IADI 17th Annual General Meeting, Conference and Workshop

Deposit Insurance and Financial Stability: Recent Financial Topics

Proceedings

Welcome and introduction

Secretary General David Walker welcomed participants to International Association of Deposit Insurers (IADI) Conference for 2018. This event brings together participants from all over the world and encompasses a vast array of stakeholder groups. The conference is theme is highlighting developments and challenges associated deposit insurance and financial stability. He spelled out this would be facilitated by three key objectives: to offer a global perspective on the key challenges that exist; to encourage the active exchange of ideas and dialogue; and to get to know, and share experiences with, others in the field of deposit insurance

The Secretary General welcomed two venerable keynotes speakers joining the Conference, thanking them for their participation – Agustín Carstens, General Manager of the Bank for International Settlements; and Jelena McWilliams, Chairman of the Federal Deposit Insurance Corporation. He then welcomed Katsunori Mikuniya, President of the IADI Executive Council, was welcomed to the stage to share his opening remarks.

Opening address

President of the IADI Executive Council, Katsunori Mikuniya, welcomed all participants to the IADI Conference. He expressed special gratitude to keynote speakers Agustín Carstens and Jelena McWilliams, and visitors from international organisations including the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD) and the World Bank.

He began his speech by summarising achievements of the Financial Stability Board and Basel Committee on Banking Supervision, and how their several initiatives provide a regulatory environment that complements the efforts of deposit insurers. Fundamental was the joint effort of IADI and Basel Committee on Banking Supervision (BCBS) on establishing the IADI Core Principles which continue to provide an essential framework for deposit insurance systems.

He talked about the strategic objectives of IADI: reorganising governance structures; increasing the capacity for research; and looking at opportunities to provide additional technical assistance to Members. These objectives will in-part be guided by the efforts of the IADI Working Group on New Funding Options as they consider and advise on emerging funding requirements.

Keynote address

General Manager of the Bank for International Settlements Agustín Carstens thanked Katsunori Mikuniya, President of the IADI Executive Council, and David Walker, IADI Secretary General, for their invitation to speak. He reiterated the benefit of IADI being hosted at the BIS in terms of facilitating close collaboration between standard setting bodies.

Carstens emphatically stated that “deposit insurance is an important pillar of trust”. This however does not mean that deposit insurers should act alone. Deposit insurance systems should seek to address systematic risks to the financial system in conjunction with other tools, hence reemphasising the need for ongoing coordination and communication between organisations. They should also be conscious of moral hazard considerations ensuring that systems are well designed to not accommodate adverse incentives.

Reflecting on the post-Global Financial Crisis (GFC) period, he observed the increase in deposit insurance coverage that occurred in order to mitigate negative repercussions on the financial system. The revisions to IADI Core Principles made necessary improvements to established ideals, particularly framed within a global environment of increased interlinkages.

On the emergence on Fintech, Carstens suggested both challenges and opportunities have arisen. This occurs within the context of potential liquidity concerns in the non-traditional banking sector spilling over into the traditional. There is a need to understand how IADI Core Principles should apply in the non-traditional banking, where many start-ups are now offering bank products and functions without deposit insurance protections. While Fintech provides a great challenge for deposit insurance systems, it has been coupled with vast improvements to data access which will drive new research and enable further tuning of policy settings.

Panel Session 1: Recent financial topics from a global perspective

Moderator: Giuseppe Boccuzzi, Director General, Interbank Deposit Protection Fund, Italy

Giuseppe Boccuzzi commenced his speech by saying that after the GFC the regulators responded promptly to address vulnerabilities introducing a wide range of macro- and micro prudential tools. As a result the Financial Safety Net (FSN) has been reinforced. However, “when a crisis happens we start to fight it with the weapons forged in the previous crises”, and time to adapt is needed. The recent financial topics seem to focus on reconsideration of the reforms put in place globally and locally. Such a reconsideration has three stages - vision, provision, and revision.

In the near meltdown of the global financial system the global community scrambled to prospect a vision of a system that would ensure that a similar crash would not occur for at least a long time. Then, that vision was transformed into a provision via laws and regulations. One of the major areas for testing over the recent years has been the treatment of banking crises with the new resolution tools. By testing it, it was realis

ed that something was not going exactly according to the plan, or that other measures were necessary. As a result, many aspects of the reform are now under scrutiny – a period of revision has been entered. Giuseppe then gave the floor to the panellists, posing to them a question, if despite the dramatic progress with the resolution principals, objectives and tools they were sure that the new resolution framework is well-designed.

