

What's New at IADI ?

Volume 2, Issue 9

March 2004

Highlights

Enterprise Risk Management Seminar

A Special Focus on the APEC Policy Dialogue on Deposit Insurance

Member Profile – Canada Deposit Insurance Corporation

Enterprise Risk Management Seminar

“Space is Limited”

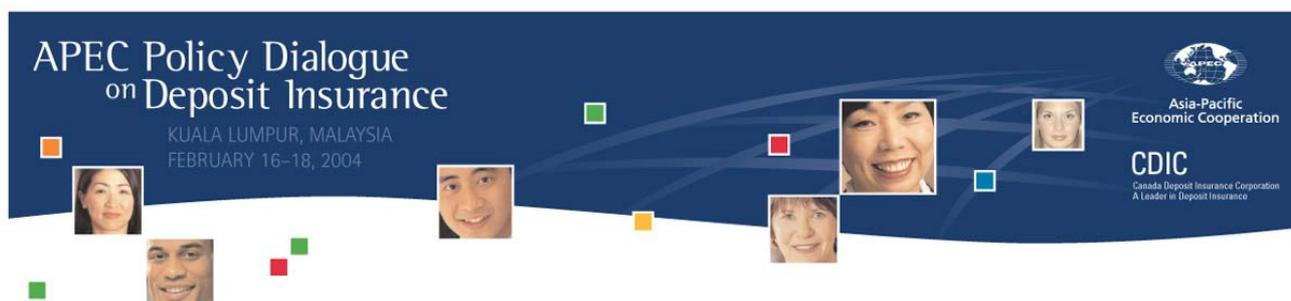
The underlying premise of enterprise risk management is that every entity, whether for-profit, or not-for-profit, or a governmental body, exists to provide value for its stakeholders. All entities face uncertainty and the challenge for management is to determine how much uncertainty the entity is prepared to accept to grow stakeholder value.



The **International Association of Deposit Insurers** and **Deloitte Touche Tohmatsu** are pleased to announce that a seminar on Enterprise Risk Management will be held at the Bank for International Settlements on 28-29 April 2004. Leon Bloom, Managing Partner of the Global Financial Services Industry Practice of Deloitte will lead this Seminar. He will be joined by Jean Pierre Sabourin, President and Chief Executive Officer, **Canada Deposit Insurance Corporation** and Danièle Nouy, Secretary General de la Commission Bancaire, Banque de France, who will focus on the state of play of ERM for safety net participants. Industry perspectives will be provided by Herman Mulder, Senior Executive Vice President, ABN AMRO, The Netherlands and Laura Olle, Chief Enterprise Risk Officer, Capital One, USA. Malcolm D. Knight, General Manager, Bank for International Settlements will provide the keynote speech.

For more information on this seminar, please contact Kim Utnegaard at: Kim.Utnegaard@iadi.org.

APEC Policy Dialogue on Deposit Insurance

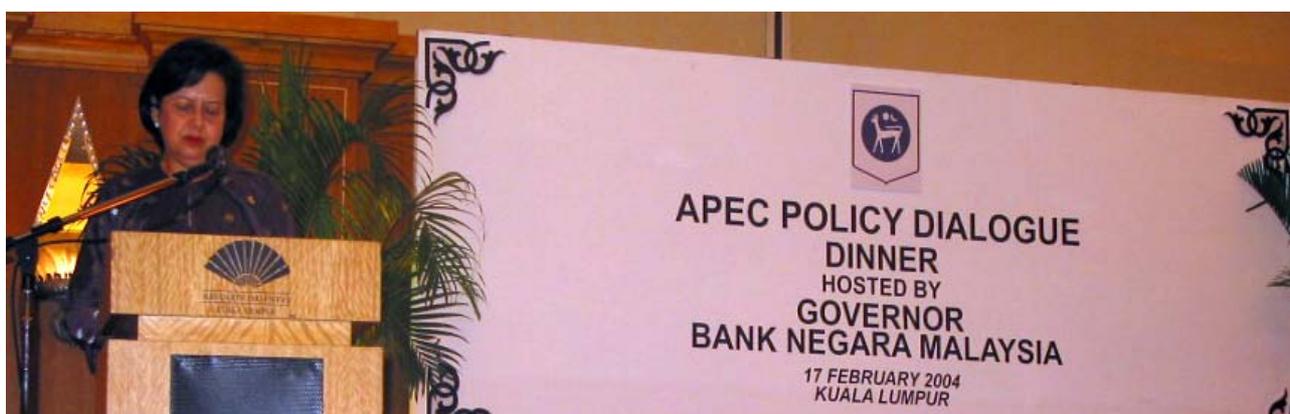


Canada Deposit Insurance Corporation was asked by the Asia-Pacific Economic Cooperation (APEC) Finance Ministers to undertake a Policy Dialogue on Deposit Insurance. The Policy Dialogue was requested because effective deposit insurance systems are an integral part of any sound financial system safety net. Drawing on experience and lessons learned in Canada, policymakers from 21 countries were informed about the need to provide legal protection and to indemnify financial safety net participants, techniques to promote sound governance measures and constructive interrelationships within financial safety nets, and arrangements to promote prompt corrective actions to deal with problem deposit-taking institutions.



