International Association of Deposit Insurers

Loss Minimisation Deposit Insurance Systems Around the World

IADI Africa Regional Committee Meeting and Conference

Deposit Protection Fund of Uganda and Bank of Uganda
16-19 September 2019

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Presentation Overview

- What is a Loss Minimising Deposit Insurance System?
- Loss Minimisers around the world
- Case study – Canada Deposit Insurance Corporation
- Success factors for loss minimisers

Definitions

The "**Mandate**" of the deposit insurer refers to the set of official instructions describing its roles and responsibilities. There is no single mandate or set of mandates suitable for all deposit insurers. Mandates can range from narrow "pay box" systems to those with extensive responsibilities. These can be broadly classified into four categories:

a. A **"pay box"** mandate, where the deposit insurer is only responsible for the reimbursement of insured deposits;

b. A **"pay box plus"** mandate, where the deposit insurer has additional responsibilities, such as certain resolution functions (e.g. financial support);

c. A **"loss minimiser"** mandate, where the insurer actively engages in a selection from a range of least-cost resolution strategies; and

d. A **"risk minimiser"** mandate, where the insurer has comprehensive risk minimisation functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases prudential oversight responsibilities.

Note:

A **"Least-cost Resolution"** is a procedure that requires the resolution authority to implement the resolution option, including liquidation of the failed Bank, that is least costly to the resolution authority, the financial system or the Deposit Insurance System.

Core Principle 2: Mandate and Powers

Core Principle 2 – MANDATE AND POWERS
The mandate and powers of the deposit insurer should support the public policy objectives and be clearly defined and formally specified in legislation.

Essential Criteria

1. *The mandate and powers of the deposit insurer are formally and clearly specified in legislation, and are consistent with stated public policy objectives.*

2. *The mandate clarifies the roles and responsibilities of the deposit insurer and is aligned with the mandates of other safety-net participants.*

3. *The powers of the deposit insurer support its mandate and enable the deposit insurer to fulfil its roles and responsibilities.*

4. The powers of the deposit insurer include, but are not limited to:

a. assessing and collecting premiums, levies or other charges;

b. transferring deposits to another bank;

c. reimbursing insured depositors;

d. obtaining directly from banks timely, accurate and comprehensive information necessary to fulfil its mandate;

e. receiving and sharing timely, accurate and comprehensive information within the safety-net, and with applicable safety-net participants in other jurisdictions;

f. compelling banks to comply with their legally enforceable obligations to the deposit insurer (e.g. provide access to depositor information), or requesting that another safety-net participant do so on behalf of the deposit insurer;

g. setting operating budgets, policies, systems and practices; and

h. entering into contracts.

Deposit Insurance Systems around the World – Loss Minimisers

IADI's 2018 global survey of deposit insurance and financial safety net frameworks received responses from 135 deposit insurers. Key highlights are:

