

# **International Association of Deposit Insurers (IADI)**



## **A Handbook for the Assessment of Compliance with the Core Principles for Effective Deposit Insurance Systems**

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## Acronyms

<b>AM</b>	Aide-memoire
<b>BCBS</b>	Basel Committee on Banking Supervision
<b>BCP</b>	Basel Core Principles for Effective Banking Supervision
<b>CBRG</b>	Cross-border Bank Resolution Group
<b>DI</b>	Deposit insurer
<b>DICP</b>	Deposit Insurance Core Principles
<b>DIS</b>	Deposit insurance system
<b>EC</b>	European Commission
<b>EFDI</b>	European Forum of Deposit Insurers
<b>FSAP</b>	Financial Sector Assessment Program
<b>FSB</b>	Financial Stability Board
<b>FSC</b>	Financial Stability Committee
<b>FSI</b>	Financial Stability Institute
<b>FSN</b>	Financial safety-net
<b>IADI</b>	International Association of Deposit Insurers
<b>IDIS</b>	Islamic Deposit Insurance System
<b>IMF</b>	International Monetary Fund
<b>JWG</b>	Joint Working Group
<b>KAs</b>	Key Attributes of Effective Resolution Regimes
<b>MDIS</b>	Multiple deposit insurance systems
<b>MOF</b>	Ministry of Finance
<b>MOU</b>	Memorandum of understanding
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>ROSC</b>	Reports on the Observance of Standards and Codes
<b>SRR</b>	Special resolution regime

## Definitions of Key Terms<sup>1</sup>

“**Bank**” refers to any entity which accepts deposits or repayable funds from the public and is classified under the jurisdiction’s legal framework as a deposit-taking institution.

“**Blanket guarantee**” is defined as a declaration by authorities that, in addition to the protection provided by limited coverage deposit insurance or other arrangements, certain deposits and perhaps other financial instruments will be protected.

“**Bridge bank**” refers to an entity that is established to temporarily take over and maintain certain assets, liabilities and operations of a failed bank as part of the resolution process.

“**Deposit insurance**” is defined as a system established to protect depositors against the loss of their insured deposits in the event that a bank is unable to meet its obligations to the depositors.

“**Deposit insurer**” refers to the specific legal entity responsible for providing deposit insurance, deposit guarantees or similar deposit protection arrangements.

“**Deposit insurance system**” refers to the deposit insurer and its relationships with the financial safety-net participants that support deposit insurance functions and resolution processes.

“**Depositor preference**” means granting deposit liabilities a higher claim class than other general creditors against the proceeds of liquidation of an insolvent bank’s assets. Depositors must be paid in full before remaining creditors can collect on their claims. Depositor preference can take a number of different forms. For example:

- national (or domestic) depositor preference gives priority to deposit liabilities booked and payable within the domestic jurisdiction and does not extend to deposits in foreign branches abroad;
- eligible depositor preference gives preference to all deposits meeting the eligibility requirements for deposit insurance coverage;
- insured depositor preference gives preference to insured depositors (and the deposit insurer under subrogation);
- a two-tiered depositor preference concept, in which eligible, but uninsured deposits have a higher ranking than claims of ordinary unsecured, non-preferred creditors, and insured depositors have a higher ranking than eligible depositors; and
- general depositor preference, in which all deposits have a higher ranking than claims of ordinary unsecured, non-preferred creditors, regardless of their status (insured/uninsured or eligible/not eligible).

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<sup>1</sup> For other terms, please refer to the IADI Glossary of Terms and Definitions.

“**Differential premium system**” (or “risk-based premiums”) refers to a premium assessment system which seeks to differentiate premiums on the basis of criteria such as individual bank risk profiles.

“**Ex ante funding**” refers to the regular collection of premiums, with the aim of accumulating a fund to meet future obligations (e.g. reimbursing depositors) and cover the operational and related costs of the deposit insurer.

“**Ex post funding**” refers to systems in which funds to cover deposit insurance obligations are only collected from surviving banks after a bank failure.

“**Financial inclusion**” refers to the extent to which individuals and entities have access to and utilise formal financial services.

“**Financial safety-net**” is defined to include the functions of prudential regulation, supervision, resolution, lender of last resort and deposit insurance. In many jurisdictions, a department of government (generally a Ministry of Finance (MOF) or Treasury responsible for financial sector policy) is included in the financial safety-net.

“**Fit and proper**” refers to fitness tests that usually seek to assess the competence of managers and directors and their capacity to fulfil the responsibilities of their positions, while propriety tests seek to assess their integrity and suitability. Formal qualifications, previous experience and track record are some of the elements focused on by authorities when determining competence. To assess integrity and suitability, elements considered include: criminal records, financial position, civil actions against individuals to pursue personal debts, refusal of admission to, or expulsion from, professional bodies, sanctions applied by regulators of other similar industries, and previous questionable business practices.

“**Liquidation**” (or “receivership”) refers to the winding-down (or “winding-up” as used in some jurisdictions) of the business affairs and operations of a failed bank through the orderly disposition of its assets after its licence has been revoked and it has been placed in receivership. In most jurisdictions, it is synonymous with “receivership.”

“**Liquidator**” (or “receiver”) refers to the legal entity that undertakes the winding-down of the failed bank and the disposition of its assets.

“**Mandate**” of the deposit insurer refers to the set of official instructions describing its roles and responsibilities. There is no single mandate or set of mandates suitable for all deposit insurers. When assigning a mandate to a deposit insurer, jurisdiction-specific circumstances must be taken into account. Mandates can range from narrow “pay box” systems to those with extensive responsibilities, such as preventive action and loss or risk minimisation/management, with a variety of combinations in between. These can be broadly classified into four categories:

- a. A “pay box” mandate, where the deposit insurer is only responsible for the reimbursement of insured deposits;
- b. A “pay box plus” mandate, where the deposit insurer has additional responsibilities, such as certain resolution functions (e.g. financial support);

- c. A “loss minimiser” mandate, where the insurer actively engages in a selection from a range of least-cost resolution strategies; and
- d. A “risk minimiser” mandate, where the insurer has comprehensive risk minimisation functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases prudential oversight responsibilities.

“**Moral hazard**” arises when parties have incentives to accept more risk because the costs that arise from the risk are borne, in whole or in part, by others.

“**Public policy objectives**” refer to the goals which the deposit insurance system is expected to achieve.

“**Resolution**” refers to the disposition plan and process for a non-viable bank. Resolution may include: liquidation and depositor reimbursement, transfer and/or sale of assets and liabilities, the establishment of a temporary bridge institution and the write-down of debt or conversion to equity. Resolution may also include the application of procedures under insolvency law to parts of an entity in resolution, in conjunction with the exercise of resolution powers.

“**Resolution authority**” is defined as a public authority that, either alone or together with other authorities, is responsible for the resolution of financial institutions established in its jurisdiction (including resolution planning functions).

“**Subrogation**” is the substitution of one party (e.g. the deposit insurer) for another (e.g. the insured depositor) with reference to a lawful claim, demand, or right, so that the party which substitutes succeeds to the rights of the other in relation to the debt or claim, and its rights and remedies.

“**Target fund size**” refers to the size of the ex-ante deposit insurance fund, typically measured as a proportion of the assessment base (e.g. total or insured deposits), sufficient to meet the expected future obligations and cover the operational and related costs of the deposit insurer.

# **Handbook for the Assessment of Compliance with the Core Principles for Effective Deposit Insurance Systems**

The following “Handbook for the Assessment of Compliance with the IADI Core Principles” is designed to provide additional guidance for assessing a jurisdiction’s compliance with the Core Principles. It is an interpretive guide and is not intended to go beyond the intent of the Core Principles by being overly prescriptive or allowing exceptions not supported by the intent of the Core Principles.

## **I. Background**

**Deposit insurance systems have become an essential feature of financial safety-nets.** The United States introduced the first publicly funded, ongoing deposit insurance system in 1933. More than eighty years later, almost 120 jurisdictions have such systems in place. The rapid increase in the number of deposit insurance systems (DIS) has heightened the importance of establishing internationally agreed principles for their effectiveness. An effective DIS must protect depositors and contribute to financial stability. Concerns about moral hazard and distortions in market perceptions of risk arising from deposit insurance should be mitigated by ensuring that DISs have appropriate design features and are supported by other features of financial safety-nets.

**The International Association of Deposit Insurers (IADI) was established in 2002 to contribute to the enhancement of deposit insurance effectiveness and safety by promoting guidance and international cooperation.**

**IADI and the Basel Committee on Banking Supervision (BCBS) issued the Core Principles for Effective Deposit Insurance Systems in June 2009.** A compliance assessment methodology for the Core Principles was completed in December 2010. The Core Principles and their compliance assessment methodology (together: the Core Principles) are used by jurisdictions as a benchmark for assessing the quality of their DISs and for identifying gaps in their deposit insurance practices and measures to address them. The Core Principles are also used by the International Monetary Fund (IMF) and the World Bank, in the context of the Financial Sector Assessment Program (FSAP), to assess the effectiveness of jurisdictions’ DISs and practices.

**The Core Principles are reflective of, and designed to be adaptable to, a broad range of jurisdictional circumstances, settings and structures.** The Core Principles are intended as a framework supporting effective deposit insurance practices. National authorities are free to put in place supplementary measures that they deem necessary to achieve effective deposit insurance in their jurisdictions.

**An assessment of compliance with the Core Principles can be a useful tool for jurisdictions that are implementing, reviewing or actively reforming a DIS.** A comprehensive, credible and action-oriented assessment should focus on the DIS and its relationship to the financial safety-net (FSN) functions which support it. The assessment of broader safety-net functions (i.e. operating environment) is mostly outside the responsibility of the deposit insurer (DI). But it can have a direct effect on the DI’s ability to fulfil its mandate. The assessment of a DIS should



identify strengths and weaknesses in the existing DIS, and form a basis for improvement or remedial measures by the DI and policymakers (e.g. government authorities or, if it is primarily a private system, its member banks), after taking into account the structural, institutional and legal features of each national DIS.

**The global financial crisis of 2007–2009 brought to light significant policy lessons for DISs.**

The evolution of the crisis showed the importance of maintaining depositor confidence in the financial system and the key role that deposit protection plays in maintaining that confidence. Increases in deposit insurance coverage and strengthening of funding arrangements helped support financial stability in many jurisdictions. In some jurisdictions, blanket guarantees were issued by authorities. Irrespective of the form of protection, policymakers recognised the importance of ensuring depositor confidence. In the aftermath of the crisis, a number of DIs saw their powers expand to include resolution tools in addition to depositor reimbursement.

**These lessons have important implications for the Core Principles, and have provided the context and the environment within which the Core Principles have been revised.** Greater awareness and emphasis have been placed on ensuring that the DI has the necessary operational independence to fulfil its mandate. The crisis also revealed DIs' need to have additional tools and an ability to be better integrated into the FSN.

**As a result of these developments, experiences using the Core Principles, and international regulatory enhancements, in February 2013 IADI established an internal Steering Committee to review the Core Principles and develop a proposed set of revisions.** As part of its review mandate, the Committee took the following into account: experience gained in using the Core Principles for jurisdiction self-assessments and FSAPs; significant developments in the regulatory landscape such as the development of the Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes (KAs); and enhanced guidance developed by IADI to address recommendations arising from the FSB Thematic Review on Deposit Insurance.<sup>2</sup>

**A revised draft of the Core Principles was presented to a Joint Working Group (JWG)** – which included representatives from the BCBS, the European Forum of Deposit Insurers (EFDI), the European Commission (EC), the FSB, the IMF and the World Bank – for use as a starting point to collaboratively develop a final revised set of Core Principles as set forth in this document. In conducting its review, the JWG sought to achieve the right balance between raising the bar for more effective DISs and retaining the Core Principles as a flexible, internationally applicable standard. The revised Core Principles continue to accommodate a diverse range of DIs. They were approved by the IADI Executive Council in October 2014 and subsequently submitted to the FSB for inclusion in its Compendium of Standards. In November 2014, the FSB replaced the 2009 Core Principles with the revised version in the Compendium of Standards.

**The Core Principles provide policy guidance on the design of DIs.** Similar to other Core Principles for banking supervision and securities regulation, the Core Principles for Effective Deposit Insurance Systems identify the broad policy direction for DIs. These principles are

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<sup>2</sup> FSB Thematic Review on Deposit Insurance, February 2012, <http://www.pfsprogram.org/sites/default/files/PFS%20Thematic%20Review%20of%20Deposit%20Insurance%20Systems%20-%20Feb%202012.pdf>.

adaptable to a broad range of jurisdictional circumstances, settings and structures, but do not incorporate country-specific conditions or consider how differences in policy objectives and mandates would affect the design features of DIs.

**The Core Principles, therefore, have been supplemented with a methodology for evaluating national systems and assessing the degree of compliance with international standards.** The Methodology includes Essential Criteria (EC) for each Core Principle, and this Handbook is designed to provide additional guidance on assessing a jurisdiction’s compliance with the Core Principles.

## **II. Use of the Assessment Methodology**

**The methodology can be used in multiple contexts. Examples include:**

- as part of IMF and World Bank FSAP reviews;
- self-assessments conducted by a DI, which may also have its results validated through IADI’s Self-Assessment Technical Assistance Program (SATAP);
- as a basis for the provision of bilateral or multilateral technical assistance by various international organisations;
- use by private third parties, such as consulting firms hired to conduct compliance assessments; and
- peer reviews and thematic assessments conducted by the FSB.

IADI will continue to interpret the Core Principles to assist users and provide training aimed at disseminating norms and good practices during the assessment process.

**The Core Principles for Effective Deposit Insurance Systems are applicable to a wide range of DIs with distinct mandates.** “Mandate” of the DI refers to the set of official instructions describing its roles and responsibilities. There is no single mandate or set of mandates suitable for all DIs. Mandates can range from narrow “pay box” systems to those with extensive responsibilities, such as taking preventive action and loss or risk minimisation/management, with a variety of combinations in between. These can be broadly classified into four categories:

- a. A “pay box” mandate, where the DI is only responsible for the reimbursement of insured deposits;
- b. A “pay box plus” mandate, where the DI has additional responsibilities, such as certain resolution functions, e.g. financial support;

- c. A “loss minimiser” mandate, where the DI actively engages in a selection from a range of least-cost resolution strategies; and
- d. A “risk minimiser” mandate, where the DI has comprehensive risk minimisation functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases prudential oversight responsibilities.

The assessors must be able to evaluate safety-net functions falling outside the direct responsibility of the DI. This design feature puts a premium on collaboration across institutions, and calls for a team approach to the assessment. The assessors must also have access to all relevant documents, including recent FSAP reviews and Reports on the Observance of Standards and Codes (ROSC). Assessors should discuss with the authorities the status of corrective actions taken in response to any recommendations.

**Quality control needs to be consistently addressed.** Assessments must accurately reflect the conditions in the assessed jurisdictions, and the grading must be explained and be considered appropriate. Moreover, the grading of assessments must be internally consistent across all Core Principles. If the assessment is conducted within an FSAP, quality control mechanisms for the FSAP will ensure accuracy. If the assessment is conducted under the aegis of IADI or other international institutions, some quality control (e.g. peer reviews) can be established by the sponsoring institution. The use of the methodology by third parties may be subject to less review and oversight than when conducted through FSAP or IADI processes.

**Guidance in the use of the methodology is considered important.** This Handbook describes the use of the methodology in the assessment process. The Handbook emphasises the importance of adequate preparation and team selection. It then reviews the methodologies for assessing each of the Core Principles and provides more detailed explanations of the key objectives for each Core Principle.

### III. Assessment Process

#### A. Overview

**The assessment of a jurisdiction’s DIS is a complex and multifaceted process.** Early and comprehensive preparation for the assessment will make the fieldwork more effective. When selecting the team members, one must keep in mind the conditions and constraints which the assessors may face. Pre-fieldwork preparations include the review of prior assessments and reports, desk reviews of laws and regulations, sending out a questionnaire, and conducting a preliminary assessment before the fieldwork begins. The assessment will be more effective if a national counterpart team (i.e. one or more senior officials from the jurisdiction being assessed) is appointed early and there is frequent contact with the counterparts. After the fieldwork, the process of reviewing and incorporating comments is an essential step in producing the final product (see Annex 1 and Annex 2 for details).

**The complex nature of the assessment makes careful planning a critical element of a successful assessment.** If conducted under an IMF/World Bank FSAP, the mission team will determine the preparation and report production process. If conducted as a third-party review, a peer review or a self-assessment, a timeline may help guide the preparation and completion of the review. In that context, preparations for a standalone assessment must begin sufficiently early so that the assessment can be effective, the on-site visit must be of the right duration, and the post-visit review and finalisation must be rapid (see Box 1 for a generic timeline). As the timeline makes clear, the full assessment process will take about three months from start to completion of the final report.

**IADI, in collaboration with the Financial Stability Institute (FSI), has developed an online tutorial on how to plan for and conduct a self-assessment of compliance with the Core Principles.**<sup>3</sup>

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<sup>3</sup> The FSI’s subscription web-based learning tool for financial sector regulators worldwide can be accessed at [www.fsiconnect.org](http://www.fsiconnect.org). For subscription information, please contact [fsiconnect@bis.org](mailto:fsiconnect@bis.org).

Typical Assessment Timeline	
Week	Activity
T-8	Select assessors and assign roles. Identify a counterpart. Develop assessment template and work plan.
T-7	Send out template. Request documents and data. Begin review of available information (laws and regulations, state of banking conditions, previous assessments, etc.).
T-6	Continue desk review.
T-5	Continue desk review.
T-4	Continue desk review.
T-3	Receive completed template. Review response and available information.
T-2	Prepare initial compliance assessment.
T-1	Final preparations.
T	On-site visit. Leave draft report, including corrective actions, at end of visit. Meet with DI management.
T+2	Send for comments internally.
T+3	Receive comments from DI staff and authorities.
T+4	Incorporate comments and finalise report.

## B. Preparation

### 1. Staffing of the assessment team

**The size of the team will depend on how the assessment is undertaken.** If the assessment is part of a broader FSAP assessment, the expert responsible for evaluating the DIS will work in close collaboration with any other team members conducting the assessment of the Basel Core Principles for Effective Banking Supervision (BCP) and crisis management framework. The FSAP team will take an integrated view about the effectiveness of the safety-net.

**If a standalone assessment is being conducted, a larger team will be needed that incorporates an adequate set of skills to review the broader safety-net features.** A broad skill mix will be needed because the team will have to come to a consensus about the effectiveness of the safety-net elements. The team will need members with experience of working in an appropriate DIS (i.e. with a comparable mandate) as well as an understanding of safety-net functions. If the DI is a risk minimiser, the team must include assessors familiar with risk-minimising DIs, including any supervision and resolution functions carried out by the agency. Even if the DI is a limited pay box, the assessment team will need staff with an understanding of supervision and insolvency frameworks.

**The team must be able to draw on a variety of sources for the assessment.** The assessment begins with a comprehensive review of available material. Available country reports, including

FSAP reviews, jurisdiction reports, and annual consultation reports, along with any other aides-memoires (AMs) left by missions from international financial organisations, banking laws, deposit insurance laws, resolution and insolvency laws, and central bank laws should all be reviewed. If possible, a preliminary assessment should also be made of the effectiveness of enforcement. The team can draw on a number of documents to come to this evaluation. In addition to the desk reviews, the assessors can review any recent FSAP reports from the IMF and World Bank, G20 peer reviews, OECD reports, and even market reports (e.g. those of rating agencies) if available. National policymakers (e.g. MOFs and regulators) may also have published reviews of the mandate and role of the DI. Many of these documents are available on public websites or can be requested from the authorities.

