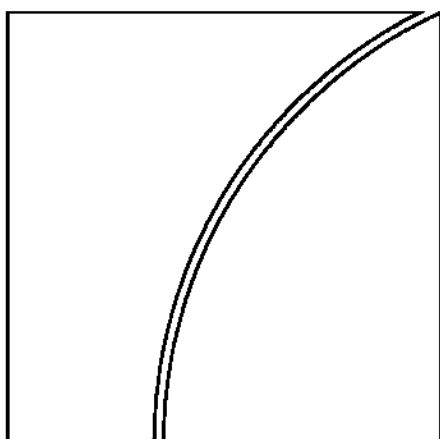


Basel Committee
on Banking Supervision

International Association of
Deposit Insurers

Consultative Document



Core Principles for Effective Deposit Insurance Systems

**A proposed methodology for
compliance assessment**

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Core Principles for Effective Deposit Insurance Systems

A proposed methodology for compliance assessment

Introduction

In July 2008, the Basel Committee on Banking Supervision (BCBS) and the International Association of Deposit Insurers (IADI) decided to collaborate to develop an internationally agreed set of core principles for deposit insurance using the IADI Core Principles for Effective Deposit Insurance Systems (February 2008) as a basis.¹ A joint working group comprised of representatives from the BCBS's Cross-Border Bank Resolution Group (CBRG) and IADI's Guidance Group was formed to develop a set of core principles to be submitted to the BCBS and IADI for their respective review and approval. The Consultative Document, entitled *Core Principles for Effective Deposit Insurance Systems*, was completed in March 2009 and endorsed by the international community in June 2009. The document presents 18 Core Principles, each of which is augmented by supporting explanations and guidance. An accompanying set of Preconditions addresses mainly external elements necessary to support effective deposit insurance systems.

The Core Principles are reflective of, and designed to be adaptable to, a broad range of country circumstances, settings and structures. The Core Principles are intended as a voluntary framework for 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. The Core Principles are not designed to cover all the needs and circumstances of every deposit insurance system or prescribe a single specific form of deposit insurance. Instead, specific country circumstances should be considered in the context of existing laws and powers to fulfill the public policy objectives and mandate of the deposit insurance system.

An assessment of a country's compliance with the Core Principles can be a useful tool for countries that are implementing, reviewing or actively reforming a deposit insurance system. A comprehensive, credible and action-oriented assessment should focus on the deposit insurance system and its relationship to the safety-net functions which support it. The assessment of the broader safety-net functions (ie preconditions) are mostly outside the jurisdiction of the deposit insurer. But, can have a direct effect on the deposit insurer's ability to fulfill its mandate. The assessment of a deposit insurance system should identify strengths and weaknesses in the existing deposit insurance system and form a basis for remedial measures by deposit insurers and policymakers (eg government authorities or if it is primarily a private system, its member banks). The review of the broader safety net will need to rely on external reports – including, for example, recent Financial Sector Assessment Programme (FSAP)s – or include assessment teams members with the necessary experience and skills. If no such reports are available then the assessment should indicate that there is insufficient information available for a complete review of preconditions.

¹ IADI was established in 2002 with a mission to contribute to the enhancement of deposit insurance effectiveness by promoting guidance and international cooperation. The IADI Core Principles were developed for the benefit of countries considering the adoption or the reform of a deposit insurance system.

The following Methodology was developed collaboratively by representatives of the BCBS, IADI, the European Forum of Deposit Insurers (EFDI), the European Commission (EC), the International Monetary Fund (IMF) and the World Bank (WB). The remainder of this introductory section addresses the Methodology use, compliance assessment, and practical considerations in conducting an assessment. The next section focuses on evaluating a country's preconditions. The last section lists in detail the criteria for assessing compliance with the Core Principles.

Use of methodology

The methodology can be used in multiple contexts: (i) self-assessment performed by the deposit insurer; (ii) IMF and World Bank assessments of the quality of deposit insurance systems, for example, in the context of the FSAP; (iii) reviews conducted by private third parties such as consulting firms; and (iv) peer reviews conducted, for example, within IADI regional committees. IADI, in cooperation with the BCBS, will be active in interpreting the Core Principles and providing training with disseminating norms and good practices during the assessment process.

Whether conducted by a deposit insurer (self-assessment) or an outside party, a fully objective assessment of compliance with the Core Principles should be performed by suitably qualified parties who bring varied perspectives to the process. It is crucial that the parties be made up of suitably qualified persons including individuals with experience working in a deposit insurance system. A fair assessment of the deposit insurance system also requires the genuine cooperation of all relevant authorities. The process of assessing each of the 18 Core Principles requires a judgmental weighting of numerous elements that only qualified assessors with practical, relevant experience can provide. To the extent that the assessment requires legal and accounting expertise in the interpretation of compliance with the Core Principles, these legal and accounting interpretations must be in relation to the legislative and accounting structure of the relevant country. The assessment must be comprehensive and in sufficient depth to allow a judgment on whether criteria are fulfilled in practice, not just in theory. Similarly, laws and regulations need to be sufficient in scope and depth. There also must be effective enforcement of and compliance with those laws and regulations on the part of regulators and supervisors and the deposit insurer. Finally, the assessment of compliance with the core principles will build upon any recent work in similar areas such as the FSAPS.

Definitions of key terms used in methodology

The term "deposit insurer" is used in this methodology to refer to the specific legal entity responsible for providing deposit insurance, deposit guarantees or similar deposit protection arrangements. In some jurisdictions this function may be assigned to another participant in the financial safety net. The term "deposit insurance system" refers to the deposit insurer and its relationships with the financial system safety-net participants that support deposit insurance functions and resolution processes. The "financial system safety net" is defined to include the functions of prudential regulation and supervision, resolution authority, a lender of last resort and deposit insurance. In many countries, a department of government (generally a Ministry of Finance or Treasury) is responsible for financial sector policy and is included in the financial system safety net.

The public policy objectives of the deposit insurance system refer to the objectives or goals the system is expected to achieve. The 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. Assigning a mandate to a deposit insurer must take country specific circumstances into account. Existing deposit insurers have mandates ranging from narrow, so-called “paybox” systems to those with broader responsibilities, such as preventive action and loss or risk-minimisation/management, with a variety of combinations in between.

Compliance assessment

The primary objective of an assessment should be to evaluate compliance with the Core Principles for Effective Deposit Insurance Systems. The assessment should review the functions inherent in providing effective deposit insurance systems as opposed to an assessment of just the deposit insurer. In so doing the assessment will identify the strength(s) of the deposit insurance system, and the nature and extent of any weaknesses. Importantly, the assessment is a means to an end, not an objective in itself. The assessment process should help the deposit insurer and policymakers benchmark their deposit insurance system against the Core Principles to judge how well the system is meeting its public policy objectives. The assessment, in turn, can also aid the deposit insurer and policymakers in making improvements to the deposit insurance system and financial safety net, as necessary.