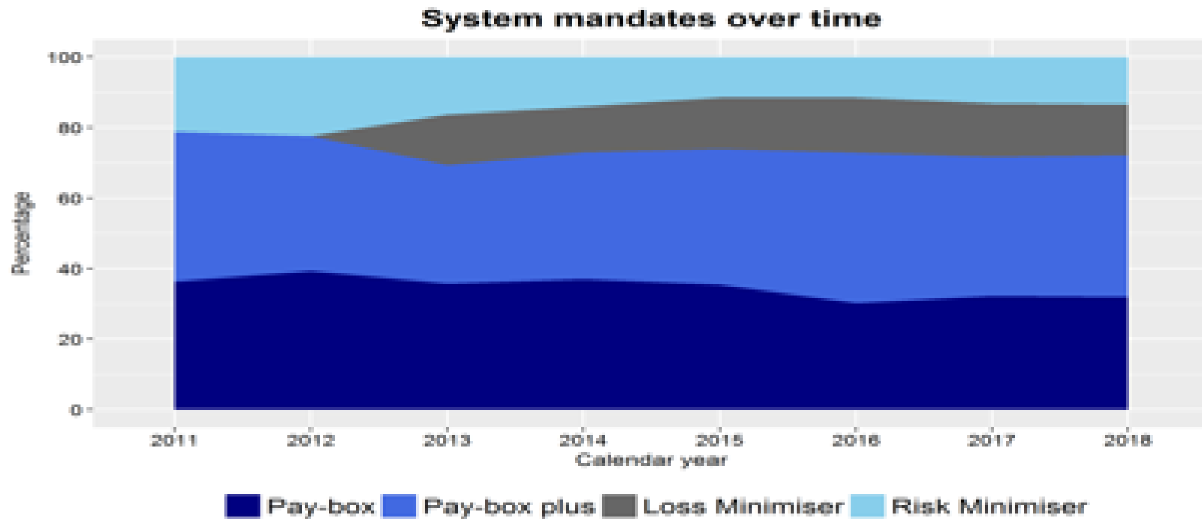
Mandates of Deposit Insurers (DIs)

- Approximately 32% of DIs are assigned a "**pay box**" mandate – focusing only on payouts.
- Approximately 40% of DIs have a "**pay box plus**" mandate, which typically include resolution functions (e.g. financial support and purchase and assumption powers).
- About 28% function as "**loss- or risk-minimisers**" acting as resolution authorities and in some cases conducting supervision.

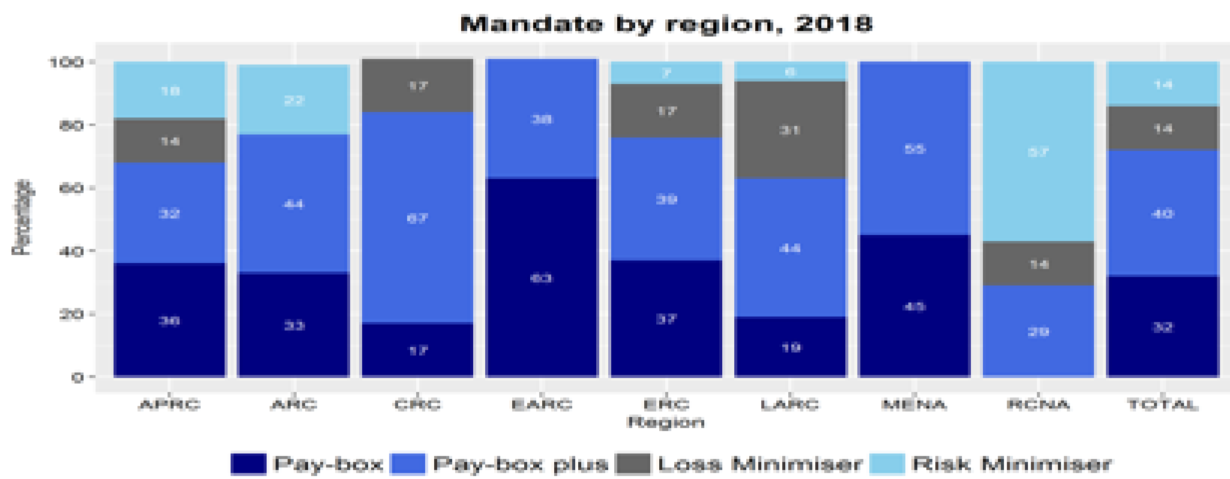
LOSS MINIMISERS AROUND THE WORLD
(by jurisdiction)

LOSS MINIMISER	
Canada	(CDIC, federal/provincial banks)
Canada (Nova Scotia)	(Provincial Credit Unions)
Colombia	(Fogafin)
Croatia	(DIA)
France	(FGD)
Indonesia	(IDIC)
Italy	(FITD)
Jamaica	(JDIC)
Japan	(DICJ)
Mexico	(IPAB)
Paraguay	(Central Bank)
Poland	(BGF)
Russian Federation	(DIA)
Turkey	(SDIF)
Ukraine	(DIA)
Uruguay	(COPAB)