## **2. Counterpart for mission coordination**

**A senior-level counterpart is essential in the preparation of the assessment.** The counterpart should be appointed by the head of the DI and be responsible for a wide variety of issues, such as providing technical support in the preparation of the mission and logistical support to the team. The counterpart should be able to ensure that the template is adequately completed, answer questions from the assessor team concerning relevant laws and regulations, and help develop the meeting schedule. As the on-site visit dates approach, the counterpart should help finalise all arrangements for the visit.

**A key step in the assessment is ensuring that adequate staffing is in place.** The DI needs to make the assessment an explicit priority, with an adequate number of qualified staff, and to ensure access to relevant stakeholders, such as financial consumer groups, member banks, and other safety-net participants. The jurisdiction counterparts are typically individuals integrated into the normal staff activities of the agency. These individuals will bring a variety of different competencies to the assessment process.

## **3. Self-assessment template**

**The self-assessment template is a critical input into the preparation of the mission.** An approach that has proved useful is to send a compliance assessment template to the DI. The DI would be asked to conduct its own self-assessment of compliance with the Core Principles and complete the template, citing specifically the laws and regulations that correspond to each of the Essential Criteria. The DI would be asked to return the completed template together with the relevant laws and regulations – translated into English or the language to be used by the assessors – where necessary, and any recent FSAP reports (e.g. from the last three to five years), including the detailed assessment of the BCP. The DI should also be asked to provide some basic information about the DI and statistical information on the banking system. An example of the format for providing such information is contained in Annex 1.

**Timing for receiving the template is critical.** The template should be distributed about seven weeks before the mission and the DI given no more than four weeks to respond. Contact with the counterpart should ensure the timely preparation of the responses. If possible, the counterpart should send information as it is prepared, rather than waiting for the submission package to be finalised.

**Once received, the assessors should review the template, and the legal and regulatory framework.** Laws, decrees and applicable regulations must be identified. In many cases, a single legal text will address numerous criteria, often spanning several different Core Principles. The review of legal references should identify the content of the laws and regulations. The reviews should include, at a minimum, the deposit insurance law, the banking law, the central bank law, any general and specialised insolvency or bank resolution laws, and any other laws affecting the banking sector. For example: the administrative code may be reviewed with regard to legal protection of supervisors; bank resolution or insolvency laws may be reviewed for the adequacy of the resolution tools; and other commercial laws may affect the delegation of powers, the separation of functions, or the ability to resolve a troubled bank. This review of laws and other documents will provide input into the description of the operating environment, as well as provide a background for the initial assessment of compliance with the Core Principles. In addition, assessors should also look for any supporting documents (i.e. MOUs between safety-net participants or DIs.)

#### **4. Schedule of meetings during on-site visit**

**The meeting schedule should be finalised before the beginning of the on-site visit.** The team should have in-depth discussions with the relevant departments within the DI. These discussions can be organised around each of the Core Principles, with the aim of clarifying any uncertainties about the information provided in the template and confirmation of the write-up. The team should also meet with other participants in the safety-net (see Annex 2 for sample questions). The team schedule can evolve if needed as the issues are more clearly revealed during the visit itself. The team's counterpart should be able to provide guidance, but such meetings could probably include the following:

- Bank supervisors could provide views about information sharing, treatment of banks in difficulty, and the overall resolution framework;
- The MOF or other relevant authority could be asked about its role in financing the DIS and bank resolution;
- The central bank could be asked about conditions for emergency liquidity support and interrelations with other safety-net participants;

- Bankers and the bankers’ associations could share views about issues such as coverage, moral hazard mitigation, funding, public awareness, the effectiveness of intervention and resolution policies, and the market impact of past resolutions;
- Both private lawyers and the legal department of the DI can provide valuable insights into the protection of staff and the effectiveness of sanctions, the governance framework, insolvency law and procedures;
- Consumer groups could provide views about public expectations and the effectiveness of the DI’s public awareness programme; and
- Other safety-net participants, financial ombudsmen, rating agency professionals and insolvency practitioners could provide various perspectives on the overall banking sector and the operating environment.

## 5. Pre-visit assessment

**Once the template and supporting documents are received, the team should finalise its review of key documents.** Both laws and regulations should be reviewed, together with IMF and World Bank reports and market reports. This review should identify any shortcomings such as: (i) the absence of any legal text addressing a particular criterion; (ii) the lack of necessary documents; (iii) legal texts that only partially address the criterion;<sup>4</sup> and (iv) legal texts that cover all aspects of the criterion but establish weak standards.<sup>5</sup> Based on this review, the team can come to an initial conclusion about the effectiveness of the DIS and, more importantly, identify key gaps in information which will require further investigation during the visit. Any requests for additional information should be sent before the on-site visit.

**Before leaving for the on-site visit, the assessment team should have prepared very preliminary drafts of the assessment report and presentation, which will be validated or modified as needed based on the on-site observations and assessment.**

## C. Fieldwork

**The on-site visit begins with in-depth meetings at the DI.** After introductory meetings, the assessors should conduct in-depth discussions with the DI staff on topics relating to each Core Principle. The objective of the meetings is to clarify the operating procedures of the DI. The

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<sup>4</sup> For example, laws on bank resolution may not suspend shareholders’ rights.

<sup>5</sup> For example, they may mandate depositor payout but provide excessive time (e.g. over a year) for completion of the payout process.



assessors will then need to meet with other safety-net participants to obtain an overview of the safety-net structure, and of how policies and procedures are implemented.

**There are four phases to the assessment process:**

- Phase 1: Updating the assessment of the legal and regulatory framework (laws, edicts and regulations);
- Phase 2: Reviewing the practical application and implementation of laws, regulations, and supervisory policies and procedures;
- Phase 3: Assessing compliance with the Essential Criteria set out in the Core Principles; and
- Phase 4: Preparing the draft assessment report and drawing up an action plan.

**Phase 1: Reviewing the legal and regulatory framework**

**The assessors must verify the gaps and shortcomings/deficiencies in the legal and regulatory framework, as identified in the pre-visit period.** Assessors should discuss with DI staff the nature of the discrepancy between what is called for in the Core Principles criteria and what is actually provided for in the law. This exercise will provide the basis for determining the steps that need to be taken (i.e. enactment of new laws or amendment of existing laws) as part of the action plan.

**Phase 2: Reviewing the practical application and implementation of laws, regulations, and supervisory policies and procedures.**

Assessors should not base their judgments solely on the legal and regulatory framework. The assessment must also consider the extent of implementation and the impact of that implementation. Assessing implementation is crucial as this determines whether legal requirements are enforced and effective in practice. This can be ascertained from responses to the questionnaire and interviews with DI officials and other safety-net participants. In phase 2, the review can lead to several different types of conclusions, for example:

- The assessor may find that the regulations are not implemented or effective in practice;
- The assessor may find that the policies and procedures satisfy a given criterion in their implementation, despite the fact that they are not supported by specific legal provisions; and

- The assessor may find that the policies and procedures followed in practice reinforce the legal framework.

**If the assessment concludes that laws and regulations were not implemented, the DIS is not considered compliant with the relevant Core Principle.** Where legal requirements and actual practice are not consistent, the assessor must judge the extent to which the policies and procedures make up for the lack of formal legal authority. A recommendation would need to be made for the authorities to take steps to have the formal framework amended so that it corresponds more closely to actual practice. The assessors may encounter situations in which the assessment of a criterion is mixed: the legal texts and informal practices may fully satisfy a criterion in some respects while falling short to a greater or lesser degree in other respects. The assessors must then come to a judgment about whether the critical objectives of the Core Principle are met.

### **Phase 3: Assessment of compliance with the Core Principles**

**The third phase of the assessment is to determine the extent of compliance.** The assessment of the DIS against the benchmark of the Core Principles follows directly from the assessment of the strengths and weaknesses in the previous two phases. The assessment follows a five-grade scale as follows:

- **Compliant (C):** When the Essential Criteria are met without any significant deficiencies.<sup>6</sup>
- **Largely Compliant (LC):** When only minor shortcomings are observed and the authorities are able to achieve full compliance within a prescribed time frame.
- **Materially Non-Compliant (MNC):** Severe shortcomings exist which cannot be easily rectified.
- **Non-compliant (NC):** No evidence of substantive implementation of the Core Principle.
- **Not applicable (NA):** Not considered given the structural, legal and institutional features of the DIS.

**Compliance with the Core Principles is assessed against the Essential Criteria.** A DIS can be in full compliance with a particular Core Principle even if it is not fully compliant with some of the Essential Criteria. The assessors must determine if the main objectives of the Core Principles are met and whether limitations in meeting some of the Essential Criteria are so serious as to undermine the overall objectives of the Core Principles.

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<sup>6</sup> In order to achieve a “Compliant” grade, it is not always necessary to achieve compliance on all Essential Criteria for each Core Principle. For example, if a DIS is compliant with eight out of nine Essential Criteria for a specific Core Principle but is not compliant in a relatively minor area, then an overall rating of “Compliant” could be given. Assessors must exercise judgment in these situations.

**Grading is not an exact science and judgement is needed to assess compliance.** The assessment criteria should not be seen as a checklist approach to compliance but as a qualitative exercise. Assessors bring their experience and their understanding to evaluating the extent to which a system meets the underlying objectives of each Core Principle. The number of criteria receiving a compliance grade and the commentary that should accompany each grade will be considered in the scoring process for each Core Principle. The assessors must decide which of the Essential Criteria have more relevance in the context of the system being assessed. Assessors would typically assign grades to each Essential Criterion for the purpose of helping them decide about the overall grade for the Core Principle. In the case of some reviews such as FSAPs, grades for Essential Criteria are not published.

#### **Phase 4: Assessment report and action plan**

**The draft assessment report should be left in the field for the authorities' initial comments.** The report should contain a summary of the legal and institutional framework, an analysis of the operating environment, a summary of the main conclusions of the team, and the detailed Principle-by-Principle compliance assessment. A typical structure for the report is provided in Annex 3.

**The last step of the assessment is to draw up an action plan.** The action plan prioritises the steps needed to address the identified deficiencies, taking into account and describing the economic realities and resources available. The DI may choose to correct the deficiency if the matter at issue falls within the authority's legal competence. Alternatively, if the issue falls outside the DI's responsibility, the DI may recommend changes to other safety-net participants. The supervisory authority may also judge that the Core Principle is not applicable to its domestic banking system. For example, if the banking system has no cross-border firms, little may be gained by upgrading the requirements relating to cross-border relationships. Ideally, the implementation of the action plan will lead to a cooperative effort between the various government agencies involved in the safety-net framework.

Prior to concluding the on-site visit, the assessors should meet with the head of the DI, the chairman of its governing board and senior DI staff to brief them on the team's findings, conclusions and recommended actions. This provides an opportunity to correct any factual errors in the assessment report.

#### **D. Post-fieldwork**

**Following the assessment mission, the team should finalise the report as quickly as possible.** This process entails producing a clean copy and sending the report for comments. If the assessment is part of an FSAP mission, the IMF and World Bank will provide comments in a peer review process. The draft assessment report could also be shared with IADI experts for their

peer review. Once comments have been received from the jurisdiction authorities, a revised report can be produced. This final report is then sent to the authorities.

**The authorities may have additional comments.** Issues are often raised in the review, or authorities may wish to add additional clarifying statements to the report. If new factual issues are identified, changes can still be made to the report. If the authorities disagree with the assessment or the grading of compliance but the assessors are not convinced of the need to modify the grading, the authorities can use the section “The Authorities’ Response” to explain their views. This section can also be used by them to explain how they intend to incorporate lessons from the assessment into their legal and regulatory framework.

### **E. Detailed review of the Core Principles**

**The detailed review section is a Principle-by-Principle analysis of compliance.** The assessors should describe in considerable detail their understanding of the current situation. Such a description is needed so that: (i) the team and authorities can agree on what is being assessed; and (ii) subsequent reviewers can understand the basis of the review. The section will then present the compliance grade and, lastly, comments in which the assessors explain their assessment.

**Assessors can use the comment section even when the system is in full compliance with the Core Principles.** The assessors may feel that the system is fully compliant but identify areas where further strengthening is possible or where there are weaknesses that, while not adversely affecting compliance, remain an issue to consider.

#### **Operating environment**

**The effectiveness of the DIS depends on the regulatory and financial environment in which it operates.** Assessors must evaluate overall external factors or preconditions. Although many of these factors are outside the authority of the DIS, they can have a direct effect on the DI’s ability to fulfil its mandate. Among the factors to be assessed are: the development and condition of the economy and banking system; the sound governance of agencies comprising the safety-net; whether there is strong prudential regulation and supervision; whether there are multiple DIs operating in the same jurisdiction; and whether there is a well-developed legal framework and accounting and disclosure regime.<sup>7</sup>

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<sup>7</sup> Please refer to IADI *Guidance for Effective Deposit Insurance Systems: Multiple Deposit Insurance Organizations*, 2015. [http://www.iadi.org/docs/IADI\\_Enhanced\\_Guidance\\_on\\_Multiple\\_Deposit\\_Insurance\\_Org\\_June\\_2015.pdf](http://www.iadi.org/docs/IADI_Enhanced_Guidance_on_Multiple_Deposit_Insurance_Org_June_2015.pdf)

**Review and assessment of the operating environment is typically based on outside sources.**

Assessors can turn to a number of sources to obtain information on the financial environment. One source will be previous FSAP reviews and BCP assessments. An FSAP analysis provides an overview of the strength of the financial system and the quality of bank supervision and problem bank resolution mechanisms. If the deposit insurance assessors are part of an FSAP team, evaluation of the preconditions will be straightforward. Should the assessors operate on a standalone basis, they can rely on the most recent FSAP analysis. If the most recent FSAP report is out of date (e.g. over five years old), deposit insurance assessors can begin with the FSAP review and then discuss with the authorities any recent changes in the safety-net framework or implementation of FSAP recommendations. If there have been no recent FSAP exercises, other elements can include IMF and World Bank reports on the financial sector, reports from other international or regional organisations, and market reports. These documents can provide an overview of the structure and strength of the supervisory and regulatory framework, and of the conditions in the financial sector. In addition, assessment teams can consult with national lawyers to review the state of the legal framework, and with accountants and auditors to obtain their evaluation of the strength of the accounting framework for banks. If the team does not have the requisite skills and no outside reports are available, the team may simply report that the selected feature of the operating environment was not assessed; therefore, the assessment would not be fully complete.

## IV. Core Principles and Compliance Assessment

### Core Principle 1 – PUBLIC POLICY OBJECTIVES

**The principal public policy objectives for DISs are to protect depositors and contribute to financial stability. These objectives should be formally specified and publicly disclosed. The design of the DIS should reflect the system’s public policy objectives.**

#### *Essential Criteria*

- 1. The public policy objectives of the deposit insurance system are clearly and formally specified and made public, for example through legislation or documents supporting legislation.*
- 2. The design of the deposit insurance system is consistent with the system’s public policy objectives.*
- 3. There is a review of the extent to which a deposit insurance system meets its public policy objectives. This involves both an internal review conducted on a regular basis by the governing body and an external review conducted periodically by an external body (e.g. the body to which the deposit insurer is accountable or an independent entity with no conflicts of interest, such as an auditor general). Any review must take into consideration the views of key stakeholders.*
- 4. If additional public policy objectives are incorporated, they do not conflict with the two principal objectives of protecting depositors and contributing to the stability of the financial system.*

#### COMMENTARY

The public policy objectives refer to the goals or objectives which the DIS is expected to achieve. They provide the frame of reference for all the Core Principles and affect the design of the DIS. Accordingly, it is essential to clarify what the objectives are. Typically, the principal public policy objectives for DISs are to protect depositors and contribute to financial stability. Additional public policy objectives are permissible, provided they do not undermine or conflict with the two key objectives. If both key objectives are in the public policy objectives, but there are other objectives that undermine or conflict with the two primary ones, the system would be MNC or LC, depending on the extent to which the two primary objectives are undermined.

Furthermore, consistency is essential among (i) the overall safety-net objectives, (ii) the objectives of the DI, and (iii) the design of the DIS. Minor inconsistencies between the DI law and other laws – sometimes reflecting out-of-date legislation – can cause the system to be ranked LC. A DIS with no public policy objectives specified, with stated objectives that are inconsistent with protecting depositors and contributing to financial stability, or with significant

inconsistencies between stated objectives for the DI and other parts of the safety-net, would be rated MNC or NC.

Governments have come to view the maintenance of financial sector stability as a key public policy objective. The laws and regulations governing safety-net objectives must be clear, therefore, on how each safety-net participant helps achieve that objective.

EC1: The overall public policy objective should be clearly and formally specified and made public through legislation or documents supporting legislation. The use of a decree is acceptable if it has the force of law. In some cases, particularly where the law is old, or it is not legal custom to include public policy objectives in law, the policy objectives may not be clearly explained. Assessors could accept as Largely Compliant systems in which supporting legislation, agreed upon statements, codes of practice, or even explanations in Annual Reports, reference the original law and provide greater interpretation. The use of regulations or by-laws is permitted, especially in cases where the DIS is a private system. However set out, the public policy objectives should be available at all times to the public.

EC2: The DI should be designed in such a way that it is consistent with its public policy objectives, particularly as regards protecting depositors and contributing to financial stability. This EC deals with issues related to broad consistency with public policy objectives, rather than deficiencies in specific design features, which will be further evaluated under other CPs. For example, if the DI is established in law but exists only as an organisation on paper, without staff or financial resources, it would be NC. Similarly, if the DI is the agency within the safety-net charged with resolving failing banks but is designed fundamentally as a pay box, the system would be MNC.

EC 3: The DI is expected to undergo two types of reviews. The first is an internal review. This could take the form of the governing body or management assessing its own performance in carrying out its public policy objectives. The second type of review is external. This review should be conducted by an independent external party, such as an auditor general, government accountability office or other type of external auditor. It may also be a statutory review mandated by parliament or another competent authority. These reviews must be more than just a review of operations – they must review the effectiveness in meeting public policy objectives. Assessors should recognise that public policy objectives do not change frequently, and that the intent of EC3 is to review performance of the DIS against public policy objectives rather than review the objectives themselves. The reviews should consider the views and experience of the DI's key stakeholders, such as financial consumer groups, member banks, and other safety-net agencies. For a finding of C, both types of reviews should be conducted and with some regularity. An organisation subject to only internal or external reviews would be LC. Irregular or infrequent reviews would be considered MNC. An established organisation that has been neither internally nor externally reviewed would be NC.

EC 4: The DI may have additional public policy objectives, but they must not conflict with the primary objectives of protecting depositors and contributing to financial stability. Policy objectives such as promoting competition among banks, generating revenue for a central government, or representing the interests of shareholders or other bank creditors could run

counter to the primary objectives. An assessor would need to use judgment as to the extent that a competing objective interferes with the two primary aims, in deciding to assign an LC or MNC rating.



