

**APEC Policy Dialogue on Deposit Insurance:
Policy Conclusions Paper**

FINAL VERSION

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Canada Deposit Insurance Corporation

Executive Summary

The first APEC Policy Dialogue on Deposit Insurance was held in Kuala Lumpur, Malaysia from February 16-18, 2004. The Dialogue was chaired by the Canada Deposit Insurance Corporation and hosted by Bank Negara Malaysia. This paper summarizes the key policy conclusions and model frameworks to emerge from presentations and discussions at the APEC Policy Dialogue on Deposit Insurance.

Three important issues affecting deposit insurers and other financial system safety net participants are addressed: (1) legal protection and indemnification for individuals working for deposit insurers and other financial system safety net participants; (2) governance and interrelationship management among safety net participants; and (3) trigger mechanisms for prompt corrective action when dealing with troubled deposit taking institutions.

Understanding and dealing effectively with these issues is critical for building effective deposit insurance systems and financial safety nets. Moreover, while each of these issues are important on their own they are also highly interconnected. For instance, strong governance and effective information sharing and coordination between deposit insurers and other safety-net participants is critical for supporting prompt corrective action when dealing with troubled banks. A strong legal protection and accountability regime for those working for safety-net organizations leads to greater vigilance in the carrying out of organizational mandates -- particularly when those mandates emphasize early intervention and prompt corrective action.

1) Legal protection and indemnification issues

- Situations exist in a number of economies where individuals (e.g. current and former employees, directors, officers and agents) working for deposit insurers and other organizations involved in the financial system safety net are held personally liable for their decisions, actions or omissions taken in good faith in the normal discharge of their legal responsibilities.
- While this lack of legal protection may have been established to help improve accountability, it reduces incentives for these individuals to be diligent in the carrying out of their mandates. This can result in costly delays when dealing with troubled banks and resolving failed banks. Ultimately, the lack of legal protection can result in a serious erosion of credibility, independence and integrity of the deposit insurer and other safety net participants.
- Thus, individuals working for deposit insurers and other safety net participants should be protected against civil and criminal liability for their decisions, actions or omissions taken in "good faith" while discharging their mandates. Legal protection should be codified in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified.
- However, legal protection must coexist in an environment where there is clear accountability. This means that while individuals should be legally protected, they must be required to follow appropriate oaths of office, conflict of interest rules and codes of conduct to ensure

they remain accountable. And, it is important that the safety net organization itself should remain accountable for its conduct. Provisions regarding secrecy and confidentiality regarding all documents, information and records pertaining to matters dealt with by the deposit insurance entity also need to be in place.

2) Governance and interrelationship management among financial safety net participants

- The sound governance of organizations comprising the safety net strengthens the financial system's architecture and contributes directly to system stability. The four major elements comprising sound governance of organizations are: independence, accountability, transparency and integrity. All are equally important and reinforce each other in supporting good governance practices.
- The view that operationally independent and accountable safety net organizations, with clear mandates and which are insulated from undue political and industry influence, provide greater integrity, credibility and legitimacy than entities lacking such independence is embodied in the standards that are assessed in the World Bank-IMF Financial Sector Assessment Program.
- Experience also shows that a separate, operationally independent and accountable deposit insurance entity working within the financial safety net is the "best practice" model available to provide: (1) the most effective incentives for the control of moral hazard affecting a deposit insurer; (2) the greatest protection of the interests of depositors; (3) more balanced and effective decision-making; and (4) promotes more extensive monitoring of potential conflicts than entities lacking such independence.
- Information sharing among all safety-net participants is essential for an effective deposit insurance system. Such information should be timely, accurate and relevant with due respect given to maintaining confidentiality when required. Formal information sharing arrangements either through legislation, memoranda of understanding, legal agreements or a combination of these techniques are necessary.
- The most important and effective way to promote smooth coordination on the part of financial safety net participants is to provide for clear mandates and the division of powers and responsibilities among them. Formal arrangements are also necessary in providing a general framework for safety net participants to coordinate their related activities.