The Methodology proposes a set of essential and additional criteria for each Core Principle. The essential criteria are the only elements on which to gauge full compliance with a Core Principle. The additional criteria are aspirational in nature and comprise suggested good practices. The essential criteria and to a significant degree the additional criteria, are drawn from the Core Principles document and related background papers prepared by IADI and BCBS. Although the additional criteria will not be used for assessing compliance with a Core Principle, a country, or deposit insurer in the case of a self-assessment, could choose to be assessed against the additional criteria in order to identify areas in which improvements to the deposit insurance system could be made.

Assessments by external parties follow a four-grade scale as follows:²

- **Compliant:** When the essential criteria are met without any significant deficiencies.³
- **Largely compliant:** When only minor shortcomings are observed and the authorities are able to achieve full compliance within a prescribed time frame.
- **Materially non-compliant:** Severe shortcomings which cannot be rectified easily.
- **Non-compliant:** No substantive implementation of the Core Principle.

² This scale is used for external assessments in the *Basel Core Principles Methodology* (Banking Supervision). <http://www.bis.org/publ/bcbs130.htm>

³ 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 deposit insurance system is compliant with eight out of nine essential criteria for a specific Core Principle but is not compliant in a relatively minor area, then the overall compliance rating could be designated “Compliant”. Assessors must exercise judgment in these situations.

- **Not applicable:** Not considered given the structural, legal and institutional features of the deposit insurance system.

Grading is not an exact science and the Core Principles can be met 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. It is critical for the assessors to receive training on consistent application of the methodology. The Core Principles are benchmarks for effective deposit insurance practice. In implementing them, deposit insurers and policymakers will need to take into account country specific factors.

Assessors should pay close attention to the adequacy of preconditions and include their opinion on gaps and weaknesses in the preconditions and actions that policymakers could take to mitigate those weaknesses. The assessment of compliance with individual Core Principles could flag the Core Principles which are likely to be primarily affected by preconditions considered to be weak, after factoring in specific country circumstances, mandate and structures of the deposit insurance system (see Annex 3 for further details). However, assessors should not undertake to assess compliance with preconditions themselves. Instead, assessors should rely on the results of recent IMF/WB FSAP reports wherever possible. If a report has not been conducted recently, assessors should request from the authorities that they be provided with updates on any changes since the previous FSAP report. If no such reports on preconditions are available assessors should assign an “Insufficient Information” to the precondition review. Recommendations with regard to the preconditions should not be part of the action plan associated with the Core Principles assessment, but should be included in other general recommendations for strengthening the deposit insurance system.

In order to assist assessors in interpreting the methodology a “Guide for Assessors” document will be developed. This document will include supporting guidance to assist assessors in applying the criteria to specific country settings and structures. It is intended that the Guide be developed and updated over time to take into account the experiences and lessons learned in conducting compliance assessments.

Practical considerations in conducting an assessment

Annex I to this document presents a format for conducting an assessment and preparing a report. It is based on the format developed by the IMF and the World Bank for conducting assessments of compliance with the *Basel Core Principles for Effective Banking Supervision (BCP)*.

Certain practical considerations should be made when conducting an assessment.

1. The assessor must have access to a range of information and interested parties. This may include, but not be limited to published information (such as relevant laws, regulations and policies) and more sensitive information (such as previously completed self-assessments, information on the health of insured institutions such as supervisory examination results, and operational guidelines for the deposit insurer). This information should be provided as long as it does not violate legal

requirements for the deposit insurer to hold such information confidential.⁴ The assessor will also need to meet with a range of individuals and organisations, including other financial system safety-net participants and relevant government ministries, commercial bankers and auditors. Special note should be made of instances when any required information is not provided, as well as of what effect this might have on the accuracy of the assessment.

Assessors should set out the range of information required from the authorities involved and explain in the opening meeting to the individuals involved how the assessment will proceed. This should include the process to be followed in the assessment for the review of preconditions.

2. The assessment of compliance with each Core Principle requires the evaluation of a chain of related requirements, such as law, prudential regulation and supervisory guidelines, among other things. The assessment must ensure that the requirements are or can be put into practice. For example, policymakers must ensure that the deposit insurer has the necessary operational autonomy, skills and resources.
3. In addition to identifying deficiencies, the assessment should also highlight positive features and specific achievements.
4. Cooperation and information sharing among safety-net participants is necessary for the effectiveness of the deposit insurance system. The assessor should be able to judge whether such information sharing occurs to the extent needed. Depending on the extent of cross-border banking, it is also important that the assessor is able to judge whether information sharing between and among deposit insurers and other safety-net participants in different countries occurs to the extent needed.

Preconditions

A deposit insurance system will be most effective if a number of external elements or preconditions are in place. Although these elements are mostly outside the jurisdiction of the deposit insurance system, they can have a direct effect on the deposit insurer's ability to fulfill its mandate. In choosing to implement a deposit insurance system, a number of interrelated components of the national financial system should be considered: the condition of the economy and banking system; the sound governance of agencies comprising the safety net; whether there is strong prudential regulation and supervision; and whether there is a well-developed legal framework and accounting and disclosure regime. Any assessment of the effectiveness of a deposit insurance system should begin with an assessment of these preconditions. The views of the public and their expectations regarding deposit protection are also important factors to be considered.

It is important to identify where existing preconditions are not ideal. If actions are necessary to address any deficiencies, they can be taken with the adoption or reform of a deposit insurance system.

⁴ Assessments of Core Principles for Banking Supervision have shown that secrecy issues can often be solved through ad hoc arrangements between the assessor and the assessed institution. See *Core Principles Methodology* (Banking Supervision), p. 4.

Assessment of the economy and banking system

To be effective, policymakers should seek to ensure that the deposit insurance system is instituted, consistent with both the country's economic and institutional settings and aligned with the public-policy objectives they are attempting to achieve. The establishment or reform of a deposit insurance system is more difficult if underlying issues relating to the health and stability of the economy and the banking system have not been addressed. Although conditions are unlikely to be perfect, it is important to determine how the economic and institutional structure of the country may impact on the deposit insurance system.

Policymakers should therefore undertake a situational analysis of the economic environment in order to identify conditions that could adversely affect the economy of the banking system and evaluate whether a deposit insurance system can be effective operating in such an environment. Key elements for review are:

1. Conditions that could adversely affect the economy or the banking system are to be identified and an evaluation is made whether a deposit insurance system can be effective operating in such an environment.
2. If actions are necessary, they are taken before or in concert with the adoption or reform of a deposit insurance system.

Macroeconomic stability

Macroeconomic instability hampers the functioning of markets and can distort financial intermediation. It is more difficult for banks and their clients to judge different types of risks in times of deteriorating economic growth, high inflation, and extreme exchange rate volatility.

The introduction or reform of a deposit insurance system will not on its own be sufficient to restore macroeconomic stability. As an element of the financial safety net, the deposit insurance system complements the prudential regulation and the lender of last resort functions. When macroeconomic conditions are unstable the introduction or reform of a deposit insurance system will be less effective. Key element for review is:

1. Conditions and factors affecting the banking system and influencing the effectiveness of a deposit insurance system should be analysed before the introduction or reform of the system. These may include: an assessment of the level of economic activity, current monetary and fiscal policies, consumer price and asset inflation as well as the condition of financial markets.