## Core Principle 2 – MANDATE AND POWERS

**The mandate and powers of the deposit insurer should support the public policy objectives and be clearly defined and formally specified in legislation.**

### *Essential Criteria*

1. *The mandate and powers of the deposit insurer are formally and clearly specified in legislation, and are consistent with stated public policy objectives.*
2. *The mandate clarifies the roles and responsibilities of the deposit insurer and is aligned with the mandates of other safety-net participants.*
3. *The powers of the deposit insurer support its mandate and enable the deposit insurer to fulfil its roles and responsibilities.*
4. *The powers of the deposit insurer include, but are not limited to:*
  - a. *assessing and collecting premiums, levies or other charges;*
  - b. *transferring deposits to another bank;*
  - c. *reimbursing insured depositors;*
  - d. *obtaining directly from banks timely, accurate and comprehensive information necessary to fulfil its mandate;*
  - e. *receiving and sharing timely, accurate and comprehensive information within the safety-net, and with applicable safety-net participants in other jurisdictions;*
  - f. *compelling banks to comply with their legally enforceable obligations to the deposit insurer (e.g. provide access to depositor information), or requesting that another safety-net participant do so on behalf of the deposit insurer;*
  - g. *setting operating budgets, policies, systems and practices; and*
  - h. *entering into contracts.*

### COMMENTARY

The mandate of the DI refers to the set of official instructions describing its roles and responsibilities within the safety-net. The mandate guides the operations and activities of the DI (rather than the overall safety-net). Roles and responsibilities of safety-net participants can differ significantly across jurisdictions.

There is no single mandate or set of mandates for all DIs. Existing DIs have mandates ranging from narrow “pay box” systems to those with broader powers or responsibilities, such as

preventative action, bank resolution, or risk minimisation/management, with many combinations in between (see definitions). For example, the DI can be tasked with protecting all depositors up to a maximum coverage level, protecting only small retail depositors, participating in the resolution of problem banks, or a combination of these. Notwithstanding this variation, mandates and responsibilities of all safety-net participants must be clearly stated and understood.

EC1: The assessor should identify the mandate of the DI and confirm that the design features are aligned with the mandate. A system may be ranked as LC if there are minor inconsistencies between the mandate and its other public policy objectives, but the mandate is clear. A system may be marked MNC or NC if the mandate is not formally defined or specified in legislation or by-laws.

EC2: Here, the assessor should ascertain that all necessary elements of supervision, problem bank resolution, and depositor protection are located somewhere within the safety-net and are suitably coordinated, and should ensure that there is no overlap or lack of clarity about where powers and responsibilities lie. Assessors may have to rely on FSAPs or other assessments of the broader safety-net to completely assess EC2.

EC3: The powers of the DI must enable it to do in practice what its mandate sets out in theory. For example, if the DI is charged with providing financial assistance to facilitate a purchase and assumption transaction (P&A) or carrying out other more extensive resolutions of problem banks, it must have the necessary power and tools to do so.<sup>8</sup> Likewise, if it is mandated to control its risk exposure or supervise banks, it must have the powers to do so. If the powers that the DI needs to carry out its mandate rest predominantly with another organisation in the safety-net and cannot be exercised by that agency at the behest or command of the DI, the EC would be MNC or LC.

EC4: These are minimum powers for any DI. Powers listed under (a) to (f) are basic powers which any insurer requires, regardless of its mandate. Powers listed under (g) and (h) are administrative powers that allow an agency to function effectively. This criterion does not address the issue of whether a DI has the requisite power to fulfil its mandate. The latter issue is covered under EC3.

With respect to EC 4b, the specific power to transfer deposits through a purchase and assumption agreement (as a method of protecting insured depositors) can reside with the DI or with another safety-net participant for a rating of C.

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<sup>8</sup> These powers are set out in Principle 14 – Failure Resolution. For jurisdictions that are home to G-SIFIs, further powers for the resolution authority – which may or may not be the DI – are set out in Key Attribute 3 of the FSB’s *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2011, [http://www.financialstabilityboard.org/wp-content/uploads/r\\_111104cc.pdf?page\\_moved=1](http://www.financialstabilityboard.org/wp-content/uploads/r_111104cc.pdf?page_moved=1).

## Core Principle 3 – GOVERNANCE

**The deposit insurer should be operationally independent, well-governed, transparent, accountable, and insulated from external interference.**

### *Essential Criteria*

1. *The deposit insurer is operationally independent. It is able to use its powers without interference from external parties to fulfil its mandate. There is no government, central bank, supervisory or industry interference that compromises the operational independence of the deposit insurer.*
2. *The governing body of the deposit insurer is held accountable to a higher authority.*
3. *The deposit insurer has the capacity and capability (e.g. human resources, operating budget, and salary scales sufficient to attract and retain qualified staff) to support its operational independence and the fulfilment of its mandate.*
4. *The deposit insurer is well-governed and subject to sound governance practices, including appropriate accountability, internal controls, transparency and disclosure regimes. The institutional structure of the deposit insurer minimises the potential for real or perceived conflicts of interest.*
5. *The deposit insurer operates in a transparent and responsible manner. It discloses and publishes appropriate information for stakeholders on a regular basis.*
6. *The governing statutes or other relevant laws and policies governing the deposit insurer specify that:*
  - a. *the governing body and management are “fit and proper” persons;*
  - b. *members of the governing body and the head(s) of the deposit insurer (with the exception of ex officio appointees) is/are subject to fixed terms and the fixed terms are staggered;*
  - c. *there is a transparent process for the appointment and removal of the members of the governing body and head(s) of the deposit insurer. Members of the governing body and head(s) of the deposit insurer can be removed from office during their term only for reasons specified or defined in law, internal statutes or rules of professional conduct, and not without cause; and*
  - d. *members of the governing body and employees are subject to high ethical standards and comprehensive codes of conduct to minimise the potential for real or perceived conflicts of interest.*
7. *The deposit insurer is regularly assessed on the extent to which it meets its mandate, and the deposit insurer is subject to regular internal and external audits.*

8. *The composition of the governing body minimises the potential for real or perceived conflicts of interest. In order to maintain operational independence, representatives of the other financial safety-net organisations that participate in the governing body do not serve as Chair or constitute a majority.*
9. *The governing body holds regular meetings to oversee and manage the affairs of the deposit insurer (e.g. on a quarterly basis and more frequently as deemed necessary).*

## COMMENTARY

EC1: Operational independence<sup>9</sup> “is the ability of an organisation to use the powers assigned to it without undue influence from external parties”. Assessors can gain a basic understanding of the DI’s operational independence from its governing legislation. However, it is necessary to observe the insurer’s operations in practice to assess its true operational independence, which could be less or greater than would appear in the laws. Assessors can form their judgment from discussions with a variety of stakeholders, including the DI itself, other safety-net agencies and banks. A system may be rated LC, if there are minor or insignificant encroachments on its operational independence; more serious breaches, including significant interference from external parties, would result in a rating of MNC.

EC 2: The mandate of the DI is determined by another authority (such as a parliament in the case of private schemes, a banking trade association, or other legally responsible entity). It typically reports to that same authority and may be called on by that authority to explain its actions. Processes to hold the DI accountable for its actions, should it fail to fulfil its mandate or exceed it, are set out in legislation and adhered to. A system where the accountability framework is unclear would be LC or MNC, depending on the significance of problems.

EC3: This EC seeks to ensure that availability of resources (e.g. operating budget) and administrative procedures and policies support the independence or autonomy of the DI. The focus is on operating budget and internal decision-making about salaries, infrastructure, staffing, and training. The EC does not focus on whether the DI has adequate resources to carry out its mandate; the issue of funding levels is covered under CP9. During the assessment, the size of the DI (number of staff, number of member institutions) should be taken into account. For example, a small DI might not run its own training programme, but should then at least offer external training courses to its staff.

EC 4: The first sentence of EC4 speaks to the governance of the DI’s internal operations. Proper controls should be in place, and the DI should be subject to internal and external audits. Proper policies should govern the contracting and disbursement of operating funds. Employees and others working for the DI should be bound by conflict-of-interest codes and codes of ethical behaviour. The second part of the EC examines whether there is any aspect of the DI’s

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<sup>9</sup> As set out in the IADI *Guidance Paper on Governance of Deposit Insurance Systems*, p.4, May 2009, [http://www.iadi.org/docs/Governance%20Final%20Guidance%20Paper%206\\_May\\_2009.pdf](http://www.iadi.org/docs/Governance%20Final%20Guidance%20Paper%206_May_2009.pdf).

institutional structure that would render it more susceptible to real or perceived conflicts of interest. This applies particularly in cases where the DI is a well-established separate entity yet relies on the infrastructure, staff, or resources of another organisation (e.g. another safety-net agency, a bankers' association). In these cases, the DI should be able to demonstrate how it has structured itself to minimise the potential for real or perceived conflicts of interest.

EC5: This EC addresses the transparency of DI operations. The DI discloses and publishes sufficient information to satisfy the needs of its stakeholders, which include not only the authority to which it is held accountable, but also depositors, member banks, consumer groups, trade associations and the media. However, the DI should not – and should not be required to – disclose member-specific confidential information.

EC6: This EC assesses the integrity and quality of the insurer's governing body. For C, the governing body should fully meet all criteria (a) to (d). A system may be LC if it meets the criteria with only minor deficiencies. Multiple deficiencies or a single major deficiency would warrant an MNC rating.

- a. Subject to “fit and proper” tests (see, Definition of Key Terms, page 6).
- b. Governing body members should be subject to fixed terms of office. Governing body members should not be able to renew their own terms. At the same time, appointments to the governing body should be staggered in time in order to preserve institutional memory.
- c. The process for appointing and removing members of the governing body and the DI's head of management (i.e. president, CEO, general manager) should be set out in law, by-laws, or administrative procedures. Only exceptional circumstances providing cause should give rise to removal of a governing body member or the head of management during their term of office. Commission of a crime, unethical behaviour, or failure to uphold the DI's mandate would notably constitute such circumstances. Governing body members or the head of management do not serve under conditions in which they may be removed during their term for unspecified reasons or without cause. Where this is the case, the system should be MNC.
- d. Governing body members and employees of the DI need to behave ethically and be free of real or perceived conflicts of interest. This can be established through mandatory adherence to conflict-of-interest codes and codes of ethical behaviour, which should be set out in law, by-laws or as part of the DI's formal policies.

EC7: Refers to both internal and external audits that assess the extent to which the DI meets its objectives and specific elements of its operations. These audits should go beyond considering the extent to which the insurer meets its public policy objectives (CP1, EC3) or has the necessary powers to do its job (CP2, EC3). Rather, they should review the extent to which the insurer's operations carry out its mandate effectively and efficiently in practice. Internal audits are ongoing and regularly focus on the policies and controls of the DI along with its management of key corporate risks (e.g. insurance risk, financial or investment risk, operational risk). From time to time, internal audit departments may also want to carry out “spot” evaluations of certain

processes of the insurer. External audits take place at least once a year and also consider the foregoing, in addition to validating the DI's financial statements. If time permits, assessors should speak with the DI's internal auditors and members of the governing body's audit committee to gauge the internal auditor's autonomy from senior management, as a lack of autonomy would cast doubt on the validity of the internal auditor's evaluations and opinions. For a rating of C, internal auditors: 1) are active in evaluating the DI's policies, controls and operations; and 2) have a high degree of independence from management. External auditors are completely independent of the DI – for example, an auditor general, government accountability office or external accounting firm. Where there are deficiencies in the extent of auditors' activity or independence or in the frequency of audits, assessors should use judgment between MNC and LC, depending on the severity of the deficiencies in question.

EC8: All members of the governing body should understand – and must act solely in the best interest of – the DI and not in their own organisation's interest. Potential real or perceived conflicts of interest on the DI's governing body arise predominantly from two sources: 1) active bankers, representatives of bankers' associations, or others with material ties to member banks; or 2) a preponderance of representatives from other safety-net organisations. If active bankers are in the governing body in some capacity, mechanisms are in place to ensure that the individual does not have access to institution-specific confidential information. If not, the system is MNC. Assessors must use judgment as to whether they are convinced that these controls will hold in all cases.

Conflicts can also arise due to the presence of ex officio members<sup>10</sup> of other financial safety-net participants on the governing body of the DI. Ex officio members can add value to governing body discussions, but they should not be in a position to exert undue influence or “control” the direction of the DI, either through Chairmanship of the DI or by constituting a voting majority of the governing body. Where this is the case, this EC is MNC.

EC9: The governing body should meet regularly, for example quarterly, but more often in times of crisis. The assessor can ask to review the notes of these meetings, to determine that these meetings do indeed take place and that substantive issues are discussed. A governing body that meets only on an ad hoc basis or does not meet to discuss substantive issues (e.g. health of the member institutions, interventions (if any) in member banks, strategic direction, human resources, succession planning, review of financials) would be MNC. If the governing body meets on a regular basis but infrequently (e.g. less than every quarter), the system may be LC. A governing body that has never met is NC.

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<sup>10</sup> An “ex officio” member is defined as a member serving on the governing body by reason of their office rather than by being elected or appointed to the position.

## Core Principle 4 – RELATIONSHIPS WITH OTHER SAFETY-NET PARTICIPANTS

**In order to protect depositors and contribute to financial stability, there should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, between the deposit insurer and other financial safety-net participants.**

### *Essential Criteria*

- 1. Ongoing information sharing and the coordination of actions is explicit and formalised through legislation, regulation, memoranda of understanding, legal agreements or a combination thereof.*
- 2. Rules regarding confidentiality of information apply to all safety-net participants and the exchange of information among them. Confidentiality of information is protected by law or through agreements so as not to prevent information sharing within the safety-net.*
- 3. Safety-net participants exchange information on an ongoing basis, and in particular when material supervisory actions are being taken in respect of member banks.*
- 4. In situations where there are multiple deposit insurers operating in the same national jurisdiction, appropriate information sharing and coordination arrangements among those deposit insurers are in place.*

## COMMENTARY

Financial safety-nets in all jurisdictions should have a coordination and information sharing framework which includes the DI. This Core Principle's objective is to ensure that such financial stability coordination committees/oversight bodies exchange information and coordinate activities with the DI on an ongoing basis and in times of difficulty, in a substantive manner. The DI needs to learn of potential bank failures so that it can manage its liquidity, move quickly to meet reimbursement obligations, or exercise other resolution options. If such timely information is not available, the DI should be rated MNC even if a majority of the specific ECs are graded C or LC.

EC1: There should be an explicit framework specified in legislation, written agreements or a combination thereof which formalises the process for ongoing information sharing and coordination between the DI and other FSN participants. Informal agreements and frequent contacts alone are not sufficient to ensure that information is received in a timely manner and that the DI perspective is considered. Written agreements are also necessary to preserve ongoing, effective safety-net coordination in the face of financial system turmoil. In addition, to be fully compliant with this EC, the agreements for coordination and information sharing between the DI and safety-net participants must be in writing, and actual, regular, substantive meetings and exchanges of information must occur as evidenced by meeting agendas and minutes where available.

EC2: There should be no impediments to information sharing between the DI and relevant safety-net participants. Overly onerous procedures, processes or the requirement of fees for information would warrant a downgrade in rating. Laws and/or agreements sufficient to protect the confidentiality of information and its exchange among safety-net participants should be in place and apply equally to all relevant parties. In addition, adherence to laws regarding the general protection of confidentiality should not be so strictly interpreted as to hinder the free flow of information. If such laws and/or agreements are lacking or insufficient to protect or hinder the free flow of information, then a rating of MNC would be appropriate.

EC3: It is critical for explicit, formal arrangements to be in place to ensure that the DI receives essential information on an ongoing basis, and, in particular, when material supervisory actions are being taken (e.g. troubled banks), in order to manage liquidity, move quickly to prepare for payout, or engage in other resolution options.

For full compliance, information sharing and coordination between the DI and relevant safety-net participants must be timely and occur both on an ongoing basis and whenever material supervisory actions are to be taken regarding member banks. If either portion of the criterion is missing, a rating of MNC is warranted. For example, the DI should hear about troubled banks and the failure of a bank before the failure has been publicly announced or has occurred. Information must be received by the DI in a timely manner and well in advance of failure, to give it sufficient opportunity to prepare for payout or other resolution options so that it can meet its reimbursement obligations or engage in resolution options.

The sufficiency of information made available to the DI as a participant in the safety-net framework will be determined in part by its mandate (See CP 2 – Mandate and Powers).

EC4: Where multiple DIs are operating in the same jurisdiction, appropriate information sharing and coordination are especially important to ensure clarity of roles and effectiveness of actions among all FSN participants. The level of information sharing and coordination necessary to further public policy objectives will depend on the structure of the system. For example, for full compliance in situations where multiple insurers are protecting the same institution or depositors, there should be formal agreements specifying the appropriate level and scope of information sharing and coordination (as evidenced by the ability of individual schemes to effectively carry out their mandate and operations) amongst all DIs in the jurisdiction.



## Core Principle 5 – CROSS-BORDER ISSUES

**Where there is a material presence of foreign banks in a jurisdiction, formal information sharing and coordination arrangements should be in place among deposit insurers in relevant jurisdictions.**

### *Essential Criteria*

- 1. Where there is a material presence of foreign banks (i.e. foreign bank subsidiaries or branches), formal information sharing and coordination arrangements are in place among relevant deposit insurers and relevant safety-net participants, subject to confidentiality provisions.*
- 2. In circumstances where a deposit insurer is responsible for coverage of deposits in a foreign jurisdiction, or where more than one deposit insurer is responsible for coverage in a jurisdiction, bilateral or multilateral agreements exist to determine which deposit insurer (insurers) is (are) responsible for the reimbursement process, setting levies and premiums, and public awareness.*

## COMMENTARY

The DI should have regular contact with foreign deposit insurers where there is a material presence of foreign banks within a jurisdiction. Such information and coordination exchange is important, both for systems with foreign-owned but locally incorporated institutions and for those with branches of foreign institutions that are not locally incorporated. Given the increasingly global nature of banking, actions taken by the parent supervisor/resolution authority may have a serious impact on local institutions. Were a parent resolution authority/supervisor concerned with financial difficulty in a parent bank, the resolution options under consideration could well influence global firm operations, market perceptions, and the operations of both subsidiaries and branches. While supervisors regularly exchange information and views about ongoing institutions, DIs should exchange information and views about failing or failed institutions. It is important to develop regular information exchange in normal times to allow for rapid and effective sharing of information in times of difficulty. Assessors should point out in their comments that such close cooperation would allow them time to develop contingency plans in case the financial difficulty should spread to the locally incorporated subsidiaries.

EC1: The Core Principle points to the need to exchange information and coordinate relevant activities where there is a material presence of foreign bank subsidiaries and/or branches. A material presence is indicated if, were they to fail, financial transactions and financial intermediation within the financial system would be significantly disrupted, or if the DI faces significant financial exposure. Such information exchange and coordination are particularly important where the branch is provided with deposit insurance from the home/host jurisdiction. However, it is also relevant in those cases where the foreign bank presence is in the form of a subsidiary, particularly if provided with deposit insurance from the home jurisdiction and in relation to how authorities would coordinate in case of a resolution. Specifically: Exchange of information and coordination arrangements in the case of branches should be required, particularly to ensure that there is no confusion or misunderstanding in coverage, and to clearly determine who is responsible for establishing and charging premiums and informing depositors

on the deposit insurance scope and coverage limits. In relation to subsidiaries, it is important for the DI and other relevant safety-net participants to exchange information and coordinate activities regarding the legal ramifications in a bank failure scenario, including to what extent the local authority may implement or recognise foreign resolution processes that may impact the subsidiary and its deposits (e.g. transfer of assets, interdependencies).

This criterion will be evaluated on the basis of the information sharing and coordination arrangements in place among relevant DIs and relevant safety-net participants subject to confidentiality provisions. Information exchange and coordination arrangements should be formalised in MOUs or other similar agreements, including institution-specific agreements. If MOUs exist, they must be reviewed on a periodic basis with the foreign counterparts. If such MOUs are not active, the system could be assessed as LC if, in the assessors' judgment, the arrangements are moribund or not effective. In that case, the assessors should highlight in the write-up that, if not regularly tested or used, MOUs can become ineffective. Nonetheless, assessors should point out in their comments that the local DI and other relevant safety-net participants would want to know when the foreign parent was in financial difficulty, so that they could develop contingency plans in case the financial difficulty should spread to locally incorporated subsidiaries.

