

What's New at IADI ?

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Special Issue:

IADI to Issue Guidance covering Governance, Claims and Recoveries, Funding and Deposit Insurer Mandates

Request for Comments and Call for Submissions

The **Research and Guidance Committee of IADI** has prepared Business Plans covering **Governance, Claims and Recoveries, Funding and Mandates**. Comments on the "Issues to be Addressed" in each of the Business Plans are requested by **8 May 2006** and observations should be sent to the sub-group chairs noted in the documents. Submissions on topics addressed in the Business Plans are also invited and interested authors should signal their intentions to the respective chairs by 15 May 2006. Here is a summary of the approach for each of the guidance topics:

Governance

A deposit insurance system can be governed in a number of different ways. Some are set up as government departments, while others are established as separate agencies or state-owned enterprises. Others still are run entirely in the private sector, usually by industry associations of deposit-taking institutions. Whatever structure a deposit insurance system takes, governance largely remains a matter of direction, oversight and accountability.

Within this overarching concept of direction, oversight and accountability, a number of important issues are worthy of consideration. The Financial Stability Forum's Working Group on Deposit Insurance laid out four such issues in its 2001 background document on Structure and Organisation of Deposit Insurers. They are: form of governance system; the composition of the governance body and its duties and responsibilities; internal control processes and mechanisms; and the development of appropriate transparency and disclosure regimes. In addition, work by the APEC Policy Dialogue on Deposit Insurance in 2004, which was subsequently adopted as guidance by the **International Association of Deposit Insurers**, stresses the importance of independence, accountability, integrity and transparency as critical components of the governance framework for a deposit insurance system.

Given the importance of good governance in building an effective deposit insurance system, there is a need for detailed and comprehensive guidance in this area. In order to develop such guidance for countries considering the establishment of a deposit insurance system or the enhancement of an existing deposit insurance system, the **International Association of Deposit Insurers ("IADI")** proposes to develop a discussion paper to set out comprehensive guidance in this area.

The main focus of the paper will be (1) to identify the different types or forms of governance systems used by deposit insurance systems; (2) to explore the relevant governance issues for a deposit insurance system; (3) to examine the advantages and disadvantages of various approaches to governance; and (4) to provide guidance on appropriate practices in governance for a deposit insurance system taking into account the different types of systems that exist. [The Governance research plan](#) sets out an initial list of key issues to be addressed in the proposed discussion paper.

Claims and Recoveries

There are many different ways to design an effective deposit insurance system, including different funding schemes, different levels of coverage, with different types of accounts covered. Yet all of the systems are designed to protect the insured depositor in the event of a bank failure. In a like manner, once the governing authority has seized control of a failed bank and the depositor claims are fulfilled, the governmental authorities responsible for resolving the failure are expected to recover as much as possible from the assets and franchise of the failed bank.

This paper will explain the tools and processes that are needed to satisfy the claims of insured depositors (and others) and what tools and techniques can be used to maximize recoveries after the failure. The paper will then examine three case studies on the claims process, Canada, the Philippines, and Russia, to compare to and improve upon the IADI current guidelines.

[Link to the Claims and Recoveries research plan](#)

Funding

A good deposit insurance system should make timely and accurate depositor payouts, while maintaining the stability of the financial system. A deposit insurance agency needs a mechanism to raise financial resources for this purpose. Financial resources ensure that the deposit insurer performs its roles in a fiscally responsible manner. But, in the absence of adequate sources of funding, the viability of the deposit insurance fund and the credibility of the whole deposit insurance system could be seriously damaged. A sound and reliable deposit insurance funding assures greater certainty of and clarity in depositor protection. The confidence in deposit insurance is what makes the system work and very important for the maintenance of the stability in case the banking sector weakens. Public confidence reduces the likelihood that depositors at an individual bank will panic and withdraw funds suddenly if concerns arise about the condition of a particular institution.

A deposit insurance system must also have access to adequate sources of funding to reimburse depositors promptly and resolve failed bank in a timely manner. The access to funds can be obtained either by building a fund *ex ante* or by having the power to raise funds when needed afterwards or a combination of these approaches. First of all, a deposit insurer must have the choice between *ex ante* and *ex post* funding when considering the deposit insurance funding mechanism. Whether one method is preferred over another will depend on how advantages and disadvantages associated with each approach interrelate with

features of the deposit insurance system and country specific considerations. The comparative advantages of funding arrangements will be examined through various criteria, such as the effectiveness, efficiency and fairness.

The sub-group will look into the related issues of deposit insurance funding, to find the comparative advantages of *ex ante* and *ex post* approaches in designing a deposit insurance system. Also, they will discuss other related issues such as the source of funding and the choice between a flat rate or a risk-based/differential rate premium, investment policy and target approach. Where appropriate, the paper will provide guidance on appropriate good (best) practices in funding deposit insurance systems. [Link to the Funding research plan](#)

Mandates

The objective is to develop guidance for the **effective mandate of deposit insurance systems**. The experience of different countries in this regard will be summarized in the form of guidance reflecting most commonly used practices in the examined systems. The sub-group will develop a discussion paper that offers guidance in designing an effective mandate of deposit insurance schemes for countries considering the adoption of deposit insurance or the revision of existing deposit insurance systems.

Deposit insurance systems vary significantly across countries. The design and mandate of deposit insurance systems is significantly affected by the roles and powers of other members within the financial safety net, which includes beside the deposit insurance function, prudential regulation and supervision, a lender of last resort, mechanisms for the orderly disposition of failed institutions, and often a department of the government such as the Ministry of Finance. In general, research has analyzed the role of deposit insurance systems in enhancing financial stability and other related issues particularly moral hazard and probability of bank failure¹. The empirical evidence to date generally supports the role of explicit deposit insurance systems in promoting financial stability. The research, however, does not address directly differences among different deposit insurance mandates, the issue of consistency between the roles and responsibilities in one hand and the powers and authorities in the other, or most importantly the linkages between Deposit insurer mandate and its public policy objectives.

To this end, the sub-group will attempt to examine and analyze the mandate of a large sample of different deposit insurance systems, mainly from IADI **members** to reflect the most widely adopted approaches, and examine the consistency of these mandates with each system's objectives.

The deposit insurance role can be restricted to the role of reimbursing depositors as a Pay Box. Risk Minimizing systems, on the other end of the spectrum, play a wider role in enhancing financial stability. Their responsibilities and authorities include direct intervention and supervision of member banks and they handle

¹ For examples of the deposit insurance literature, please refer to attachment II. The **FDIC** has also compiled an annotated bibliography on deposit, which is available on their website www.fdic.gov.

directly the bank failures. The third category of deposit insurers include those pay box systems with extended, but still limited, roles and powers. The contribution of the three different types of deposit insurance systems to financial stability depends on the consistency of each system's mandate with its policy objectives and on the extent of harmony between deposit insurer mandate and the role of other safety net participants. The literature, in general does not clearly favour a particular type of deposit insurance systems; one size does not fit all. The issue however, is to identify the characteristics of systems with effective consistent mandates, bearing in mind that the aforementioned classification is an arbitrary one, and some deposit insurance systems may not fit easily into these broad categories according to their roles and responsibilities.

The research project will include a review of the relevant literature and a survey of the relevant elements that will utilize the completed questionnaires available from earlier research conducted by **IADI members**. Direct coordination with deposit insurers will be considered in order to complete the data set required for the development of the guidance. [Link to the Mandates Research plan](#)

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This newsletter was issued on 20 April 2006. To submit articles or items for consideration for a future issue, please send them to kim.white@iadi.org by 1 May 2006.