Sharing Deposit Insurance Expertise with the World
International Association of Deposit Insurers

What's New at the IADI?

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Members Adopt Business Plan

A General Meeting was held on October 30, 2002 *via* a Web cast. The Members adopted their first **Business Plan** detailing a number of important initiatives aimed at sharing deposit insurance expertise with the world and a **Budget** that will help to lay the foundation of the Association. The Members also approved a process that will be used to develop guidance on deposit insurance; more information on the process and subject areas are on **www.iadi.org**.

Sharing Deposit Insurance Expertise!

The new IADI Web site has been launched – better functionality, nicer graphics and more user friendly. Check it out! Same location **www.iadi.org**.

The IADI is partnering with the European Bank for Reconstruction and Development to conduct a **Seminar on Deposit Insurance** for Krgyz Republic, Tadjikistan, Turkmenistan, Kazakhstan, Uzbekistan and Mongolia. The seminar is planned for January 29-31, 2003 in Basel at the Bank for International Settlements.

The **Second Annual IADI Conference** will take place in **Seoul, Korea on October 23 and 24, 2003**. Details on the conference will be provided at **http://www.iadi.org/aConfer.htm**. If you have any suggestions on topics that you would like to have addressed please send an email to **info@iadi.org** .

What's Happening with the Standing and Regional Committees

A draft Business Plan for the **Training and Conference Committee** has been prepared which outlines 14 prioritised initiatives. The highest priorities are given to those initiatives that relate to the preparations of the AGM in October 2003 and to the assessment of the training needs of the Participants and the development of training plans. The Chairman, Mr. András Fekete-Györ, would welcome feedback on their initiatives. He can be reached at: (**fekete@oba.hu**).

The **2003 IADI Conference** working theme is “Effective Depositor Protection: Enhancing Governance Arrangements”. A program is being prepared and speakers are being approached. The Chairman of the Task Force, Mr. Wonkeun Yang, can be reached at: (**wkyang@kdic.or.kr**).

The **Membership and Communications Committee** have developed an application form and process for handling participation in IADI**.** Annual fees for new applicants, which become Participants during the year, will be pro-rated, on a quarterly basis. The Committee has welcomed BearingPoint LLC (formerly KPMG Consulting) as an Observer. The Chairman, Mr. Mileti Mladenov, can be reached at: (**m.mladenov@dif.bg)**.

The **Finance and Planning Committee** reviewed the Business Plan and Budget of the IADI which was adopted by the Members on October 30, 2002. The Committee also discussed an approach to the management of the liquid assets of the Association. The Chairman, Mr. Charles Cornut **(ccornut@garantiedesdepots.fr**),.and his Committee is developing an investment policy for IADI funds.

The **Governance Committee** will be organizing a Web cast in the January/February period to discuss a work plan for this committee. The Chairman, Mr. Jean Pierre Sabourin (**jpsabourin@cdic.ca**), has noted that this Committee needs to put in place a sound corporate governance framework for the IADI, set out a process as to how this committee should function, and explore the role of the Executive Council in sound corporate governance of the Association.

The **Africa Committee** plans to have a conference in Nigeria involving stakeholders from the region in the first quarter of 2003. Later in the year, they plan to have a training program for deposit insurers from the region. The Chairman of this Committee, Mr. Ganiyu A. Ogundo, can be reached at: (**ogundojo@centralbank.go.ke**).

The **Asia Committee** has informed those Members of the IADI who are not on the Executive Council as well as the Associates, that this Committee has been formed. Their support was requested along with co-operation to promote the activities of the regional committee. The Deposit Insurance Corporation of Japan has appointed Mr. Masanori Ishizuka, Senior Director, to promote cooperation among the regional participants and other institutions interested in deposit insurance issues. The Chairman of this Committee, Mr Hajime Shinohara, can be reached at: (**hajime-shinohara@dic.go.jp**).

The **Caribbean Committee** has prepared a Business Plan for 2002/03. The main items include the advancement of the objectives of the Association, the development of strategies to recruit new participants and the identification of common issues in the Caribbean Region. The Chairman, Mr. Winston Carr, can be reached at:(**jdic@cwjamaica.com**).

