#### Role of Deposit Insurance in Bank Resolution

- International Guidance & Taiwan Experience

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## "History does not repeat itself, but it does rhyme."

~ Mark Twain



#### **Outline**

- I. Lessons learned
- II. Key areas of convergence
- III. International guidance on bank resolution
- IV. Taiwan experience
- V. Conclusion



### **Lessons Learned:**

Why do we need deposit insurance?



#### Why do we need deposit insurance?

#### Lessons from the past

 Explicit deposit insurance as a means to protect small depositors and maintain public confidence

56 DIs before 1995 v.s. 111 DIs in March 2011

#### Lessons from the present

- Needs for better financial consumer protection
- Needs for speed & more available tools for orderly resolution
- Needs for more effective & coordinated deposit insurance systems



#### **Financial Consumer Protection**

Financial legal framework & supervision

**Financial Education** 

Before consumers enter financial market

When consumers are in financial market

Consumer protection scheme as financial institutions fail

- Ensure consumers' rights appropriately protected
- Examine consumers' personal data protection
- Review standardized service contract

- Financial information disclosure and understanding
- Management & supervision of the consumer personal data protection
- Depositor reimbursement and protection
- Other financial consumers compensation

Handling consumers' disputes



## **Key Areas of Convergence**



## **Convergence in DIS - Resolution**

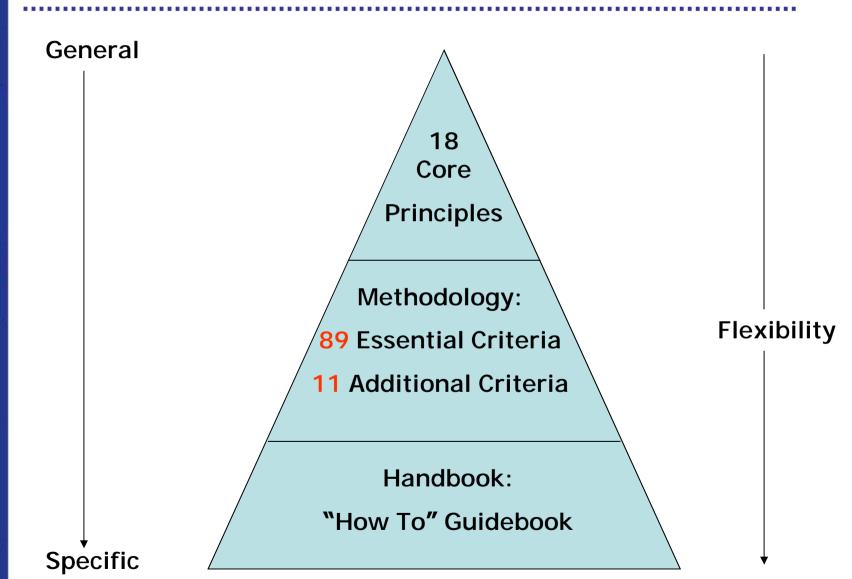
- Mandate and Powers: broader mandates
  - From "paybox" to risk minimizer (including risk management and failure resolution)
  - About 2/3 have mandate more than a "paybox"
- Reimbursing Depositors
  - A quick payout: e.g. EU DI Directive
  - Impact factors: quality and security of bank deposit records, deposit insurers' access to data, systems and capability of the deposit insurers and legal/accounting regimes.
- Failure Resolution Options
  - Over 70% DIS have more than one resolution tools/options
  - Over 50% have authority to conduct purchase and assumption transactions