[Jean Pierre Sabourin]

Jean Pierre Sabourin chaired the Policy Dialogue on Deposit Insurance in Kuala Lumpur on 16-18 February 2004. Presenters included: Stefan Ingves, **International Monetary Fund**; John R.V. Palmer, **Monetary Authority of Singapore**; David K. Walker, **Canada Deposit Insurance Corporation**; Michael J. MacNaughton, Borden Lander Gervais LLP; Jay Carfagnini, **Goodmans LLP**; Ju-Hung Lee, **Korea Deposit Insurance Corporation**; John Di Clementi, **Federal Deposit Insurance Corporation**; and J.R. LaBrosse, **IADI**. Also featured on the program were Professor Joe Norton, London University; Christine Cummings, Federal Reserve Bank of New York; and Rafiah Salim, International Centre for Leadership in Finance. Governor Zeti Akhtar Aziz, of **Bank Negara Malaysia** delivered the keynote speech.



[Governor Zeti Akhtar Aziz]

The Policy Dialogue discussed model frameworks for the three policy issues. The preliminary conclusions and draft summary recommendations are as follows:

Summary of Key Points

1. Legal Protection and Indemnification

- Situations exist in a number of economies where individuals working for deposit insurers and other organizations involved in the financial system safety net (i.e. current and former employees, directors, officers and agents) are held personally liable for their decisions and actions taken in good faith and on behalf of their organizations. While this lack of legal protection may have been established to help improve accountability, it has resulted in reduced incentives for these individuals to be vigilant in the carrying out their mandates.
- The need for legal protection is well recognized. The Financial Stability Forum Working Group on Deposit Insurance recommended that personnel should receive legal protection against civil and criminal liability for their official actions in the normal course of deposit insurance activities or supervision. In addition, the BIS Core Principles for Effective Banking Supervision clearly emphasizes the need for legal protection of supervisory personnel.
- Thus, individuals working for deposit insurers and other financial safety-net system participants should be protected against civil and criminal lawsuits for their decisions and actions taken in “good faith” while discharging their mandates. Legal protection should also be codified in legislation and administrative procedures, be automatic, and include the full coverage of legal costs for those indemnified.
- However, legal protection must coexist in an environment where there is clear accountability. This means that while individuals should be legally protected, they must be required to follow appropriate oaths of office, conflict of interest rules and codes of conduct to ensure they remain accountable. As well, it is important that the safety net organization itself should be held accountable for its actions and not be indemnified.
- Provisions regarding secrecy and confidentiality regarding all documents, information and records pertaining to matters dealt with by the deposit insurance entity need to be in place.

2. Governance and Interrelationships Among Financial Safety-Net Participants

- The sound governance of agencies comprising the financial system safety net strengthens the financial system’s architecture and contributes directly to system stability. The four major elements comprising sound governance of agencies are: independence, accountability, transparency, and integrity. All are equally important and reinforce each other.
- Operationally independent and accountable safety net organizations with clear mandates and which are insulated from undue political and industry influence provide greater integrity, credibility and legitimacy than entities lacking such independence. This is embodied in the standards that are assessed in the World Bank-IMF Financial Sector Assessment Program. Operational independence exists when an organization is granted independence in using the instruments and means assigned to it in order to fulfil its mandate.
- Experience has shown that a separate, operationally independent and accountable deposit insurance entity working within the financial safety net is the “best practice” model available to promote the four key elements of sound governance. This arrangement also provides: (1) the most effective incentives for the control of moral hazard affecting a deposit insurer; (2) the greatest protection of the interests of depositors; (3) more balanced and effective decision-making; and (4) promotes more extensive monitoring of potential conflicts than entities lacking such independence.

- A deposit insurer's interrelationship management needs vary according to its mandate and powers, but the need for close coordination and information sharing among safety-net participants is essential in all cases.
- Information sharing among all safety-net participants is essential for an effective deposit insurance system. Such information should be timely, accurate, and relevant with due respect given to maintaining confidentiality when required.
- Formal information sharing arrangements either through legislation, memoranda of understanding, legal agreements or a combination of these techniques are necessary.
- The most important and effective way to promote smooth coordination on the part of financial safety net participants is to provide for clear mandates and a division of powers and responsibilities among them. Formal arrangements are necessary in providing a general framework for safety net participants to coordinate their related activities.

