

The Core Principles

Legal Protection Matters in Deposit Insurance Effectiveness

Selected Legal Issues



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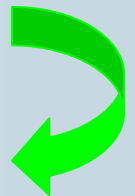
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Overview

- Introduction
- Selected Legal Issues
- Some background
- The Principal – Agent problem in a bank resolution
- Next steps

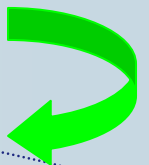
Introduction

Would you imagine a fireman without equipment?



Introduction

Would you imagine a policeman without equipment?



Selected Legal Issues

Principle 13 – Legal protection:

“The deposit insurer and individuals working for the deposit insurer should be protected against lawsuits for their decisions and actions taken in “good faith” while discharging their mandates...”

Principle 14 – Dealing with parties at fault in a bank failure:

“A 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.”

Reference:

www.iadi.org/NewsRelease/JWGDI%20CBRG%20core%20principles_18_June.pdf



Some background

2001

- IADI endorsed the guidance set forth in the “Guide for the Establishment of Effective Deposit Insurance Systems”

2004 - 2005

- The “APEC Policy Dialogue on Deposit Insurance” issued key policy conclusions related to LP.

2005

- IADI formally adopted the conclusions related to LP as Principle 13 in its recently published “**Core Principles for Effective Deposit Insurance Systems**”.

Some background

2006

- The Research and Guidance Committee of IADI created the Subcommittee on LP.

2007 - 2008

- IPAB chaired the subcommittee Group that prepared the document: “Guidance for the Establishment of a Legal Protection Scheme for Deposit Insurance Systems”.

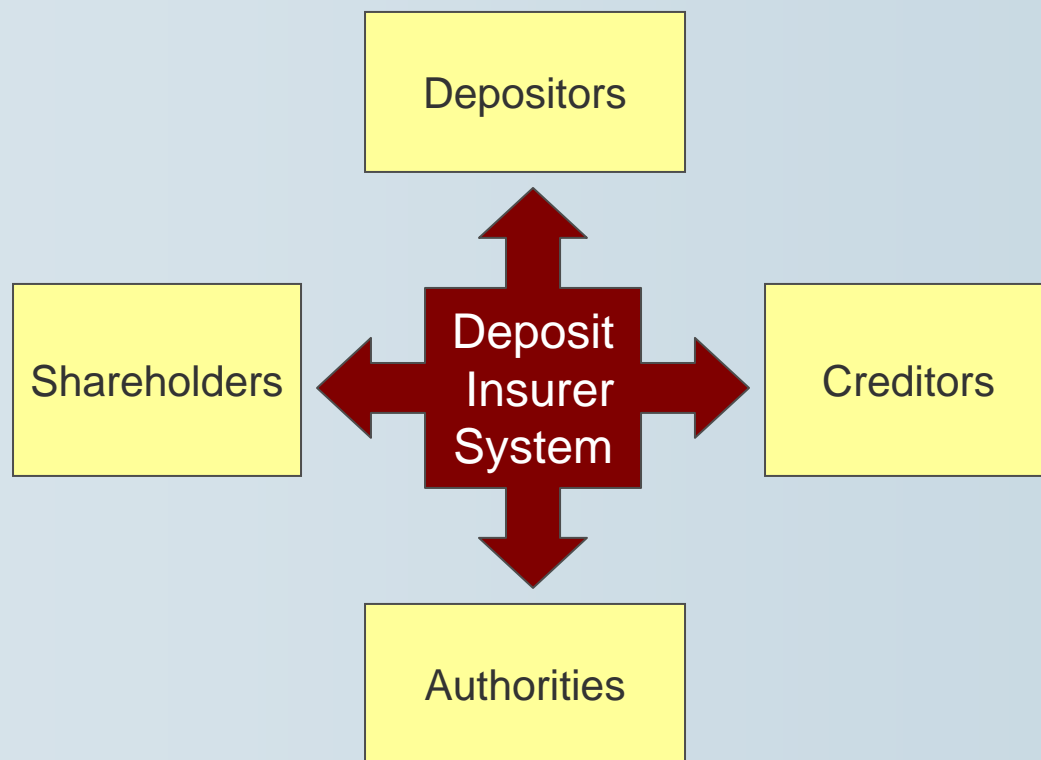
2008

- The Basel Committee on Banking Supervision and the IADI agreed to collaborate to develop an internationally set of Core Principles using the IADI Core Principles for Effective Deposit Insurance Systems as a basis.



