



Governance of Deposit Insurance Systems: Has the Bar Been Raised High Enough?

Introduction

This issue highlights the main issues articulated in the **Governance Discussion Paper** which will be discussed during IADI's Fifth Annual Conference from 15 to 17 November 2006.

As part of its work, IADI undertakes research to suggest guidance on deposit insurance issues. The objective of this paper is to offer advice regarding the governance of deposit insurance systems. It is designed for deposit insurance practitioners and other interested parties and is based on the judgment of IADI members, associates and partners. The paper also draws on relevant literature available on the subject.

Definitions and key concepts

Governance generally refers to the processes, structures and information used for directing and overseeing the management of an organisation. Importantly, governance also pertains to the relationship between the deposit insurance system and the authority from which it receives its mandate or other authority to which it is ultimately held accountable. Thus, a sound governance framework is a critical component of an effective deposit insurance system. The key elements of a sound governance framework are: 1) operational independence; 2) accountability; 3) integrity; and 4) transparency and disclosure. All are equally important and reinforce each other in supporting sound governance.

- **Operational independence** is defined as the ability of an organisation to use the powers and means assigned to it without undue influence from external parties. An organisation that is operationally independent does not have the authority, however, to control its objects and mandate, as these are set by a higher authority.¹
- **Accountability** means that individuals and organizations should be responsible for their actions and for fulfilling their objectives.

¹ It is crucial to differentiate between operational independence and independence of goal. The principle of 'goal' independence exists where an organisation has independent control over its objectives and mandate. Goal independence is, by definition, excluded as a form of independence for deposit insurance systems and other financial system safety net participants. See: Stefan Ingves, Speech, *Strengthening Governance Arrangements for Financial Sector Oversight Agencies: Evidence from the FSAPs*, (presented to: APEC Policy Dialogue on Deposit Insurance, Kuala Lumpur, 16-17 February 2004) and Stefan Ingves and Marc Quintyn, presentation, *Financial Stability Assessments: Implications for Governance Arrangements*, (Presented to: IADI Conference on "Effective Depositor Protection: Enhancing Governance Arrangements, Seoul, 24-24 October 2003).



- **Integrity** describes two concepts. The first is the principle that individuals should pursue their objectives of their organisation without compromising them due to their own or others' behaviour or self-interest. Second, integrity refers to the soundness of an organisation. The integrity of a deposit insurance system can, therefore, be enhanced through the appointment of quality governing body members and head of management and through clear terms of office and criteria for removal of those individuals.
- **Transparency and Disclosure:** **Transparency** is the principle fostered when the actions and decisions of an organisation, such as a deposit insurer, are revealed and clarified to the organisation's stakeholders. Disclosure refers to the release to stakeholders of information necessary for them to judge the effectiveness of the deposit insurer's conduct.

Scope and guidance

Just as the mandates, roles and responsibilities of deposit insurers can vary across countries, so too can governance structures. Whatever governance structure is chosen, all share certain common characteristics. All deposit insurance systems include some form of higher authority from which they receive their mandates or to which they are ultimately held accountable; a governing body (e.g. board of directors or supervisory board, or even a department head); and, the deposit insurer's management. This paper considers deposit insurance governance structures; relationships; the governing body; audit and legal protection; and transparency and disclosure.

The following 14 points summarise the main conclusions of this paper and set out good practices that support sound governance frameworks for deposit insurance systems, particularly with respect to promoting accountability, integrity, operational independence, transparency, and disclosure. These points of suggested guidance are reflective of, and adaptable to, a broad range of circumstances and structures:

1. The mandate of a deposit insurance system should be clearly defined and preferably set out in legislation.
2. A deposit insurance system should have a governing body.
3. It is a good governance practice for a deposit insurer to have operational independence in using the powers and means accorded to it to fulfil its mandate.
4. The governing body of a deposit insurance system should be structured in such a way as to prevent undue influence from political forces, the financial services industry, or other safety-net participants.
5. A deposit insurance system should be structured such that the potential for conflicts of interest respecting members of the governing body and management is minimised.

6. It is a good governance practice for governing body members, senior officers, and employees of a deposit insurance system to be subject to laws and/or codes respecting conflicts of interest and ethical behaviour.
7. It is a good governance practice for a deposit insurance system to maintain a profile of desired skills for its governing body and senior executive team and for governing body members to be knowledgeable of and adequately trained in matters related to deposit insurance and the financial services industry.
8. It is a good governance practice for the governing body to conduct meaningful self-assessments.
9. It is a good governance practice that the governing body set the strategic direction of the deposit insurance system and that management take action to carry out that strategic direction.²
10. It is a good governance practice for the governing body to have a charter or policy in place that lays out the governing body's responsibilities.
11. Governing body members, senior officers and employees of a deposit insurance system should be provided with legal protection for decisions made, omissions, and actions taken in good faith and while discharging the mandate of the deposit insurance system.
12. It is a good governance practice for a deposit insurance system to be subject to regular external audits and examinations and for those audits and examinations to be made public.
13. It is a good governance practice for a deposit insurance system's internal audit function to report to the audit committee of the governing body.
14. A deposit insurer should be as transparent as possible and disclose appropriate information on its activities, governance practices, structure, and financial results. This disclosure can take the format of a public annual report.

² Here the difference should also be stressed between a deposit insurance system's strategic direction and its overall objects. As noted above, the objects, or goals, of a deposit insurance system should be set out in legislation by the authority from which the deposit insurance system receives its mandate. The deposit insurance system's strategic direction, on the other hand, comprises the courses of action the system will follow in order to fulfill its objects.



Where to get further information on the discussion paper?

For further information, please see the full text of Discussion Paper in the IADI Fifth Conference website:

http://www.iadi2006.org.br/ing/img/pres_conference.htm.

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