# International Guidance on Bank Resolution

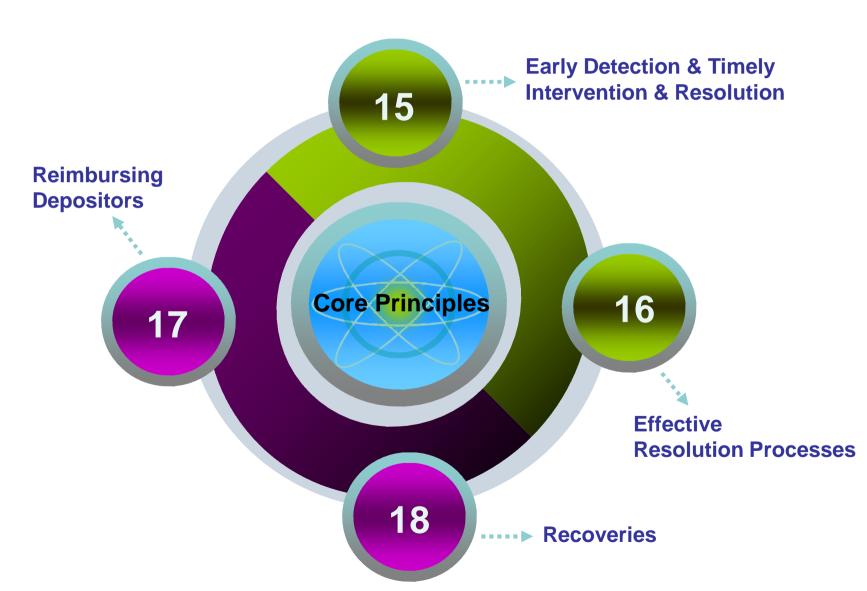


# Core Principles for Effective Deposit Insurance Systems





### **Major Related Phases of Bank Resolution**





#### Core Principle 15 & 16



#### **CP15:**

**Early Detection & Timely Intervention & Resolution** 

DI is part of early detection, intervention & resolution framework

Clearly defined trigger mechanism

Acted by FSN member with operational independence & power

#### **CP16:**

**Effective Resolution Processes** 

Facilitate DI's ability to meet its obligation

Minimize resolution cost & market disruption

**Maximize asset recoveries** 

Reinforce discipline through legal actions



#### **IADI** Guidance on Bank Resolution

#### **Preconditions**

**Interrelationship** 

**Statutory Powers** of Deposit Insurers

Operational/ Administrative Issues

Resolution of problem banks

- Strong institutional framework
- Operational Independent & accountable DI with clear mandate & insulated from undue political & industry influence
- Resolution authority consistent with public policy objectives
- Adequate legal system
- Clearly defined duties & responsibilities among FSN members
- Information sharing & coordination mechanism in place
- Explicit statutory mechanism for dealing with systemic crises
- Necessary funding; participate in decision process
- Conduct on-site reviews, perform due diligence & have access to depositor records before bank closure
- Legal protection for employees
- Legal authority to sue bank officials & directors
- Authority to contract outsourcing services CPAs, asset valuation, etc.
- Effective public awareness/communication mechanism
- Rule-based trigger mechanism;
- professional team of experts to assess viability of problem banks; least cost option;
- maximize asset recoveries;
- well defined rules for liquidation



#### **Resolution Options**

#### DI's resolution tools:

- One (27%), Two (24%), Three or more (49%)
  - 1. Reimbursement (Paybox) 82%
  - 2. Purchase and Assumption (P&A) 55%
  - 3. Bridge Bank 26%
  - 4. Open Bank Assistance 35%
  - ... most appropriate option depends on a jurisdiction's legal framework (e.g., insolvency laws) and DI's mandate and authorities.



## **Taiwan Experience**

CDIC's early intervention & resolution mechanism



#### **CDIC Profile**

- ü Established in Sep. 1985
- ü Government agency: under
- ü Competent authority: Financial Supervisory Commission
- **ü** Mandate
  - § Handle deposit insurance issues
  - **§ Control insured risks**
  - § Deal with problem financial institutions
  - § Special inspection