The **Latin America Committee** has established contact with institutions and regional groups to invite them to share experiences, information and questions about deposit insurance. As well, contact has been made with the Chief Representative of the Office for the Americas of the Bank for International Settlements, which has been recently established in Mexico City. The Chairman, Mr. Carlos Isoard, can be reached at: (**cisoard@ipab.org.mx**).

Mr. Oscar Armando Perez (**operez@igd.gob.sv**) did some outreach work for the IADI through the banking supervisor of his country who attended a meeting of the Committee of Supervisors of Central America.

Mr. Carlos Isoard and Mr. Winston Carr represented the IADI at the first meeting of the Financial Sector Regional Forum held at the Inter-American Development Bank in Washington, D.C on September 13, 2002. The theme of the meeting was "The Institutional Structure of Financial Regulation and Supervision".

Deposit insurance and other current issues in international finance

On the occasion of the founding of the IADI and its First Annual Meeting, **MR. ANDREW CROCKETT**, General Manager, Bank for International Settlements, was invited to speak to at a dinner on May 7, 2002. We are pleased to include a transcript of his remarks, which were generously prepared by **Instituto para la Proteccion al Ahorro Bancario**, Mexico. Please note that any errors or omissions are the responsibility of the Editor.

Mr. Crockett

It is a great pleasure to be here this evening to celebrate the establishment of the International Association of Deposit Insurers and to mark its first Annual General Meeting.

Jean Pierre Sabourin remarked that this building is some 750 years old and that deposit insurance is much younger than that. What you did not mention, however, is that this building was one of the very, very few to withstand the earthquake that shook Basel some 650 years ago. That shows, I think, that whoever insured it knew that this building was a good one to insure.

I want to pay tribute to you, the members of the Association and to JP, its first chairman, on what is I think quite a historical occasion. I feel sure that, many years hence, we will look back to this moment when the **International Association of Deposit Insurers** was established as an important milestone in securing the safety and integrity of the international financial system.

There are many components to creating a sound and safe financial system. Sound deposit insurance arrangements are one of them. The Financial Stability Forum, which I chair, has as its main charge to bring together those responsible for different elements of financial stability. I thought I might on this occasion; when you as deposit insurers are joining the network of bodies that help underpin financial stability, report a little on some of the activities of the Financial Stability Forum and on what is going on in other parts of the field.

The recent past has been an active and difficult time for those whose responsibilities are in the area of international financial stability. Of course in our minds right now do our colleagues in Argentina face the difficulties, but this is, I might say, only the latest in a number of episodes of currency or financial crises. Helping to prevent and resolve financial crises is the primary objective of the Financial Stability Forum and of all of those international organizations and national authorities that work together with us. There are two elements to this work: one is finding mechanisms for better preventing the emergence of financial fragility that leads to instability, and the other is finding better mechanisms to resolve financial and sovereign debt crises if and when they emerge. Since we cannot hope to completely eliminate financial crises, both elements deserve attention.

In the area of prevention, the international community has in effect decided that the best strategy is to devise codes and standards of best practice in prudential regulation, supervision and other areas whose implementation would strengthen national financial systems, make them more efficient, more effective in serving their economies, but also to make them more resilient to crises. These codes and standards cover the whole range of subjects that are relevant to an efficient financial system. That is to say, they cover transparency, they cover accounting standards, they cover corporate governance standards, supervision of financial institutions, banks, securities houses, insurance companies, supervision of the markets and so on. And a part of a social financial system is, of course, having an effective safety net, and a part of having an effective safety net is to have an appropriate, well structured, deposit insurance mechanism.

Although generating consensus on the international best practice to be written into codes and standards is not always straightforward, it is a relatively easy task compared with the enormous amount of detailed and painstaking effort that is needed at national levels to put best practices in place. We have in this room those who are working in one area, that of deposit insurance. But we also welcome frequently at the BIS the groupings of national authorities in other areas: banking supervision, insurance supervisors and so on and so forth. They meet to discuss developments in their fields, the challenges of implementing best practices in their own economies, and areas in which existing standards need to be updated to reflect improved understanding. This is a tradition that I hope the IADI will take up as well.

So, in the area of prevention, I think we have come quite a long way in the last few years in generating consensus of what are the appropriate standards for a safe and sound financial system. The Financial Stability Forum has highlighted twelve key international standards on which priority ought to be focused, depending on country circumstances. The IMF and The World Bank have developed various instruments (ROSCs, FSAPs) to help assess observance of these standards and to offer technical assistance to accelerate implementation. Let's remember that the long term objective is to better serve the needs of the real economies in our various countries: to provide better prospects for economic growth and development, and to strengthen resiliency in the face of the shocks that invariably occur.