Speaker: Eva Hüpkes, FSB Adviser, Financial Stability Board

In the beginning of her speech Eva Hüpkes reminded the audience the GFC demonstrated that large financial institutions could not be resolved in a manner that maintained the continuity of critical functions and without exposing taxpayers to the risk of loss. Ms Hupkes then set herself the task of responding to the following three questions: what has changed since the GFC; what hasn't changed; and what remains to be done. Several items were quoted among the achievements to date, including establishment of resolution authorities in most G-SIB home and key host jurisdictions with powers and tools to resolve systemic financial institutions while maintaining the continuity of functions critical for financial stability; a new paradigm built around resolution planning through Crisis Management Groups (CMGs); and G-SIB resolvability monitoring through the FSB Resolvability Assessment Process (RAP).

On a negative note, some remaining uncertainty around the cross-border enforceability of resolution actions with the balance between locally prepositioned ('internal TLAC') and centrally managed ('surplus TLAC') resources yet to be determined for many G-SIBs; there is lack of adequate public information to gauge firms' resolvability in the market; finally, many jurisdictions still lack some or all the powers and tools needed to resolve systemic firms (reference was made to the forthcoming FSB 2018 Resolution Report which was published the following month). Reflecting on the things remaining to be done, she noted the need to continue to build a system that is transparent and perceived by all stakeholders as allocating losses fairly balancing flexibility and certainty; cross-border challenges should be addressed through continued close cooperation and coordination amongst home and host authorities; and reforms should be extended beyond G-SIBs.

Speaker: Marlon Rolston Rawlins, Financial Sector Specialist, Finance & Markets Global Practice World Bank

Marlon Rawlins started his speech with an impressive fact that the GFC is estimated to cost the United States alone more than USD 22 trillion. Against this background, the work the World Bank has been doing in respect to financial stability as well as regulation and supervision is just a mere fraction of the cost of the GFC. Stating that the poor FSN leads to deeper and longer recession, he outlined four key components of the FSN: Prudential Regulation and Supervision, Emergency Liquidity Assistance (Lender of Last Resort), Deposit Insurance Systems, and Bank Resolution. While these elements serve different purposes, they all contribute to the objective of minimising adverse impacts arising from distress or failure; it is critical that all components should work in concert. An FSN is only as strong as its weakest component, and so the World Bank continues to work across all the FSN elements.

Marlon went on categorising the work of the World Bank into three major elements: first, supporting countries with diagnostics and assessments against international standards and best practices (on a standalone basis or as part of the Financial Sector Assessment Program – together with the IMF). When the assessment is done the focus is to highlight gaps and challenges that exist with countries being able to meet the international standards. Following that, technical assistance is provided to strengthen the legal, institutional, regulatory and supervisory frameworks surrounding the FSN. Crisis simulation exercises is a key element here, with more than 40 already done on both domestic and cross-border/

regional levels. Finally, lending operations are performed to support the strengthening of the FSN.

Reflecting on the deposit insurance's role, he suggested it is not a cure for a weak banking system but it is best to be introduced in time when the system is indeed stable. In practice, quite often the announcement of the DIS establishment serves as a policy response to the weak banking system and is used to boost the public confidence. In conclusion, it was noted that the authorities in charge need to strengthen the policies and arrangements in respect of ELA; strengthen bank resolution frameworks in broad alignment with the FSB Key Attributes; develop and strengthen DIS in line with the IADI Core Principles; and enhance cooperation and coordination.

Speaker: Jan Nolte, Senior Financial Sector Expert Financial Crisis Preparedness & Management Division, International Monetary Fund

Jan Nolte started his presentation by recommending the recent IMF Technical Note "Resolution Funding: Who pays when financial institutions fail?", by Oana Croitoru, Marc Dobler, and Johan Molin, which was published in August 2018. He continued by identifying the pros and cons of establishing a separate resolution fund - an area with no 'silver bullet'. IMF staff typically do not recommend establishing a separate resolution fund, particularly in simple deposit funded financial systems, and in countries where national savings are scarce. If the DIF is ex-post or underfunded, priority should be given to increasing the DIF's resources and making it available to fund bank resolutions (subject to safeguards). Where there is a preference for setting up a resolution fund, it may be advisable to set up an ex-post one.

