

Hard Lessons on Getting Your Money Back

Introduction

This issue focuses on the main issues highlighted in the **Guidance Discussion Paper on Claims and Recoveries** which will be discussed during IADI's Fifth Annual Conference from 15 to 17 November 2006.

The capacity to manage the assets and liabilities of a failed bank is an essential function of an effective financial safety net. It involves disposing of a failed banks' assets and satisfying liability holders who have bona fide claims against the bank. The optimal strategies for the claims and recoveries processes reflect differences in economies, and in legal and political systems, and the effectiveness of the processes must be measured within the constraints of those country-specific conditions.

The purpose of the discussion paper is to develop suggested guidance on conducting the claims and recoveries processes. It is designed for deposit insurance practitioners and other interested parties and is based on the judgment of IADI members, associates and observers. The paper also draws on the relevant literature where applicable.

Guidance Points for Carrying Out Efficient Claims Process

Conducting a timely and accurate payout of insured deposits is the most important function of the deposit insurer. Determining who should be reimbursed and ensuring that insurance limits are respected are the most crucial and time-consuming steps in the deposit-reimbursement process.

Accordingly, the deposit insurer needs information about its deposit obligations as quickly as possible once it has been determined that a bank is in trouble or likely to fail. Coordination among safety-net participants plays an important role in conducting a successful resolution. In some countries, the deposit insurer will not have information until a bank is closed. Whether information is available pre-closure or a deposit insurer must wait until closure to begin its payout function, the deposit insurer needs a plan that it can execute for determining who to pay and the amount of the payment.

A source of funding also needs to be identified. If the deposit insurer has to wait until funds become available, the payout process, by necessity, will be delayed. Depositors should be made aware of the time frame for the payout so that their expectations will not exceed the deposit insurer's capabilities. A plan also needs to be in place to replenish the deposit insurer's funding in case asset recoveries are not sufficient to cover the deposit insurer's obligations. The credibility of the deposit insurer hinges upon its ability to meet its current and future obligations to depositors.

In many countries the deposit insurer may not only be responsible for paying the claims of insured depositors, but also conducting the claims process in general. Again, timely and accurate information is key to conducting the process. Additionally, it is important to have clear and enforceable priority-of-claims rules to carry out this function. Uncertainty or



inequality in the treatment of creditors or creditor groups may jeopardize confidence in the financial system, with attendant costs. In general, the guidance points suggested to carry out an effective and efficient claims process are as follows:

1. A deposit insurer should develop a clear and detailed plan that can be implemented upon the failure of an insured institution.
 - a. The plan needs to include a clear delineation of when to start and when to complete the claims process and what the responsibilities of the deposit insurer are;
 - b. A deposit insurer should test its plan to ensure that it has addressed all relevant issues with respect to the claims process; and
 - c. Following a deposit insurance payout, a deposit insurer should conduct a post mortem to determine how well the process was handled and whether the plan should be modified.
2. A working relationship should be fostered with the supervisory authority, other relevant safety-net players, and the receiver to ensure the cooperation necessary for a timely, accurate and efficient payout of insured depositors.
 - a. A communication strategy should be developed and channels of communication established with others involved in the failure resolution process.
 - b. The deposit insurer should have advance notice of an impending closure and should have access to the deposit records of the failed institution, preferably before closure.
3. A source of funding must be identified so that depositors are not unduly delayed in receiving their funds.
4. The deposit insurer needs to begin the claims process immediately upon closure of an institution.
 - a. The deposit insurer should secure depositor and other claimant information as quickly as possible after closure.
 - b. The insurance status of each depositor needs to be determined.
 - c. The deposit insurer should be able to examine proof of insurance.
 - d. A deposit payout should begin as soon as possible, without having to wait for all claims and recoveries to be settled.
5. The deposit insurer needs to notify depositors of the reimbursement procedures at the time of a bank failure.
 - a. Depositors need to be informed as to when they will receive their funds.
 - b. If proof of insurance is required, depositors need to be informed how that information will be collected.
 - c. If appropriate, the deposit insurer needs to inform other creditors how to file a claim against the bank.



- d. The deposit insurer may need to establish an appeals process.
6. The scope and level of coverage should be clearly defined in law.
 - a. Countries should establish and enforce orders of priority directing how claimants will be paid in the event of a bank failure.
 - b. This information should be available to depositors prior to the failure of a bank.

Guidance Points for Conducting the Recovery Process

Once a bank has failed, liquidation of its assets should be pursued on the basis of the economic merits of the available choices with the goal of recovering maximum value possible for the assets. Decisions regarding how to proceed should consider the need to return funds to the creditors of the bank quickly and the need to avoid prolonged turmoil in the asset markets. Success will depend upon having the resources available to conduct the recoveries process and upon developing strategies consistent with the conditions in the country. Although many asset-disposition strategies are possible, not all will be suitable in all circumstances. Success will also depend upon the ability of the receiver to obtain clear title to the assets and exercise such authorities as are needed to maintain the value of the assets and dispose of them.

Although it is not common for the deposit insurer to act as the receiver of the failed institution, in a number of jurisdictions this is the practice. In others, the deposit insurer may be called upon to oversee the process. In general, the guidance points suggested for conducting the recovery process are as follows:

1. The receiver must be able to obtain clear title and take control of the assets of the failed institution.
2. Effective and efficient asset-disposition strategies reflect the type and quality of assets that must be sold and should include tools to validate valuation assumptions employed in the appraisal process.
 - a. The receiver must identify, quantify, and manage or hedge risks related to interest rates, market fluctuations, disposition strategies and asset-specific and legal issues.
3. Transparency and access to information are critical to obtaining maximum value for assets.
 - a. The quality of information and access to information are key factors in the determination of asset prices by the market; the market will discount asset prices if there is uncertainty about the quality of the asset.
 - b. The unique nature of some assets may make private negotiation a better alternative to market sales.



4. The availability of staff skilled in the management of bad assets needs to be factored into the decision to retain such assets.
5. Two goals—disposing of assets quickly and achieving maximum value—must be balanced by the receiver in its decisions regarding asset sales.
 - a. Asset-disposition strategies should maximize value on a net present value basis.
 - b. If other considerations (such as a concern for system-wide stability, or those required by the laws of the country) are mandated to take precedence over these goals they should be identified and addressed explicitly by the receiver.

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.

This Research Letter was issued on 9 November 2006.

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