

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



## **IADI Core Principles for Effective Deposit Insurance Systems**

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## Acronyms

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

# Core Principles for Effective Deposit Insurance Systems

## I. Introduction

The International Association of Deposit Insurers (IADI) and the Basel Committee on Banking Supervision (BCBS) issued the *Core Principles for Effective Deposit Insurance Systems* in June 2009.<sup>1</sup> A *Compliance Assessment Methodology for the Core Principles* was completed in December 2010. The Core Principles and their compliance assessment methodology (together: the Core Principles) are used by jurisdictions as a benchmark for assessing the quality of their deposit insurance systems and for identifying gaps in their deposit insurance practices and measures to address them. The Core Principles are also used by the International Monetary Fund (IMF) and the World Bank, in the context of the Financial Sector Assessment Program (FSAP), to assess the effectiveness of jurisdictions' deposit insurance systems and practices.

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

An assessment of compliance with the Core Principles can be a useful tool for jurisdictions that are implementing, reviewing or actively reforming a deposit insurance system. A comprehensive, credible and action-oriented assessment should focus on the deposit insurance system and its relationship to the financial safety-net functions which support it. The assessment of broader safety-net functions (i.e. operating environment) is mostly outside the responsibility of the deposit insurer. But it can have a direct effect on the deposit insurer's ability to fulfil 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 (e.g. government authorities or, if it is primarily a private system, its member banks), after taking into account the structural, institutional and legal features of each national deposit insurance system.

The global financial crisis of 2007–09 brought to light significant policy lessons for deposit insurance systems. The evolution of the crisis showed the importance of maintaining depositor confidence in the financial system and the key role that deposit

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<sup>1</sup> In July 2008, the BCBS and IADI decided to collaborate on developing 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. A joint working group, comprising 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 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.

protection plays in maintaining that confidence. Increases in deposit insurance coverage and strengthening of funding arrangements help support financial stability in many jurisdictions. In some jurisdictions, blanket guarantees were issued by authorities. Irrespective of the form of protection, policymakers recognised the importance of ensuring depositor confidence. In the aftermath of the crisis, a number of deposit insurers saw their mandates expand to include resolution tools in addition to depositor reimbursement. Based on a recent IADI survey, the percentage of deposit insurance agencies with some kind of role in resolution increased from about half in 2005 to almost 65 per cent in 2011.<sup>2</sup>

These lessons have important implications for the Core Principles, and have provided the context and framed the environment within which the Core Principles have been revised. A greater awareness and emphasis has been placed on ensuring that the deposit insurer has the necessary operational independence to fulfil its mandate. The crisis also revealed deposit insurers' need to have additional tools and an ability to be better integrated into the financial safety-net.

As a result of these developments, experiences using the Core Principles, and international regulatory enhancements, IADI established an internal Steering Committee to review and update the Core Principles and develop a proposed set of revisions in February 2013. As part of its review mandate, the Committee took the following into account: experience gained in using the Core Principles for jurisdiction self-assessments and FSAPs; significant developments in the regulatory landscape such as the development of the Financial Stability Board's (FSB) *Key Attributes of Effective Resolution Regimes*; enhanced guidance developed by IADI to address recommendations arising from the FSB *Thematic Review on Deposit Insurance*; IADI guidance related to Islamic deposit insurance systems; and financial inclusion issues.<sup>3</sup>

The IADI proposal was presented to a Joint Working Group (JWG)<sup>4</sup> – which included representatives from the BCBS, the European Forum of Deposit Insurers (EFDI), the European Commission (EC), the FSB, the IMF and the World Bank – for use as a starting point to collaboratively develop a final revised set of Core Principles as set forth in this document. In conducting its review, the JWG has sought to achieve the right balance between raising the bar for more effective deposit insurance systems and retaining the Core Principles as a flexible, internationally applicable standard. The revised Core Principles continue to accommodate a diverse range of deposit insurance systems (DIS).