If there are no significant foreign-owned branches and/or subsidiaries, the rating for CP5 should be "Not Applicable" (N/A).

EC 2: The assessors must evaluate the extent to which roles and responsibilities are clearly identified among different DIs. The objective of this criterion is to ensure that institutions cannot exploit the DI, by seeking to increase effective coverage. The assessors must also determine the extent of public awareness of the differences between systems. Overlapping functions or a lack of clarity and/or misinformation among the public regarding where relevant roles lie, and particularly whether deposit insurance is provided by a local or foreign authority, could result in an MNC rating if the assessors consider that the systems do not coordinate or that differences could undermine financial stability.

## **Core Principle 6 – DEPOSIT INSURER’S ROLE IN CONTINGENCY PLANNING AND CRISIS MANAGEMENT**

**The deposit insurer should have in place effective contingency planning and crisis management policies and procedures, to ensure that it is able to effectively respond to the risk of, and actual, bank failures and other events. The development of system-wide crisis preparedness strategies and management policies should be the joint responsibility of all safety-net participants. The deposit insurer should be a member of any institutional framework for ongoing communication and coordination involving financial safety-net participants related to system-wide crisis preparedness and management.**

### ***Essential Criteria***

- 1. The deposit insurer has its own effective contingency planning and crisis management policies and procedures in place, to ensure that it is able to effectively respond to the risk of, and actual, bank failures and other events.*
- 2. The deposit insurer develops and regularly tests its own contingency planning and crisis management plans.*
- 3. The deposit insurer is a member of any institutional framework for ongoing communication and coordination involving safety-net participants related to system-wide crisis preparedness and management.*
- 4. The deposit insurer participates in regular contingency planning and simulation exercises related to system-wide crisis preparedness and management involving all safety-net participants.*
- 5. The deposit insurer participates in the development of pre- and post-crisis management communication plans involving all safety-net participants, to ensure comprehensive and consistent public awareness and communications.*

## **COMMENTARY**

A significant lesson from recent financial crises is that DIs play an important role in the safety-net and must be included in contingency planning and crisis management. The specific role of the insurer will depend on its mandate but each type of DI, from a pay box to a risk minimiser, has a role in contingency planning and crisis management. All DIs must have sufficient notice of emerging problems in order to prepare contingency planning and crisis management processes and procedures. The DI must participate in the planning of crisis measures to ensure that it has a voice especially in funding decisions. Broad-mandate DIs plan and implement the resolution process.

EC 1: Every DI should engage in contingency planning and crisis management to ensure that it is prepared to fulfil its mandate, whether that involves effectively implementing a payout or providing the financial assistance to facilitate a P&A, or other resolution measures that may be included in its mandate. The system will be graded C if contingency plans are in place and

policies and procedures are well documented. The system will be graded LC if contingency plans exist but are not comprehensive, are infrequently tested, or if documentation is not well developed so policies and procedures need to be rewritten or revised each time. If there are no plans in place, the rating will be NC. If there are inadequate plans in place, the rating will be MNC.

EC 2: Plans should be tested on a regular basis. Testing is particularly important in systems where there have been few, if any, failures. Under such conditions, testing is the only means of ensuring that procedures and systems are effective. Such testing can take a variety of forms, from simple scenario planning and tabletop exercises to a comprehensive test of preparations for failure and other events and the collection of any necessary information. Not all systems need to be tested at once. For example, the DI can opt to test separately elements of its monitoring, such as the early warning system and payout procedures. Some testing of some components should be conducted every year, with a full test of all components every five years; the incidence of an actual reimbursement counts in lieu of a full test. Systems will be graded C if they have a regular process of testing sub-systems and, occasionally, the full system. Systems that test irregularly may be graded LC and those that do not test MNC or NC.

EC 3: The DI should be a member of an institutional framework for ongoing communication and coordination involving safety-net participants related to system-wide crisis preparedness and management. As an example of such framework, jurisdictions have been encouraged to create inter-agency information sharing and policy coordinating bodies. In stable times, relevant agencies monitor risk in the system and develop contingency plans. In periods of crisis, they can become the body to prepare the crisis management strategy. The DI, irrespective of its mandate, should be a member of such inter-agency bodies, if all communication and coordination involving safety-net participants related to system-wide crisis preparedness and management are conducted only through the formal meetings of such an inter-agency body. A system where the DI receives adequate information and fully participates in decision-making will be fully compliant. If the agency participates in formal meetings but is not an equal partner with other safety-net agencies (i.e. not receiving all information before meetings, not being invited to all preparatory meetings, not fully participating in deliberations), it may be graded LC or MNC depending on the level of engagement. Systems where the DI is excluded from such bodies will be NC.

EC 4: The DI should participate fully in coordination or contingency planning exercises on a system-wide scale. The assessors will have to determine if the DI is routinely included in all exercises, has full access to preparations and review of the results, and participates in the development of follow-up action plans.

EC 5: The DI should participate in the development of communication plans that are part of the contingency planning process for all its banks. The DI has special knowledge of depositor behaviour and issues determining private sector confidence. The insurer should be frequently consulted, have input into communication strategies, and ensure a consistent communications strategy for a C rating.

## Core Principle 7 – MEMBERSHIP

**Membership in a deposit insurance system should be compulsory for all banks.**

### *Essential Criteria*

- 1. Membership in a deposit insurance system is compulsory for all banks, including state-owned banks (with or without explicit guarantees), and all banks are subject to sound prudential regulation and supervision.*
- 2. If upon entry to a newly established deposit insurance system, a bank does not comply with all the supervisory or membership requirements and is allowed entry into the system, it is required to have credible plan to address any deficiencies within a prescribed time frame (e.g. one year).*
- 3. The conditions, process and time frame for attaining membership are explicitly stated and transparent.*
- 4. If the deposit insurer is not responsible for granting membership in the deposit insurance system, the law or administrative procedures describe a clear and reasonable time frame within which the deposit insurer is consulted or informed in advance, and is given sufficient information about an application for a new licence.*
- 5. When membership is cancelled upon the revocation or surrender of a bank's licence, immediate notice is given to depositors to inform them that existing deposits will continue to be insured up to a specified deadline.*
- 6. When membership is terminated by the deposit insurer, arrangements are in place to coordinate the immediate withdrawal of the bank's licence by the relevant authority. Upon termination, immediate notice is given to depositors to inform them that existing deposits will be covered up to a specified deadline. Any new deposits made will not receive deposit protection.*

### COMMENTARY

The key objective of this Core Principle is that all banks are covered under a DIS. In jurisdictions with multiple DISs, it is expected that each bank is a member of one such DIS. The legal framework must ensure that all banks are members of a DIS subject to sound prudential regulations and supervision on a regular basis. The determination of sound prudential regulation and supervision is made by ensuring compliance with the BCPs.

EC 1: Membership in a deposit insurance system is compulsory for all banks, including state-owned banks (with or without explicit guarantees), and all banks are subject to sound prudential regulation and supervision.

EC 2: If upon entry to a newly established DIS, a bank does not comply with the supervisory or membership requirements and is allowed entry into the system, it is required to have a credible plan to address any deficiencies within a prescribed time frame.<sup>11</sup> The time frame will depend on the severity of deficiencies. The key components of a credible plan include, but are not limited to: specifics regarding accomplishments; agency responsible for implementation; time frame or transition plan for restructuring the institution; laws or regulations that will enable implementation of the proposed change; and alternative strategies if such enabling laws or regulations are absent. In addition, the overall reasonableness of the plan must be considered.

The absence of any plan would suggest a rating of NC. If one or two key elements are missing, MNC may be appropriate.

EC 3: The process and requirements for attaining membership should be clear and easily accessible to potential members via external websites or some such medium. The absence of both clarity and accessibility would result in a rating of NC, while MNC may be appropriate if one of these two elements is missing or inadequate. If the requirements are absent, NC would be appropriate; if the requirements are not clear or not easily accessible, MNC would be appropriate.

EC 4: Since the DI is assuming the risk, it should receive sufficient information about the membership application or relevant supporting information at the same time as the supervisory agency receives it. The DI should then have an opportunity to voice and discuss with the supervisor any concerns or suggestions. If the DI receives membership application information after the supervisory authority grants the membership, then MNC will be appropriate. If the time frame for the DI to receive information about potential members is not specified in laws, agreements or MOUs, or if the time frame is unreasonably short, then MNC may be appropriate.

EC 5: In some jurisdictions where the DI has termination powers and the supervisor has licence revocation powers, the use of these powers is coordinated and actions tend to follow each other in close order. In the case of licence revocation, immediate notice is given to depositors to inform them that existing deposits will continue to be protected up to a specific deadline. Lack of a reasonable and formal communications process would result in a rating of MNC. EC 5 focuses on the cancellation of membership upon the revocation or surrender of a bank's licence, while EC 6 focuses on the termination of a bank's membership by the DI.

EC6: Timing is a critical issue here. If there is an unreasonable gap between termination of membership and withdrawal of the bank's licence, a rating of MNC would be appropriate. An MNC rating would also be given if, upon termination, immediate notice is not given to the depositors that their existing deposits will continue to be insured up to a specific deadline.

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<sup>11</sup> For example the government may mandate that the immediately DI accepts certain types of institutions as members, in order to ensure that the system is mandatory for all banks. However, some of these banks may not meet the standards immediately, and will need more time to reach them.

## Core Principle 8 – COVERAGE

**Policymakers should define clearly the level and scope of deposit coverage. Coverage should be limited, credible and cover the large majority of depositors but leave a substantial amount of deposits exposed to market discipline. Deposit insurance coverage should be consistent with the deposit insurance system’s public policy objectives and related design features.**

### *Essential Criteria*

1. *Insured deposits are clearly and publicly defined in law or regulation and reflect the public policy objectives. This definition includes the level and scope of coverage. If certain types of deposits and depositors are ineligible for deposit protection, they are clearly specified, easily determined and do not affect the speed of reimbursement.<sup>12</sup>*
2. *The level and scope of coverage are limited and are designed to be credible so as to minimise the risk of runs on banks, and do not undermine market discipline. The level and scope of coverage are set so that the large majority of depositors across banks are fully protected while leaving a substantial proportion of the value of deposits unprotected.<sup>13</sup> In the event that a substantial proportion of the value of deposits is protected, moral hazard is mitigated by strong regulation and supervision, as well as by the other design features of the deposit insurance system.<sup>14</sup>*
3. *The deposit insurer applies the level and scope of coverage equally to all its member banks.*
4. *The deposit insurer does not incorporate co-insurance.*
5. *The level and scope of coverage are reviewed periodically (e.g. at least every five years) to ensure that it meets the public policy objectives of the deposit insurance system.*
6. *In the event of, or prior to, a merger or amalgamation of separate banks that are members of the same deposit insurance system, depositors of the merged or amalgamated banks enjoy separate coverage (up to the maximum coverage limit) for each of the banks for a limited but publicly stated period, as defined in law or regulation. Merging banks must be held responsible for notifying the affected depositors, including informing them of the date on which the separate coverage will expire.*

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<sup>12</sup> In particular, some specific types of deposits may be excluded or considered ineligible for protection. These may include but are not limited to: interbank deposits; deposits of government departments and of regional, provincial, and municipal governments and other public bodies; deposits of individuals who are regarded as responsible for the deterioration of an institution, including deposits belonging to the directors, managers, large shareholders, and auditors of banks; and bearer deposits.

<sup>13</sup> For additional guidance on setting coverage limits, scope and foreign currency deposit coverage, see: IADI, *Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage*, March 2013, [http://www.iadi.org/docs/IADI\\_Coverage\\_Enhanced\\_Guidance\\_Paper.pdf](http://www.iadi.org/docs/IADI_Coverage_Enhanced_Guidance_Paper.pdf)

<sup>14</sup> Strong regulation and supervision are demonstrated by a high level of compliance with the BCPs.

7. *The residency status or nationality of depositors has no effect on coverage.*
8. *In situations where there are multiple deposit insurers operating in the same national jurisdiction, any differences in coverage across banks operating within that jurisdiction do not adversely affect overall deposit insurance system effectiveness and financial stability.*
9. *Foreign currency deposits are insured if they are widely used in a jurisdiction.*
10. *In cases where there is a blanket guarantee in place, there is a credible plan to transition from the blanket guarantee to a limited coverage deposit insurance system. This includes:*
  - a. *an assessment of the economic environment as it affects the financial system, which is conducted before a jurisdiction begins the transition from a blanket guarantee to limited coverage.*
  - b. *the pace of the transition to limited coverage is consistent with the state of the financial industry, prudential regulation and supervision, the legal and judicial framework, and accounting and disclosure regimes.*
  - c. *policymakers have effective communication strategies to mitigate adverse public reaction to the transition.*
  - d. *where there is a high level of capital mobility, and/or a regional integration policy, the decision to lower coverage limits and/or scope considers the effects of different jurisdictions' protection levels and related policies.*

## **COMMENTARY**

This CP involves seeking the right combination of sufficiently high coverage to protect depositors and contribute to financial stability by preventing depositor runs while, at the same time, seeking to limit moral hazard.<sup>15</sup>

The determination of a rating for CP 8 will require a broad evaluation of coverage within the context of the safety-net. If coverage levels are extremely high, with a large portion of depositors covered and a majority of the value of deposits covered, assessors must evaluate if there are additional factors mitigating moral hazard (see EC2). Examples may include strong supervision and a highly effective bank resolution regime. If such mitigating factors exist, CP 8 may be rated as C or LC. If such mitigating factors do not exist, CP 8 should be rated as MNC.

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<sup>15</sup> For an in-depth discussion of the issues surrounding the determination of appropriate coverage levels, see: IADI, *Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage*, March 2013, [http://www.iadi.org/docs/IADI\\_Coverage\\_Enhanced\\_Guidance\\_Paper.pdf](http://www.iadi.org/docs/IADI_Coverage_Enhanced_Guidance_Paper.pdf)



EC1: The appropriate definition of insured deposits must be consistent with the public policy objectives. Assessors must evaluate the design features of the system and then ensure that they are compatible with the public policy objectives. For example, a policy of only covering very small retail deposits may not be consistent with a public policy of ensuring financial stability. This criterion may be rated C if deposits and coverage levels are well defined and consistent with stated public policy objectives, LC if there are only minor definition and/or inconsistency issues, and MNC if there are significant discrepancies between stated objectives and coverage limits.

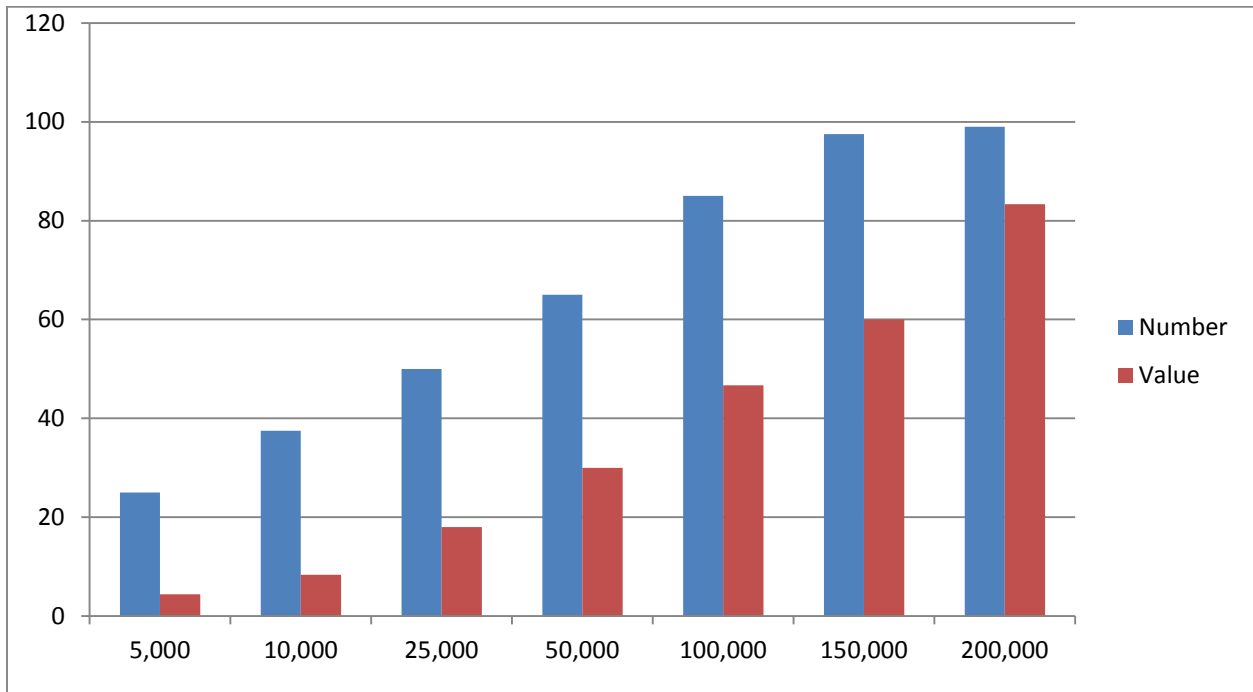
**Table 1<sup>16</sup>**

**Impact of Different Coverage Levels**

Proposed coverage	Fully covered		Percent covered	
	Number of accounts	Value of accounts	Number	Value
5,000	50,000	132,000	25.0	4.4
10,000	75,000	250,000	37.5	8.3
25,000	100,000	540,000	50.0	18.0
50,000	130,000	900,000	65.0	30.0
100,000	170,000	1,400,000	85.0	46.7
150,000	195,000	1,800,000	97.5	60.0
200,000	198,000	2,500,000	99.0	83.3
<b>Total deposits</b>	<b>200,000</b>	<b>3,000,000</b>	<b>100.0</b>	<b>100.0</b>

<sup>16</sup> This table is for illustrative purposes only and does not represent any specific recommendation or standard on coverage.

**Chart 1**



The assessors should review the methodology for determining coverage levels. Typically, determining coverage levels is an iterative process. Authorities first determine the coverage level that fully protects most depositors. Coverage levels should be limited, credible, and cover the large majority of depositors but leave a substantial amount of deposits exposed to market discipline. Authorities then estimate the value of deposits at risk and the likelihood of failure. Complicated methods can be used (such as value-at-risk or probabilities of bank failure) or more prosaic methods (such as covering a given number of small and medium-sized banks). Authorities must determine the appropriate size of the fund, the premium levels needed to build the fund over time, and available emergency backup funding arrangements. The deposit insurance fund must be adequate to cover losses of reasonable size. If the resulting funding level is not realistic and the resources cannot be made available, coverage levels will need to be modified.

After the assessors identify the methodology for determining coverage levels, they will need to review several additional issues affecting coverage levels. Specifically:

- The coverage levels of DISs in neighbouring jurisdictions will affect the appropriateness of coverage levels. Setting a coverage level that is disproportionately higher or lower than its neighbours (particularly where capital flows are significant) can lead to depositor flight into or out of the jurisdiction.
- The history of banking crises may lead jurisdictions to maintain relative high coverage levels until public confidence is fully restored.

- High coverage levels may be a policy choice undertaken temporarily while the authorities clean up the financial sector, implement new prudential rules and regulations, or because of other factors.