But the international community also needs to address the issue of how to resolve a crisis when it emerges. This is an area which can best be described as a work in progress: we do not yet have in the international community a satisfactory means of dealing with a situation when a country finds itself, temporarily or for a longer period, unable to service its international obligations.

As you know, the International Monetary Fund and The World Bank are very important agencies for providing finance. Particularly the IMF provides finance in case of a payments crises, but that comes with a catch that you as insurers or safety net providers know very well: If you provide financial assistance, then you encourage the recipient, and its creditors and investors, to be less than adequately careful in their activities. If you provide support too sparingly, then you may allow crises to develop that you could have prevented.

And, another problem in this area is the relative responsibilities of the public and private sectors. Increasingly now, most of the finance provided to emerging markets comes from private capital flows: portfolio flows, private direct investment and so on. So the lending activity being undertaken in the market is, in the largest part, provided by private sector individuals pursuing their own agenda, trying to respond to the needs of their shareholders to make returns that are commensurate with the risks. But what should happen when a country gets into financial difficulties?

In the past, we have seen the official sector framework leading to ever larger lending programs, at the same time as the private sector - whether domestic of foreign - has withdrawn its lending. That is not a satisfactory solution in the longer term and s in the richer countries that provide the IMF with resources have made clear that they would no longer be willing to support that approach. So the international community is now searching for a sovereign debt restructuring mechanism to find a better balance between private sector involvement and public sector support.

The IMF's First Deputy Managing Director, Ms. Anne Krueger, has suggested what is sometimes called a statutory framework, that is to say, national parliaments would pass rules amending the statutes of the IMF that would enable the international community to endorse a standstill by a country facing difficulties that would then be followed by negotiations between the creditor and the debtor country and the results of those negotiations, when agreed to by the majority of all the creditors, would then be enforced on all the creditors. This might involve a haircut, or it might involve a rescheduling for the agreement to become generally applicable.

And as I describe it, this is not dissimilar to the kind of bankruptcy procedures that exist in national jurisdictions. There are other attractions, I think, to that approach. The international community has now endorsed further work to follow this up. But there are also difficulties in this area, not least because sovereign liquidity crises are not quite the same as corporate crises. A country cannot be eventually dissolved and its assets distributed, nor can the management of the country, that is to say the government, be replaced the same way that management in companies can be replaced.

So the comparison is not exact. In part for this reason, there has been more interest in pursuing what is sometimes called a contractual rather than a statutory approach. That is, should we not try to get creditors and governments to agree, when they sign the terms of bond issues or other lending instruments, to include in those contracts clauses which define how the creditor and the debtor will resolve problems that might arise in the event that the original contract cannot be serviced on the original terms?

These two approaches, the statutory one working through the IMF or the appropriate authority and the contractual one with the voluntary inclusion of debt clauses in the original contracts are both being debated. I think the debate will probably go on for some time. It is, I would say, the single most difficult unresolved question in the international financial architecture.

The fact that it is a relevant question can be realized by looking back over the past five or seven years when we have had difficult crises in Mexico, in 1994-95, in Russia in 1998, in the East Asian countries in 1997-98 and now, a particularly intractable one in Argentina. And the solution that is sought, I should emphasize, will mark a break with the current model. It is very much an attempt to build a stronger basis for the future.

I do not want to spend a long time talking to you this evening. I know you have a very full day and you are looking forward, I am sure, to dinner. But, I think Jean Pierre was very wise to suggest that we should have the speeches before dinner so that we can relax and adjourn after the speech. But let me just mention a couple of other elements that you will think of when you come to Basel.

One is the Basel Capital Accord. As deposit insurers, you will have a particular interest in how your work interacts with that of the Basel Committee in defining adequate capital standards for banks, that is, standards that hopefully prevent banks from getting into difficulties that would require the intervention of deposit insurance.

But we have to balance things here. While more capital would make banks less vulnerable to risks, of course it would also make them less competitive relative to other institution and intermediaries that do not face such requirements. So, the challenge for the Basel Committee is to find capital standards that are more risk sensitive than the present standards but not so onerous as to prevent them from playing their full role in the financial system.