3. Trigger Mechanisms for Early Intervention and Failure Resolution

- In a competitive financial system banks can and do fail. Financial-system safety net providers must ensure that a framework exists for the prompt detection and resolution of troubled deposit-taking institutions. This helps reduce the social costs of failures, contributes to stability and can help lessen the likelihood of future crises.
- Institutional arrangements for prompt corrective action need to include clear objectives and roles for all safety net participants. This involves ensuring that the safety net participants involved have clearly defined mandates, roles and responsibilities and that the framework is well defined, transparent and understood by safety net participants, the banking industry and the general public.
- Measures for prompt corrective action need to be supported by strong regulation and supervision, sound accounting and disclosure regimes, and an effective legal system.
- Information sharing and coordination among the various agencies that make up the safety net, particularly when dealing with troubled banks, should also be addressed as part of the framework associated with an early intervention resolution system.
- The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well defined and transparent trigger mechanisms by safety net participants with the operational independence and legal authority to act.
- Because a bank's financial performance and capital position can deteriorate quickly, trigger mechanisms based on single measures such as capital insolvency or liquidity may not be sufficient. Effective trigger mechanism for prompt corrective action should include a variety of relevant indicators.

A report on the Policy Dialogue is being prepared for the APEC Secretariat so that Finance Ministers can consider the recommendations at their September 2004 meeting in Chile.

Copies of presentations and papers delivered at the Policy Dialogue can be found at the following location:
<http://www.cdic.ca/?id=361> .

[From left to right: Harrison Hwang, John Raymond LaBrosse, David K. Walker, Christine Cumming, Chin-Tsair Tsay, Hsin-Tair Chou]



Member Profile – Canada Deposit Insurance Corporation

A Founding Member of IADI



Canada Deposit
Insurance Corporation

Société d'assurance-dépôts
du Canada

Canada

Overview

CDIC is a federal Crown corporation that insures eligible deposits at member institutions (up to \$60,000 per depositor) and reimburses depositors for the amount of their insured deposits when a member institution fails. CDIC contributes to the stability of Canada's financial system by insuring deposits in member institutions; by promoting standards of sound business and financial practices among these institutions; and by limiting the effect on the financial system and the economy if a member institution becomes insolvent.

Since its beginning in 1967, CDIC has dealt with the failure of 43 member institutions. In those cases, the Corporation protected more than two million depositors holding some \$24 billion of insured deposits. There have been no failures since 1996. One reason for this was Parliament's decision to enlarge CDIC's mandate to early identify, monitor and, if necessary, intervene to address risks to member institutions. By operating proactively in this fashion as a "risk minimizer", and by disseminating information to the public about deposit insurance, CDIC averts financial difficulty and strengthens public confidence in Canada's financial system.

Another important tool that CDIC uses is ensuring adherence to its *Standards of Sound Business and Financial Practices*. In order to retain deposit insurance, member financial institutions must attest on an annual basis that CDIC's Standards are being met.

CDIC is an integral part of Canada's financial system safety net. It works in partnership with the Office of the Superintendent of Financial Institutions, the Financial Consumer Agency of Canada, the Department of Finance, the Bank of Canada as well as provincial agencies to implement Canada's financial policies and provide Canadians with a financial safety net.

Internationally, CDIC has played a primary role in the development of a global network of deposit insurers. CDIC chaired the Financial Stability Forum's international study and working groups on deposit insurance, which led to the creation of the International Association of Deposit Insurers in May 2002. As a founding member of **IADI**, the Corporation has been a leading-edge proponent of best practices thereby enhancing deposit insurance effectiveness and the stability of financial systems worldwide. Through its bilateral international activities, CDIC has helped over 30 countries form their deposit insurance systems and it has provided technical assistance and counsel to several insurers on improving their deposit insurance systems.

Every year since 1995 CDIC has been a finalist in the Auditor General of Canada's Award for Excellence in Annual Reporting by Crown Corporations. CDIC won the award in 1996.



Organisation

CDIC is governed by a Board of Directors that comprises the Chairperson, five *ex officio* directors - the Governor of the Bank of Canada, the Deputy Minister of Finance, and the Superintendent and the Deputy Superintendent of Financial Institutions as well as the Commissioner for the Financial Consumer Agency of Canada – and five private-sector directors.

The President and Chief Executive Officer is the executive head of the Corporation's management. CDIC has approximately 90 employees.

Deposit Insurance

✓ **Membership**

Membership is limited to banks, trust companies, loan companies and associations to which the *Cooperative Credit Association Act* applies. Membership totals 87 and CDIC insures some \$363 billion in deposits.

✓ **Coverage**

Protection is provided for eligible deposits held in member institutions. If a member institution fails, the depositor is reimbursed up to \$60,000 (principal and interest combined) for eligible deposits; they must be in Canadian currency and payable in Canada and term deposits must be repayable no later than five years from the date of deposit.