Sound banking system

In looking at the financial system, the issue is not just whether there are unsound institutions in the system but whether the banking system in its entirety is sound. The assessment should look at both the financial health and structure of the banking sector. Key elements for review are:

1. An assessment of the health of the banking system and other deposit taking institutions which includes a detailed evaluation of capital adequacy, liquidity, credit quality, risk-management policies and practices, and the extent of any problems. When problems exist, an assessment is made as to whether they are confined to individual deposit taking institutions or are systemic in nature.

2. The structure of the banking system in terms of the number, type and characteristics of deposit taking institutions as these will have design implications for a deposit insurance system. Policymakers also may need to examine the extent of interconnectedness, competition, concentration, and the ownership of institutions.⁵
3. Any pre-existing depositor protection arrangements (eg depositor preference) and how these arrangements would interact with the introduction or reform of a deposit insurance system.

Sound governance of agencies comprising the financial safety-net

The sound governance of agencies comprising the safety-net strengthens the financial system's architecture and contributes directly to financial system stability. Governance generally refers to the processes, structures and information used for directing and overseeing the management of an organisation. Importantly, governance also pertains to the relationship between the organisation and the authority from which it receives its mandate or other authority to which it is ultimately held accountable. Sound governance is comprised of independence, accountability, transparency and disclosure, and integrity. Key elements for review are:

1. Each safety-net participant is operationally independent. The organisation(s) have the ability to use the powers and means assigned to them without undue influence from external parties. The deposit insurer and other safety-net participants should be aligned in their objectives in the financial safety-net in order to achieve them without compromise.
2. In support of the deposit insurance system, the other safety-net participants should be provided with all powers necessary to fulfill their mandates.

Strong prudential regulation and supervision

The strength of prudential regulation and supervision will have direct implications for the effectiveness of a deposit insurance system. Strong prudential regulation and supervision should allow only viable banks to operate and be members of the deposit insurance system. Banks should be well-capitalised and follow sound-and-prudent risk management, governance and other business practices. The supervisory authority should have an effective licensing or chartering regime for new banks, conduct regular and thorough examinations of individual banks and have a troubled bank resolution framework that includes early detection and timely intervention. Key element for review is:

1. The system of prudential regulation and supervision is in compliance with the BCP.

Well-developed legal framework

Deposit insurance systems cannot be effective if relevant laws do not exist or if the legal regime is characterised by inconsistencies. A well-developed legal framework should include

⁵ In situations where resource distribution and credit decisions are directed mainly by the state, the state is viewed as being responsible for the results of such operations. Deposits in such systems generally are perceived as having a full government guarantee.

a system of business laws, including: corporate, insolvency processes, contract, consumer protection, anti-corruption/fraud and private property laws. Furthermore, the legal framework must enable the deposit insurance system to compel member banks to comply with their obligations to the deposit insurer.⁶ Key elements for review are:

1. The legal system is well-developed with clear property rights.
2. Laws are in place under which the banking system and the deposit insurer can operate.
3. A legal framework exists for handling a bank failure that includes a method for effective failure resolution in a timely manner. Policymakers have determined whether the failure resolution framework should be governed by bankruptcy/insolvency laws or by a special resolution regime.
4. Banking laws and regulations are updated as necessary to ensure that they remain effective and relevant to a changing industry.
5. Information exchange between the deposit insurance system participants and the supervisor is legally protected for all measures necessary in order to protect the deposits and to enable safety-net participants to intervene in case a bank is at risk.
6. Appropriate participants in the financial safety net are entitled to protect depositors through a number of options including transferring deposits from the troubled bank to a healthy bank.
7. The deposit insurance system participants, or other relevant authority, can take legal action against the management of a failing bank.

Sound accounting and disclosure regime

Sound accounting and disclosure regimes are necessary for an effective deposit insurance system. Accurate, reliable and timely information provided by these regimes can be used by management, depositors, the marketplace, and authorities to make decisions regarding the risk profile of a bank, and thereby increase market, regulatory and supervisory discipline. A sound accounting and disclosure regime should include comprehensive and well-defined accounting principles and rules that command wide international acceptance. A system of independent audits is needed for companies of significant size, including banks, to ensure that users of financial statements, have independent assurance that the accounts provide a true and fair view of the financial position of the company and are prepared according to established accounting principles, with auditors held accountable for their work. In cases where there are signs that a bank is at risk and the deposit insurer does not otherwise have access to information about that bank from another safety-net participant, the deposit insurer must be entitled to obtain/receive the necessary information in a timely manner. Key elements that assessors need to focus their review on are:

1. Accounting and disclosure regimes support the ability of the supervisor and deposit insurer to adequately evaluate the health of individual banks and the banking system as a whole.

⁶ The term “bank” is used to denote financial institutions which accept insured deposits.

2. Accounting and disclosure regimes support the accurate and timely identification of information on depositor accounts for the purposes of prompt reimbursements.
3. Accounting and disclosure regimes support the use of risk-adjusted differential premium systems if adopted by the deposit insurer.
4. The deposit insurer has the right to seek, or request the supervisor or other safety-net participant, to carry out or provide for an audit of a member bank in a timely manner if evidence shows that deposits may be at risk.

Core Principles Methodology Assessment Criteria

Setting objectives

Principle 1 – Public policy objectives

The first step in adopting a deposit insurance system or reforming an existing system is to specify appropriate public policy objectives that it is expected to achieve. These objectives should be formally specified and well integrated into the design of the deposit insurance system. The principal objectives for deposit insurance systems are to contribute to the stability of the financial system and protect depositors.

Essential criteria

1. The public policy objectives of the deposit insurance system are clearly defined and formally specified, for example, through legislation or documents accompanying legislation.⁷
2. The public policy objectives of the deposit insurance system are publically disclosed.
3. There is a review of the extent to which a deposit insurance system is meeting its public policy objectives on a regular basis (eg between two to five years or on a more frequent basis as deemed necessary). This review takes into consideration the views of stakeholders.

Principle 2 – Mitigating Moral Hazard

Moral hazard should be mitigated by ensuring that the deposit insurance system contains appropriate design features and through other elements of the financial system safety net (see Core Principles for Effective Deposit Insurance Systems “Preconditions” paragraph 16).

Essential criteria

1. The design of the deposit insurance system recognises the existence of moral hazard and mitigates it as much as possible in-line with public policy objectives. Specific design features that mitigate the risk of moral hazard may include: limited deposit insurance coverage and scope; where appropriate, deposit insurance premiums that are assessed on a differential or risk-adjusted basis; and, minimising the risk of loss through timely intervention and resolution by the deposit insurer or other participants in the safety net with such powers.
2. The financial safety net creates and supports appropriate incentives to mitigate moral hazard. These may include: the promotion of good corporate governance and sound risk management of individual banks, effective market discipline and frameworks for, and enforcement of, strong prudential regulation, supervision and

⁷ The public policy objectives of the deposit insurance system refer to the objectives or goals the system is expected to achieve. The mandate of the deposit insurer refers to the set of official instructions describing its roles and responsibilities.

laws and regulations (to be assessed through a review of “Preconditions”, see pages 7-9.).