The old Basel Accord, which was signed here some 15 years or so ago, has by now become out of date. I am sure you all know that the risk weight applied to all lending to the private sector is identical and that does not make too much sense because we know that different borrowers have different degrees of risk or creditworthiness. The old standard also attached a uniform lower risk weight to banks and we all know too that some banks are more risky than others, or more risky than high quality corporations. So a more risk-sensitive approach is needed. What the Basel Committee has come up with is what is now called the “Three Pillars Approach” to assessing capital adequacy.

Pillar one defines, on the basis of quantitative criteria, what is the minimum capital ratio. The minimum ratio will be the same as the previous Basel minimum of eight percent, but with much more sophistication and differentiation in assigning risk weights to different credits.

The second and third pillars are innovations relative to the previous approach. Pillar two will give more weight to the judgment of supervisors in assessing capital adequacy. This makes a lot of sense, because we all know that a bank can have a portfolio that looks similar on the surface, but if supervisors drill down and understand the banks' risk management practices and internal controls, they can get a pretty good idea of which is the riskier institution by virtue of its culture, its lack of diversification and so on. So we need supervisory judgment to add to the minimum capital ratios established by quantitative calculations.

And finally, and this perhaps is the most significant innovation for the longer term, supervisors will be enlisting market forces in the supervisory task. Markets are sensitive to risk and communicate that sensitivity through the equity values of corporations and through credit risk spreads on e.g. bond issues. Pillar three tries to give to the market two things to enable it to participate in the supervision of banks. One is the information to judge the situation of individual institutions, that is to say, a level of transparency and disclosure by banks so that market participants can understand how they are doing and where they are going. And the second is to give markets an incentive to judge. Under the new capital accord, market participants' differentiation of banks according to their financial position will have implications for their own costs of providing capital for exposures.

The revised Basel Accord has taken quite long time to be negotiated. But there is a very good chance now that by the end of this year, the quantitative impact study will be completed and definitive proposal put forward for adoption in 2006.

I do not need to tell you as deposit insurers what a strong interest you have in making sure that a good, robust, appropriate, harmonized set of banking capital regulations is put in place. It will enormously affect and facilitate your tasks. But, I want to say this, and these will be my closing words: both, in relation to banking regulation and supervision, and in relation to deposit insurance, the job is never done. The financial world changes all the time and those who supervise and regulate the financial world have to be prepared to change too. So I do not have any doubt that soon after Basel II is in place, we will have to start to think about Basel III. I do not like to say this to my colleagues in the Basel Committee because they say *"oh no, I have been up all night for years doing Basel II"*. But there is no doubt that the task will have to be engaged.

Yours is a very important task. Few things are more important in modern economies than making sure that the financial system works well. The financial system distributes the real resources of the economy to their uses. If it works badly, then the best that happens is that resources are used inefficiently. But the worst of course is a financial crisis, which we know are enormously costly. So, I want to assure you that those who are not in your area recognize the importance of what you are doing.

We wish you well, we congratulate you and we congratulate Jean Pierre Sabourin as the first chairman, on setting up what is, and for some time will remain, the newest international financial organization.

We are very happy that you decided to establish your headquarters in Basel and we look forward to welcoming many of you frequently to the conferences and working sessions you will have.

And with that, we are done with speeches for this evening. Please enjoy your dinner and I hope you have a chance afterwards to take a walk outside and enjoy this meeting by the Rhine.

Thank you very much.

What's Happening in Your World?

On November 28, 2002, a draft law was adopted in the **Russian Federation**, which will lead to the implementation of a deposit insurance system covering household deposits. The next step is to submit the draft law to the State Duma (the lower chamber of the federal assembly). After that, it will go to the Council of the Federation (the upper chamber) and then it will be presented to the President of the Russian Federation with implementation expected in the first half of 2003.

The draft law stipulates that the **State Corporation "Agency for Reconstructing Credit Organization Institutions"** will be responsible for the management of the household deposit insurance system. The Government of the Russian Federation and the **Bank of Russia** will supervise the system. The Bank of Russia will determine which banks can be members of the new system, a deposit insurance fund will be created, coverage limits will be set on a graduated scale on a per depositor per bank basis, and transitional arrangements will go into effect until 2007 for the state-controlled savings bank.