An issue to be addressed is how to manage the recent trend towards protection of most depositors for financial stability purposes. Assessors may accept that high protection in periods of crisis is justifiable. Following the 2008/2009 global financial crisis, most jurisdictions significantly increased their coverage levels. However, high coverage levels raise concerns about misallocation of domestic resources, moral hazard, and financial distortions that could adversely impact the DI's reserve fund. Assessors should clarify public policy objectives concerning any exceptionally high and temporary depositor protection and ensure that the procedures for returning to more normal protection levels are appropriately planned.

EC 2: Coverage should be credible, provide adequate coverage and yet, at the same time, not undermine market forces. The appropriateness of coverage levels can only be determined within the context of the overall safety-net framework.<sup>17</sup> The appropriate coverage level depends on a variety of factors, including the authorities' policy objectives, the cost of that policy, and the structure of the financial system. Coverage levels should be set so that, given the public policy objectives, a large majority of individual depositors in banks are fully protected.

The assessment should explicitly consider the authorities' policy objectives in evaluating coverage levels. Jurisdictions with an objective of protecting only small depositors will identify the total amount of retail deposits at risk. Jurisdictions wishing a broader stability framework may extend coverage to other entities (e.g. businesses).

The assessors must then come to a view about the adequacy of coverage, given the policy objectives of the authorities. If coverage levels are set too low, depositors may run when faced with uncertainty about their banks. If coverage levels are very high (and the scope of coverage is very wide), large sophisticated depositors may be less inclined to impose market discipline and banks may engage in higher risk activities. But in both cases, strong supervision and an effective bank resolution framework can mitigate some of the negative impact of misaligned coverage limits and must be considered in determining the rating for CP 8.

The first step for the assessors is to evaluate the overall coverage level. A useful option is to have the DIS provide information on the number of depositors covered and the percentage value of deposits covered at a series of different coverage levels. A hypothetical example is given in Table 1 and Chart 1. Table 1 shows, for each coverage level, the number of depositor accounts fully covered and the value of deposits fully covered. In principle, coverage levels should cover as many individual depositors as possible while leaving a significant portion of the total value of deposits still subject to market discipline.<sup>18</sup> This numerical approach in Table 1 allows the assessors to review in detail the impact of different coverage levels and form a view about the

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<sup>17</sup>For an in-depth discussion of the issues surrounding the determination of appropriate coverage levels, see: IADI, *Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage*, March 2013, [http://www.iasi.org/docs/IADI\\_Coverage\\_Enhanced\\_Guidance\\_Paper.pdf](http://www.iasi.org/docs/IADI_Coverage_Enhanced_Guidance_Paper.pdf)

<sup>18</sup>Coverage levels should be set so that small retail depositors do not have an incentive to run at the slightest provocation and large depositors do not feel complacent in the face of risky or unsafe banking activities.

financial stability implications of the coverage. In the example, a significant increase in coverage of the number of depositor accounts can be achieved by increasing the maximum insured amount from 50,000 to 100,000, which significantly raises the number of fully covered individuals while keeping a reasonable value of total deposits at risk to avoid moral hazard.

EC3: The deposit insurer applies the level and scope of coverage equally to all its member banks, regardless of size or banking institution. Different coverage limits may apply in systems where there are multiple deposit insurance systems (MDIS) in place.

EC4: Co-insurance, defined as a loss-sharing arrangement whereby depositors are covered for a pre-specified portion of deposits that is less than 100% of their insured deposit amount, should not be incorporated into DIS coverage.

EC5: Coverage levels should be reviewed periodically to ensure that they continue to meet the public policy objectives. The assessors must determine the appropriateness of the review period when grading for this criterion. In stable times with steady economic growth, a review every five years may be appropriate. Under conditions of rapidly changing financial structures or high inflation, a more frequent review may be justified. The grading of compliance will be determined by the extent to which financial conditions could undermine stability and the frequency of review of coverage levels.

EC6: Depositors in merged banks or amalgamated banks enjoy separate coverage (up to the maximum coverage limit that they initially had in each bank).<sup>19</sup> They must have time to adjust their holdings and bring deposits in any one bank under coverage limits. Such extra coverage must be limited in time. The longer the time period, the more the purposes of limited coverage are undermined. The assessors must come to a view based on the ease of transferring deposits to new institutions, flexibility in financial markets, and the degree of concentration in the banking system. This criterion is rated C if depositors have a short but adequate period in which to adjust their deposit allocation among banks. This criterion is rated MNC or NC either if depositors do not have adequate time to reallocate deposits or if excessive time is permitted.

EC7: The residency status or nationality of depositors has no effect on coverage. The nationality of a depositor should make no difference to depositor protection and for financial stability purposes. Similar deposits in similar institutions should have the same coverage and should receive the same treatment. If this is not the case, a rating of NC would be appropriate.

EC 8: The assessors will need to evaluate the impact of multiple DISs. There may be legitimate reasons for differences in coverage among different DISs. Credit unions, for example, may have their own system and have different rules and coverage levels than banks. The assessors must ask a number of questions to evaluate the impact of multiple systems:

- Are there incentives for deposits to flow to those institutions with the highest coverage?

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<sup>19</sup> For an in-depth discussion of the issues surrounding the determination of appropriate coverage levels, see: IADI, *Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage*, March 2013, [http://www.iadi.org/docs/IADI\\_Coverage\\_Enhanced\\_Guidance\\_Paper.pdf](http://www.iadi.org/docs/IADI_Coverage_Enhanced_Guidance_Paper.pdf)

- Are funding differences between the deposit insurance funds significant, leading depositors to fly to safety during financial difficulty?
- Are regional differences so pronounced as to merit differences in the design of DISs?

This criterion may be rated C or LC if the multiple systems do not undermine financial stability or provide excessive coverage. This criterion may be rated MNC or NC if the multiple systems cover the same types of institutions and depositors, if there are significant differences in coverage levels and if depositors can exploit the insurance system to obtain unwarranted benefits.

EC 9: All foreign currency deposits are insured if they are widely used in a jurisdiction. Failure to include such deposits can result in sharp liquidity flows in periods of financial difficulty or premature capital flight and significant losses. In this case, the exchange rate in place on the day of the failure would be the appropriate rate. Rapid payout would, in this case, be essential (see CP 15). If foreign currency deposits form a significant portion of deposits, the DI may be forced to pay out in foreign currency. In this case, the deposit insurance fund must also be constituted with an appropriate amount of foreign currency holdings or appropriately hedge against currency risk. A jurisdiction may be rated C or LC if (i) foreign currency deposits are not covered but comprise an insignificant portion of insured deposits, (ii) foreign currency deposits are covered but paid out in local currency or (iii) foreign currency deposits are paid out in foreign currency and the DI has an appropriately structured fund or emergency liquidity arrangements to mitigate potential foreign exchange risk.

EC 10: Blanket guarantees were common several years ago, but even with the proliferation of explicit limited DISs, ad hoc enhanced depositor protection was common in the 2008–2009 crisis. A fully compliant rating is justified if all elements of the plan are in place. A rating of MNC or NC is justified if serious deficiencies exist that potentially undermine financial stability or if there is no plan in place. Assessment should consider the following issues:

- a. The plan should include an assessment of the soundness of the banking system, its resilience to shocks, and its ability to maintain financial stability in the face of reduced depositor protection. The assessors will need to review both the prudential framework and any likely changes to it, as well as analysing the impact of the changes on banks. An evaluation of reasonable scenarios, including stress tests, should then be conducted.
- b. The plan should include an assessment of the speed of and timetable for relaxing emergency measures. In that context, policymakers should be able to describe how the market is reacting to the possibility of reductions in exceptional coverage, and plan the transition so that the reduction of coverage has no impact on the credibility of the DIS or the strength of the financial system.
- c. The assessors must determine whether policymakers have an adequate communication plan and whether they are aware of the impact of reductions in coverage (possibly based on past reactions to bank failures or market commentary, or by surveying the general public to try and gauge confidence in financial stability).

d. In cases where cross-border flows are significant, assessors need to evaluate the extent to which the authorities have considered the cross-border impact of exit from emergency measures, and how closely they have coordinated moves with relevant neighbouring jurisdictions.

## Core Principle 9 – SOURCES AND USES OF FUNDS

**The deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims, including assured liquidity funding arrangements. Responsibility for paying the cost of deposit insurance should be borne by banks.**

### *Essential Criteria*

1. *Funding for the deposit insurance system is provided on an ex ante basis. Funding arrangements are clearly defined and established in law or regulation.*
2. *Funding the deposit insurance system is the responsibility of the member banks.*
3. *Initial “start-up” or “seed” funding (e.g. from government or international donor organisations) is permitted to help establish a deposit insurer. Any start-up funding provided by a government should be fully repaid before the deposit insurer reduces any or all bank premiums.*
4. *Emergency funding arrangements for the deposit insurance system, including pre-arranged and assured sources of liquidity funding, are explicitly set out (or permitted) in law or regulation. Sources may include a funding agreement with the government, the central bank or market borrowing. If market borrowing is used, it is not the sole source of funding.<sup>20</sup> The arrangement for emergency liquidity funding is set up in advance, to ensure effective and timely access when required.*
5. *After establishing an ex ante deposit insurance fund:*
  - a. *the target fund size is determined on the basis of clear, consistent and transparent criteria, which are subject to periodic review; and*
  - b. *a reasonable time frame is set to achieve the target fund size.*
6. *The deposit insurer has responsibility for the sound investment and management of its funds. The deposit insurer has a defined investment policy for its funds that aims at ensuring:*
  - a. *the preservation of fund capital and maintenance of liquidity; and*
  - b. *that adequate risk management policies and procedures, internal controls, and disclosure and reporting systems are in place.*
7. *The deposit insurer may hold funds in the central bank. The deposit insurer establishes and complies with rules to limit significant investments in banks.*

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<sup>20</sup> Where applicable (e.g. in the European Union), deposit insurers may borrow from each other's funds.

8. *Where the deposit insurer is not the resolution authority, it has the option, within its legal framework, to authorise the use of its funds for resolution of member institutions other than liquidation.<sup>21</sup> In such situations, the following conditions are met:*
- a. the deposit insurer is informed and involved in the resolution decision-making process;*
  - b. the use of the deposit insurer's funds is transparent and documented, and is clearly and formally specified;*
  - c. where a bank is resolved through a resolution process other than liquidation, the resolution results in a viable, solvent and restructured bank, which limits the exposure of the deposit insurer to contribute additional funding in respect of the same obligation;*
  - d. contributions are restricted to the costs the deposit insurer would otherwise have incurred in a payout of insured depositors in a liquidation net of expected recoveries;*
  - e. contributions are not used for the recapitalisation of resolved institutions unless shareholder's interests are reduced to zero and uninsured, unsecured creditors are subject to parri passu losses in accordance with the legal claim priority;*
  - f. the use of the deposit insurer's funds is subject to an independent audit and the results reported back to the deposit insurer; and*
  - g. all resolution actions and decisions using the deposit insurer's funds are subject to ex post review.*
9. *Should deposit insurer income/revenue (e.g. premiums received, recoveries from failed banks and interest accrued on investment funds) be taxed by the government, it is at a rate which is neither punitive nor disproportionate to other corporate taxation, nor unduly hinders the accumulation of the deposit insurance fund. Any remittances to the government by the deposit insurer are limited to repayment of government-provided start-up funding and government-provided liquidity funding.*
10. *If the deposit insurer uses differential premium systems:<sup>22</sup>*
- a. the system for calculating premiums is transparent to all participating banks;*
  - b. the scoring/premium categories are significantly differentiated; and*

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<sup>21</sup> Such use may be compulsory under national law.

<sup>22</sup> See IADI, *General Guidance for Developing Differential Premium Systems*, 2011.



- c. the ratings and rankings resulting from the system pertaining to individual banks are kept confidential.*

## **COMMENTARY**

Adequate funding is critical for the credibility of the DI. The public must have no question about the ability and willingness of the DI to meet its obligations, and specifically reimburse insured depositors in a timely manner. Any uncertainty will undermine credibility, make depositors more sensitive to shocks, and possibly undermine financial stability. The key issue is that funds must be available quickly to meet depositor payouts in full. Administrative procedures, such as requiring that funding requests be approved on a case-by-case basis by either the central bank or the MOF or that funding supplements be approved by parliament, could cause delays and undermine confidence in the DIS.

The assessors should keep in mind that during systemic crises, when a large segment – or even all – of the banking sector is at risk of failure, a DIS will generally lack the resources to address the problem on its own. Funding the resolution of a systemic crisis will require participation by all safety-net participants. Legal requirements and decision-making processes vary between jurisdictions but at a minimum the DI should have a role in decision-making regarding any use of its funds.

EC1: The importance of a stable funding source points to the need for an explicit ex ante fund. The Criterion will be rated C if the ex-ante fund is established in law. If the fund exists but is not established in law, the assessors will have to determine whether the funding structure is credible (a rating of LC), or if the fund is not considered credible (a rating of MNC). Payment commitments within banks (e.g. as foreseen in the EU Deposit Guarantee Scheme Directive) could be considered equivalent to ex ante funding if they are fully collateralised, easily liquidated, and do not represent the sole source of ex ante funding available to the DI.

EC2: Primary responsibility for funding rests with the banks covered under the DIS. The DIS must make such responsibility clear. However, assessors must also recognise that these institutions may not be able to quickly reconstitute a deposit insurance fund or quickly fund a new DIS. Excessive demands for rapid replenishment once the fund is depleted could undermine profitability and competitiveness. Accordingly, a timetable for reconstituting the fund should be established that balances the need for rapid build-up with the cost burden on the industry. The public authorities can provide funding to the DI with the understanding that the banks will build up the fund so that it can repay the government over a specified period. The Core Principle can be considered C or LC so long as the commercial banks have eventual responsibility for building the fund and repaying any government support within a specified time frame.

EC3: While the funding of DISs is provided by the industry, new systems do not always have the time or capacity to build an adequate fund quickly. Accordingly, governments or international organisations may provide some initial funding to ensure that the system is credible. Concerning repayment, a distinction should be made between initial seed funding for the DI and initial funding (e.g. capital) for administrative costs, staffing, and operational expenses not necessarily expected to be repaid by the industry.

Over time, all other government start-up resources (e.g. those contributions which are not part of any initial endowment for administration, staffing, and operational expenses) should be repaid. There is no strong view about how quickly such funding should be repaid; an C or LC rating will depend in part on how long the repayment is planned after the target fund size has been reached. However, deposit insurance premiums should not be lowered until all such funding has been repaid. Some international donor organisations, however, provide funding with the explicit agreement that such funding is not repaid. Such contractual arrangements are acceptable and would not result in a lowering of the compliance rating.

EC4: The deposit insurance fund serves two critical functions. First, it ensures that adequate resources are available in the event of a bank failure. Second, it provides comfort and assurance to private depositors. The DI fund must be complemented with a robust backup or emergency funding mechanism. That mechanism must be available to ensure that resource constraints do not inhibit the ability of the DI to pay out within an appropriate time frame (see CP 15, Reimbursing Depositors).

Emergency funding arrangements (i.e. emergency backup funding) can take the form of a special line of credit from a MOF, a Treasury, or even a guaranteed line of credit from the central bank. No matter what the source, an unambiguous, pre-arranged system that guarantees a rapidly disbursing backup funding mechanism for the DI is required for an effective DIS. An unambiguous and rapidly disbursing emergency funding line is rated fully C, while an arrangement with minor limitations or restrictions that slightly delays the immediate disbursement of funds can be rated LC. If access is not guaranteed and immediate in practice, or if procedures must be followed that delay disbursement of needed funds, the DIS is rated MNC or NC.

Many systems allow the DI to borrow in the market, but that authority alone is not considered an adequate backup funding capacity. Market access may become impossible in times of banking stress, and credibility may be undermined by uncertainty about the ability of the DI to pay out depositors.

EC5: This criterion refers to assessing (i) whether the methodology for assessing the size of the fund is appropriate and reasonable and (ii) whether the fund size is adequate. The target fund size refers to the eventual objective of the authorities, not necessarily the current size of the fund. As described above, the public must view the fund as adequate in order for public confidence in the system to be maintained. The target size of the fund should be sufficient to participate in the resolution and payout of a number of small bank failures or several medium-sized bank failures, depending on the size and composition of the banking sector. The required spending for past financial crises could be a possible factor in determining target fund size.

Once the target size of the fund is determined, assessors will have to determine if the time frame for meeting the target size is adequate. Issues to be considered include the financial state of the banking system (if weak, the fund will need to be at or near its target fund ratio or a strong backup funding facility must exist) and the financial burden on banks to meet the annual premiums to constitute the target level.

A rating of C or LC for this EC will reflect that the target fund size is properly estimated and the time frame for reaching the target is consistent with the strength of the banking system and the likelihood of bank failures. An MNC could reflect the lack of a target fund, an inappropriate target estimate or an excessively long period for constituting the fund.

The fund serves several functions. First, it ensures that adequate resources are available in the event of a bank failure. Adequacy of the fund, however, is difficult to determine in isolation and depends on jurisdiction-specific conditions. The assessment will need to consider several factors, including:

- the role of the fund in bank resolution – does the role of the DI in resolution create a need to review the size of the fund to finance resolution options?
- the distribution of banks – if the banking system is concentrated, the fund may have to be very large or alternative resolution tools may have to be in place;
- the strength of the banking system – if the system is perceived as weak, the fund will have to be correspondingly higher; and
- the effectiveness of bank supervision – the stronger and more effective bank supervision is, the lower the likelihood of bank failure, which means that the DI fund can be smaller.

Another role of the fund is to provide comfort and assurance to private depositors. For confidence building, backup funding may be too obscure to be effective. The public must consider the deposit insurance fund to be adequate. Assessing adequacy in this context is less about the absolute amount of the fund than public expectations. Information from banks, banking trade associations and the DI itself may help determine the adequacy of the fund for maintaining private confidence in the DIS.

A final function of the fund is to cover the operational and related costs of the DI.

EC6: The DI's investment policy must emphasise safety and liquidity over return – the DI must have prompt access to funding so as to quickly reimburse all insured depositors. DIs often invest funds in government securities. Such securities, in most cases, are safe and can be liquidated quickly to meet payout obligations. Care should be taken that the fund does not materially invest in high-risk instruments or products with volatile returns or in significant amounts in banks covered by the DIS. If economic conditions are unstable in the jurisdiction and if permitted by law, the DI could consider holding a portion of its funds abroad but must be assured of immediate and unfettered access to those funds.

If foreign currency denominated deposits are reimbursed by the DI in foreign currency rather than paying the foreign currency equivalent in local currency, the fund should also be invested in assets denominated in that currency or appropriately hedged.

EC7: The DI should have the option of maintaining cash holdings at the central bank. DIs benefit from placing cash holdings at the central bank because this avoids the insolvency risk of commercial banks and liquidity disruptions in client banks following a bank failure and payout obligations. DI funds may be deposited in commercial banks. However, large balances should not be held for long periods at commercial banks where the use of such funds could undermine the bank's position or where a failure of the bank could result in losses to the DI.