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<sup>2</sup> See IADI, *Annual Survey, 2013* and FSB, *Thematic Review on Deposit Insurance, 2012*.

<sup>3</sup> See: FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions, 2011*; IADI's Enhanced Guidance documents on moral hazard, deposit insurance coverage, reimbursement systems and practices, and public awareness, 2012/13; FSB, *Thematic Review on Deposit Insurance Systems, 2012*; and the IADI Discussion Paper *Deposit Insurance from a Shariah Perspective, 2010*.

<sup>4</sup> See Annex II for a list of members of the Steering Committee and Joint Working Group.

The existing Core Principles have served their purpose well in terms of helping jurisdictions assess their deposit insurance systems and identify areas for improvement. While conscious efforts were made to maintain continuity and comparability as far as possible, the Core Principles and the compliance assessment methodology have been merged into a single comprehensive document. The revised set of Core Principles has also been reorganised to foster implementation through a more logical structure. Important enhancements include:

- improving the clarity and consistency of terminology;
- reducing overlap and duplication among a number of Core Principles;
- strengthening the Core Principles in certain areas (e.g. governance, depositor reimbursements, coverage, funding) and improving safeguards for the use of deposit insurance funds;
- incorporating IADI enhanced guidance on reimbursements, public awareness, coverage, moral hazard, and funding;
- addressing moral hazard concerns within all relevant Core Principles instead of restricting moral hazard guidance to a single Core Principle;
- updating the Core Principles related to intervention and failure resolution, in order to better reflect the greater role being played by many deposit insurers in resolution regimes, and to ensure the consistency of the Core Principles with the FSB Key Attributes;
- adding more guidance on deposit insurers' role in crisis preparedness and management;
- incorporating considerations related to the operation of Islamic deposit insurance systems;
- updating and enhancing Core Principles related to cross-border deposit insurance issues;
- adding guidance on the operation of multiple deposit insurance systems in the same national jurisdiction; and
- upgrading some additional criteria to essential criteria while adding new assessment criteria where warranted.

As a result of this review, the number of Core Principles has decreased from 18 to 16, encompassing 96 assessment criteria. Six additional criteria from the existing assessment methodology have been upgraded to essential criteria.

The revised Core Principles will continue to provide a comprehensive standard for establishing or enhancing effective deposit insurance systems. Given the importance of consistent and effective standards implementation, IADI stands ready to encourage work at the national level to implement the revised Core Principles in conjunction with other financial safety-net participants.

## II. Definitions of Key Terms

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

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

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

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

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

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

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

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



creditors, and insured depositors have a higher ranking than eligible depositors; and

- general depositor preference, in which all deposits have a higher ranking than claims of ordinary unsecured, non-preferred creditors, regardless of their status (insured/uninsured or eligible/not eligible).

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

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

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

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

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

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

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

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

**“Mandate”** of the deposit insurer refers to the set of official instructions describing its roles and responsibilities. There is no single mandate or set of mandates suitable for all deposit insurers. When assigning a mandate to a deposit insurer, jurisdiction-specific circumstances must be taken into account. Mandates can range from narrow “pay box”

systems to those with extensive responsibilities, such as preventive action and loss or risk minimisation/management, with a variety of combinations in between. These can be broadly classified into four categories:

- a. A “pay box” mandate, where the deposit insurer is only responsible for the reimbursement of insured deposits;
- b. A “pay box plus” mandate, where the deposit insurer has additional responsibilities, such as certain resolution functions (e.g. financial support);
- c. A “loss minimiser” mandate, where the insurer actively engages in a selection from a range of least-cost resolution strategies; and
- d. A “risk minimiser” mandate, where the insurer has comprehensive risk minimisation functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases prudential oversight responsibilities.