Mandates and powers

Principle 3 – Mandate

It is critical that the mandate selected for a deposit insurer be clearly and formally specified and that there be consistency between the stated public policy objectives and the powers and responsibilities given to the deposit insurer.

Essential criteria

1. The deposit insurer has a mandate that is clearly defined and formally specified, for example, through legislation or documents accompanying legislation.⁸ The mandate clarifies the role and responsibilities of the deposit insurer within the financial safety net.
2. The mandate is consistent with the stated public policy objectives and the powers, roles and responsibilities given to the deposit insurer.

Principle 4 – Powers

A deposit insurer should have all powers necessary to fulfill its mandate and these should be formally specified. All deposit insurers require the power to finance reimbursements, enter into contracts, set internal operating budgets and procedures, and access timely and accurate information to ensure that they can meet their obligations to depositors promptly.

Essential criteria

1. The powers (legal authority) of the deposit insurance system are clearly defined and formally specified in law or regulation (including approved self-regulation in the context of private or public deposit insurance systems).
2. The powers of the deposit insurer are aligned to its mandate and public policy objectives.
3. The deposit insurer has the following minimum powers:
 - (a) compel member banks to comply with their obligations to the deposit insurer, or request that the supervisor or another safety-net participant do so on behalf of the deposit insurer;
 - (b) have the legal authority and capability to reimburse depositors;

⁸ The mandate of an organisation is a set of official instructions or statement of purpose describing its roles and responsibilities. There is no single mandate or set of mandates suitable for all deposit insurers. Existing deposit insurers have mandates ranging from narrow, so-called “paybox” systems to those with broader powers or responsibilities, such as preventive action and loss or risk-minimisation/management, with a variety of combinations in between.

- (c) enter into contracts (eg agreements/transactions to obtain goods and services/insurance);
 - (d) set internal operating budgets and internal policies and procedures (eg in areas such as human resources and information technology);
 - (e) access timely and accurate information to promptly meet their obligations to depositors;
 - (f) share information with other safety-net participants;
 - (g) engage in information sharing and coordination agreements with deposit insurers in other jurisdictions (subject to confidentiality when required); and
 - (h) engage in contingency planning.
4. In support of the deposit insurance system, the other participants in the financial safety net are provided with all powers necessary to fulfill their mandates (see Preconditions).

Governance

Principle 5 – Governance

The deposit insurer should be operationally independent, transparent, accountable and insulated from undue political and industry influence.

Essential criteria

1. The deposit insurer is able to use the powers and means assigned to it without undue influence from external parties. There is in practice no significant evidence of government or industry interference in the operational independence of the deposit insurer and its ability to obtain and deploy the resources needed to carry out its mandate.
2. The operational funding of the deposit insurer is provided in a manner that does not undermine its autonomy or independence and permits it to fulfill its mandate. Examples include:
 - (a) Salary scales that allow it to attract and retain qualified staff;
 - (b) The ability to hire outside experts to deal with special situations, subject to appropriate confidentiality restrictions;
 - (c) A training budget and programme that provides regular training opportunities for staff;
 - (d) A budget for computers and other equipment sufficient to equip its staff with tools needed to fulfill its mandate; and
 - (e) A travel budget that allows appropriate on-site work.
3. The governing statute or internal policies of the deposit insurer specify:
 - (a) the governing body and management are fit and proper persons and have the requisite knowledge or experience;

- (b) members of the governing body (with the exception of ex-officio appointees) and the head of the deposit insurer are subject to limitations on their term of appointment; and
 - (c) members of the governing body can be removed from office during their term only for reasons specified or defined in law, and not without cause.
4. The members of the governing body (eg directors or officers) and management of the deposit insurer are held accountable to a higher authority, whether public or private, through a transparent framework for the discharge of the system's duties in relation to its objectives and mandate.
 5. The deposit insurer operates in a transparent and responsible manner. It discloses and publishes on a regular basis appropriate information on its activities, governance practices, structure and financial results.
 6. The deposit insurer is structured such that the potential for conflicts of interest for or between members of the governing body and management is minimised and that they are subjected to appropriate codes of conduct/ethics.
 7. The deposit insurer takes into consideration the views of stakeholders.
 8. Where decision making is delegated by the governing body of the deposit insurer to its employees, the governing body has appropriate procedures to oversee the exercise of delegation.
 9. The deposit insurer is subjected to regular external audits with reports provided to the authority to which it is accountable.
 10. The deposit insurer has a governing body approved strategic plan in place.⁹
 11. Regular board meetings are held (eg on a quarterly basis or more frequently as deemed necessary).

Additional criterion

1. The deposit insurer adheres to best practices in corporate governance, such as:
 - (a) Regular assessments of the governing body are carried out. Systems and practices are in place to facilitate assessments of its effectiveness; and
 - (b) The governing body has a well-defined charter that outlines the specific powers reserved for the board and those delegated to management.

⁹ The term "strategic plan" refers to a document which sets out an organisation's goals and how it plans to achieve them.

Relationships with other safety-net participants and cross-border issues

Principle 6 – Relationships with other safety-net participants.

A framework should be in place for the close coordination and information sharing, on a routine basis as well as in relation to particular banks, among the deposit insurer and other financial system safety-net participants. Such information should be accurate and timely (subject to confidentiality when required). Information-sharing and coordination arrangements should be formalised.

Essential criteria

1. A framework for timely information sharing and the coordination of actions among the deposit insurer and other safety-net participants, on a routine basis as well as in relation to particular banks, is explicit and formalised through legislation, memoranda of understanding, legal agreements or a combination of these instruments.
2. Planning and operations of safety-net participants, both individually and together, not only cover past and ongoing circumstances but also consider plausible future scenarios.
3. All deposit insurers are provided with information on a timely basis to be able to reimburse depositors' claims promptly including information on the amount of insured deposits held by individual depositors.
4. Rules regarding confidentiality of information apply to all safety-net participants and the exchange of information among them.
5. The safety-net participants make information on banks that are in financial difficulty or are expected to be in financial difficulty available to the deposit insurer in advance and, where confidentiality requirements prevent this, or where the information is not available from other safety-net participants, the deposit insurer has the power to collect information directly from such banks.

Additional criterion

1. A deposit insurer with a broader mandate, such as "loss-" or "risk-minimisation", has access to timely and accurate information so that it can assess the financial condition of individual banks, as well as the banking industry. These deposit insurers may also need access to information regarding the value of the bank's assets and the expected time frame for the liquidation process, given that the value of a bank's assets depends, in part, on the time necessary to liquidate them.

Principle 7 – Cross-border issues

Provided confidentiality is ensured, all relevant information should be exchanged between deposit insurers in different jurisdictions and possibly between deposit insurers and other foreign safety-net participants when appropriate. In circumstances where more than one deposit insurer will be responsible for coverage, it is important to determine which deposit insurer or insurers will be responsible for the reimbursement process. The deposit insurance already provided by the home country system should be recognised in the determination of levies and premiums.