3) Trigger mechanisms for prompt corrective action when dealing with troubled banks

- In a competitive financial system banks can and do fail. Ensuring that a framework exists for prompt corrective action and resolution of troubled banks can reduce the costs to depositors and the deposit insurer, contribute to financial system stability and help reduce the likelihood of an isolated bank failure turning into a financial crises.
- Institutional arrangements for prompt corrective action need to ensure that the safety net participants involved have clearly defined mandates, roles and responsibilities, that the

prompt corrective action framework is well defined, transparent and well understood and that there are sound information sharing and coordination arrangements among the safety net organizations. In addition, these arrangements need to be supported by strong regulation and supervision, sound accounting and disclosure regimes, and an effective legal system.

- When dealing with troubled banks, neither a purely “rules-based” or “discretionary” prompt corrective action approach is recommended. Instead, a balance needs to be struck between these approaches. An effective method adopted in many economies is to use a sliding scale intervention framework where the use of rules and discretion, the form of intervention and its timeliness is proportionate to the severity of the problems encountered by a troubled bank.
- The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well defined and transparent trigger mechanisms by safety net participants with the operational independence and legal authority to act.
- Because a bank’s financial performance and capital position can deteriorate quickly, trigger mechanisms based on single measures such as capital insolvency or illiquidity may not be sufficient. Effective trigger mechanism for prompt corrective action should include a variety of relevant indicators.

1. Introduction

This paper summarizes the key policy conclusions and model frameworks to emerge from presentations and discussions at the Asia-Pacific Economic Cooperation (APEC) Policy Dialogue on Deposit Insurance.

Under the auspices of the APEC Finance Ministers' process, the Policy Dialogue was held in Kuala Lumpur, Malaysia from February 16 to 18, 2004. It supports APEC's ongoing efforts to promote greater understanding of the policies needed to strengthen financial systems in the APEC region. The Dialogue provided an opportunity for participants to meet and share information and experiences on building effective deposit insurance systems. It was comprised of presentations from invited international experts and practitioners and open discussion on selected policy issues.

The Dialogue was chaired by the Canada Deposit Insurance Corporation (CDIC) and hosted by Bank Negara Malaysia. It was attended by representatives from 16 of the 21 APEC economies as well as a number of non-APEC economies. Most attendees were senior policy makers and representatives of deposit insurers, supervisory authorities, finance ministries and central banks. Participants from the International Association of Deposit insurers, International Monetary Fund, the World Bank, academics and private business firms were also in attendance.

It was agreed that a paper would be prepared to summarize the main issues discussed in the Policy Dialogue and this paper would be presented at the APEC Finance Ministers' Meeting in Santiago, Chile in September 2004. The paper covers three major issues:

- (1) Legal protection and indemnification for individuals working for deposit insurers and other financial system safety-net participants¹ – including, oaths of office, conflict of interest codes and confidentiality provisions;
- (2) Governance and interrelationship management among financial safety-net participants; and
- (3) Trigger mechanisms for prompt corrective action when dealing with troubled deposit taking institutions (i.e. hereafter referred to as banks).

Understanding and dealing effectively with these issues is critical for building effective deposit insurance systems and financial safety nets. Moreover, while each of these issues are important on their own they are also highly interconnected. For instance, strong governance and effective information sharing and coordination between deposit insurers and other safety-net participants is critical for supporting prompt corrective action when dealing with troubled banks. A strong legal protection and accountability regime for those working for safety-net organizations leads to greater vigilance in the carrying out of organizational mandates -- particularly when those mandates emphasize early intervention and prompt corrective action.

¹ A financial system safety net usually includes the functions of prudential regulation and supervision, lender of last resort facilities and some form of deposit insurance.

In recognition of the importance of these issues to deposit insurer and other financial safety-net participants, the following sections of the paper provide additional information arising from the Dialogue and propose a series of model frameworks in these three areas.

2. Legal Protection and Indemnification Issues

Situations exist in a number of economies where individuals (e.g. current and former employees, directors, officers and agents) working for deposit insurers and other organizations involved in the financial system safety net are held personally liable for their decisions, actions or omissions taken in good faith in the normal discharge of their legal responsibilities. While this lack of legal protection may have been established to help improve accountability, it has resulted in reduced incentives for these individuals to be vigilant in the carrying out of their mandates.

The lack of legal or statutory protection can reduce incentives for individuals to be diligent in the carrying out of their mandates - particularly in cases where deposit insurers and other safety net participant's mandates emphasise promptness in the detection, intervention and resolution of troubled banks. For instance, this can result in costly delays when dealing with troubled banks and resolving failed banks. Ultimately, the lack of legal protection can result in a serious erosion of credibility, independence and integrity of the deposit insurer and other safety net participants.