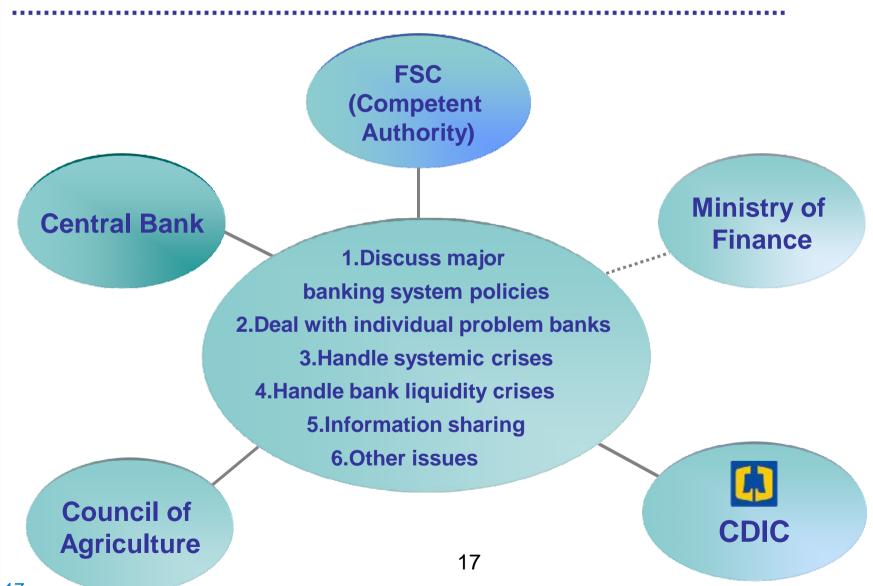
Pay Box



**Risk Minimizer** 



## Financial Safety Net & Its Liaison System





## **Risk Management Mechanisms**

**Financial Early Warning System** 

Strengthening Risk Management

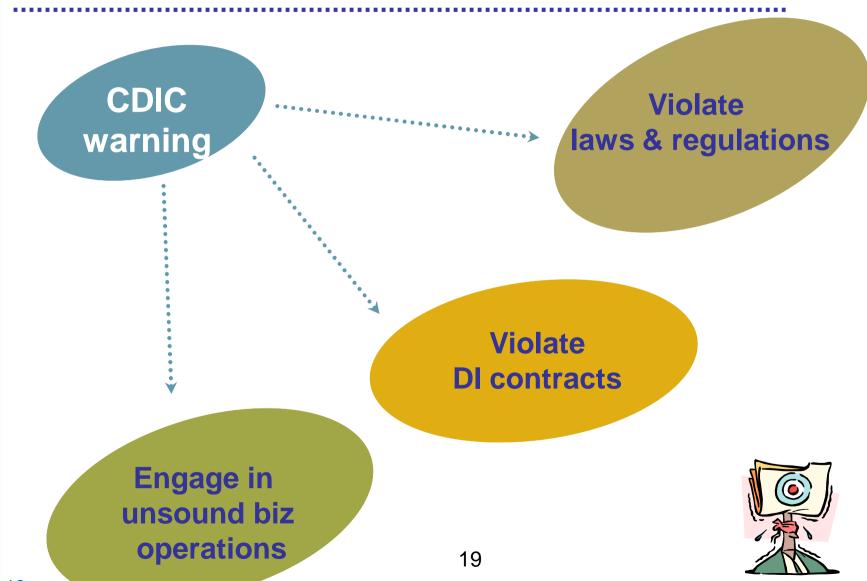
**Real-time Internet Transmission System** 