Essential criteria

1. Appropriate cross-border bilateral/multilateral agreements are in place in circumstances where, due to the presence of cross-border banking operations, coverage for deposits in foreign branches is provided by the deposit insurer in another jurisdiction or by a combination of deposit insurers in different jurisdictions. For example, where the home country system provides coverage for the branches of its domestic bank, banks in the host countries and/or the host country system provides supplementary coverage for foreign bank branches.
 - (a) The agreements involve appropriate home and host deposit insurers as well as other appropriate financial safety-net participants when appropriate, including in circumstances where one deposit insurer will be solely responsible for coverage.
 - (b) The agreements provide for ongoing close coordination and information sharing between home/host deposit insurers and possibly other safety net participants, as well as in relation to particular banks when necessary.
 - (c) The agreements specify which deposit insurer or insurers will be responsible for reimbursement as well as premium assessment, cost sharing, and the deposit insurance public awareness issues raised by cross-border banking.
2. Depositors in the jurisdictions affected by cross-border banking arrangements are provided with clear and easily understandable information on the existence and identification of the deposit insurance system legally responsible for reimbursement and the limits and scope of coverage. Information on the deposit insurance system's source of funding and standard claims procedures and reimbursement options is also available to affected depositors (eg such as on the deposit insurer's website, through printed materials or similar means).

Additional criterion

1. Where a deposit insurer perceives a real risk that it may be required to protect depositors in another jurisdiction, its contingency planning allows for cross-border arrangements or agreements. For example, it has an agreement with the deposit insurer in that jurisdiction to provide for insured depositor reimbursements.

Membership and coverage

Principle 8 – Compulsory membership

Membership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (eg retail and small business depositors) to avoid adverse selection.

Essential criteria

1. Membership in a deposit insurance system is compulsory for all financial institutions accepting deposits from those deemed most in need of protection (eg retail or individual depositors and small business depositors).
2. Policymakers determine whether eligible banks will be given membership as a part of the licensing process or upon application to the deposit insurer.

3. Criteria for membership that detail the conditions, process and time frame for attaining membership are explicitly stated and transparent.
4. If the deposit insurer does not control membership (ie cannot refuse membership), the law or administrative procedures describe a clear time frame in which the deposit insurer is consulted about or informed in advance of “newly licensed” banks.
5. When deposit insurance membership is terminated by the deposit insurer, arrangements are in place that provide for coordination in withdrawing the bank’s operating license by the relevant authority. If relevant, an appropriate general notice is given to depositors (eg on the deposit insurer’s website) to inform them that any new deposits issued will not receive deposit protection.
6. All financial institutions accepting deposits are subject to strong prudential regulation and supervision and are financially viable when they become members of a deposit insurance system.¹⁰

Principle 9 – Coverage

Policymakers should define clearly in law, prudential regulations or by-laws what is an insurable deposit. The level of coverage should be limited but credible and be capable of being quickly determined. It should cover adequately the large majority of depositors to meet the public policy objectives of the system and be internally consistent with other deposit insurance system design features.

Essential criteria

1. Insured deposits are clearly and publicly defined. This comprises the level and scope of coverage. If certain depositors are ineligible for deposit protection, the criteria are clearly defined.
2. The definition of “insured deposit” reflects the public policy objectives of protecting depositors and promoting public confidence and financial stability (eg protect small transaction accounts).
3. The level of coverage is limited but credible (eg the level of coverage is high enough to maintain confidence, but limited to maintain market discipline). The level of coverage is consistent with the deposit insurer’s public policy objectives.
4. Depositors have sufficient information readily available to determine the amount of coverage for their individual deposits.
5. The coverage limit applies equally to all banks in a deposit insurance system.
6. The deposit insurance system does not incorporate co-insurance, where depositors absorb some portion of the loss under the coverage limit in the event of bank failure.¹¹

¹⁰ See discussion “Preconditions” pages 2, 6 and 8.

¹¹ Although the use of co-insurance can encourage depositors to monitor bank risk taking, it presents a number of serious problems. In order to provide effective market discipline it assumes that depositors will have access

7. If set-off is utilised by a deposit insurance system, it is consistent with the prevailing legal framework.

Additional criteria

1. Deposit insurance coverage is reviewed periodically and adjusted when necessary to ensure that it can meet the public policy objectives of the deposit insurance system.
2. In the event of a merger of separate banks that are members of the deposit insurance system, depositors of the merged banks enjoy separate coverage (up to the maximum coverage limit) for each of the banks for a limited but publicly stated period in which case the merging banks must be held responsible for notification of affected depositors, including the date at which time the separate coverage will expire.

Principle 10 – Transitioning from a blanket guarantee to a limited coverage deposit insurance system

When a country decides to transition from a blanket guarantee to a limited coverage deposit insurance system, or to change a given blanket guarantee, the transition should be as rapid as a country's circumstances permit.¹² Blanket guarantees can have a number of adverse effects if retained too long, notably moral hazard. Policymakers should pay particular attention to public attitudes and expectations during the transition period.

Essential criteria

1. A situational analysis of the economic environment as it affects the banking system is conducted before a country begins a transition from a blanket guarantee to limited coverage.
2. The situational analysis assesses structure and soundness of the banking system including an evaluation of the condition of banks' capital, liquidity, credit quality, risk management policies and practices, and the extent of any problems; and an evaluation of the number, type and characteristics of banks.
3. The situational analysis assesses the strength of prudential regulation and supervision, the effectiveness of the legal framework, and the soundness of the accounting and disclosure regimes.

to the necessary financial information and that most retail/individual depositors can accurately assess risk. And, even when depositors are in a position to make such determinations, co-insurance provides strong incentives for depositors to run on a bank to avoid even a small loss of their funds. Nevertheless, there may be limited exceptions where co-insurance may be appropriate (eg for use with certain investment products, for deposit amounts above a very high threshold level).

¹² A "blanket guarantee" is 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. A wide range of factors need to be considered when introducing blanket guarantees, including decisions on the scope of the guarantee (eg the type of institutions, products and term maturities covered) and whether the banks utilising the guarantees will be required to contribute in some manner to the costs of providing the guarantees.

4. The pace of the transition to limited coverage is consistent with the state of the banking industry, prudential regulation and supervision, legal framework and accounting and disclosure regimes.
5. Policymakers are aware of the tradeoff between the length of time it takes for the transition to the limited coverage system and the degree of moral hazard in the system, and have planned the transition accordingly.
6. Policymakers are aware of and anticipate the reaction of the public to a reduction in coverage levels. Policymakers develop effective communication strategies to mitigate adverse public reaction to the transition.
7. Where there is a high level of capital mobility, and/or a regional integration policy, the decision to lower coverage levels (and/or scope) considers the effects of different countries' protection levels and related policies.
8. The new limited-coverage deposit insurance system has access to adequate funding during and after the transition. Policymakers consider the capacity of the banking system to fund a limited-coverage deposit insurance scheme. If the banking system is unable to fund the cost of the blanket guarantee, government funding may be needed.

Funding

Principle 11 – Funding

A deposit insurance system should have available all funding mechanisms necessary to ensure the prompt reimbursement of depositors' claims including a means of obtaining supplementary back-up funding for liquidity purposes when required. Primary responsibility for paying the cost of deposit insurance should be borne by banks since they and their clients directly benefit from having an effective deposit insurance system.