A recent IMF survey using information collected from the World Bank-IMF Financial Sector Assessment Program (FSAP) shows that legal protection of individuals working in the financial safety net system is not well established in many economies.² Another survey conducted by the Canada Deposit Insurance Corporation indicated that one third of the 48-country deposit insurance systems surveyed lacked legal protection for individuals.³

This need for legal protection has been well recognized. The Financial Stability Forum Working Group on Deposit Insurance recommended that individuals should receive legal protection against civil and criminal liability for their official action in the normal course of deposit insurance activities or supervision. And, the BIS Core Principles for Effective Banking Supervision clearly emphasize the need for the legal protection of supervisory personnel.

In developing a model framework in this area, the experiences of other economies which provide legal protection for individuals should be considered. For instance, commonly used elements of a legal protection regime can include:

- 1) granting express statutory immunity to individuals from civil and criminal liability for their decisions, actions or omissions taken in the normal discharge of their legal responsibilities;
- 2) making the safety net organization liable for their actions or omissions;

² See Ingves, S. and M. Quintyn: "Financial Stability Assessments: Implications for Governance Arrangements", a paper presented at the Second IADI Conference, Seoul, Korea, October 23-24, 2003.

³ Canada Deposit Insurance Corporation, "International Deposit Insurance Survey", Ottawa, Canada, 2003.

- 3) including appropriate indemnification provisions in their contract of employment; or
- 4) a combination of these mechanisms.

To provide incentives for good conduct, however, the relevant statutory or contractual provisions for individuals must be wide and unambiguous. They should also not qualify the protection by requiring the individual to establish that their actions and decisions (including decisions not to take action) were “reasonable”, not “negligent” or consistent with some other state of mind of this type.

Legal protection should be codified in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified. Legal protection, however, should not extend to protecting individuals where they have acted in bad faith; for example, where they have acted fraudulently or maliciously.

Accountability Issues

Legal protection of individuals must coexist in an environment where there are clear mandates and an accountability framework. Individuals working for deposit insurers and the other organizations involved in the safety net must be required to justify and accept responsibilities for their actions against the background of their mandates and responsibilities.

This involves having appropriate oaths of office, conflict of interest rules and codes of conduct in place with enforcement provisions. Ensuring public confidence in the integrity of the deposit insurer and those who work for it can be reinforced by establishing clear, well-documented and transparent rules respecting potential conflicts and clear performance objectives and measures. As such, individuals must ensure that their private affairs do not result in a real, potential or apparent conflict with the organizations interests.

And, while individuals should receive legal protection, it is important that the safety net organization itself remain accountable for its decisions, actions or failure to take appropriate action.⁴

Confidentiality

Most deposit insurance systems and other safety net participants need to rely on confidential information collected from institutions and other safety-net players to fulfil their mandates. Thus, measures to ensure that this information remains confidential are important. Economies should introduce provisions regarding secrecy and confidentiality regarding all documents, information and records pertaining to matters dealt with by the insurance entity.

⁴ Different views were expressed during the Dialogue as to the extent of the legal protection which should be provided to safety net organizations. A number of Dialogue participants stressed that the safety net organization itself should not be indemnified. Others took the view that the extent of legal protection accorded to the organization depended on considerations specific to the legal regime present in each economy.

Please refer to Appendix A for examples of indemnification, accountability and confidentiality provisions.

3) Governance and Interrelationship Management among Financial Safety Net Participants

Good governance and effective interrelationship management are essential elements of a well functioning deposit insurance and financial safety net system.

The sound governance of organizations comprising the safety net strengthens the financial system's architecture and contributes directly to system stability. The four major elements comprising sound governance of organizations are: independence, accountability, transparency and integrity. All are equally important and reinforce each other in supporting good governance practices.

When addressing independence for a deposit insurer and other safety net participants, a distinction must be made between "goal" independence and "operational" independence. Goal independence refers to a situation where an organization has independent control over its objectives and mandate. By definition, this form of independence is excluded for a deposit insurer and other safety net participants. The goals and the mandate of these organizations are set out in the law or statute that establish the organization, and are defined by those (the legislature typically) who delegate the power. However, operational independence -- defined as independence in using the instruments and means assigned to the organization in order to fulfill its mandate -- is necessary for an effective deposit insurer and other safety net organizations. Organizations with operational independence are much more effective at resisting undue political and industry influence than organizations lacking such independence.