EC8: A resolution authority is a public authority that, either alone or together with other authorities, is responsible for resolution of banks established in its jurisdiction. As defined in the CPs, resolution may include liquidation and payouts. With respect to the "key" resolution authority, this may be viewed as the resolution authority with the most significant or critical role in the resolution process for the financial institution in question. Where the DI is not the key resolution authority, it has the option, within its legal framework, to authorise the use of its funds for the resolution of member institutions by methods other than liquidation.<sup>23</sup> If the DI is the key resolution authority, agency funds may be used in the resolution of a failed institution.<sup>24</sup> Objectives such as least-cost resolution guide the use of such funds. However, if the DI is not the key resolution authority, safeguards must be placed on the use of its funds in resolution. Specifically:

- a. If the DI does not have an implementing role in the resolution of a failing bank but it remains responsible for raising funds for insured depositor payouts, it must be involved in the decision-making process even if it is not necessarily the decision-maker. It must be informed about proposals to use its funds for resolution and should be able to voice its view in deliberations. The DI has a unique perspective (protecting its funds and ensuring readiness for depositor payout and contributing to financial stability) and, as such, can contribute to the decisions about resolution. A system will be rated NC if the DI is not informed and has no role in discussions. It will be rated C, LC, or MNC depending on how early in the process the insurer is informed and the extent to which it can voice its views.
- b. The resolution agency must explain to the DI how and when its funds will be used, and whether and how the DI will be reimbursed. EC8 (b) will be rated C if the DI is involved early and fully, LC if it is informed late in the resolution process and MNC/NC if the DI is isolated from the decision-making process.
- c. The DI must be reasonably confident that the restructured institution is viable and solvent, and that the DI has access to the information needed to reach an informed view. The threat to the DI is that its funds are used for restructuring and then the restored institution fails again, forcing deposit payouts and resulting in increased costs to the

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<sup>23</sup> Where the use of the deposit insurance fund is compulsory under national law (e.g. EU), authorisation of the use of funds would not be required.

<sup>24</sup> The FSB defines resolution authority broadly to include DIs that pay out in a resolution. EC 8 therefore makes a distinction between the key resolution authority, which determines resolution strategies and implements them, and other DIs that do not have such a direct role in resolution.

deposit insurance fund. Assessors must evaluate methods in place to ensure that a viable institution emerges from restructuring, and that the DI is part of that analysis.<sup>25</sup>

- d. The DI should be liable only up to its net exposure to loss – its expected payout in the event of liquidation minus the expected recoveries from the resolution of assets. The objective is that the DI contributes only what it would otherwise have paid out in liquidation. Calculating the net cost of liquidation, however, is complex and difficult. Estimated future recoveries will depend on the time horizon, market conditions, and the structure of the financial system. The assessors must evaluate the plans that authorities have and the methodology they use for determining net costs in a liquidation.
- e. This EC aims at restricting the use of deposit insurance funds in the form of open-bank assistance. Before DI funds are used, shareholders must be written down for losses.
- f. The use of the DI’s funds is subject to an independent audit, with the results reported back to the deposit insurer.
- g. Resolution actions and decisions should be subject to review, but the reviews may differ depending on the type of action. Full post mortems are important to review the use of funds as well as procedures and policies following the failure of a major institution. Such a review allows the authorities to identify inefficiencies and areas for further policy adjustment. However, in the case of smaller failures, the review may range from an informal review of the entire process to selective reviews of particularly important steps or selected processes.

EC9: The key role of the DI in the safety-net is to ensure that depositors have confidence in the ability to recover their deposits in the event of a failure. Having an adequate deposit insurance fund is critical to reinforcing that confidence. The DI should not be subject to taxes or “legacy expenses” (such as paying for debt from past crises) if such payments limit the effective recuperation and maintenance of an appropriately sized insurance fund. Taxation of deposit insurance funds, especially premiums, at unduly high rates limits the rate at which funds accrue in the deposit insurance fund. This may be of particular importance for jurisdictions in which the target size of the fund has not been achieved. Where deposit insurance funds are taxed at an unduly high rate, there will be a rating of NC.

EC10: In systems with differential premiums, the assessors should ensure that the system for calculating risk premiums is transparent and appropriately differentiates risk categories. The scoring/premium categories should be reviewed, and the ratings and rankings resulting from the system pertaining to individual banks kept confidential.

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<sup>25</sup> Refer to FSB Key Attribute 14 for more detailed guidance on resolution.

## Core Principle 10 – PUBLIC AWARENESS

**In order to protect depositors and contribute to financial stability, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.**

### *Essential Criteria*

1. *The deposit insurer is responsible for promoting public awareness of the deposit insurance system, using a variety of communication tools on an ongoing basis as part of a comprehensive communication programme.*
2. *In the event of a bank failure, the deposit insurer must notify depositors, as appropriate and as described in law, via media such as press releases, print advertising, websites and other media outlets, of the following details:*
  - a. *where, how and when insured depositors will be provided with access to their funds;*
  - b. *the information that an insured depositor must provide in order to obtain payment;*
  - c. *if advance or interim payments are being made; and*
  - d. *whether any depositors will lose funds, and procedures whereby uninsured depositors can make claims to the liquidator for their uninsured portion.*
3. *The public awareness programme or activities convey information about the following:*
  - a. *the scope (i.e. which types of financial instruments and depositors are covered by deposit insurance, and which are not);*
  - b. *a list of which banks are members and how they can be identified;*
  - c. *deposit insurance coverage level limits; and*
  - d. *other information, such as the mandate of the deposit insurer.*
4. *The objectives of the public awareness programme (e.g. target awareness levels) are clearly defined and consistent with the public policy objectives and mandate of the deposit insurance system.*
5. *The deposit insurer sets a long-term strategy to meet its public awareness objectives, and makes budget allocations to build and maintain a target level of public awareness about deposit insurance.*
6. *The deposit insurer works closely with banks and other safety-net participants to ensure the consistency and accuracy of the information provided to depositors and to maximise awareness on an ongoing basis. Law or regulation requires banks to provide information about deposit insurance in a format/language prescribed by the deposit insurer.*

7. *The deposit insurer monitors, on an ongoing basis, its public awareness activities and arranges, on a periodic basis, independent evaluations of the effectiveness of its public awareness programme or activities.*
8. *Depositors in jurisdictions affected by cross-border banking arrangements conducted through foreign bank branches or subsidiaries are provided with clear information on the existence and identification of the deposit insurer legally responsible for reimbursement, and the limits and scope of coverage.*

## COMMENTARY

EC1: A DI, no matter how well designed, must be understood by the public if it is to be effective in its role of supporting financial stability. It is the responsibility of each DI to promote public awareness of the DIS on an ongoing basis. For full compliance, the DI must have in place a comprehensive communications plan, designed to efficiently reach a defined target population within its jurisdiction. Plan components must utilise a variety of communication tools based on the resources and limitations of the jurisdiction, to ensure that information is easily accessible, readily understood and reaches a large percentage of the public. Examples include television broadcasts, radio, print, mobile and internet platforms (including social media). In addition, public awareness messaging as described in EC 3 should be visible and/or readily available in all member banks. A rating of LC is warranted in instances where only minor shortcomings are observed which do not raise any concerns about the DI's ability and clear intent to achieve full compliance with the EC within a prescribed period of time. A rating of NC would be appropriate if a jurisdiction has no public awareness programme or activity in place, and MNC if there are very limited public awareness activities reaching a limited number of depositors.

EC2: To ensure and maintain depositor confidence and ongoing financial stability, effective mechanisms must be in place to quickly disseminate information to depositors regarding where, how and when insured depositors can gain access to their funds (e.g. whether there is an assuming bank or agent bank to assume deposits and pay or make them available); if they will lose funds (e.g. if deposits are within the scope of the scheme but above coverage limits); and how to make claims for uninsured funds. A rating of NC is appropriate if no notice is given to depositors or if such notice is significantly delayed. If any of the elements of the communication programme listed above are missing, a rating of MNC may be appropriate. Information should be disseminated at a time and in a manner prescribed by law and/or any communications and crisis management plans of the DI.

EC3: Depositors should be provided with information as to the existence and key components of their jurisdiction's deposit insurance regime. It is the responsibility of the DI to ensure that an effective public awareness programme or activity is in place that communicates the mandate, scope, members, and coverage limits of the jurisdiction's regime in a format and language prescribed by the DI. Any missing elements of this EC would require a full-level downgrade in rating, and only in very limited instances would the DI receive a rating higher than MNC.

EC4: For full compliance, the objectives of a DI's public awareness programme or activity must support its public policy objectives and mandate. The objectives must be clearly defined, measurable and supported by a process for execution and by programme activities. A complete

lack of stated objectives would warrant a rating of NC. Where public awareness objectives exist, but are not in support of a jurisdiction's mandate or public policy objectives, or where there are significant gaps/omissions in the public awareness programme process that cannot be easily overcome, a rating of MNC is appropriate.

EC5: In addition to the execution of activities as prescribed in its ongoing public awareness programme or activity, the DI must set a long-term (forward-looking) communication strategy and accompanying implementation plan, and make budget allocations to maintain or reach target levels of awareness and understanding of deposit insurance within the jurisdiction. A lack of either element (strategy or budget) would warrant a rating of MNC, and lack of both a rating of NC.

EC6: It is important that all information disseminated to the public as specified in EC2 and EC3 is consistent and accurate. Thus, member banks should be obligated either by law or regulation to provide information in a format/language prescribed (i.e. written) by the DI. The DI and, where relevant, safety-net participants have corresponding obligations to set clear standards for the dissemination, form and content of relevant information, provide adequate support and ongoing education to member banks and relevant safety-net participants to meet public awareness guidelines, and work with member banks to continually maximise awareness. If the DI or other safety-net participants have no oversight or have limited involvement in ensuring the consistency, accuracy and format of DI information, a rating of NC is appropriate. An MNC should be given where there are inaccuracies in information and/or inconsistencies in dissemination. Where key elements of this EC are in place but the DI fails to provide ongoing education and support, a rating of LC is warranted.

EC7: The DI must exercise prudent oversight of its communication programme and budget. In addition to this ongoing internal oversight, independent external evaluations of the "effectiveness" of the jurisdiction's public awareness programme must be conducted. Assessors should examine internal documents for evidence of ongoing reviews of communication plans. Relevant documents may include: performance reports from media outlets; click-through data from online campaigns; the results of public surveys and/or tracking reports of the quantity of materials disseminated within a specified time frame; and awareness of the existence of the DI and the terms and conditions of coverage. For this EC, a jurisdiction should be rated NC if there is an absence of ongoing internal and/or periodic independent external evaluations of its public awareness activities. A rating of MNC is warranted if there are no independent evaluations, or they are not carried out regularly.

EC8: In jurisdictions where cross-border banking arrangements are in place, at a minimum, insured depositors must be provided with clear, readily available information regarding the existence of the provision of deposit insurance, and the specific identity of the DI responsible for reimbursement to these depositors. Clear, consistent and accurate information regarding the scope of coverage and deposit coverage limits must also be provided to insured depositors. Such information should be readily available, namely, in foreign bank branches and subsidiaries located within the jurisdiction. If information is not readily available, a rating of MNC is warranted. LC is warranted if it is available, but is missing critical elements of the EC.



## Core Principle 11 – LEGAL PROTECTION

**The deposit insurer and individuals working both currently and formerly for the deposit insurer in the discharge of its mandate must be protected from liability arising from actions, claims, lawsuits or other proceedings for their decisions, actions or omissions taken in good faith in the normal course of their duties. Legal protection should be defined in legislation.**

### *Essential Criteria*

- 1. Legal protection is specified in legislation and provided to the deposit insurer, its current and former directors, officers and employees and any individual<sup>26</sup> currently or previously retained or engaged by the deposit insurer, for decisions made and actions or omissions taken in good faith in the normal course of their duties.*
- 2. Legal protection precludes damages or other awards against such individuals and covers costs, including funding defence costs as incurred (and not just reimbursement after a successful defence).*
- 3. The operating policies and procedures of the deposit insurer require individuals with legal protection to disclose real or perceived conflicts of interest and to adhere to relevant codes of conduct, to ensure that they remain accountable.*
- 4. Legal protections do not prevent depositors or other individual claimants or banks from making legitimate challenges to the acts or omissions of the deposit insurer in public or administrative review (e.g. civil action) procedures.*

## COMMENTARY

EC1: Adequate legal protection (indemnification) relieves current and former directors, officers and employees of the DI, as well as individuals currently or formerly retained by the DI, from challenges to, or liability arising from, carrying out their official duties while discharging the DI's mandate. However, neither a contractual indemnity in an individual's employment agreement/contract nor private insurance is sufficient for full compliance with this Core Principle. Legal protection must explicitly be specified in legislation.

It is permissible for protections to individuals to be provided by legislation outside of the law governing the DI. However, it is insufficient that legal protection is provided in a jurisdiction as a matter of practice/general policy. Without regulation or legal support for such policies, a jurisdiction's rating must be MNC; if legal protection is non-existent, it must be NC.

Assessors must also ensure that the provision of legal protection is not explicitly reserved for directors, officers and higher levels of employees of the DI. All employees and agents, both current and former, must be indemnified; if not, a rating of MNC is appropriate.

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<sup>26</sup> A contractual indemnity in an individual's contract of employment or engagement with the DIA and/or private insurance is not a substitute for legal protection defined in legislation or recognized in law.

EC2: To receive a rating of C, legal protection should cover all damages and legal fees and other associated costs for the individuals mentioned in EC1 as incurred. A rating of NC is warranted in instances where legal protection is not offered to the individuals mentioned in EC1, or where legal costs are not borne upfront by the DI. In instances where only partial legal protection is provided or where legal costs are reimbursed to individuals only after they are found to have acted in good faith and within the scope of DI's mandate (such determinations are typically made by an internal review committee or a court of law), the rating would be MNC.

Protection can be given in a variety of ways. In some systems, employees may not even have to appear in court when charged. There are a variety of approaches available for providing legal protection. Some of the most common include:

- granting legal protection to individuals and/or providing insurance that covers legal and other associated costs which may arise from civil and criminal liability for their decisions and/or actions taken in good faith during the normal discharge of their legal responsibilities;
- granting statutory immunity to the deposit insurance organisation;
- including appropriate indemnification provisions in employment contracts; or
- a combination of these approaches.

EC3: Legal protection only extends to individuals discharging their duties in accordance with relevant codes of conduct, oaths of office and conflict-of-interest rules. Assessors should look for specific guidance from the DI regarding the types of behaviours/actions required by DI staff and agents to meet ethical standards and remain accountable. Such requirements should be sufficiently broad, applied uniformly, specified in policy and prevent actual and potential conflicts of interest.

If the individuals mentioned in EC1 fail to comply with provisions regarding disclosure of real or perceived conflicts of interest and/or fail to adhere to the relevant codes of conduct, then the protection provided may be void. However, the DI must clearly and formally establish (in codes, by-laws, manuals or operating procedures) what conditions individuals must fulfil to be covered by any legal protection mechanisms provided by the DI. Ideally, the DI should provide training to ensure that such requirements are understood, so as to mitigate the potential for inadvertent breaches of code of conduct.

Codes of conduct for a DI's officers and/or staff and agents should be specified. There is no requirement to cover (or continue to cover) acts or omissions outside the scope of an individual's regular duties or where the individual is determined to have had a conflict of interest. In instances where appropriate legal protections are in place but clear codes of conduct are absent, a rating of LC is appropriate if conduct/ethical requirements can be implemented expeditiously.

EC4: Any provisions for legal protection by the DI must not prevent, and may provide mechanisms to address, legitimate challenges to acts or omissions by the DI in public or administrative review (e.g. civil action) procedures.

## **Core Principle 12 – DEALING WITH PARTIES AT FAULT IN A BANK FAILURE**

**The deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in a bank failure.**

### ***Essential Criteria***

- 1. The conduct of parties responsible for, or contributing to, the failure of a bank (e.g. officers, directors, managers, owners), as well as the conduct of related parties and professional service providers (e.g. auditors, accountants, lawyers and asset appraisers), is subject to investigation. The investigation of the conduct of such parties may be carried out by one or more of the following: the deposit insurer, supervisor or regulatory authority, criminal or investigative authorities, or any other professional or disciplinary body, as applicable.*
- 2. The relevant authority takes the appropriate steps to pursue those parties that are identified as culpable for the failure of the bank. The culpable parties are subject to sanction and/or redress. Sanction or redress may include personal or professional disciplinary measures (including fines or penalties), criminal prosecution and civil proceedings for damages.*
- 3. The deposit insurer, or other relevant authority, has policies and procedures in place to ensure that insiders, related parties and professional service providers acting for the failed bank are appropriately investigated for wrongdoing and for possible culpability in a bank failure.*

### **COMMENTARY**

This Core Principle is designed to ensure that a formal mechanism exists for the investigation of, and imposition of penalties against, parties contributing to bank failure within a jurisdiction. Procedures for investigating and imposing penalties on parties at fault can act as a deterrent against illegal acts, limit moral hazard in the financial sector, and aid in the process of maximising recoveries from bank failures.

EC1: This EC requires a framework with the requisite power and resources to ensure formal investigation of the conduct of all parties who contributed to a bank's failure. Importantly, this EC exempts neither related parties nor professional service providers from the group of individuals whose conduct is subject to formal review. Assessors should not downgrade ratings if investigative powers are not specifically bestowed upon the DI. A jurisdiction can be fully compliant as long as the legal power to investigate inappropriate conduct is vested in any one of a jurisdiction's government entities (e.g. supervisory, regulatory, criminal or investigative authorities, or any other professional or disciplinary body, or the bankruptcy administrator). The conduct of related parties and/or professional service providers must be included within the scope of investigations; otherwise a rating of MNC is appropriate.

EC2: The first part of this EC requires that some authority within the jurisdiction has the power and authority to delineate an appropriate process for determining fault, and to pursue those parties deemed to be at fault in a bank failure. An absence of this authority would warrant an MNC. It is not unusual for laws governing banking and/or DIs to cross-reference a jurisdiction's

general laws regarding fraud or criminal activity when discussing the pursuit of parties at fault in the financial industry. Assessors should query the DI for guidance regarding the government agency they consider responsible for pursuing negligent/criminal activity pertaining to bank failures, and subsequently review legislation regarding the scope of powers of that entity, to ensure that the requirements of this EC are satisfied.

The second part of this EC requires that parties at fault are subject to sanction and/or redress. An absence of this element of the EC would warrant a rating of MNC. Assessors are not in a position to judge the appropriateness of sanctions. Different jurisdictions will have different criteria and different types of sanctions. The sanctions should be consistent with the broader legal framework. The presence of sanctions that are inconsistent would garner a rating of LC unless other elements of the EC are also missing. Assessors should seek to determine whether there are widespread, inappropriate sanctions (or a lack of sanctions).

EC3: While EC1 requires that there is an entity within the jurisdiction responsible for the investigation of parties contributing to bank failure, EC3 ensures that the responsible entities have policies and procedures in place to ensure that the investigations are appropriate. Assessors should initially look to legislation governing the actions of the appropriate investigative authority for procedural guidance. If the laws are silent regarding policy and procedure, by-laws, regulations and/or internal policy/procedural manuals should be analysed to determine appropriateness. Assessors should rate a jurisdiction NC where specific policies and procedures for investigating bank failures are absent, and MNC where investigations are inconsistent, informal, or do not include insiders, related parties and professional service providers.