EVOLUTION OF LOSS MINIMISATION MANDATES: 2011-2018



Source: IADI Annual Survey



Loss Minimiser Example: Canada Deposit Insurance Corporation (CDIC)

- CDIC established by an Act of Parliament in 1967 to insure depositors against loss in member banks, trust /loan companies, cooperative credit associations & federal credit unions.
- CDIC's statutory objects are to:
  - provide insurance against loss of deposits;
  - promote and otherwise contribute to financial stability; and
  - pursue its objects for the benefit of depositors and in such a manner as to minimize CDIC's exposure to loss unless otherwise directed by the Governor-in-Council.

- CDIC:
  - Is a Crown corporation governed by a Board of Directors;
  - insures deposits up to CDN 100k per depositor per account;
  - has 85 member institutions with CDN 792 billion in insured deposits;
  - has an ex-ante fund of CDN 5 billion funded by a differential premium system; and
  - has a current borrowing authority of CDN 23 billion.

Note: CDIC may seek an exemption from, or could be directed to act without consideration for minimization of its exposure to loss object, where the situation might have an adverse impact on the stability of the financial system in Canada or public confidence in that stability. Source: CDIC Annual Report: 2018/19

Deposit insurance in practice: overview of CDIC in managing bank risk

- CDIC is a **"loss minimising"** deposit insurer provided with:
  - —a "minimize exposure to loss object";
  - —risk assessment and intervention powers; and
  - —a full suite of resolution tools (including tools to resolve Canada's Global Systemically Important Bank (G-SIB) and 5 domestic SIBs.
- CDIC started as a **"pay-box plus"** in 1967 and was given additional resolution powers making it a "**loss minimizer"** in 1987.
- Between 2009-18 additional resolution powers were added to make CDIC the "**DSIB resolution authority"**.