Touching upon the safeguards to enhance the resolution fund's credibility as well as to mitigate the moral hazard, Jan stressed the importance of having a resolution framework with the powers and roles clearly specified, as well as the triggers for the use of the fund. Losses should be first imposed on the shareholders and creditors, to the extent possible, before the resolution fund is used. Risk-based contributions should be introduced so that riskier or more systemic institutions pay more than others; and an institution under the resolution should be viable afterwards.

Speaker: Sebastian Schich, Principal Economist, Directorate for Financial and Enterprise Affairs, Organisation for Economic Cooperation and Development (OECD)

Sebastian Schich commenced his speech by suggesting that as a result of the policy response to the GFC, there has been a qualitative change in the FSN which consisted of a new function of the Guarantor of last resort being added in a more or less explicit form. That included temporary extension of deposit guarantee coverage limit, DIS backing by the public institutions, as well as introducing a DIS in countries where it had not existed. At present, there are attempts to withdraw that function as part of the financial regulatory reform.

He then made a reference to the conclusion the OECD's Committee on Financial Markets has come to, that the addition of the Guarantor of last resort function was necessary to avoid the worst outcome; however, it was not costless. In particular, the perceptions that the bank benefits from implicit guarantee have been further enhanced. Such perceptions are obviously undesirable as they imply that the financial costs of the bank are artificially lowered, functioning of market discipline is weakened and thus too much risk-taking is encouraged. Since then, the policy makers have been trying to target such perceptions of implicit guarantees.

In 2014 the Committee undertook a survey of self-assessments among the OECD Member countries on the issue of how financial regulatory reform is expected to effect the value of implicit guarantees. Sebastian went on describing the three basic possibilities to reduce the value of an implicit guarantee: simply to make the bank stronger; strengthening the capacity to withdraw the Guarantor of the last resort function; third opportunity (rather conceptual) is to levy a kind of a user fee in order to incentivise less use of this type of guarantee (e.g. by stimulating banks to become less systemically important).

Sebastian concluded by noting that despite the big progress most jurisdictions have made in terms of resolution regimes, there is evidence suggesting that the value of implicit guarantees remains substantial, though it has declined. Moreover, empirical work on determinants of that value reveals persistence of undesirable links (e.g. credit strength of bank home country, role of domestic failure resolution regimes and practices). Guarantor of last resort function might not yet have been withdrawn – thus, bail-in might not yet be fully credible.

Keynote address

Chairman of the Federal Deposit Insurance Corporation Jelena McWilliams commenced her speech via reflection on the many achievements made by IADI during a relatively short period of time. The FDIC is a founding member of IADI, with both mission statements resonating deeply with her. She spoke about her upbringing in Belgrade where her entire family savings were lost during bank failures. This has seen her develop a personal connection with deposit insurance.

Jelena McWilliams viewed compliance with IADI Core Principles as a priority for deposit insurance systems. She saw the current period of relative stability as an opportunity to better prepare deposit insurance systems for adverse events and improve the capacity to respond – “fill the engines with water so we can put out the fires”. Training was viewed as a core avenue to facilitate compliance, with the FDIC commitment exemplified by the efforts of Tony Sinopole in chairing the IADI Training and Conference Technical Committee. This point was rounded out by suggesting that the IADI Secretariat requires additional resourcing to coordinate such training efforts.

Turning to the GFC, she identified that economies with well-established deposit insurance systems fared much better post-GFC. The dynamics of bank runs ten years ago were unprecedented, and it has thus provided a valuable lesson to standard setters in taking stock of evolving risks – “we are very good at regulating the *last* crisis”. This will best enable maximum value to be returned to the private sector as quickly as possible.

The FDIC ‘Trust through Transparency’ initiative was announced as her first major priority as FDIC Chairman. In part, Ms McWilliams hopes to strengthen public confidence and stability in the U.S. financial system by providing increased access to data that are accessible to anyone, anytime, and anywhere; that are understandable to most audiences; and that are responsive to new ideas and demands. She urged other deposit insurance systems to improve their own levels of transparency – “the stronger the action, the greater the need to be as transparent as possible”.

