insurance coverage should be consistent with the deposit insurance system’s public policy objectives and related design features.
CP 9: Sources and Uses of Funds

The deposit insurer should have ready available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors’ claims, including assured liquidity funding arrangements. Responsibility for paying the cost of deposit insurance should be borne by banks.
CP 10: Public Awareness

In order to protect depositors and contribute to financial stability, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.
CP 11: Legal Protection

The **deposit insurer and individuals** working for the deposit insurer in the discharge of its mandate **must be protected** against actions, claims, lawsuits or other proceedings for their decisions, actions or omissions taken in good faith in the normal course of their duties. Legal protection should be defined in legislation.
CP 12: Dealing with Parties at Fault in a Bank Failure

The deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in a bank failure.
The deposit insurer should be part of a framework within the financial safety-net that provides for the **early detection of, and timely intervention in, troubled banks**. The framework should provide for intervention before the bank becomes non-viable. Such actions should protect depositors and contribute to financial stability.
CP 14: Failure Resolution

An effective failure-resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability. The legal framework should include a special resolution regime.
The deposit insurance system should give depositors **prompt access to their insured funds** in order to contribute to financial stability. There should be a clear and unequivocal trigger for insured depositor reimbursement.
CP 16: Recoveries

The deposit insurer should have, by law, the **right to recover its claims** in accordance with the creditor hierarchy in law.