Independence, however, cannot be justified without accountability. Adequate accountability arrangements -- allowing the organization to clearly explain what it does and why -- will support its independence, because it provides legitimacy to the organization. An organization that goes against its mandate for an extended period of time will lose its independence. Accountability helps avoid such a situation emerging.

Transparency is a vehicle for safeguarding independence and providing accountability. By making actions and decisions transparent, chances for interference from outside parties are reduced. Transparency also helps to establish and safeguard integrity in the sense that if arrangements to ensure integrity are published, they provide even better protection for safety net participants.

Transparency is particularly important for the supervisory and failure resolution process. Transparent frameworks and appropriate disclosure on resolutions (e.g. reports on the progress of liquidations) provides the public with information necessary to judge the effectiveness of the conduct of safety net participants. It can also guard against inappropriate political and industry interference and help reinforce the integrity of the whole system.

Integrity refers to those mechanisms that ensure that individuals working for deposit insurers and safety net organizations can pursue their goals without compromising them due to their own behaviour, or self-interest. Integrity affects the work of people at various levels. First, procedures for appointment of heads, their terms of office, and criteria for removal should be such that the integrity of the board-level appointees (i.e. members of a policymaking body) be safeguarded. Second, the integrity of the organization's day-to-day operations also needs to be ensured. Effective internal governance implies that internal control and audit arrangements and internal governance rules be in place to ensure that the organization's objectives are clearly set and observed, that decisions are made, and accountability is maintained. Third, integrity also implies that there are standards for the conduct of personal affairs of officials and individuals to prevent exploitation of conflicts of interest. And, finally, assuring integrity implies that individuals working for the safety net organization receive legal protection.

Independence and integrity also reinforce each other. Legal protection for individuals working for safety net organizations, as well as clear rules for appointment and removal of agency heads, support both their independence and their integrity. Independence helps integrity in the sense that, when organization personnel feel they are independent, they will not easily yield to outside interference. Finally, accountability and integrity are mutually reinforcing. Accountability requirements provide additional incentives for individuals to maintain their integrity.

The view that operationally independent and accountable safety net organizations, with clear mandates and which are insulated from undue political and industry influence, provide greater integrity, credibility and legitimacy than entities lacking such independence is embodied in the standards that are assessed in the World Bank-IMF Financial Sector Assessment Program.⁵

Moreover, experience shows that a separate, operationally independent and accountable deposit insurance entity working within the financial safety net is the "best practice" available to provide: (1) the most effective incentives for the control of moral hazard affecting a deposit insurer; (2) the greatest protection of the interests of depositors; (3) more balanced and effective decision-making; and (4) promotes more extensive monitoring of potential conflicts than entities lacking such independence.

It must also be emphasized that separate and operationally independent deposit insurers require well-defined mandates and strong accountability frameworks to ensure the integrity, transparency and credibility of the system.

Interrelationship management

Information sharing and coordination mechanisms need to be clearly and explicitly addressed in order to promote and maintain the credibility of the safety net. The need for coordination and goodwill among the safety-net participants is related to the potential conflicts between them. For example, conflicts between the supervisory authority and the deposit insurer may arise if the

⁵ The prevailing trend for new deposit insurance systems is also the independent model. For example, Hong Kong SAR, Malaysia and Singapore have indicated a preference for creating separate and independent deposit insurers. For further information, see the CDIC International Deposit Insurance Survey (2003) *op cit*.

supervisor, who is generally in charge of closing a bank, is viewed to be delaying action through forbearance. Forbearance will always be present, so long as failures of insured banks are thought to somehow represent supervisory failures. Thus, there can be a tendency to give troubled banks “another last chance” in order to avoid a failure and its attendant effect on the supervisor’s reputation.

The most important and effective way to promote smooth coordination is to put in place a clear division of powers and responsibilities, especially with regard to when and how to intervene in troubled banks.

With respect to information sharing, the supervisory authority is usually the primary source of information on banks since they undertake examinations. In order to ensure that the deposit insurer obtains the information it needs, while minimising reporting burdens on banks, it is important to closely coordinate the collection and sharing of information between the safety net participants.

A deposit insurer’s information needs vary significantly according to its mandate and powers. Depending on the breadth of their individual mandates, deposit insurers may need to supplement information provided by supervisors with information directly collected from insured banks.