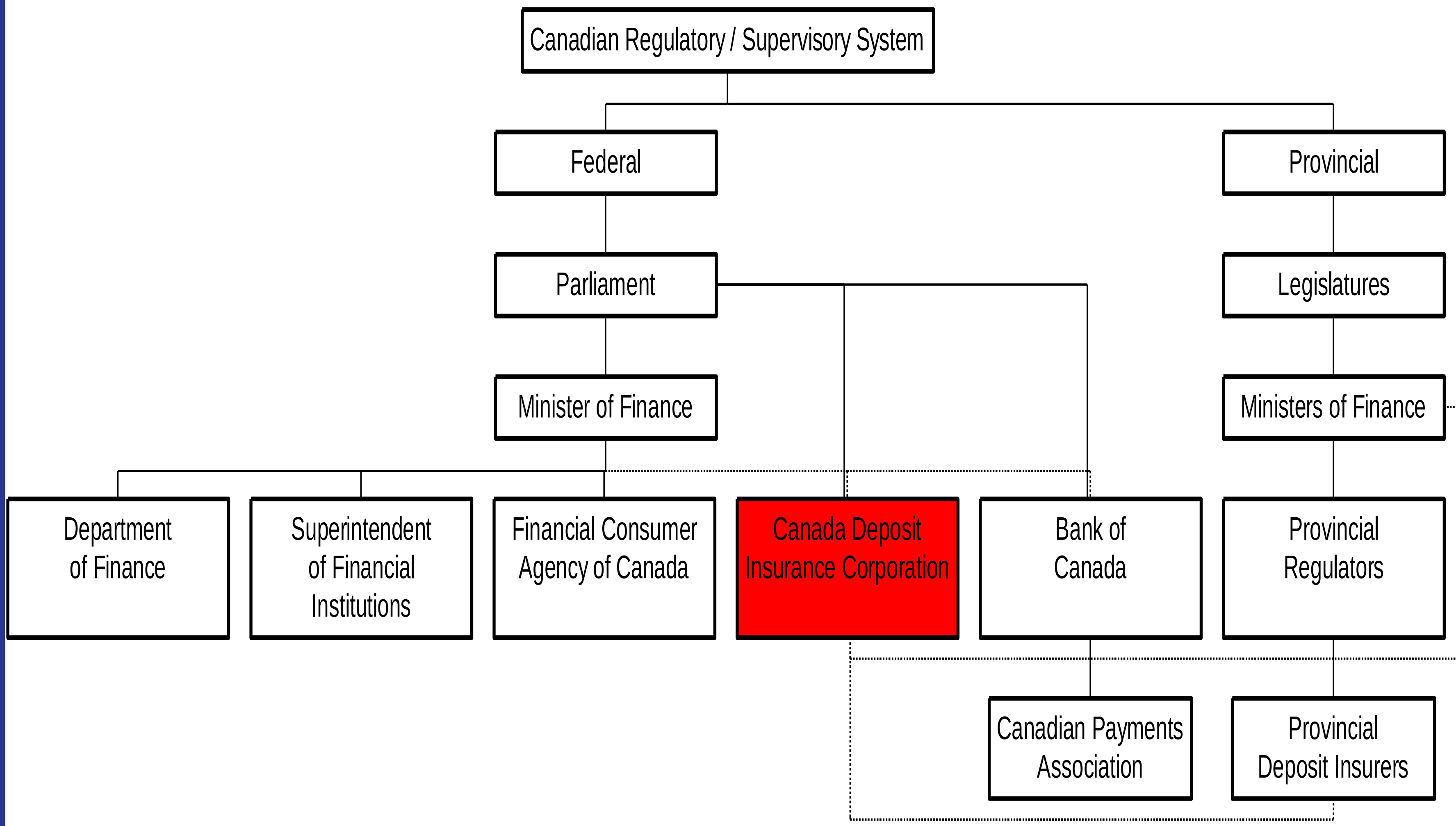
Source: Canada Deposit Insurance Corporation Annual Report: 2018/19

Evolution of CDIC loss minimizing resolution toolkit

1967	1967	1992*	1996	2009	2010-2015	2016*
Payout of Deposit Insurance ➢ **Payment of insurance on eligible deposits held by a failed member institution (MI)**	Assisted Transaction ➢ Ability to make or guarantee loans or advances	Recapitalization ➢ Acquisition of equity, with consent of MI (*Ownership restrictions amended in 2009)	Financial Institution Restructuring ➢ Forced sale of shares or assets held by CDIC, with possible restructuring, to imminent acquirer (“FIRP)	Bridge Institution ➢ Ability to transfer selected “good” assets and critical services, with all insured deposits, to new MI owned by CDIC	Various Powers ➢ Ability (conditional) to share information with DIs and RAs resulted in MOUs with key regulators ➢ Deposit Data requirements ➢ Government systemic over-ride	Open Bank & Bail-in (DSIBs only) ➢ Ability to take temporary control of shares or business ➢ Conversion of eligible liabilities to equity (*Bail-in power - currently pending regulations)

Source: CDIC

CDIC's role within Canada's financial system safety net



Governance, domestic information sharing and coordination

Governance:

- CDIC Board of Directors
- 11 members: Independent Chair, Governor of Central Bank, Head Supervisor and their Assistant, Deputy MoF, Financial Consumer Agency Head, and 5 private-sector directors

Key information sharing and coordination mechanisms:

- Financial Institution Supervisory Committee (FISC)
- Senior Advisory Committee (SAC)
- OSFI-CDIC "Guide to Intervention for Federal Financial Institutions"
- OSFI-CDIC Strategic Alliance Agreement
- Regular staff meetings between CDIC and OSFI

Membership and coverage

- 85 member institutions (e.g. banks, trust and loan companies, foreign bank subsidiaries, federal credit unions)
- D-SIBs comprise almost 90% of CDIC's insured deposit base
- CDIC heads a G-SIB Crisis Management Group (CMG) – for the Royal Bank of Canada -- and is a member of the Honk Kong Shanghai Bank (HSBC) CMG.

