

Benchmarking Deposit Insurance Fund

- Theoretical and Practical Considerations

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Agenda

- § Introduction
- § Theoretical considerations
- § Practical considerations in application
- § Taiwan experience
- § Conclusion

Introduction



Funding as Reservoir



Advantages of Ex-ante Funding System with a Target Ratio

- § To prevent delay of bank resolution
- § To avoid pro-cyclical effect on economy
- § To reduce political interference
- § To relieve burden on taxpayers

Further Advantages

- § To demonstrate a calculable funding regime to the industry
- § To enhance
 - Financial health of a deposit insurer
 - Public confidence in a sustainable DIS

Theoretical Considerations

- International papers on funding issues
- Funding factors
- Calculation methods
- Policy Implications

IADI Draft Discussion Paper

- Suggested Guidance Points

- § Adequate funds to ensure prompt reimbursement
- § Ex-ante and hybrid funding approaches are recommended in most circumstances
- § Target reserve ratio is sufficient to cover the potential losses of the insurer under normal circumstances

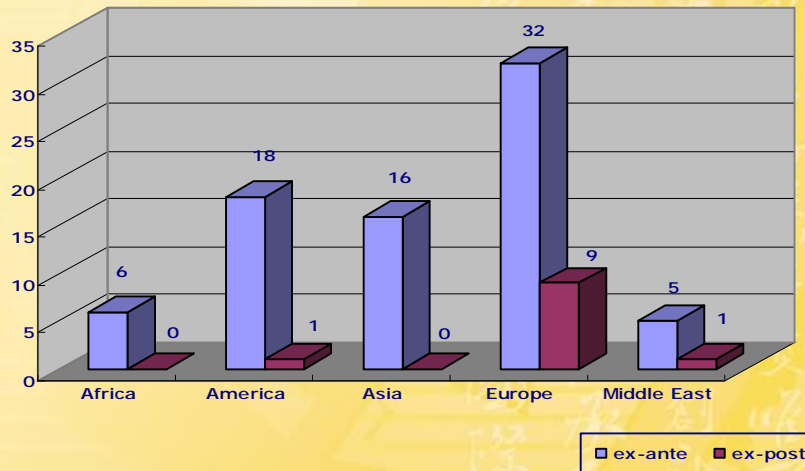
IMF Occasional Paper

- Countries adopting ex-ante system

The distribution for funding method



IMF Occasional Paper - Countries adopting ex-ante system

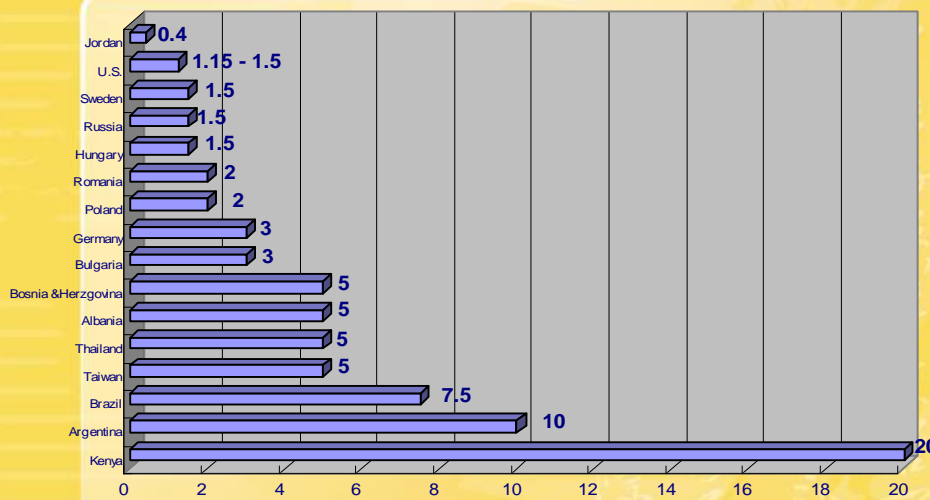


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Source: The Design & Implementation of Deposit Insurance Systems, IMF, 2006

IMF Occasional Paper - Ranges of target ratios among countries



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Source: The Design & Implementation of Deposit Insurance Systems, IMF, 2006

Funding Factors

Frequency X Severity = Loss

Risk environment + Vulnerability



Substantial Cushion

Funding Factors

§ Expected losses (typically based on the past experience)

- **Number and size of banks**
- **Liabilities of member banks**
- **Risk exposure of a deposit insurer**
- **Possibility of bank failures**

§ Unexpected losses

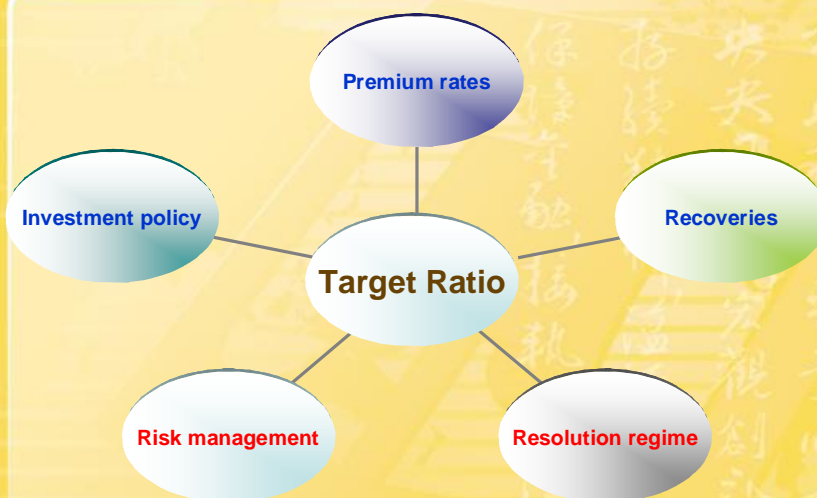
Calculation Methods

§ Mathematical & statistical models

- **Monte-Carlo Historical Simulation and Markov-Switching Model**
- **Credit-Risk Model**

§ Other methods

Policy Implications



Policy Implications

§ From cash inflow perspectives

- Premium rates
- Investment policy
- Recoveries

Policy Implications

§ From cash outflow perspectives

- Risk management
- Resolution regime
- Threshold for possible interventions
(TBTF policy)

Practical Considerations in Application

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Practical considerations

Practical Considerations in Reaching Target Ratio

- § Economic and financial condition
- § Burden on members
- § Systemic crisis
- § Selecting/defining an investment portfolio mix in the framework of overall investment strategy of DIS

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Taiwan Experience

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Design Features of DIS in Taiwan

- § Established in 1985
- § Moving toward a risk minimizing DI
- § Legal receiver
- § Funding arrangement
 - * Ex-ante funding system
 - * Target ratio: 2% of covered deposits
 - * Risk premium system
 - * Special premium after systemic crises
 - * Investment policies

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Experience in Deciding Target Ratio

§ Method

- All factors assume a moderate/general position
- Based on past experience
- Able to manage 1 big bank or 1 ~ 4 medium banks within an economic cycle

§ Complement measures

Experience in Deciding Target Ratio

§ Current situation

- Not able to reach the target within the expected timeframe
- Adopting gradual approach in implementing risk premium system

Conclusion

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Conclusion

- § Ex-ante funding system with a target ratio is recommended
- § CDIC's design features are compatible, though practical situation does not allow CDIC to reach the target in expected timeline
- § Necessary complement measure:
 - **Sufficient liquidity and appropriate funding regime**

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