At a minimum, a deposit insurer should have ready access to specific information related to banks’ deposit base, including the amount of insured and total deposits, so that plans for resources and funding needs can be developed. Accordingly, effective standards and guidelines may need to be issued to ensure that banks maintain and safeguard appropriate records.

A deposit insurer with a risk-minimisation mandate (i.e. with an emphasis on minimizing its exposure to losses through proactive risk identification, assessment and management) must have access to timely and accurate information so that it can assess the financial condition of individual banks, as well as the banking industry. It also must work in close collaboration with the supervisor and anticipate the financial troubles of banks and deal with them effectively when they arise. The deposit insurer also needs information regarding the value of the bank’s assets and the expected time frame for the liquidation process, given that the value of a bank’s assets depends, in part, on the time necessary to liquidate them.⁶

However, it is important to balance the need for the deposit insurer to obtain supplemental information against the need not to place an undue burden on the industry or to impose unproductive information requirements. It is particularly important that there be no legal impediments to the flow of information from banks to safety net players. Bank secrecy laws, which are in place in some economies, clearly represent an obstacle to the unimpeded flow of information.

Although informal arrangements for information sharing can be used, it is not the most effective mechanism as it relies too much on the goodwill of the representatives of the other safety-net

⁶ Risk-minimizing deposit insurance systems can be highly effective at minimizing losses associated with bank failures and in dealing with the potential regulatory forbearance which can occur when dealing with troubled banks.

participants. It is very important to legislate understandings and responsibilities to ensure a strong accountability regime. Also, maintaining confidentiality requires that such arrangements should be formalised through legislation or legal agreements. Formal arrangements are also critical in providing a general framework for safety-net participants to coordinate their related activities. These agreements should also be well documented and transparent to the public.

Common safety-net information and coordination mechanisms in use in many countries include membership of safety net players on the deposit insurance system's board of directors, the deposit insurance licensing process, specially designated committees, memoranda of understanding and legal agreements.

Please refer to Appendix B for examples of coordination and information sharing mechanisms.

4) Trigger Mechanisms for Prompt Corrective Action When Dealing With Troubled Banks

In a competitive financial system banks can and do fail. Ensuring that a framework exists for prompt corrective action and resolution of troubled banks can reduce the costs of deposit insurance, contribute to financial system stability and help reduce the likelihood of an isolated bank failure turning into a financial crises. A critical component of any prompt corrective action regime is the use of trigger mechanisms to initiate early intervention and if necessary, the resolution of failed banks.

Institutional and legal arrangements

In some countries prompt corrective action decisions are made by a central bank, supervisor or deposit insurer, in some it is by a government ministry or department, while in others, it is a combination of safety-net participants. Whatever the case, the institutional and legal arrangements need to include clear roles, responsibilities and objectives for all the safety-net participants. In addition, resolution criteria should be well defined, transparent and understood by safety-net participants and individual banks.

Institutional arrangements for prompt corrective action must be fully supported by strong regulation and supervision, sound accounting and disclosure regimes and an effective legal system.

Another important institutional issue is whether intervention should be “rules-based” or “discretionary”. A rules-based approach primarily relies on statutory provisions requiring mandatory corrective action for troubled banks within a specified time frame. Discretionary approaches rely primarily on the judgment of the supervisory authority on the timing and severity of intervention into the affairs of a troubled bank.

“Rules-based” intervention approaches have the advantage of being automatic and leaving no room for the possibility of supervisory forbearance. However, these approaches can be inflexible and leave little or no room for tailoring responses to particular circumstances.

Flexibility and judgement can be valuable when dealing with troubled banks and are particularly useful in dealing with the early stages of problems before more serious problems develop.

Thus, when dealing with troubled banks, neither a purely “rules-based” or “discretionary” prompt corrective action intervention approach is recommended. Instead, a balance needs to be struck between these approaches. An effective method adopted in many economies is to use a sliding scale intervention framework where the use of rules and discretion and the form of intervention and its timeliness is proportionate to the severity of the problems encountered by a bank. For example, in situations where a bank’s problems are less serious and management is cooperative, corrective action can be characterized by flexibility and reliance on judgement within approved guidelines. As problems become more serious and/or bank management becomes less responsive, more rules-based intervention can be employed.