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

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

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

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

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

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

### **III. Moral Hazard, Operating Environment and Other Considerations**

#### **Minimising Moral Hazard**

A well-designed financial safety-net contributes to the stability of the financial system. However, if poorly designed, it may increase risks, notably moral hazard. Moral hazard arises when parties have incentives to accept more risk because the costs are borne, in whole or in part, by others. In the context of deposit insurance, protecting depositors from the threat of loss (e.g. through explicit limited deposit insurance or the belief that banks will not be allowed to fail) insulates them from the consequences of unsafe and unsound bank practices, and can lead to greater risk-taking by banks than might otherwise be the case.

Deposit insurance, like any insurance system, must be designed to mitigate the impact of moral hazard on the behaviour of shareholders, bank management and depositors, while recognising that most depositors are typically less able to differentiate between safe and unsafe banks. Such mitigation is a function of the overall design of the system. Moral hazard is also mitigated by other safety-net participants.

More specifically:

- Key design features of the deposit insurance system, described in these Core Principles, aim at mitigating moral hazard. Examples include, but are not restricted to: limited coverage levels and scope; differential premiums; and timely intervention and resolution by the deposit insurer or other participants with such powers in the safety-net.
- The financial safety-net creates and supports appropriate incentives to mitigate moral hazard through several mechanisms, including: the promotion of good corporate governance and sound risk management at individual banks; holding parties at fault responsible for losses; effective market discipline; and the frameworks for, and enforcement of, strong prudential regulation, supervision, resolution, and laws and regulations.

The assessment of the extent to which moral hazard affects a deposit insurance system is based on an overall evaluation of the effectiveness of supervision, the legal framework, and the early warning, intervention and resolution regimes.

#### **Operating Environment**

The effectiveness of a deposit insurance system is influenced not only by its design features but also by the environment within which it operates. The operating environment includes macroeconomic conditions, the strength of the sovereign, the financial system structure, prudential regulation and supervision, the legal and judicial framework, and the accounting and disclosure system. The operating environment is largely outside the scope of authority of the deposit insurer. However, it influences the deposit insurer's ability to fulfil its mandate and determines, in part, its effectiveness in protecting depositors and contributing to a jurisdiction's financial stability. While the operating

environment is not formally assessed (and there is no corresponding compliance determination), it forms the foundation for the assessment of compliance with the Core Principles. The conditions outlined in this section must be thoroughly analysed in order to make an accurate assessment of the appropriateness and effectiveness of the design and operation of the overall system. Identically designed deposit insurance systems may have a very different impact on financial stability and depositor protection, reflecting differences in the environment within which they operate.

### **1. Macroeconomic conditions**

Macroeconomic conditions influence the effectiveness of markets, the ability of the financial system to intermediate resources, and economic growth. Persistent instability hampers the functioning of markets, and such conditions affect the ability of financial institutions to absorb and manage their risks. In periods of economic instability, market volatility can lead to destabilising creditor runs (including depositor runs). Moreover, uncertainties about future movements in relative prices, including asset prices and exchange rates, can make it difficult to determine the medium-term viability of an institution.

In stable periods, the Core Principles provide guidance on minimum features for an effective deposit insurance system. The deposit insurance system supports depositor confidence in the face of idiosyncratic bank failures. In the face of persistent macroeconomic instability, however, the Core Principles provide guidance on areas that a deposit insurance system will need to reinforce, in order to provide robust support to depositors. The system may require a variety of enhancements, including larger-than-usual reserves, stronger emergency funding options, and close coordination and participation with other safety-net participants in reinforcing financial stability. Introduction of a deposit insurance system under these conditions, however, will have to be carefully considered as the new system, if it is not supported by the necessary institutional reforms, could be discredited and fail to bolster depositor confidence.

Evaluations of the macroeconomic conditions in a jurisdiction are found in the jurisdiction reports of international organisations such as the IMF, the World Bank and the Organisation for Economic Co-operation and Development (OECD). These reports often include an analysis of recent conditions and projections of the likely path for macroeconomic variables.