Coverage is CAD $100,000 per depositor per member institution

- Individual savings and chequing accounts
- Term deposits and guaranteed investment certificates
- Separate coverage also provided for registered accounts (e.g. retirement accounts, joint and trust accounts, mortgage accounts etc.)
- Deposits must be booked in Canada (but foreign currency deposits are now covered).

Source: Canada Deposit Insurance Corporation Annual Report: 2018/19

Risk assessment

- **Setting the terms and conditions of membership**
  - Policy of Deposit Insurance
  - CDIC By-laws
- **Working closely with the supervisor to monitor and assess member risk:**
  - Receive supervisory examination results for all members
  - Perform off-site risk assessment
- **Actively managing exposure to higher risk members**
  - E.g. through undertakings, preparatory and special exams, terminating membership
- **Utilize CDIC's "off-site" risk assessment system**
  - Risk Assessment Reports
  - CDIC Watchlist
  - Annual Membership Review

Failure resolution

- **CDIC has dealt with 43 member institution failures since 1967 involving C$ 24 billion in protected deposits**
- Failure definition based on **"non-viability"** determination by the supervisor.
- Supervisor takes control of a failed bank and typically initiates a **"winding-up"**. But, CDIC also has the power to initiate closure.

Key resolution tools

- **Intervening in the affairs of failing members which can include:**

  1) Liquidation and Payout of Insured Depositors
  2) Assisted Transaction (e.g. Purchase and Assumption)/ Restructuring
  3) Bridge Institution
  4) Temporary Ownership (Financial Institution Restructuring Provision and enhancements - FIRP)
  5) Bank recapitalization and conversion (“Bail-in”) regime for SIBs

     ✓ Supplements other regulatory initiatives, including non-viability contingent capital, DSIB surcharges and enhanced supervision (including resolution planning).

     ✓ The regime applies to future issuance of long-term debt

       - Senior debt would be converted to shares
       - All deposit liabilities would be excluded from bail-in
       - Regime would be compliant with Financial Stability Board TLAC standard
       - Compensation provisions included

Source: CDIC Act and CDIC Annual Report: 2018/19

OSFI-CDIC Guide to Intervention

- **Jointly developed by OSFI and CDIC**
- **Intervention measures by OSFI and CDIC become more intrusive as failure becomes more likely**
  - **Stage 0:** No Problems
  - **Stage 1:** Early Warning
  - **Stage 2:** Risk to Financial Viability
  - **Stage 3:** Future Financial Viability in Serious Doubt
  - **Stage 4:** Failure Imminent

CDIC DSIB resolution framework & objectives

Resolution Planning for DSIBs	Preparedness and Coordination
• Ensure banks are resolvable • Develop and maintain resolution plans • Conduct resolvability assessments • Identify bank-specific resolution challenges and propose actions to address impediments to resolution and implementation • Host resolution-focused Crisis Management Groups (CMGs)	• Domestic & international outreach. • Work with stakeholders (including Financial Market Infrastructures) on coordinated processes • Internal preparedness • Conduct tabletop and simulation exercises

Source: CDIC

Funding

- **Ex-ante system with differential premiums assessed on total insured deposits:**
  - C$ 792 billion in insured deposits (2019).
  - C$ 645 million in premiums collected (2019).

- **Operating expenses of C$ 43 million for 143 authorised employees**

- **Provision for loss and surplus of C$ 5.0 billion:**
  - 59 basis points of insured deposits with a target of 100 bp.

- **Back-up liquidity borrowing authority:**
  - Authorized to borrow C$ 23 billion from government and/or markets.