The Principal – Agent problem in a Bank resolution

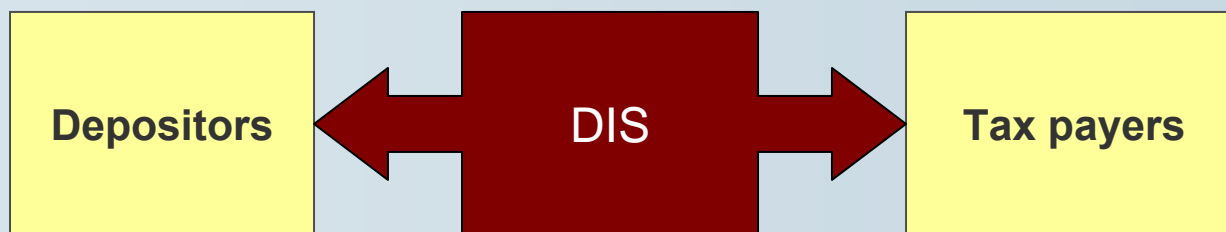
A bank resolution implies a complex interaction of participants:



Different (and powerful) players with different (and strong) interests!

The Principal – Agent problem in a Bank resolution

- In this interaction, the Deposit Insurance System (DIS) is the main player, whose function is to guarantee depositor's savings with the minimal possible fiscal cost.
- This mandate implies for the DIS two authorities: depositors and tax payers.



The Principal – Agent problem in a Bank resolution

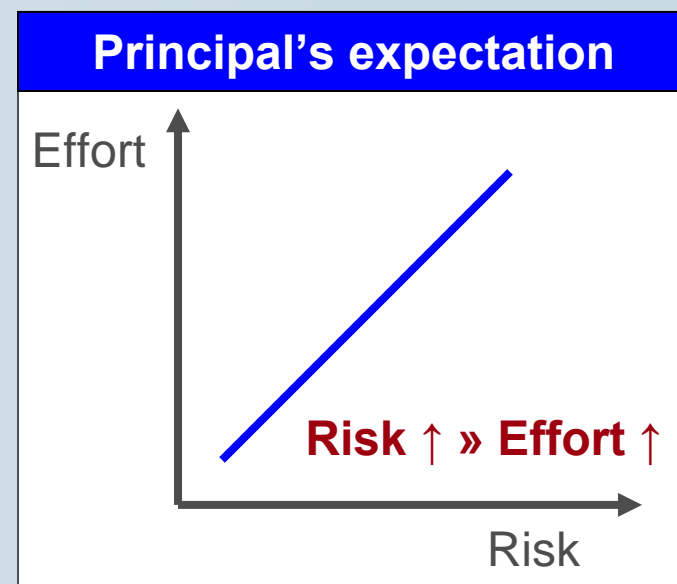
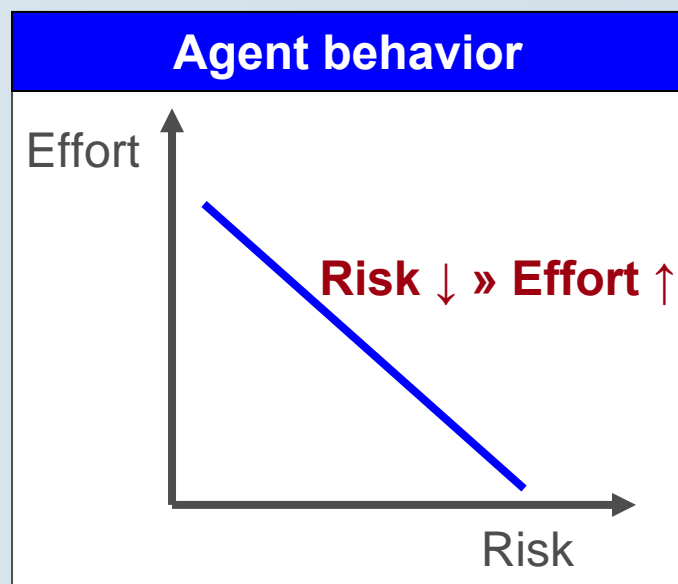
However, in the performance of its mandate, the individuals working for the DIS could affect third parties (or institutions), producing an additional cost for them: **the risk of claims or complaints filed by third parties!**

The Principal – Agent problem in a Bank resolution

- The tradeoff between the fulfillment of the mandates and its cost (due to the taken risk) is known as the **principal — agent problem**.
- The principal (depositors and tax payers) requires from the agent (DIS) the highest possible effort in the fulfillment of its functions.
- However, the agent's effort - i.e. when an agent forgoes his objectives to attend the wishes of the principal - is a function of the perceived risk.

The Principal – Agent problem in a Bank resolution

- From an agent's perspective, the more risk he/she perceives, the lower effort he/she devotes (if there is not the adequate incentive). In contrast, the principal seeks higher effort if there is higher risk.



- The agent has also the incentive to prolong and exhaust all means available in order to avoid legal actions from auditors and oversight, in spite of its mandate.

The Principal – Agent problem in a Bank resolution

- As in the fireman's case, it is necessary to provide the agent with the equipment that protect him from hazards, so that he minimizes the risk involved and consequently promotes the effort to succeed in his mandate:

Legal framework and legal protection

- In order to:
 - **Guarantee depositor's savings**
 - **Minimize the potential cost at the highest speed**



Next steps

- **Principle 14: Dealing with parties at fault in a bank failure** needs to start to develop a guidance document.
- The issue of legal protection must be treated in depth in the questionnaires that are being developed.



Thank you very much!

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