For deposit insurance systems (whether ex-ante, ex-post or hybrid) utilising risk-adjusted differential premium systems, the criteria used in the risk-adjusted differential premium system should be transparent to all participants. As well, all necessary resources should be in place to administer the risk-adjusted differential premium system appropriately.

Essential criteria

1. Funding arrangements for the deposit insurance system are provided on an ex-ante or an ex-post basis or some (hybrid) combination of these and are clearly defined and established in law or regulation.
2. Funding arrangements for the deposit insurance system ensure the prompt reimbursement of depositors' claims and include a pre-arranged and assured source(s) of back-up funding for liquidity purposes. Such sources may include a funding agreement with the central bank, a line of credit with the government treasury, or another type of public fund or market borrowing. If market borrowing is used by the deposit insurer it should not be the sole source of back-up funding. The deposit insurer should not be overly dependent on a line of credit from any single private source.

3. Primary responsibility for funding the deposit insurance system is borne by member banks and is enforceable by the deposit insurer.
4. If an ex-ante deposit insurance fund is established the size of the fund (eg the fund reserve ratio) is defined in order to meet the public policy objectives.
5. The deposit insurance fund has sound investment policies and procedures, internal controls and disclosure and reporting systems. These are approved by the deposit insurer's governing body and subjected to regular review by an independent party. Investment policies emphasise the need to ensure the preservation of fund capital and liquidity.
6. For deposit insurers that use risk-adjusted differential premium systems:
 - (a) the system for calculating premiums is transparent to all participants;
 - (b) the ratings and rankings resulting from the system pertaining to individual member banks are kept confidential; and
 - (c) policymakers ensure that the deposit insurer has the necessary authority, resources and information in place to carry out its responsibilities with regard to the operation of such systems.
7. In so far as the funds of the deposit insurer may be used by other members of the safety net for the purposes of depositor protection and/or bank resolution, those circumstances are clearly stated and public and known to member banks. The deposit insurer has adequate information to:
 - (a) understand the use of the funds;
 - (b) seek reimbursement for the estate of the failed bank or participate in recoveries from the bank;
 - (c) restrict the resolution or depositor reimbursement amount to the costs the deposit insurer would otherwise have incurred without such intervention or resolution.

Public awareness

Principle 12 – Public awareness

In order for a deposit insurance system to be effective 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 and how the system works, including its benefits and limitations, on an on-going basis.
2. The objectives of the public awareness programme are clearly defined and consistent with the public policy objectives and mandate of the deposit insurance system.

3. The public awareness programme or activities convey information about the following:
 - (a) which financial instruments are covered by deposit insurance and which are not (eg whether the system covers foreign deposits);
 - (b) which financial institutions offer insured deposits and how they can be identified;
 - (c) deposit insurance coverage limits and the potential for losses on deposits in excess of those limits; and
 - (d) the reimbursement process – how, when and where depositors may file claims and receive reimbursements in the event of a bank failure.
4. There is an effective contingency planning process for public awareness and communication that addresses plausible future scenarios and that involves the cooperation and coordination of other safety-net participants as appropriate.
5. The deposit insurer works closely with member banks and other safety-net participants to ensure consistency in the information provided and to maximise awareness on an ongoing basis.
6. The deposit insurer receives or conducts a regular evaluation of the effectiveness of its public awareness programme or activities.

Additional criterion

1. The public awareness program is tailored to the needs of clearly defined target audience and utilises a variety of communication tools. The desired level of visibility and awareness among the target audiences is a primary factor in determining the budget for the public awareness programme.

Selected legal issues

Principle 13 – Legal protection

The deposit insurer and individuals working for the deposit insurer should be protected against lawsuits for their decisions and actions taken in “good faith” while discharging their mandates. However, individuals must be required to follow appropriate conflict-of-interest rules and codes of conduct to ensure they remain accountable. Legal protection should be defined in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified.

Essential criteria

1. The deposit insurer and individuals working for the deposit insurer are protected against lawsuits for their decisions and actions taken in “good faith” while discharging their mandates.
2. Individuals are required to follow appropriate conflict-of-interest rules and codes of conduct to ensure they remain accountable.
3. Legal protection is defined in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified.

Additional criterion

1. Legal protections do not prevent depositors or other individual claimants, or member banks from making legitimate challenges to the acts or omissions of the deposit insurer in public or administrative review (eg civil action) procedures.

Principle 14 – Dealing with parties at fault in a bank failure

A 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 who contributed to the failure of a bank (eg officers, directors, managers, auditors, asset appraisers and related parties of the failed bank) are subject to investigation by the deposit insurer or other relevant national authority. 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 a professional or disciplinary body, as applicable.
2. If identified as culpable for the failure of a bank, such 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

Failure resolution

The deposit insurer may, but often does not, perform many or most of the roles identified in Core Principles 15 and 16. However, it is essential that one or more of the financial safety-net participants performs these roles.

Principle 15 – Early detection and timely intervention and resolution

The deposit insurer should be part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks. The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well defined criteria by safety-net participants with the operational independence and power to act.

Essential criteria

1. The deposit insurer is part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks (failure resolution framework).
2. The failure resolution framework is established by law or regulation, and is effective at the early detection and timely intervention and resolution of troubled banks. The failure resolution framework is insulated against legal actions that aim at the reversal of early and timely decisions related to corrective procedures, interventions and resolutions of troubled banks..

3. The safety-net participants have the operational independence and power to perform their respective roles in the failure resolution framework and a clearly defined early intervention mechanism exists (including resolution tools) to ensure that appropriate action is taken (to allow the orderly resolution of a troubled bank) by the responsible party without delay.
4. The failure resolution framework includes a set of criteria that are used to identify banks that are or are expected to be in serious financial difficulty and are used as a basis to initiate some form of early intervention or corrective action to reduce the likelihood that a resolution would be necessary. Such action should minimise losses to the deposit insurance fund.
 - (a) The criteria are clearly defined in law or regulation and are well understood by banks and their stakeholders; and
 - (b) The criteria will be country specific and may reflect concerns about a bank's capital, liquidity, and asset quality, among other factors.

Additional criterion

1. A mechanism exists to review decisions taken with respect to the early detection and timely intervention and resolution of troubled banks.

Principle 16 – Effective resolution processes

Effective failure-resolution processes should: facilitate the ability of the deposit insurer to meet its obligations including reimbursement of depositors promptly and accurately and on an equitable basis; minimise resolution costs and disruption of markets; maximise recoveries on assets; and, reinforce discipline through legal actions in cases of negligence or other wrongdoings. In addition, the deposit insurer or other relevant financial system safety-net participant should have the authority to establish a flexible mechanism to help preserve critical banking functions by facilitating the acquisition by an appropriate body of the assets and the assumption of the liabilities of a failed bank (e.g., providing depositors with continuous access to their funds and maintaining clearing and settlement activities).