**Account Officer Analysis System** 

\* Warning of Deposit Insurance Contract Termination

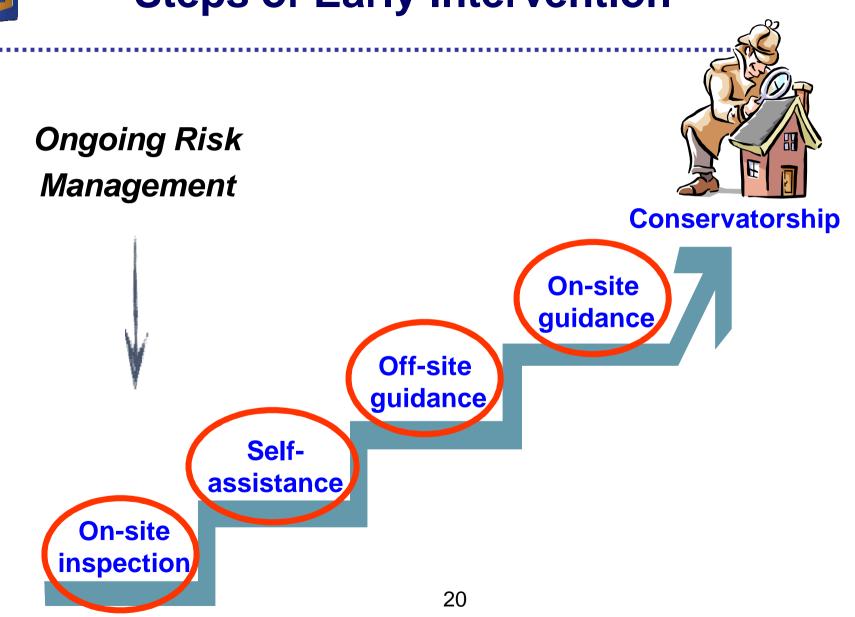


## **Warning of DI Contract Termination**





## **Steps of Early Intervention**





**Early Banking Resolution** 

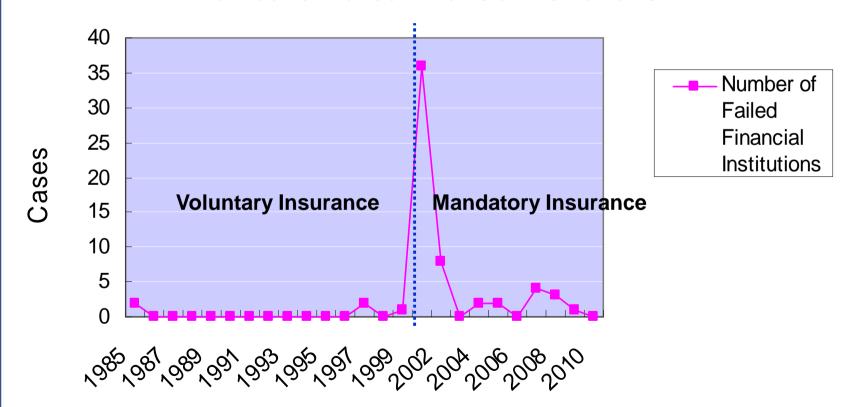


#### **Funding Sources: Resolution methods** Premiums; Borrowing from government and market. Collecting special premiums under systemic crisis. Deposit transfer Bridge bank P&A Open bank assistance **Payout** (systemic crisis) (systemic crisis) Friday: Recruit financial Entrusted Bank closure consultant to draw bank Conditions: Non-Transfer of disposition strategies makes Problem bank is transfer of domestic payout on Sunday: critically underassets and businesses. behalf of Submit the strategies Print & capitalized and put liabilities **CDIC** to FSC and get good assets mail letter under approval and some conservatorship notices to necessary Bank failure will depositors, Open bid announcement liabilities Receivership trigger a systemic including crisis Due diligence by potential investors payout Competent authorities amount Decide reserve price deem it non-viable **CDIC** and shall be closed Monday: Open bid **Bridge Depositors** bank receive Sign P&A contract with winner notices **Others** Loans and can Settlement receive P&A **Deposits** payout CDIC continues to deal with payment unsettlement items soon



### **Number of Failed Financial Institutions**

#### **Number of Failed Financial Institutions**



**Total failed banks: 57** 



#### **Purchase and Assumption**

- § The only method adopted by CDIC in all the past resolution cases.
- § The most cost effective way in protecting depositors and preserving critical banking functions to minimize disruption of markets.





### **On-site Inspection**

- § Any event causing termination of deposit insurance contract
- § Assets and liabilities of insured institutions before bank closure
- § Properties of employees of failed insured institutions, who violate the laws, to pursue civil liabilities
- § Accuracy of deposit assessment base and content of electronic data files



#### **On-site Inspection of Electronic Data Files**

**Legal basis** 



§ Deposit Insurance Act

•Fls are required to set up e-data files based on CDIC's format Electronic
Data Files
- 7 categories
with 25
types
of data

**Inspection emphasis** 



- File format
- Data type
- Data content



## **Retained Asset Management**

- § Follow market mechanism, in principle
- § Various disposal measures per features of assets
- § Careful monitoring and management
- § Entrust specialized institutions for auction
  - § Major goal ..... Disposal as soon as possible





#### **CDIC's Compliance with Core Principles**

Taiwan's early intervention & bank resolution mechanism



# Core Principles for Effective Deposit Insurance Systems

Principle 15 – Early detection & timely intervention & resolution

Principle 16 – Effective resolution processes



#### **Conclusion**

- § Effective DIS is an important link of financial consumer protection in bank resolution
- § Quick and accurate resolution/reimbursement is key to a successful DIS
- § Resolution mechanism will be effective when five areas are met: preconditions, interrelationship, aligned mandate & powers, operational readiness and clear legal framework
- § DIS should benchmark Core Principles for Effective DIS with appropriate legal framework



"The Chinese use two brush strokes to write the word crisis.

One brush stroke stands for danger; the other for opportunity.

In a crisis, be aware of the danger, but recognize the opportunity."

~ John F. Kennedy



## Thank You