- **Bank of Canada Emergency Liquidity Assistance:**
  - Temporary short-term liquidity support in recovery and resolution (limited by available collatoral)

- **Parliamentary appropriations**

Source: Canada Deposit Insurance Corporation Annual Report: 2018/19

CDIC Differential Premium System

Criteria or Factors	Maximum Score
Quantitative:	
1.1 Capital Adequacy - Leverage Ratio	10
1.3 Capital Adequacy - Tier 1 Capital Ratio	10
2. Return on Risk-Weighted Assets	5
3. Mean Adjusted Net Income Volatility	5
4. Stress-Tested Net Income	5
5. Efficiency Ratio	5
6. Net Impaired Assets to Total Capital	5
7. Three-Year Moving Average Asset Growth	5
8. Real Estate Asset Concentration (Non-DSIBs only)	5
8-1. Asset Encumbrance Measure (DSIBs only)	5
9. Aggregate Commercial Loan Concentration Ratio	5
Sub-total: Quantitative Score	**60**
Qualitative:	
Examiner's Rating (ER) is the rating assigned by the examiner of the member as of April 30 of the filing year, as follows.	35
Other Information about circumstances that represent a threat to or compromise the safety, soundness, financial condition or viability of the institution	5
Sub-total: Qualitative Score	**40**
Total Score	**100**

Composite Risk Rating		Stage Rating		Examiner Rating	DP Score
Low	+	None	=	1	35 points (max)
Moderate	+	None	=	2	31 points
Moderate	+	Staged	=	3	21 points
Above Average	+	Whether staged or not	=	4	11 points
High	+	Whether staged or not	=	5	0 points

Score	Premium Category	Premium Rates (Basis Points)
≥ 80	1	7.5
≥ 65 and < 80	2	15.0
≥ 50 and < 65	3	30.0
< 50	4	33.3

Source: IADI Research Paper on Evaluating Differential Deposit Insurance Premium Systems (2018) and CDIC Annual Report: 2018/19

Some key Success factors for loss minimisers

1) Clearly defined mandate, powers and loss minimization objective.

2) Very high level of informational sharing and coordination with other financial safety-net participants domestically -- and where applicable, cross-border deposit insurers/resolution authorities.

3) Ability to conduct risk assessment for its membership (off-site and/or on-site).

4) Contingency planning, crisis preparedness and crisis management framework in-place with deep involvement of the deposit insurer.

5) Wide range of resolution tools (e.g. payout, assisted transactions, bridge institutions etc).

6) Access to sufficient funding (including emergency liquidity support).

7) Operational independence.

THANK YOU
FOR YOUR ATTENTION

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ANNEX

Guide to Intervention in Detail

- Stage 0 – No problem

→ **Normal risk assessment and supervisory procedures by OSFI and CDIC**

- Stage 1 – Early Warning
  - Deficiency in policies or procedures
  - Believed to be remedial.

→ **OSFI's examination report to CDIC identifies issues requiring remedial measures. OSFI and CDIC coordinate remedial measures – e.g. possible use of undertakings.**

- Stage 2 – risk to financial viability or solvency
  - Situation could deteriorate into serious problems if not addressed promptly.

→ **OSFI/CDIC coordinate communications with FI. Monthly reporting by OSFI to CDIC. Contingency planning . Possible use of premium surcharge etc.**

Guide to Intervention in Detail

- Stage 3 – future viability in serious doubt
  - Problems pose a material threat to future financial viability or solvency.

→ **Inform FI management, board and auditor of problems. Initiate special examination and preparatory exams. P&A/FIRP transactions explored. Section 30 process typically initiated (leading to termination).**

- Stage 4 – non-viability or insolvency imminent
  - Severe financial difficulties resulting in failure to meet regulatory capital and surplus requirements

→ **Frequent meetings with mgmt and board of FI to exert pressure for final resolution. Notification to regulatory agencies. Terminate/cancel deposit insurance begun. Seek Winding-Up order.**

Risk assessment framework