Essential criteria

1. The overall national legal framework ensures the effective and timely functioning of the failure resolution framework, permitting the orderly liquidation of the bank, the payout or transfer of insured deposits and the intervention by a receiver to carry out the resolution functions.
2. The mandate of the deposit insurer or other safety-net participants allows for the effective resolution of banks of all sizes.
3. Bank resolution and depositor protection procedures are not limited to depositor reimbursement. The deposit insurer or other safety-net participant has effective resolution tools designed to help preserve critical bank functions, to achieve a transfer of accounts or assets/businesses and/or maintain continuity of banking services.
4. Where no single authority is responsible for all resolution processes, the mandate, roles and responsibilities of each safety-net participant is clearly defined and formally specified.

5. One or more of the resolution procedures allows the flexibility for resolution at a lesser cost than otherwise likely on a depositor reimbursement in a liquidation.
6. A clear and well-sustained methodology is available to the deposit insurer or other safety-net participant to provide for the transfer of insured deposits to stronger banks.
7. Resolution procedures clearly ensure that bank shareholders take first losses.

Principle 17 – Reimbursing depositors

The deposit insurance system should give depositors prompt access to their insured funds. Therefore, the deposit insurer should be notified or informed sufficiently in advance of the conditions under which a reimbursement may be required and be provided with access to depositor information in advance. Depositors should have a legal right to reimbursement up to the coverage limit and should know when and under what conditions the deposit insurer will start the payment process, the time frame over which payments will take place, whether any advance or interim payments will be made as well as the applicable coverage limits.

Essential criteria

1. The deposit insurer is able to reimburse depositors promptly after the deposit insurance system is triggered by law, contract or the relevant authority.¹³
2. The time frame for accomplishing the reimbursement process is prompt and clearly stated to meet the public policy objectives of protecting depositors and promoting public confidence and financial stability of the deposit insurance system. The time frame is made public.
 - (a) Depositors are provided information after the failure on when and under what conditions the deposit insurer will start the reimbursement process and when the process is expected to be completed;
 - (b) Information on coverage limits, scope of coverage and whether advance or interim payments will be made is provided; and
 - (c) If there is an interest-bearing account, the deposit insurer shall reimburse depositors for interest as provided by contract, law or regulation up until at least the date the deposit insurance obligation is triggered.
3. In order to promptly reimburse depositors, the deposit insurer has:
 - (a) Access to necessary data, including deposit account records, to prepare for reimbursing depositors as soon as the supervisor is aware of a likelihood of failure.
 - (b) The power to review in advance by itself (or by request from the supervisory authority) the way depositor records are kept by banks to ensure the reliability of records, to reduce the time needed for calculation and verification of depositors' claims;

¹³ A prompt reimbursement is defined to be when depositors are reimbursed within a time frame that does not undermine financial stability.

- (c) A range of payment methods for reimbursing depositors; and
 - (d) Access to adequate and credible sources of funding (eg reserve fund, Ministry of Finance, central bank) to meet its obligations under the established time frames.
4. The deposit insurer has the capacity to carry out the reimbursement process in a timely manner, including:
- (a) Adequate computer capabilities; and
 - (b) Adequate personnel (in-house or contractor).
5. In situations where there may be extended delays in reimbursements, the deposit insurer has the power to make advance or interim partial payments.

Additional criteria

1. The deposit insurer has contingency plans as well as regularly scheduled tests of its systems.
2. The reimbursement process is audited by an independent auditor or authority.

Principle 18 – Recoveries

The deposit insurer should share in the proceeds of recoveries from the estate of the failed bank. The management of the assets of the failed bank and the recovery process (by the deposit insurer or other party carrying out this role) should be guided by commercial considerations and their economic merits.

Essential criteria

1. If the deposit insurer plays a role in the recovery process, its role is clearly defined in law or regulation and the deposit insurer maximises recoveries to the extent that it can from the failed bank on a commercial or economic basis.
2. The deposit insurer shares in the proceeds of the recoveries arising from the failure of its member banks. The deposit insurer is clearly recognised as a creditor of the failed bank for the reimbursement of losses and costs it incurs; and receives recoveries from the estate of the failed bank directly.
3. The deposit insurer has at least the same or comparable creditor rights or status as a depositor in the conduct of the estate of the failed bank, and has access to information to make and pursue its recovery claim against the estate and to exercise the appropriate degree of influence on the conduct of the estate.
4. If, in addition to creditor status, the deposit insurer is the receiver/liquidator/conservator of the failed bank or of only some assets of the failed bank, then:
 - (a) the role played by the deposit insurer for asset management and recovery is clearly defined in law or regulation; and

- (b) its asset management and recovery strategies are guided by such factors as: the quality of the assets, market conditions, expert advice, and any legal requirements.¹⁴
5. In determining the asset management and recovery strategy, the interests of all creditors are given appropriate weight and decisions on asset disposal are made using net present value concepts to balance the competing goals of securing maximum value and early disposal.

Additional criterion

1. The deposit insurer is entitled or authorised to sit on the committee of creditors to follow the liquidation process of the failed bank as it is usually subrogated to the rights of the insured depositors.

¹⁴ In some circumstances the deposit insurer may seek to pursue the parties responsible for fraud or misconduct even though costs may exceed recoveries.

Annex 1

Evaluation of Compliance with Core Principles for Effective Deposit Insurance Systems

This Annex presents guidance and a format for the organisation and methodology of the assessment reports that draws on the format used in the *Basel Core Principles Methodology (Banking Supervision)*.¹⁵

The assessment report should include the following:

- A general section that provides background information on the 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.
- Overview of the institutional and macroeconomic setting and market structure.
- Review of the preconditions for effective deposit insurance systems.
- A detailed Principle-by-Principle assessment, providing a description of the system 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 deposit insurance system and practices (Table 3).

¹⁵ That format was recommended by the IMF and the World Bank for use by assessors in the context of FSAP or Offshore Financial Center Program (OFC) missions. In order to maintain comparability and consistency, this format was also recommended for standalone assessments or self-assessments by a country. See, Core Principles Methodology (Banking Supervision) Annex.

Draft Assessment and Summary Tables

Table 1 Core Principles for Effective Deposit Insurance Systems Assessment Summary Table	
Core Principle 1: (repeat verbatim text of Core Principle 1)	
Description	
Assessment	
Comments	
Core Principle 2: (repeat verbatim text of Core Principle 2)	
Description	
Assessment	
Comments	
Repeating for all 18 Core Principles	

Table 2 Core Principles for Effective Deposit Insurance Systems Compliance Summary Table	
Evaluation	Core Principles
Compliant	Core Principles a, b, ...
Largely Compliant	Core Principles c, d, ...
Materially Non- compliant	Core Principles e, f, ...
Non-compliant	Principles g, h, ...
Not Applicable	Principles i, ...

Table 3 Core Principles for Effective Deposit Insurance Systems Recommended Action Plan	
Reference Principle	Recommended Action
Principle a	Description of deficiency Suggested course of action
Principle b	Description of deficiency Suggested course of action
Etc.	Etc.

Annex 2

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Annex 3

Recommended assessment process for review of the preconditions for effective deposit insurance systems

This section should provide an overview of the preconditions for effective deposit insurance, as described in the Basel/IADI Core Principles document. These preconditions include:

- an ongoing assessment of the economy and banking system;
- sound governance of agencies comprising the financial system safety net;
- strong prudential regulation and supervision; and
- a well developed legal framework and accounting and disclosure regime.