Panel Session 2 - Recent Financial Topics from a Deposit Insurer’s Perspective

Moderator: Thierry Dissaux, Chair of the Management Board, FGDR, France and Chair, European Forum of Deposit Insurers

Thierry Dissaux began the session, briefly mentioning that the speakers of this second session were geographically diversified. Further, he also changed the rule to induce more interaction among workshop participants. He introduced and invited each speaker to maximise the twelve minutes of speaking time allocation as well as for the question and answer session.

Speaker: William Su – Chairperson of APRC / President of CDIC, Chinese Taipei

William Su spelled out that his presentation were divided into three main agendas: 1. Challenges from global perspective; 2. Challenges to Asia Pacific Region; and 3. Conclusion and recommendations.

On the global challenges, he mentioned that it was time to say goodbye to goldilocks economy, as we were currently facing extreme uncertainty of the whole world. These were imminent as recently interest and inflation rates are increasing, whilst economic growth becoming more volatile. Moreover, we also see increasing risks of both global trade wars and rising debt problems, which all of these risks may lead to a shaking in international financial stability.

With respect to Asia Pacific Level, he indicated that the situation might be worse than global. This was due to some countries in the region were impacted by the quantitative easing exit side effects. Other indications foreign exchange devaluation; fall in stock markets, rising Debt/GDP ratio; and increased interest rates.

William also identified challenges and risks in Banking Industry in 2018 and 2019 (based on survey being held for APRC members), namely: increasing cyber-attacks, decreasing economic growth rate, and rising NPL ratio. While for DIA based in APRC, according to the same survey, the challenges and issues are: low level of public awareness on deposit insurance systems (70% of DIA in Asia Pacific Regions has below than 75% public awareness ratio), limited mandates and inadequate cooperation with other relevant government agencies.

Mr Su also mentioned recent enhancement in the region, both made by Supervisors as well as made by DIAs. Finally, he concluded some recommendations for domestic financial safety net members, including precautionary measures by the Government aimed at reducing fiscal deficit, preventive supervisory policies and precautionary risk measures by deposit insurers.

Speaker: Alex Kuczynski – Chief Corporate Affairs Officer, FSCS, United Kingdom

Alex Kuczynski started his presentation mentioning issues related to the recent financial topics from the FSCS perspectives. On first issue of access to liquidity, he mentioned that the United Kingdom (UK) is adopting a hybrid model between pay as you go regime and a prefunded regime. Every year they estimate the needs of fund for covering deposits in failing banks. Most of the years, a GBP 10 – 20 Million is needed to cover small but consistent flow of credit union failures. This is apart from the annual levy limit – amounting to GBP1.5 billion. If the fund is running short during the year, an overdraft facility is available, while still waiting on raising the levy facility. The FSCS also uses a revolving credit facility (amounting of GBP 1.5 billion) which is agreed by the market with a selection of lenders of 10-15 banks (to be renewed annually) but is a one-year facility, which has to be repaid within a year. If that is not enough, FSCS may go to the government and ask for the prefund that was set aside on the Deposit Guarantee Scheme Directive (DGSD) rules to be provided to FSCS although it has to be repaid. Further, if that is still not enough, FSCS may ask for an additional funds under the scheme of Non Directive Funds (NDF) as they are not the part of DGSD.

As in the beginning of November 2018, FSCS will be convening together with the authorities in the UK (including Treasury Debt Management Office and the Bank of England) to do an exercise on how the access to money works in reality. This exercise is also to meet the compliance of the European Stress Tess Guidelines.

Alex mentioned the importance of recoveries as FCSC needs to get back from the estate or the third parties as much as they can to repay either lenders or the levy payers. FSCS has the advantage of being a preferred creditor under both UK and EU Legislation.

On issues relating to the Brexit, Alex quoted from the statement from the PM. He stated that this is a very open issue in the UK, as there are various perceptions on the issue and the outcome was currently uncertain. Obtaining agreement may go into a lengthy process and we may see an extended transitional period. From purely deposit insurer's perspective, the main issue will be cross border depositor protection, because currently FSCS protects depositors across the EU where they bank with branches of UK banks and similarly within the UK, there are depositors protected by EU counterparts where they bank with the counterpart EU banks based in the UK. Alex confirmed that currently the FSCS do not know of what the outcome would be, and how these issues would be resolved.