## **Core Principle 13 – EARLY DETECTION AND TIMELY INTERVENTION**

**The deposit insurer should be part of a framework within the financial safety-net that provides for the early detection of, and timely intervention in, troubled banks. The framework should provide for intervention before the bank becomes non-viable. Such actions should protect depositors and contribute to financial stability.**

### ***Essential Criteria***

1. *The deposit insurer is part of an effective framework within the financial safety-net that provides for the early detection of, and timely intervention in, banks in financial difficulty before the bank becomes non-viable.*
2. *Safety-net participants have the operational independence and power to perform their respective roles in the framework for early detection and timely intervention.*
3. *The framework includes a set of clearly defined qualitative and/or quantitative criteria that are used to trigger timely intervention or corrective action. The criteria:*
  - a. *are clearly defined in law, regulation or agreements;*
  - b. *include safety and soundness indicators such as the institution's capital, asset quality, management, earnings, liquidity and sensitivity to market risk; and*
  - c. *are reviewed periodically, and the procedure for this review is formalised.*

## **COMMENTARY**

CP 13 requires the presence of all necessary elements of prudential supervision and regulation for the early detection of banks in difficulty, and a timely decision to intervene in their operations, within a jurisdiction's financial safety-net. All such activities (especially within the supervisory framework) must be effectively coordinated to include the DI, ensure the ongoing protection of depositors and maintain financial stability.

EC1: This criterion has two components. The first component asks if the DI is effectively integrated into the early detection and intervention part of the safety-net framework. The second asks if the safety-net's early warning systems and intervention mechanisms for troubled banks are timely and effective.

A jurisdiction's system(s) of prudential regulation and supervision should be in compliance with international standards, and their effectiveness assessed using the BCPs.<sup>27</sup> Assessments of compliance may also be conducted as part of an IMF/World Bank FSAP review. Assessors should rely on the results of assessments conducted by these international organisations to determine the effectiveness of the framework for early detection and the corrective action regime.

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<sup>27</sup> See BCBS, *Core Principles for Effective Banking Supervision*, 2012, <http://www.bis.org/publ/bcbs230.pdf>.

Recent assessments of compliance with BCPs should be used as a starting point for the Core Principles compliance assessment team. If such a report is not readily available, then an IMF Article IV Consultation Report should be used for guidance. Even older reports (e.g. five years or more) are useful for identifying problems within the supervisory framework. In the absence of recent external reviews, assessors should examine any useful self-assessments or reports of the jurisdiction, laying out the existing structure and gaps compared to international standards.

Assessors must use judgment in determining the materiality of actions taken or omitted since problems were identified within the system. Deficiencies in the regulatory and/or supervisory framework identified in such reviews must be factored into the assessment/rating of this CP in proportion to their materiality. Additionally, actions should incorporate relevant recommendations from BCP assessments and/or FSAPs. In the absence of strong regulation and supervision, the risks to the DI cannot be fully mitigated and a rating of MNC or NC would probably be appropriate.

If the DI has (or shares) responsibility for early detection and timely intervention, then the overall effectiveness of the DI's early warning system and corrective actions can also be directly assessed. Assessors must examine whether the methodology for identifying banks in financial difficulty is sufficiently accurate for the jurisdiction. Factors such as the appropriate integration of market data, flexibility in qualitative models or over-reliance on quantitative assessments should be examined.

Additionally, banks should undertake corrective actions where material deficiencies are found by supervisory authorities. Diagnosis and viability assessment must be coordinated among relevant safety-net participants. Based on the agreed findings, concerted intervention measures must be timely (before non-viability) and effective (corrective action sufficient to mitigate risk factors, identified by the supervisory authority that could cause or are likely to cause bank failure). Additionally, there should be an appropriate sequence and range of early detection actions. An early warning system that fails to lead to regulatory action would be NC, or at best MNC.

EC2: It is critical to also begin an assessment of compliance with EC2 against the BCPs. Assessors must check for any relevant systemic flaws in the regulatory framework. Safety-net participants must have the operational independence and power to perform their respective roles. These powers should ensure a collection of timely, accurate and relevant information to facilitate ongoing evaluation of both individual banks and the banking sector as a whole.

There must also be the legal authority for some entity within the safety-net to exercise supervisory powers. These powers must be clearly specified in legislation and include oversight responsibility for banks and for the identification of problem banks; such a designation must be based on a transparent methodology using qualitative and/or quantitative data, and the entity must have the power to quickly and effectively intervene once a bank has been identified as troubled.

Safety-net participants must be able to exercise a range of discretionary intervention powers on a continuum from detection of an emergent risk to imminent non-viability. These powers should ensure timely and effective intervention that is proportionate to the seriousness of a bank's

weaknesses. The minimum powers that should exist within the safety-net framework include but are not limited to: requiring additional information from banks, making a declaration or official finding of non-compliance with regulatory/supervisory requirements and mandating compliance, escalating the level and scope of oversight, and monitoring corrective actions (e.g. orders imposing capital requirements and business restrictions).

The BCBS has specified that, should a bank engage in unsound banking practices or breach statutory or other key supervisory requirements, the banking supervisor should have the power to compel the bank to take necessary remedial action – and a statutory responsibility to ensure that the remedial action taken is appropriate.

Actions undertaken and enforcement actions taken by the supervisory authority must not be unduly delayed or overturned. The ability of a party (e.g. the owners of the banks or the creditors of the bank) to override the power of the supervisor through injunctions or lawsuits would necessitate the early warning systems being rated MNC or even NC.

EC3: Triggering of intervention must be timely, clear, understood and coordinated among all relevant safety-net participants, and used to initiate the implementation of corrective measures to prevent bank non-viability. The criteria triggering intervention should be identical in banking and deposit insurance law. The triggering criteria can be based on quantitative or qualitative measures, or a combination of both.

- a. Informal agreements among safety-net participants as to the criteria for triggering intervention/corrective actions are insufficient for full compliance. The “clearly defined criteria” balance the objectives of prompt and effective intervention and coordination amongst the relevant authorities against allowing measures that can be targeted to specific circumstances.
- b. A jurisdiction’s triggering mechanisms must be clearly specified in legislation, regulation, or at a minimum by formal written agreements among relevant safety-net participants. The BCPs should be used for additional guidance.

Regardless of the methodology used to trigger intervention, the criteria should be based in part on the assessment of financial soundness indicators recommended by authorities such as the FSB and BCBS, which include capital adequacy, asset quality, management soundness, earnings and profitability, liquidity, and sensitivity to market risk and relevant macro-level factors.<sup>28</sup> The trigger mechanism for authorities to take control of a bank and initiate actual failure resolution procedures may include criteria such as, but not limited to:

- the failure to meet regulatory capital requirements exists or is imminent; or
- statutory conditions for taking control are met (such as failure to comply with orders to increase capital); or

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<sup>28</sup> IMF, *Financial Soundness Indicators: Analytical Aspects and Country Practices*, 2002, <http://www.imf.org/external/pubs/nft/op/212/>.



- failure to develop and implement a viable business plan, thus making either of the two preceding circumstances inevitable within a short period of time.

For full compliance, a jurisdiction must periodically review the criteria for triggering corrective action and have a formal procedure for such a review.

## Core Principle 14 – FAILURE RESOLUTION

**An effective failure resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability. The legal framework should include a special resolution regime.**

### *Essential Criteria*

- 1. The deposit insurer has the operational independence and sufficient resources to exercise its resolution<sup>29</sup> powers consistent with its mandate.*
- 2. The resolution regime ensures that all banks are resolvable through a broad range of powers and options.*
- 3. Where there are multiple safety-net participants responsible for resolution, the legal framework provides for a clear allocation of objectives, mandates, and powers of those participants, with no material gaps, overlaps or inconsistencies. Clear arrangements for coordination are in place.*
- 4. Resolution and depositor protection procedures are not limited to depositor reimbursement. The resolution authority/ies has/have effective resolution tools designed to help preserve critical bank functions and to resolve banks. These include, but are not limited to, powers to replace and remove senior management, terminate contracts, transfer and sell assets and liabilities, write down or convert debt to equity and/or establish a temporary bridge institution.*
- 5. One or more of the available resolution methods allows the flexibility for resolution at a lesser cost than otherwise expected in a liquidation net of expected recoveries.*
- 6. Resolution procedures follow a defined creditor hierarchy in which insured deposits are protected from sharing losses and shareholders take first losses.*
- 7. The resolution regime does not discriminate against depositors on the basis of their nationality or residence.*
- 8. The resolution regime is insulated against legal action that aims at the reversal of decisions related to the resolution of non-viable banks. No court can reverse such decisions. The legal remedy for successful challenges is limited to monetary compensation.*

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<sup>29</sup> In this document, “resolution” refers to the disposition plan and process for a non-viable bank. Resolution may include the liquidation and reimbursement of insured deposits, the transfer and/or sale of assets and liabilities, the establishment of temporary bridge institutions, and the write-down and/or conversion of debt to equity of the non-viable institution. Resolution may also include the application of procedures under insolvency law to parts of a firm in resolution, in conjunction with the exercise of resolution powers. A jurisdiction’s resolution regime may involve multiple resolution authorities. The specific resolution powers assigned to a DI may vary depending on its mandate.

9. *The resolution regime keeps the period between depositors losing access to their funds and implementation of the selected resolution option (e.g. depositor reimbursement) as short as possible.*

## COMMENTARY

EC1: This criterion refers to the overall effectiveness of the DI in resolution. Not all DIs are resolution authorities but all DIs are involved in the resolution process to some degree. All resolution authorities will need operational independence and sufficient resources to fulfil their mandate. A system is rated C if such operational independence and sufficient resources exist. The assessors will need to cross-check against the assessment of CP 3, Governance.

EC2: The resolution framework must be sufficiently flexible to allow for the resolution of small, medium-sized and large banks. The assessors will have to evaluate both the tools available and the decision-making processes. A fully compliant system has the tools needed for all sizes of banks, and has appropriate manuals and legal support for their implementation. If the resolution tools are established in law but there are no implementing regulations or means of implementing the law, the jurisdiction may be rated MNC.

EC3: A critical aspect of this Essential Criterion is the existence and use of coordination mechanisms among safety-net participants. Related to information sharing (see CP 4), this criterion looks at the formal allocation of objectives, mandates and powers, ensuring that all relevant safety-net participants are involved in the resolution of a failed bank.

EC4: The assessment will revolve around the following issues: (i) are there adequate legal powers (using the FSB's KAs as a benchmark); (ii) are those powers supported by appropriate policies, procedures, manuals and implementing regulations; and (iii) are the tools used appropriately? The assessors will need to assess whether the authorities have a clear understanding of when to use which tools. In principle, specialised tools (e.g. bail-in) aimed at resolving systemic institutions should not be applied to small and medium-sized institutions.

EC5: This criterion refers to the importance of tailoring the resolution strategy to the characteristics of the failed institution. Neither the law nor national practice should limit the resolution authorities to only one resolution method. Rather, in each case, the range of interventions should be analysed against the objectives and mandate of the resolution authority, including what options involve a lesser cost than otherwise likely in the case of a depositor reimbursement. One important issue, however, is the selection of bank resolution tools in a systemic crisis. The legal frameworks in many jurisdictions have a systemic override provision. This override provision, introduced in jurisdictions such as the US, Japan and Canada, is triggered by a systemic event requiring the DI to override its cost test. The assessors will have to determine if there are adequate limitations on the use of such override provisions to avoid the excessive use, or the misuse, of this power. For example, systemic override provisions should only be utilised in exceptional circumstances involving a serious threat to financial stability, and should involve the DI and other safety-net participants in the development of a strategic analysis that would form the core of the decision-making process.

EC6: This criterion is fully compliant if the creditor hierarchy is clearly set out in law, and if insured deposits are protected from sharing losses and shareholders take first losses. This criterion will be rated MNC if shareholders do not absorb first losses in a resolution, and NC if no creditor hierarchy is in place.

EC7: As with coverage limits, the resolution process should not discriminate against depositors or creditors on the basis of residency status or nationality. The nationality of a creditor makes no difference for financial stability purposes. If this is not the case, a rating of NC is appropriate.

EC8: The objective of this criterion is not to limit or inhibit judicial review. Rather, it requires that resolution of legal disputes should not include the reversal of resolution actions once those actions have been taken. Compensation for successful challenges is limited to monetary compensation. If compensation for successful challenges is not limited to monetary compensation, a rating of NC would be given.

EC9: This criterion addresses the issue of long delays in selecting and implementing a resolution option during stable times. The deposit insurer cannot pay out until the intervention has been triggered and the resolution begun. Prolonged delays in triggering resolution (under the guise of prolonged analysis, review of data, or prolonged analysis of resolution options) could lead to payout periods that are longer than the recommended seven days (see CP 15, Reimbursement). However, this criterion is not meant to suggest that the DI should pay out in the event that systemic crisis management imposes limitations on depositors' access to their funds (such as a moratorium or deposit freeze). Such policy options have systemic implications and the DI is not expected to reverse such decisions.

## Core Principle 15 – REIMBURSING DEPOSITORS

**The DIS should reimburse depositors’ insured funds promptly, in order to contribute to financial stability. There should be a clear and unequivocal trigger for insured depositor reimbursement.**

### *Essential Criteria*

1. *The DI is able to reimburse most insured depositors within seven working days. If the DI cannot currently meet this target, the DI has a credible plan in place to do so.*
2. *To be credible, the reimbursement plan:*
  - a. *has a clear time frame for implementation (e.g. within two years);*
  - b. *is supported by relevant laws, regulations, systems and processes (e.g. intervention and resolution manuals); and*
  - c. *has clear and measurable deliverables.*
3. *In situations where reimbursement is triggered and there may be extended delays in reimbursements, the DI may make advance, interim or emergency partial payments.*
4. *In order to provide depositors with prompt access to their funds, the DI:*
  - a. *has access to depositors’ records at all times, which includes the authority to require banks to maintain depositor information in a format prescribed by the DI in order to expedite insured depositor reimbursement;*
  - b. *has the authority to undertake advance or preparatory examinations (e.g. on-site and independently or in conjunction with the supervisory authority) on the reliability of depositor records and has tested member institutions’ IT systems and data to ensure the capability to produce such records; and*
  - c. *has a range of reimbursement options.*
5. *The DI has the capacity and capability to promptly carry out the reimbursement process, including:*
  - a. *adequate resources and trained personnel (in-house or contractor) dedicated to the reimbursement function and supported with reimbursement documentation or manuals and information technology;*
  - b. *information systems to process depositor information in a systematic and accurate manner;*
  - c. *pre- and post-closing activities specified in closing documentation or manuals; and*

- d. scenario planning and simulations, including simulations on bank closings with supervisory and resolution authorities.*
- 6. A review (e.g. post mortem) following a bank failure is performed to determine and analyse elements of the reimbursement process (including the resolution procedure where applicable) which were successful or unsuccessful.*
- 7. An independent party conducts a periodic audit of the reimbursement process to confirm that appropriate internal controls are in place.*
- 8. If set-off of insured deposits against past due claims (e.g. debt service and arrears) or matured loans is applied, such application is timely and does not delay prompt reimbursement of insured depositors' claims or undermine financial stability.*
- 9. Working arrangements and/or agreements are in place with relevant clearing and settlement system agencies and liquidators, to ensure that transit items are dealt with in an appropriate, consistent and timely manner.*
- 10. In cases where the DI does not have the authority to act as a liquidator, the liquidator is obliged by law or regulation to cooperate with the DI to facilitate the reimbursement process.*

## **COMMENTARY<sup>30</sup>**

This Core Principle has three key components: reimbursing the insured depositors promptly (within seven working days); having access to depositors' records at all times; and having the capacity and capability to promptly carry out the reimbursement process.

The key assessment criterion for promptness is whether most insured depositors receive their funds (in whole or in part) within a time frame that maintains confidence and financial stability. If the DI cannot (or does not seem prepared to) reimburse most depositors within seven working or business days, and does not have a credible plan to reach the target of seven days, then the overall compliance rating should be NC. The existence of a credible plan to reach the seven-day target within two years would result in a rating of C.

EC1: This criterion establishes a very specific target date of seven working days for reimbursing most insured depositors. The target date refers to the ability to complete the reimbursement to most insured depositors – not just the start of the process. The EC recognises that it would operationally be extremely difficult to reimburse – within seven working days – some types of deposits such as trust accounts with multiple beneficiaries, temporary high-balance accounts or other deposit instruments whose ownership cannot be easily and promptly determined. Many smaller and/or newly established DIs may not be able to meet this aggressive target date in the near future, or may not have any credible plan to achieve this target. In such cases, these systems would receive a rating of MNC or NC.

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<sup>30</sup> See also the IADI Guidance Paper on *Reimbursement Systems and Processes*, 2012, [http://www.iadi.org/docs/IADI-Reimbursement\\_Enhanced\\_Guidance\\_Paper.pdf](http://www.iadi.org/docs/IADI-Reimbursement_Enhanced_Guidance_Paper.pdf).

EC2: Such a plan, to be acceptable and credible, should include:

- a reasonable time frame (e.g. not more than two years) for implementation;
- specific intermediate steps, including corresponding start and end dates;
- deadlines and corresponding deliverables;
- identification of adequate resources (staff and funds for obtaining external services) and an IT framework (e.g. within the bank or DI) to be able to implement the plan; and
- any necessary establishment or revision of relevant laws or regulations used to support the reimbursement target.

If the plan meets these conditions, a rating of C may be given. If the DI can reimburse most depositors within seven working days or has a credible plan to reach the target of seven days within a reasonable period (e.g. two years), the assessors may assign a rating of C or LC.

EC3: In situations where reimbursement is triggered and there may be extended delays in reimbursements, the DI may make advance interim or emergency partial payments to avoid hardship for depositors. The use of interim payments is aimed at mitigating the impact of significant, protracted payout delays that cause hardships for depositors. It is not proposed that interim payouts be used frequently or in the normal course of depositor reimbursements, as they may delay the payout process. The DI, through its public awareness programme, should ensure that such interim payments are made mainly to minimise hardship for small depositors, and do not imply potential insolvency of the deposit insurance fund.

EC4: There are three components in this EC:

- a. The DI should have access to depositor records at all times, and should have the authority to require banks to maintain and share with it DI information in a standard format (e.g. single customer view) created by the DI. The DI's access to such records should be direct and not through the supervisory agency or the central bank.

All DIs, including those with a pay box mandate, should have ongoing access to depositor records. If such access is direct, then a rating of C would be appropriate. A rating of LC may be appropriate if the access is ongoing but through another safety-net participant such as the supervisory authority, and formal specific procedures are in place for providing such access. If the access is neither ongoing nor direct, NC or MNC may be appropriate.

- b. The DI has the ability to assess/test the reliability of depositor records. This provides the DI with the authority to conduct off-site and/or on-site examinations of banks, independently or in conjunction with the supervisory agency, to test and verify the

accuracy and reliability of depositor records and the IT/data systems generating such records.

A rating of MNC may be appropriate if the DI does not have this ability, or the opportunity to do so directly or with the supervisor.

- c. The DI has a range of reimbursement options. These may include cash and cheque payments, electronic transfers, payment agent, ATM and transfer of deposits through closed bank P&A transactions.

Depending upon how limited the options are, ratings of LC or MNC may be appropriate.

EC5: A rating of C or LC is appropriate if the DI has the capacity and capability to promptly carry out the reimbursement process, including adequate financial, human and IT resources.

EC6: Such reviews can be cursory or very detailed depending upon the size of the failed bank, the primary cause of the bank's failure and the reimbursement process used. A comprehensive review merits a rating of C. An MNC or LC should be given depending on the post mortem's scope. A rating of NC should be given in the absence of any post mortems.

EC7: Every few years, the DI should conduct a thorough review of the entire disbursement process, and take appropriate corrective actions. Such reviews (also known as programme audits) should be conducted by an external independent organisation and should particularly focus on the effectiveness of internal controls built into the reimbursement process. The scope, frequency and independent nature of the review should guide the assignment of a compliance rating.