Assessors should pay close attention to the adequacy of preconditions. This section requires a succinct and well structured factual review of preconditions, as experience has shown that insufficient implementation of the preconditions can have a direct effect on the deposit insurer's ability to fulfill its mandate. It is important that the reader of the assessment report is able to properly interpret the grading of the individual Principles in light of the way in which the preconditions are met. The review of the preconditions should strictly follow the headings indicated above, and provide the necessary factual information to give a clear view to the reader of the assessment of the Core Principles. The assessment of compliance with individual Principles could flag the Principles which are likely to be primarily affected by preconditions considered to be weak, after factoring in specific country circumstances, mandate and structures of the deposit insurance system. However, standards assessors should not undertake to assess preconditions themselves. The review normally should take up no more than one or two paragraphs for each type of precondition.

Ongoing assessment of the economy and banking system

In particular with regard to the presence of an ongoing assessment of the economy and banking system, the review of the preconditions should be descriptive, including the frequency with which policy makers conduct an analysis of the macroeconomic environment in the country (including current monetary and fiscal policy, and the soundness of the banking system), and should not express an opinion on the adequacy of policies in these areas, other than through reference to the analysis and recommendations in existing IMF and World Bank documents, such as Article IV, FSAs, FSSAs and other Bank and Fund program-related reports.

Also with regard to other components of the preconditions, the reviewers should rely to the greatest extent possible on official Fund and Bank documents and seek to ensure that the description and possible recommendations are consistent with other Fund and Bank positions on these issues.

When relevant, the assessors should attempt to include in their analysis the linkages between these factors and the ability of the deposit insurance system to achieve its objectives.

Sound governance of agencies comprising the financial system safety-net

A review of sound governance of agencies comprising the financial safety-net should focus on elements relevant to the deposit insurance system and, where appropriate, rely on the assessment made on other safety net participants by other specialists on the mission and the Fund / Bank country teams. This part of the review of the preconditions should be combined with an analysis of: (i) coordination; (ii) formal arrangements (ie MOUs) to ensure timely information sharing and cooperation; (iii) alignment of mandates with the institutional settings and public-policy objectives; and (iv) consistency of integrity and transparency policies of safety net participants.

Review of prudential regulation and supervision

An overview assessment of the strength or robustness of the prudential regulation and bank supervision (fundamentally relying on assessment reports prepared by the IMF/WB missions and peer group exercises) should focus on issues that could have direct implication for the effectiveness of the deposit insurance. The overview assessment should also cover the following elements: an analysis of the functions of the key entities involved such as the Central Bank, supervisory authority and the deposit insurer. Any duplicative or overlapping functions should be noted as well as any apparent gaps in the responsibilities. This should be followed by a review of the existence of a well-defined and documented process for dealing with the situation of a failing/failed financial institution.

Assessment of the legal framework and accounting and disclosure regime

On the basis of Reports on the Observance of Standards and Codes (ROSCs), FSSAs, FSAs and other reports by the IMF/WB or other international institutions, the assessor would form an opinion on the existence of proper legal framework by focusing on issues such as rules on corporate governance; protection of shareholders' rights; availability of market and consumer information; consumer protection laws; privacy and disclosure laws; professional liability laws to enable legal actions against bank directors and managers; indemnification laws to protect supervisory/regulatory staff; legal framework for mergers, takeovers and acquisition of equity interests; laws governing foreign entry into the market; bankruptcy laws; contract laws; general property rights; mechanisms for fair dispute resolution; and disclosure of government ownership and influence in financial institutions.

Relying on the sources discussed above the review of the existing accounting and disclosure regime could include: presence of reliable and well trained accounting and auditing professions; financial sector regulations; efficient payment, clearing and settlement systems; transparency and public disclosures of financial statements; and adherence to generally accepted accounting and auditing standards.

Annex 4

Role of deposit insurance system in crisis preparedness and a systemic crisis

This section describes certain activities generally outside the deposit insurance system's purview. It also deals with the desired coordination between the deposit insurance system and other safety-net participants during a systemic crisis.

The objectives of deposit insurance systems are relatively simple; consisting of protecting depositors and contributing to financial stability. In normal times, an adequately funded deposit insurance system should be able to promptly reimburse a large number of insured depositors for a reasonable quantity of small bank failures, thus helping to preserve confidence in the rest of the banking system.

However, a deposit insurance system has a number of limitations during systemic crises. Most deposit insurance systems lack the mandate and powers to deal with a systemic crisis.¹⁶ As with virtually all insurance endeavors, a deposit insurance system, by design, can absorb only a few losses among its insured pool. During systemic crises, when a large segment, or even all, of the banking sector is at risk of failure, a deposit insurance system lacks the resources to address the problem on its own. Unless other safety-net participants provide resources for crisis resolution, the deposit insurance system's key objective of promoting confidence to market participants will be undermined.

Various countries are taking steps to ensure adequate preparedness to deal with systemic crises, primarily by adopting contingency planning for crisis preparedness. This is evaluated in FSAPs under the Financial Safety Nets section, along with lender-of-last-resort (LOLR) facilities, the legal and regulatory framework for effective problem bank resolution, and the role of the deposit insurance system. In brief, crisis preparedness is usually led by the Ministry of Finance or equivalent and includes the other safety net members (MOF should lead since the other safety-net participants are usually politically independent).

While positive, the adoption of crisis management arrangements is in some cases introducing areas of potential conflict between the deposit insurance system and the crisis management committee. For instance, in some cases the deposit insurance system funds are included as part of the funds available to deal with a systemic crisis. By law, most deposit insurance system funds are dedicated to reimburse insured depositors in case of bank failure, unless its use was already permitted by law, or was closely connected to the protection of depositors (such that costs did not exceed what the deposit insurer might otherwise have been called on to meet). If a government were to decide to use deposit insurance system funds for other uses, such as to recapitalize a bank, such use should only be at the government's direction and carry a government guarantee that the deposit insurance system will be repaid.

¹⁶ For example, a deposit insurer provided with a wide mandate may have the power to resolve a bank, but be limited by a "least-cost" test; while the need for speed and/or systemic stability may preclude implementing the "least-cost" test.

Furthermore, the deposit insurer as a safety-net participant is sometimes not represented in crisis management during a systemic crisis. Generally, a crisis management committee will develop a coordinated communications strategy. This is an area where the crisis management committee could benefit from the deposit insurer's experience in designing a message to promote confidence during normal times. Advance preparation of public communications is critical during a "normal" bank closing (eg Where/when will deposits be repaid? Must I continue making loan payments?); and it is even more critical to prepare in advance the most positive messages to respond to a crisis (eg Is my deposit safe?). A deposit insurer's experience in promoting public confidence via effective public awareness campaigns can usefully contribute to the crisis management committee's coordinated communication program; however, the deposit insurer should not unilaterally decide to handle communications during a crisis.¹⁷

¹⁷ Some deposit insurers, with wider mandates and accompanying powers, have played additional roles in a systemic crisis such as through the administration of blanket guarantees.