The **Korea Deposit Insurance Corporation** held its Third Annual International Financial Symposium on October 25, 2002; the theme was "*Overcoming Financial Crisis: Financial Reform in Asia*". The symposium was designed to share experiences of dealing with financial crises in the Asian countries and to elicit policy implications for financial system reform to achieve financial stability in a global financial environment. Prominent scholars from Japan, China, Hong Kong and Korea were invited to present papers and to discuss issues such as the banking crisis in Japan, bank balance sheet channel of crisis propagation in developing countries, and economic precondition for a possible currency union in Asia.

A paper entitled *"Introducing Deposit Insurance System in China: A Comparative Study from Korean Experience"* co-authored by Wonkeun Yang, Sun Eae Chun and Zhigang Xie (Shanghai University of Finance and Economics) was presented. The paper maintains that China can greatly benefit from establishing an explicit deposit insurance system. The economic and financial conditions in China are explored in the context of needed structural reforms leading to the accession to WTO. Some recommendations are made for the design of DIS based on the Korean experience of running a deposit insurance system particularly during the crisis management period. The full paper can be found at: (***http://www.iadi.org/pdf/Introducing_DIS_China.pdf***). Here is an Abstract of the paper:

Facing sequential opening up of financial market upon accession to WTO, reform process of the financial sector in China should be accelerated. The immediate challenges are to dispose of the existing NPL portfolio in an efficient and transparent manner, to re-capitalize and restructure the banks, while distressed business corporations and financial institutions will be required to exit from the market.

Establishment of a formal Deposit Insurance System (DIS) in China may be used as an opportunity to put the missing laws that are designed explicitly to govern the demise of failed financial institutions into place. Explicit DIS may also serve as an restructuring agent providing the financial support, facilitate the resolution of financial institutions through merger and acquisition during the restructuring process. Membership could be applied to embrace small and large banks alike preventing adverse selection. The Korean case illustrates that even though the DIS scheme could be operated on an ex ante basis, supplementary funding, should be available for government to cover emergency and crisis situation. It is recommended that an independent DIS be established but in close cooperation with the central bank, PBC, taking into account the possible conflict with the ability to run sound monetary policy.

The Peoples' Bank of China (PBC) held an international workshop in Shanghai on October 17 and 18, 2002 on deposit insurance for China. Participants and speakers came from the PBC and there were deposit insurance experts from overseas and academics. Representatives from the IMF and European Central Bank also attended

The IADI was represented by Mr. Kazumi Inoue (Deposit Insurance Corporation of Japan), Mr. Chiho Kim (Korea Deposit Insurance Corporation), Mr. J. Reidhil (Federal Deposit Insurance Corporation), Mr. Raymond Li (Hong Kong Monetary Authority), Mr. Dániel Jánossy (National Deposit Insurance Fund of Hungary), Mr. J.A. Afolabi (Nigeria Deposit Insurance Corporation) and Ms. Rosalinda U. Casiguran (Philippine Deposit Insurance Corporation). The workshop is expected to help the PBC in the consideration of the introduction of a deposit insurance system in China.

The future of banking in the USA

Last summer, when Wal-Mart moved to acquire a small California bank, for the sole purpose of enabling it to process transactions internally, rather than using banks to do so, the reaction of the banks was swift. The result was the California legislature passed legislation prohibiting the proposal, and Wal-Mart withdrew its proposal.

At the annual meeting of the American Bankers Association, Mr. Donald Powell, the Chairman of the **Federal Deposit Insurance Corporation** announced the launch of a study on the future of banking in the United States. Mr. Powell noted the dramatic changes in the industry - consolidation, the development of technology, as well as innovation in financial products has created a situation where "your share of the pie has never been richer - but it has never been smaller, either."

Mr. Powell referred to the Wal-Mart proposal, which in effect is pushing the envelope on the issue of mixing banking and commerce. The example, he cited, was the marketplace being the driver of the situation, and if the marketplace demands innovation and evolution, the regulator needs to react. He noted that the study on the future of banking in America will begin with an analysis of underlying trends in the economy and the industry. Implications of these trends – including possibly mixing banking and commerce - will be used to develop emerging policy questions that are likely to impact regulators and industry over the next decade. Ultimately, the study will affect more than how the FDIC conducts its own activities.

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