EC8: In cases where set-off/netting is applied to insured deposits, an advantage could be provided to certain uninsured depositors, and the reimbursement process could be delayed.<sup>31</sup> Assessors should ascertain what procedure the DI has in place for applying set-off/netting and then determine if this is likely to delay the reimbursement process for most insured depositors. In such cases, an MNC or NC rating is warranted.

EC9: Transit items<sup>32</sup> should be subject to prior agreements among relevant parties (e.g. the bank or the DIS with relevant clearing and settlement system agencies and payment system operators) to ensure that the items after a bank failure are dealt with in an appropriate and consistent manner, and as quickly as possible. The absence of any working arrangements and/or formal agreements would result in an MNC. If arrangements are specified but lack supporting guidance, a rating of LC would be appropriate.

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<sup>31</sup> See Financial Stability Forum, *Guidance for Developing Effective Deposit Insurance Systems* (p. 40), BIS, September 2001.

<sup>32</sup> See IADI, *Enhanced Guidance for Effective Deposit Insurance Systems: Reimbursement Systems and Processes*, November 2012, [http://www.iadi.org/docs/IADI-Reimbursement\\_Enhanced\\_Guidance\\_Paper.pdf](http://www.iadi.org/docs/IADI-Reimbursement_Enhanced_Guidance_Paper.pdf).



EC 10: Cooperation between the DI and the liquidator should be specified in laws or regulations, thus expediting the reimbursement process. Absence of such a requirement should result in a rating of NC.

## Core Principle 16 – RECOVERIES

**The deposit insurer should have, by law, the right to recover its claim in accordance with the statutory creditor hierarchy.**

### *Essential Criteria*

- 1. The deposit insurer's role in the recovery process is clearly defined in law. The DI is clearly recognised as a creditor of the failed bank by subrogation.*
- 2. The deposit insurer has at least the same creditor rights or status as a depositor in the treatment in law of the estate of the failed bank.*
- 3. The deposit insurer, in its capacity as creditor, has the right of access to information from the liquidator, so that it can monitor the liquidation process.*
- 4. The management and disposition of assets of a failed bank are guided by commercial and economic considerations.*
- 5. Those working on behalf of the deposit insurer, other financial safety-net participants, and third party professional service providers providing resolution services are not allowed to purchase assets from the liquidator.*

### COMMENTARY

There is considerable variation among jurisdictions in the asset management role and in the responsibility for handling claims and recoveries paid by DIs and other safety-net participants. Where deposit insurance payments are generally made upon the liquidation of a bank, the DI is usually subrogated to the rights of the insured depositors, and is likely to file and actively manage the claim arising from the deposit insurance payment.

In some instances, DIs have significant roles in the recovery process (e.g. as a creditor or possibly liquidator and receiver). And, even if not, the DI may nominate a liquidator or have a significant role in the liquidation process through other means, such as oversight over the liquidator or participation on creditor committees. In other cases, these functions are the responsibility of other entities within the safety-net, or of the courts. In any case, the DI should endeavour to maximise recoveries on liquidated assets and should share in the proceeds of the recoveries arising from the failure of its member banks.

EC1: Because of the possibility of the DI having multiple roles in the recovery process, these roles should be clearly defined in law or regulation. If the roles are not formally specified, an MNC or NC rating should be given. The DI is clearly recognised as a creditor of the failed bank by subrogation.

EC2: The DI has at least the same creditor rights or status as a depositor (including any preferred status) in the treatment in law of the estate of the failed bank. In jurisdictions where deposit insurance payments are generally made upon liquidation of a bank, the DI is usually

subrogated to the rights of the insured depositors, and must file and actively manage and enforce the claim arising from the deposit insurance payments. The DI's costs, when it is acting as a receiver, should be treated as administrative expenses.

EC3: The DI's right to access relevant information from the liquidator in its capacity as creditor should be specified in law. This is critical for the DI in order to monitor the liquidation process. If such rights are not specified in law, then an NC rating should be given. LC or MNC may be appropriate if the rights are specified in regulations or other official documents.

EC4: The management of the assets of the failed bank and the recovery process should be guided by commercial considerations and their economic merits. This means consideration of factors such as:

- quality of the assets;
- depth and condition of markets;
- use of net present value of assets to balance the competing goals of securing maximum value and early disposal;
- legal requirements relating to the disposition of assets; and
- availability of expertise in asset management and disposition.

EC5: Third-party professional service providers to the failed bank or its estate, including certified public accountants, attorneys, appraisers, asset managers, and relevant IT service providers, are prohibited from buying assets from the liquidator. These restrictions on asset purchases are in place to avoid any abuse of inside information and a potential conflict of interest. If such restrictions are not provided through laws or regulations, an MNC or LC would be appropriate. This EC does not prohibit a public asset management company or deposit insurer from purchasing assets from the liquidator.

## ANNEX 1

### COMPLIANCE ASSESSMENT METHODOLOGY

#### INDEX OF DOCUMENTS AND INFORMATION NEEDED FOR ASSESSMENT

##### **I. Responses to the template**

##### **II. General information**

Safety-net structure including organisational charts for the DI (and, where available, for other safety-net participants); history of the DI; any unique circumstances and issues.

##### **III. Documents**

1. Banking law – general provisions, authorisations and revocations – bank licences, operations, prompt corrective actions, and banking resolutions.
2. Deposit insurance law.
3. Banking and securities laws.
4. Central bank law.
5. Bankruptcy law or bankruptcy code.
6. Regulations governing problem banking resolutions:
  - Guidelines on the implementation of a bank liquidation;
  - Guidelines for the DI administration on the supervision and monitoring of appointed legal representatives acting as liquidators and receivers of banks;
  - Guidance on the transfer of assets and liabilities;
  - General rules on the treatment of joint accounts or those that have more than one account;
  - General rules that should be observed by the multiple banking institutions with regard to classifying information on guaranteed obligations; and
  - Rules and regulations concerning the provision of liquidity.
7. MOU between the bank supervisor and the DI on information sharing and inspection visits to banking institutions.
8. MOUs with other DIs if there are multiple DIs within the jurisdiction, and with foreign DIs if there are cross-border issues relating to foreign branches/subsidiaries and/or

branches/subsidiaries abroad.

9. Results of any recent FSAPs, BCBS reviews or AMs from missions by international financial institutions.
10. Information on the DI's public awareness programme and its evaluation.
11. A description of any special measures, taken by the DI or others as a result of the most recent international financial crisis, to extend depositor protection or support the financial system.
12. Mechanisms used by a central bank, MOF, and/or Treasury for emergency liquidity support.
13. DI funding arrangements.
14. Relevant case studies or experience.

#### **IV. Data**

1. Balance sheet and income statement of the DI.
2. Balance sheet and income statement for banking sector.
3. Deposit levels for last 12 months disaggregated by (i) currency; (ii) maturity; (iii) size; and (iv) insured/non-insured.
5. Deposit distributions – aggregate and by individual bank.
6. Insured deposits/total deposits – aggregate.
7. Reserve fund size as a percentage of insured deposits and percentage of total deposits for last 12 months.

## ANNEX 2

### EXAMPLES OF QUESTIONS POSED TO THE DEPOSIT INSURER, SAFETY-NET PARTICIPANTS, BANKERS AND OTHER PARTIES

#### Questions for a MOF, Treasury or other relevant authority

1. What is the role of the authority in developing financial sector policy/legislation and coordinating activities of safety-net participants?
2. What are the views of the authority on the DIS and its contribution to financial stability and the protection of depositors?
3. What are the views of the authority on the effectiveness of the current information sharing and coordination approach, and on whether there is a need to enhance this in the safety-net?
4. Is there a need to enhance simulations and contingency planning among safety-net participants?
5. Are there any legal impediments to enhancing information sharing and coordination between the authority, central bank and DI?
6. What does the authority think about the adequacy of funding for the DI? Are mechanisms sufficiently robust to back up funding sources?
7. What resolution tools are available to authorities (e.g. P&A, liquidation, bridge bank and payout)?
8. What is the breakdown of recent bank failures, the resolution method used, and lessons learned?
9. Are there plans for introducing a special resolution regime (e.g. bridge bank)?
10. What is the impact of the international financial crisis on the financial system and depositors?
11. Are the current and former staff members of the authority and its agents provided with legal protection and, if so, how is it structured?
12. Contingency planning and crisis simulation exercises – what has been done and who is included?
13. Backup funding for the DI – how would it work if the need arose? Is the guarantee formal and explicit?

14. What are the authority's views on consumer financial literacy and the role of public awareness about deposit insurance?

### **Questions for liquidators and receivers**

1. What general approach have you taken to receivership and liquidation for failed banks?
2. How are liquidators appointed (e.g. by court, by DI, by creditor committee)?
3. Is there a creditor hierarchy? Please describe.
4. What have been your experiences as regards loss rates on assets?
5. What is the system for paying dividends/what are the historical dividend rates?
6. Are there any operational manuals?
7. Are there any legal or operational impediments to receivership/liquidation?
8. Are there adequate staff training opportunities?

### **Questions for bankers**

1. What are your views on the importance of deposit insurance to your bank (e.g. promoting stability, increasing public confidence)?
2. What are your observations about the general level of knowledge among depositors as regards deposit insurance, and how important is deposit insurance for depositors when making savings decisions?
3. Are there any areas of concern as regards deposit insurance, the DI and the financial sector in general (e.g. coverage limits, premiums and funding levels, information requests)?
4. What are your experiences in bank resolution? Have you been a paying agent for the DI?

### **Some additional questions for the DI (if not already covered in its response to the template)**

#### **1. Governance/operational issues**

- Confirm the organisational framework of the DIS.
- Is it public, private, or a hybrid system?
- Does the board of the DI have active bankers? How are conflicts of interest in board members mitigated?

## **2. Relationships with safety-net participants**

- What are the formal information sharing arrangements?
- Would it be helpful if the DI were informed earlier about troubled banks (i.e. in light of efforts to enhance payout speeds and better manage liquidity)?

## **3. Coverage**

- What proportion of individual depositor's accounts is fully covered? What percentage of total deposits?
- Do you cover small and medium-sized enterprises?

## **4. Funding/investment policy**

- What is the methodology used to determine fund adequacy? Please clarify.
- What is the capacity of the fund/reserve to handle future bank failures, both at present and when the fund target is reached (e.g. number of possible bank failures covered, largest size of bank failure that could be covered)?
- How long will it take to reach your fund target under given scenarios?
- What is the limit on emergency borrowing for the DI? With whom is the borrowing arrangement and how is it accessed?
- Are you concerned that borrowing first from the market will signal problems?
- Should there be access to both markets and public borrowing, but with decisions left up to the DI?
- Does the DI have a written investment policy and, if so, what is it?

## **5. Public awareness**

- Please explain the approach to “ongoing” public awareness activities. For example, what tools do you have for increasing public awareness (e.g. signs, brochures in branches, bank staff training, website, toll-free numbers, awareness campaigns)?
- What is the current level of public awareness about deposit insurance? Is the DI satisfied with this level? How do you measure public awareness levels?



- Do you receive feedback from bankers? And from consumers?
- What are your plans for maintaining/expanding public awareness in the future?

## **6. Legal protection/legal redress from parties responsible**

- What is the current arrangement for protecting the DI and its current and former employees as well as its agents?
- Are central bank and other public authority staff legally protected in a similar manner?
- Does the DI receive any share in the proceeds of litigation against parties at fault in a failure?

## **7. Supervision and resolution**

- If one exists, what is the supervisory early warning system? Please describe.
- How does your intervention framework function? What tools are used? Is the process transparent to the industry?
- What is the trigger for taking control of a failed bank (e.g. insolvency, viability)? (Please explain the process.)
- What information is provided to the DI? Are there any factors that restrict information provided to the DI?
- Would payout speed be enhanced by providing information to the DI earlier?
- What resolution tools are available to authorities (e.g. P&As, liquidation and payout)?
- Do you have a special resolution regime? If not, are there plans to introduce a special resolution regime (e.g. bridge bank)?

## **8. Reimbursement**

- What advance warning does the DI receive from supervisory authorities?
- Are there plans to provide the DI with more information in advance, rather than being provided with information only upon the central bank determining insolvency?
- How is insolvency determined (trigger used)?

- How long does each step in the payout process take (e.g. describe stages and indicate number of days to accomplish)?
- Do you have manuals, training, and payout plans in place?
- What is your view of the current quality of deposit data received from the banking system (is there a need for a standardised template for all banks)?
- Does the supervisor review the quality of bank records on a regular basis?
- What changes are planned to enhance payout speed? For example:
  - special software systems for the DI
  - standardised templates for banks
  - new information sharing arrangements
- What training programmes are envisioned for staff to implement new payout systems?
- Do you plan on running simulations of the current or any new payout system when completed?
- Can deposits be transferred and, if so, how does this process work?

## **9. Recoveries**

- What is the process for receivership/liquidation? (Please describe.)
- How are liquidators appointed (e.g. by court, by DI, by creditor committee)? (Please describe.)
- Is there an insolvency order and, if so, what is the position of depositors and the DI?
- What has been the historical recovery rate?
- Are there any impediments to effective recoveries worth noting in the legal system?

## ANNEX 3

### ASSESSMENT OF COMPLIANCE WITH THE IADI CORE PRINCIPLES FOR EFFECTIVE DEPOSIT INSURANCE SYSTEMS

This template presents a summary of guidance and a format for the organisation and methodology of a self-assessment report. The assessment report should include the following:

- A general section that provides background information on the self-assessment conducted, including information on the organisation being assessed and the context in which the assessment is being conducted.
- A section on the information and methodology used for the assessment.
- An overview of the institutional and macroeconomic setting and market structure.
- A review of the operating environment for effective Dis, which should include:
  - Assessment of the economy and banking system
  - Macroeconomic stability
  - Sound banking system
  - Sound governance of authorities comprising the FSN
  - Strong prudential regulation and supervision
  - Well-developed legal framework
  - Sound accounting and disclosure regime
- A detailed Principle-by-Principle assessment, providing a description of the DI with regard to a particular Principle, a grading or “assessment,” and a “comments” section (Table 1).
- A compliance table, summarising the assessment results (Table 2).
- A recommended action plan providing Principle-by-Principle recommendations for actions and measures to improve the DI and practices (Table 3).
- Authorities’ comments and feedback.

Assessments follow a five-grade scale as follows:

- **Compliant** – A DI will be considered compliant with a Core Principle when the Essential Criteria applicable for this jurisdiction are met without any significant deficiencies.
- **Largely Compliant** – A DI will be considered largely compliant with a Core Principle when only minor shortcomings are observed which do not raise any concerns about the authority’s ability and clear intent to achieve full compliance with the Principle within a prescribed period of time.

- **Materially Non-Compliant** – A DIS will be considered materially non-compliant with a Core Principle when there are severe shortcomings, despite the existence of formal rules, regulations and procedures, and there is evidence that the DIS has clearly not been effective, that practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority’s ability to achieve compliance.
- **Non-Compliant** – A DIS will be considered non-compliant with a Core Principle when there has been no substantive implementation of the Principle, several Essential Criteria are not complied with, or execution is manifestly ineffective.
- **Not Applicable** – In addition, a Core Principle will be considered not applicable when, in the view of the assessor, the Principle does not apply given the structural, legal and institutional features of a jurisdiction.

Grading is not an exact science, and compliance with the Core Principles can be achieved in different ways. The assessment criteria should not be seen as a checklist approach to compliance but as a qualitative exercise. The number of criteria receiving a compliance grade and the commentary that should accompany each grade will be weighed in the scoring process for each Core Principle; however, not all criteria will carry equal weight. The Core Principles are benchmarks for effective deposit insurance practice. In assessing them, the DIs and policymakers will need to take into account jurisdiction-specific factors.

Compliance with the Core Principles will be assessed and graded with reference to the Essential Criteria.

The detailed Principle-by-Principle self-assessment should provide a “description” of the system with regard to a particular Principle. The template also includes spaces for a grading or “overall assessment”, and a “comments” section, if the jurisdiction opts to include a grade in its self-assessment.

- **The “Overall Assessment” section, if the jurisdiction opts to include the grade in the self-assessment**, should contain only one line, stating whether the system is “compliant”, “largely compliant”, “materially non-compliant”, “non-compliant” or “not applicable” as described above.
- **The “Description” section of the template should provide information on the practice in the jurisdiction being assessed.** It should cite and summarise the main elements of the relevant laws and regulations. This should be done in such a way that the relevant law or regulation can be easily located, for instance by reference to URLs, official gazettes, and similar sources. Insofar as possible and relevant, the description should be structured as follows: (1) deposit insurance and banking laws and supporting regulations; (2) deposit insurance regulations and relevant supervisory/regulatory reports; (3) institutional capacity of the deposit insurance authority; and (4) evidence of implementation and/or enforcement, or the lack of it.
- **The “Comments” section will be used by the assessors to explain why a particular grading was given, in particular, when a less than “compliant” grading was given.**

This section could be structured as follows: (i) reasons related to the state of the laws and regulations and their implementation; (ii) the state of the DI’s tools and instruments; (iii) the quality of practical implementation; (iv) the institutional capacity of the DI; and (v) enforcement practices. In the case of a less than “compliant” grading, this section will be used to highlight which measures would be needed to achieve full compliance, or why, despite the system seeming to be compliant on the basis of the laws, regulations and policies in place, a less than “compliant” grading was given – perhaps due to weaknesses in procedures or implementation. Jurisdictions choosing not to include grades in the self-assessment can use this section to introduce additional information, in particular references to planned initiatives aimed at amending existing practices, or legislation and regulations still in draft.

**Table 1. Detailed Assessment of Compliance with the IADI Core Principles**

<b>Core Principle 1: PUBLIC POLICY OBJECTIVES</b> The principal public policy objectives for DISs are to protect depositors and contribute to financial stability. These objectives should be formally specified and publicly disclosed. The design of the DIS should reflect the system’s public policy objectives.	
Description	
Assessment	C, LC, MNC, NC, NA <sup>33</sup>
Comments	
<b>For each Essential Criterion:</b>	C, LC, MNC, NC, NA <sup>34</sup>
Description	
Assessment	
Comments	
Repeat for all Core Principles	

<sup>33</sup> Compliant (C), Largely Compliant (LC), Materially Non-Compliant (MNC), Non-Compliant (NC), Not Applicable (NA).

<sup>34</sup> It is recommended that each Essential Criterion be graded by the assessor. However, the assessment grade for each Essential Criterion should not be included in the FSAP ROSC final reports provided to authorities.

**Table 2. Summary Compliance with the IADI Core Principles**

<b>Core Principle</b>	<b>Grade</b>	<b>Comments</b>
1. Public Policy Objectives	C, LC, MNC,NC, NA	
2. Mandates and Powers	Repeat for all Core Principles	
3. Governance		
4. Relationships with other Safety-net Participants		
5. Cross-border Issues		
6. Contingency Planning and Crisis Management		
7. Membership		
8. Coverage		
9. Sources and Uses of Funds		
10. Public Awareness		
11. Legal Protection		
12. Dealing with Parties at Fault		
13. Early Detection and Timely Intervention		
14. Failure Resolution		
15. Reimbursing Depositors		
16. Recoveries		
<i>Aggregate:</i> Compliant (C) – xx, Largely Compliant (LC) – xx, Materially Non-Compliant (MNC) – xx, Non-Compliant (NC) – xx, Not Applicable (NA) – xx		

**Table 3. Recommended Action Plan to Improve Compliance with the IADI Core Principles**

Reference Principle	Recommended Action
Core Principle 1	Description of deficiency Suggested course of action
Core Principle 2	Description of deficiency Suggested course of action
Repeat for all Core Principles with a recommended action	Description of deficiency Suggested course of action