Speaker: John Chikura – Former CEO, Deposit Insurance Corporation of Zimbabwe, Former Chair IADI Africa Regional Committee

John Chikura spoke about providing or extending deposit insurance to a financially linked deposit, or in other words focusing to the area of fintech. He focused on deposit insurer's perspective from the Africa Regional Committee Perspective. The issue of fintech can be generally defined as the emergency of technology and innovative ways to provide financial services that ordinarily were offered through traditional ways e.g. cryptocurrencies and mobile money (with more focus on the mobile money). The increase in the usage of mobile technology and its acceptance has opened a window for new delivery channels for financial services, as well as an opening of a new suit of financial product offerings. These developments create both opportunities and risks or difficulties for deposit protections schemes.

John begins with question of whether there is a business case in protecting fintech deposits or products. The fact is there is a business case that makes protection of these e-banking products as a justifiable initiative. This is parallel with the effort of promoting financial inclusion, including adding accessible avenues for the unbanked public. Small depositors mostly use such products.

Based on experiences in Africa regional committee, John concluded that in order to ensure robust framework for covering fintech products, the laws should ensure that it has clauses that address issues of:

- Fund Isolation - Providers are required to create trust accounts in a bank where they store customer funds and beneficiaries will be the e-money customers.
- Fund Safeguarding - Providers are prohibited from using the funds to finance business expenses, use funds as collateral, extend credit, but only to repay customers wanting to cash out.

- Minimising operational risk - There is need for auditing (the provider should audit agents accounts) and active monitoring to enforce terms on behalf of clients.

Speaker: Juan Carlos López-Mora – Head of Communication and Corporate Affairs, Fondo de Garantías de Instituciones Financieras (FOGAFIN), Colombia

Juan Carlos López-Mora talked about deposit insurance and bank failure resolutions. He started out with the question of who should resolve failing banks. What is the optimal design? Who should resolve all the political influences that resolution authority faces during financial distress period? Finally, who can minimise conflict of interest, especially from the perspective of deposit insurance agencies (both public and private), as well as from the perspective of both banking supervisors and central bank?

Juan Carlos mentioned that FOGAFIN took the data IADI offered and did a comparative analysis of the data that being obtained. They found out that there were ten countries (namely are Slovenia, Finland, Japan, Trinidad and Tobago, Bulgaria, Ukraine, Czech Republic, Peru, Singapore and Estonia) that had no input in the decision-making process in the resolution of failing member institution in 2012 and these countries are now showing greater involvement in decision making.

FOGAFIN analysed the mandate and found that eight of these ten countries showed increasing resolution role from 2012 to 2016. FOGAFIN also analysed the size of the DIS fund for resolution. There appears to be a positive correlation between an increase of mandates and increase of funding. FOGAFIN then explored the roles that the DIS has taken in resolving the failing of the member institutions. The result of the observation for this phase is that the numbers are quite aligned with an increase in the number of countries that have “No input but are obligated to participate in Resolution Funding”; decrease in the number of countries that stated that they have “No input of responsibility in Resolution Funding”; and more countries are obligated to participate in the resolution exercise, typically with higher DI Fund / Eligible deposits ratio.

Juan Carlos closed his presentation by stating that, the correlation between the current resolution environment and the topic of the discussion that we are discussing in this part of session is that there is an increased participation of DIs in resolution. The challenge is, as economic environment is changing, would deposit insurers be prepared enough to assume these new roles under the new economic environment. Moreover, would these efforts be enough for deposit insurers us to reconstruct or rebuild our reserve and address the need of the IADI members in the short term.

Summary and closing remarks

Patrick Déry set himself the task of summarising the day’s events into a single sentence. He suggested “the proof of the pudding will be in the eating” reflecting on practical experience being the key mechanism to judge the real value of deposit insurance. There was a reiteration that while many high profile individuals and organisations will attempt to predict, standard setters do not know when the next crisis will occur, and rather “sleep with their eyes open”. While there have been tremendous efforts by IADI and Members since the GFC, we do not know if these efforts will be effective. Nevertheless he encouraged Members to explore avenues to increase compliance with the IADI Core Principles. Finally, Patrick concluded by thanking everyone for their participation in the day’s events.