Although basic coverage is limited to \$60,000 for eligible deposits per depositor in each member institution, CDIC also provides separate coverage at the same member institution for joint deposits, deposits held in trust, deposits held in Registered Retirement Savings Plans and deposits held in Registered Retirement Income Funds.

✓ **Funding sources and premium policy**

Premiums are levied against member institutions and CDIC can borrow up to \$6 billion, if it is needed, to pay depositors should an institution fail.

In 1999, CDIC introduced a differential premium system and institutions are now classified into one of four premium categories based on a series of quantitative and qualitative measures, including their compliance with the "*Standards*". Premium levels now vary based on such factors as capitalization, asset concentration, profitability and its supervisory rating.

CDIC eliminated its deficit in 1999 and presently does not have any outstanding debts. In fact, as at March 31, 2003, CDIC's combined balance of cash and investments was \$1,066 million.

Risk Management

✓ **Monitoring and Examinations**

CDIC has the power to establish conditions and standards governing the terms on which insurance is provided and to decide and control entry as to which applicants obtain insurance and to actively monitor and assess the ongoing performance of insured institutions and their risk to the insurance fund.

CDIC conducts on-going analysis and monitoring of the risk level of its members and the membership as a whole. It also conducts more rigorous monitoring for higher-risk members and undertakes appropriate intervention activities including Special Examinations, as required.

✓ **Handling Problem Financial Institutions**

CDIC has a strong, proactive mandate to minimize the risk of failures among its member institutions, and to contribute to the stability of the financial system. CDIC reduces its risk by identifying potential problems at an earlier stage. Formalizing such a process for early intervention has increased the likelihood of averting a member institution's failure. In fact, CDIC may enter into a variety of transactions to help a member through temporary problems or to support an alternative to liquidation, such as ongoing restructuring.

✓ **Intervention Methods**

CDIC has used creative failure resolution methods that best suit the failing institution and particular market forces at the time. It has also put in place sophisticated processes to ensure the efficient payment of insured deposits and to maximize recoveries from the estate of the failed member institution.

These failure resolution methods include, among others, the wind-up and liquidation of a member institution by a court-appointed liquidator, the creation of a company to manage and dispose of certain assets belonging to the failed institution and the provision of guarantees or other financial assistance to promote the sale of a failed institution's

assets to another member institution. The most commonly used method of failure resolution involves the wind-up and court-supervised liquidation of the failed member institution.

Interventions

✓ **State of Readiness**

CDIC's business requires that it maintain an appropriate state of readiness at all times.

Challenges

As the issue of governance becomes increasingly important in the global economy, CDIC has established a framework of on-going evaluation of its performance and is ensuring that, through enterprise risk management and other initiatives, that the Corporation applies sound business practices. Furthermore, one of the continuing issues that CDIC faces is the lack of public awareness and the misconceptions about deposit insurance. Accordingly, CDIC has set the following four corporate priorities:

- Be ready and alert to events affecting the members
- Be a cost-efficient operation using high governance standards
- Communicate and consult with stakeholders
- Inform consumers about deposit insurance

CDIC's Officers

[From left to right:
Guy L. Saint-Pierre, Executive Vice-President and Chief Operating Officer;
Michèle Bourque, Vice-President, Insurance and Risk Assessment;
Jean Pierre Sabourin, President and Chief Executive Officer;
M. Claudia Morrow, Vice-President, Corporate Affairs, General Counsel and Corporate Secretary;
and Thomas J. Vice, Vice-President, Finance and Administration, and Chief Financial Officer]



What's New in Your World?

Japan

The **Deposit Insurance Corporation of Japan** is hosting an International Seminar on Deposit Insurance and the Second Asian Regional Committee meeting in Kyoto, Japan on 18-19 March 2004.

As noted in previous issues of this Newsletter, the main theme of the International Seminar will be "Challenges for Deposit Insurers in a Post Banking Crisis". The Seminar will feature presentations by international organizations and academics, and deposit insurers focusing on issues such as: (i) Independency of a deposit insurer and its relationship with other safety net players; (ii) Strengthening deposit insurance fund arrangements; and (iii) Risk assessment functions of deposit insurers. In the second session, the issue of differential premiums will be discussed in terms of its potential as a new funding tool after a banking crisis. There will be Q & A session for each of the sessions.

Information on these events can be obtained from Kazumi Inoue, Senior Adviser, International Affairs, Deposit Insurance Corporation of Japan at: kazumi-inoue@dic.go.jp.

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This newsletter was issued on 11 March 2004. Want to share your expertise? To submit articles or items for consideration for a future issue please send them to info@iadi.org by 15 April 2004.