FSB publishes peer review on deposit insurance systems

The Financial Stability Board (FSB) published today the peer review report on deposit insurance systems.

The global financial crisis illustrated the importance of effective depositor compensation arrangements. In response, the Basel Committee on Banking Supervision (BCBS) and the International Association of Deposit Insurers (IADI) jointly issued in June 2009 the Core Principles for Effective Deposit Insurance Systems. Using the Core Principles as a benchmark, the peer review takes stock of deposit insurance systems (DISs) in FSB member jurisdictions and draws lessons about the effectiveness of reforms in response to the crisis.

The speedy adoption by many jurisdictions of extraordinary arrangements to enhance depositors’ confidence during the financial crisis signals the importance and necessity of having an effective DIS. Explicit limited deposit insurance has become the preferred choice among FSB member jurisdictions. The crisis resulted in greater convergence in practices across jurisdictions and an emerging consensus about appropriate DIS design features. These include higher coverage levels; the elimination of co-insurance; improvements in the payout process; greater depositor awareness; the adoption of ex-ante funding by more jurisdictions; and the strengthening of information sharing and coordination with other safety net participants. The mandates of deposit insurers also evolved, with more of them assuming responsibilities beyond a paybox function to include involvement in failure resolution.

The reviewed DISs are broadly consistent with the Core Principles, particularly in areas such as mandates, membership arrangements and adequacy of coverage. However, there remain some areas where there appear to be divergences from, or inconsistencies with, the Core Principles that need more time and effort to address. These include avoiding unlimited deposit coverage that could adversely affect the DIS’s effectiveness; ensuring that resources (including back-up funding options) are adequate and immediately available to meet financing requirements; establishing and publicly communicating a prompt target timeframe for reimbursing depositors; adjusting governance arrangements in deposit insurance agencies to ensure adequate public oversight and to mitigate the potential for conflicts of interest; and formalising information sharing and coordination arrangements with other safety-net participants. Further enhancements of DISs may be necessary in these areas.

In addition, there are certain areas in the Core Principles where more precise guidance may be needed to achieve effective compliance or to better reflect leading practices. These include developing benchmarks to monitor the effectiveness and adequacy of coverage levels; identifying instruments and good practices that can help mitigate moral hazard; ensuring that there is effective coordination across systems in jurisdictions with multiple DISs.
and that any differences in depositor coverage across institutions operating within that jurisdiction do not adversely affect the systems' effectiveness; conducting regular scenario planning and simulations to assess the capability of making prompt payout; exploring the feasibility and desirability of greater use of ex-ante funding; and developing appropriate mechanisms to regularly monitor public awareness of the DIS. Additional guidance in these areas by relevant standard-setting bodies would further enhance the effectiveness of DISs.

The report contains four recommendations:

- FSB member jurisdictions without an explicit DIS should establish one in order to maintain financial stability by protecting depositors and preventing bank runs;
- FSB member jurisdictions with an explicit DIS should undertake actions to fully align their DIS with the Core Principles in areas where there appear to be divergences from, or inconsistencies with, those principles;
- IADI should, in consultation with the BCBS and other relevant bodies where appropriate, update its guidance that pre-dates the financial crisis. It should also consider developing additional guidance to address areas where the Core Principles may need more precision to achieve effective compliance or to better reflect leading practices; and
- The FSB should review and evaluate the actions taken by its members in response to the recommendations in this report.

Mark Carney, Chairman of the FSB, said “National authorities have made good progress in strengthening their deposit insurance systems. However, there is still room for improvement and efforts to achieve full and consistent implementation should continue.”

Tiff Macklem, Chairman of the FSB’s Standing Committee on Standards Implementation (SCSI), said “The financial crisis provided a number of useful lessons on deposit insurance. We will monitor progress made by our members in adopting the report’s recommendations to further strengthen their deposit insurance systems, particularly given the links with the FSB’s ongoing work to develop effective resolution regimes for financial institutions.”

Notes to editors

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

The FSB began a regular programme of peer reviews in 2010, consisting of thematic reviews and country reviews. Thematic peer reviews focus on implementation of international financial standards, policies agreed within the FSB or, where such standards or agreed policies do not exist, a stock-taking of existing practices in the policy area. The objectives of the reviews are to encourage consistent cross-country and cross-sector implementation, to evaluate the extent to which standards and policies have had their intended results and, where relevant, to make recommendations for potential follow-up by regulators, supervisors and standard setters. They provide an opportunity for FSB members to engage in dialogue.
with their peers and to share lessons and experiences. All completed peer review reports are available on the FSB website.

This report describes the findings of the peer review on deposit insurance systems, including the key elements of the discussion in the FSB SCSI. The draft report for discussion was prepared by a team of experts drawn from FSB member institutions and led by Arthur Yuen, Deputy Chief Executive of the Hong Kong Monetary Authority.

The BCBS and IADI jointly issued the Core Principles for Effective Deposit Insurance Systems (http://www.bis.org/publ/bcbs156.pdf) in June 2009. The FSB in February 2011 included the Core Principles in the list of key standards for sound financial systems that deserve priority implementation depending on country circumstances (http://www.financialstabilityboard.org/cos/key_standards.htm).

The FSB is chaired by Mark Carney, Governor of the Bank of Canada. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.financialstabilityboard.org.