One example of a primarily “rules-based” approach is that used by the U.S. Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991 which contains prompt corrective action provisions that formalize the timing of certain regulatory actions and closure on the basis of various capital ratios. The framework is well defined and transparent to all safety-net participants and member banks.

In Canada, a “Guide to Intervention for Federal Financial Institutions” is used to summarize the circumstances under which intervention measures may be expected, and it describes the co-ordination mechanisms in place between the relevant federal supervisory authorities when dealing with problem banks. The system relies heavily on financial “non-viability” criteria to trigger intervention.

The Guide outlines what banks can normally expect when encountering difficulties and serious problems. However, it is important to note that this intervention process combines both a rules based approach and discretionary elements and is not a rigid regime under which every bank or every situation is necessarily addressed with a predetermined set of actions.

Information sharing and coordination among the various agencies and authorities that make up a financial safety-net system, particularly when dealing with troubled banks, should also be addressed as part of the framework associated with an early intervention and resolution system.

Trigger mechanisms

The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made on the basis of well-defined and transparent criteria by safety-net participants with the legal authority to act. Prompt corrective action in the affairs of a troubled bank usually involves certain thresholds or trigger mechanisms, which must be crossed before intervention can occur.

The most common trigger mechanisms in use involve some form of a “balance-sheet” or insufficient capital criteria. Generally this involves a bank triggering corrective action by violating a minimum capital requirement or threshold. While in theory this appears to be a straightforward mechanism, in practice it is often difficult to employ effectively. For instance,

by the time the specific threshold of capital is crossed and intervention has occurred it is often too late and the bank has become effectively insolvent. This places depositors, deposit insurers and other creditors at serious risk of loss.

Other approaches use an illiquidity threshold where intervention begins when a bank is unable to pay its obligations as they fall due. For example, the European Union (EU) directive on deposit guarantee schemes is concerned with illiquid and not necessarily insolvent banks. No EU directive currently requires the closure of an insolvent bank.⁷ Although illiquidity can foreshadow insolvency, in some cases illiquidity can be temporary and not indicate insolvency and can be addressed through interbank lending and use of lender of the last resort facilities.

Because of the problems of relying solely on capital insolvency or illiquidity triggers, a third approach has evolved which uses a variety of criteria for prompt corrective action and resolution. A financial “non-viability” trigger can include the following:

- Concerns over the bank’s ability to meet capital and surplus, or vesting requirements on an ongoing basis
- Deterioration in the quality or value of assets, or the profitability of the business undertaken by the bank
- Undue exposure to off-balance sheet risk
- Questionable reporting of earnings or operating losses or expenses
- Low level of accessible liquidity or poor liquidity management in context of the institution's situation
- Less than satisfactory management quality or deficiency in management procedures or controls (including material breaches of standards or guidelines)
- Other concerns arising from a financially weak or troubled owner, rapid growth, and non-compliance with regulatory requirements, credit rating downgrades, and systemic issues.

The trigger mechanisms and processes used by authorities to take control of a bank and initiate resolution procedures are generally more rules-based than in other situations and tend to be more focused on regulatory capital. For instance, the most commonly used trigger is the failure (or imminent failure) to meet regulatory capital and surplus requirements.⁸

⁷ EU Directive (94/19/EEC) requires the activation of the deposit-guarantee scheme when deposits become unavailable. Although the EU also has adopted directives 89/647/EEC and 89/299/EEC that outline capital standards consistent with the Basel capital standards, no EU directive currently requires the closure of an insolvent bank.

⁸ Additionally, some economies use other criteria such as when statutory conditions for taking control are met (such as failure to comply with orders to increase capital); or failure to develop and implement an acceptable business plan, thus making either of the two preceding circumstances inevitable within a short period of time.

For instance, when it is determined that a bank has deteriorated below a specified threshold, even though it may still meet minimum capital requirements and be considered solvent otherwise – early intervention is initiated. Unlike the other trigger mechanisms, this type of approach provides greater flexibility to act promptly to intervene in the affairs of a troubled bank, and if necessary, initiate closure or other proceedings.

Finally, when dealing with trigger mechanisms and the institutional and legal framework to be used for prompt corrective action, it is important to recognize the need for ongoing capacity building to help economies deal with troubled banks. This can include developing training exercises, documentation of policies and procedures and the development of various failure resolution options.

Please refer to Appendix C for examples of prompt corrective action frameworks and trigger mechanisms.