

Bank Resolutions and Differential Premium Systems: Proceedings from an Africa Regional Committee Workshop

Introduction

The **Africa Regional Committee** held a Workshop on "*Bank Resolutions and Differential Premium Systems*" in Abuja on 6-8 March 2007. This event was organized by the **Nigeria Deposit Insurance Corporation** with a view to help build the capacity of middle staff of ARC Member institutions. The Workshop included participants from Canada, Turkey, Kenya, Tanzania, Zimbabwe, Nigeria and the Commission Bancaire de l'Afrique Centrale (COBAC) of Cameroon.

The sessions began with opening remarks by Ganiyu A. Ogunleye, Chairman of the ARC and Managing Director and Chief Executive of the NDIC, and Elias Mbam, Minister of State for Finance. Greetings and best wishes for a successful workshop were delivered by Obadia Mailafia, Deputy Governor of the Central Bank of Nigeria on behalf of the Governor.

The Workshop featured the guidance points articulated in IADI's Paper on Bank Resolution and the Guidance Paper on Differential Premium systems. Attention also focused on the challenges and lessons learned from bank resolution experiences of ARC Members. The speakers from Canada Deposit Insurance Corporation and Savings Deposit Insurance Fund of Turkey presented their experiences with differential premium system. One of the sessions was dedicated to addressing issues and challenges for developing countries when implementing differential premium systems.

What were the main issues addressed during the Workshop?

One of the central themes was the General Guidance for the Resolution of Bank Failures. The Guidance covers, among other things, interrelationships and cross-border issues, powers and mandates, operational issues, and early intervention strategies. One of the central conclusions of the Workshop was that Members should conduct self-assessment using the Guidance as a benchmark. A number of other matters were explored; notably, funding, governance, capacity of the financial sector to address post-consolidation issues and some case studies drawing on lessons learned from the experiences in Nigeria were explored in detail.

The Workshop also drew on the expertise of officials from some other jurisdictions. In relation to Zimbabwe, the attendees explored the origins of the deposit insurance system in that country and the challenges that had to be addressed. Foremost among them were the need for adequate capital standards, improved corporate governance, the importance of public disclosure, and ways to improve prompt corrective action.

With respect to Kenya, attention was drawn to an urgent need to terminate the liquidation processes of institutions whose valuable assets had been realized and where the continuation of the liquidation exercise was no longer sustainable. Other issues identified were: the difficulty of realizing on securities held in rural areas; low response rates to



claims; the need for proactive engagement before institutions become insolvent; loan recoveries being hampered by court processes; and need for the harmonization of laws that govern the operations of the fund.

The Workshop also addressed a range of deposit insurance pricing regimes. Without a doubt, flat premium systems are the most prevalent but attention is increasingly being focused on differentiated pricing arrangements because of the clear advantages that are offered in introducing or adding to market discipline that can lower moral hazard. Cases were drawn from the U.S. experience, Canada, Turkey, the IADI Guidance and the particular challenges presented by developing countries in implementing these types of regimes.

Some of the key lessons that could be drawn from the workshop include the following:

- In order to ensure timely and effective resolution of bank failures, the existence of the following factors, amongst others, is imperative:
 - a supportive legal system;
 - effective disclosure and sound accounting regimes;
 - adequate statutory arrangements for the deposit insurance agency;
 - the need for effective public awareness mechanisms;
 - the importance of operational independence of the deposit insurer; and
 - the critical need for effective asset disposal strategies.
- One of the important technical issues to contend with in the design of a deposit insurance system is the establishment of an appropriate deposit insurance pricing structure;
- In implementing a differential premium system, there is the need to determine the appropriate balance between the desire to promote accountability, market discipline and sound management and the need to ensure confidentiality; and
- Differential premium systems need to be regularly re-assessed as to their effectiveness and efficiency in meeting their objectives and if necessary be updated/revised to meet changing conditions;

Success in the adoption of a Differential Premium System in developing countries depends on: financial system stability, sound accounting systems, sound legal and supervisory regimes, expertise and experience on the part of the deposit insurer to design and run the differential system, having a "Buy-in" from the industry, depositors and other safety-net participants and adequate resources to undertake the development of the system. In the short-run, the cost of such systems may exceed the benefits for many insurers in developing countries but, in the long-run and with the right conditions, the benefits of a well-designed system can exceed its cost.

The Workshop noted that Differential Premium Systems require elaborate planning and should take into account local peculiarities. The participants improved their knowledge of such operations and the experiences shared were very valuable. As an aside, it was underscored that effective asset disposal strategies are critical to prompt reimbursement of uninsured deposits.



In the final session, participants expressed views that the workshop was very instructive and beneficial and consideration should be given to holding similar events in the future.

Where can I download the proceedings?

For further information, please find the full text of the Workshop proceedings at the following linked webpage: [Proceedings from the Africa Regional Committee Workshop](#).

This Research Letter was issued on 2 October 2007.

Editor: Gye Hwang Cho
Visiting Researcher
International Association of Deposit Insurers
Tel: +41 (61) 280 92 54 (Basel, Switzerland)
Fax: +41 (61) 280 95 54
E-mail GyeHwang.Cho@iadi.org www.iadi.org