### **2. Financial system structure**

The soundness of a financial system influences the appropriate design features of a deposit insurance system. Any assessment of a deposit insurance system should consider the health and structure of the financial sector, and the range of possible demands on the deposit insurer. Elements for consideration include:

1. An assessment of the health of banks based on an evaluation of capital adequacy, liquidity and credit quality of the financial system. The resources of the deposit insurer, its ability to identify emerging threats, and its relationships with other safety-net participants must be strong. Similarly, the location or

currency composition of deposits, and related coverage and reimbursement rules, will influence how resources are maintained by the insurer.

2. The structure of the financial system in terms of the number, type and characteristics of banks, and types of deposits and depositors covered. This information has implications for the assessment of the strength and effectiveness of the deposit insurer. The extent of interconnectedness, competition and concentration within the system will all influence the possibilities for contagion and systemic shocks. The presence of poorly supervised banks can lead to unidentified risks to the financial system that materialise unexpectedly. The deposit insurance system should be designed to take account of these risks.
3. Any pre-existing depositor protection arrangements (e.g. depositor preference and institutional protection arrangements) and the effect of these arrangements on the introduction or reform of a deposit insurance system.

Descriptions of the financial system can come from a variety of sources. The jurisdiction itself should have an evaluation and assessment of the strength and safety of the system, although institution-specific information may not be public. In addition, jurisdiction reports by international organisations such as the IMF, World Bank, FSB or OECD will also contain descriptions of the financial system and recommendations to address any risks and deficiencies.

### ***3. Prudential regulation, supervision and resolution***

The strength of prudential regulation, supervision and the resolution regime influences the functions and effectiveness of a deposit insurance system. Strong prudential regulation and supervision ensure that an institution's weaknesses are promptly identified and corrected. Implementation of corrective measures is monitored and, where deficient, early intervention and an effective resolution regime help to lower the costs associated with bank failures.

The strength of prudential regulation and supervision is a critical factor in mitigating moral hazard. If shareholders and management of an institution feel they can operate their institution in an unsafe or unsound manner without effective market discipline, supervisors become the last defence against poor practices. In the absence of strong regulation and supervision, the risks to the deposit insurer cannot be fully understood or mitigated. Intervention in weak banks comes late, increasing the cost of resolution and the cost to the deposit insurer. The supervisory authority should have an effective licensing or chartering regime for new institutions, conduct regular and thorough examinations of individual banks, and have an effective early warning system. All banks within the safety-net should be subject to an effective resolution regime. Sound governance of agencies comprising the safety-net should also be in place, to strengthen the financial system's architecture and contribute directly to financial stability.

The system of prudential regulation, supervision and resolution should be in compliance with international standards, including the BCBS's Core Principles for Effective Banking

Supervision and the FSB's Key Attributes of Effective Resolution Regimes. Assessments of such compliance are conducted under the IMF/World Bank FSAP review. In the absence of recent external reviews, such as FSAP or FSB reviews, jurisdictions may also have useful self-assessments or reports laying out the existing structure and gaps compared to international standards.

#### **4. The legal and judicial framework**

Deposit insurance systems cannot be effective if relevant and comprehensive laws do not exist or if the legal regime is characterised by significant inconsistencies. The legal framework has an impact on the activities of the deposit insurance system. A well-developed legal framework should incorporate a system of business laws, including corporate, insolvency, contract, creditor rights, consumer protection, anti-corruption/fraud and private property laws. These laws guide financial transactions and ensure that norms exist and are enforced. The legal system should be supported by a well-functioning judiciary. For the deposit insurance system, the legal framework must lay out its appropriate powers and enable it to compel member banks to comply with their obligations to the deposit insurer.

Effective bank insolvency laws include a special resolution regime (SRR) for banks that is separate from the general corporate insolvency laws.<sup>5</sup> Corporate insolvency laws may allow for negotiated settlement, in which the weak firm can restructure its finances, reorganise its operations, reduce debt obligations and modify payment terms. These measures give a corporation time to rebuild profitability. However, the financial position of a bank can deteriorate rapidly, causing contagion to other financial institutions and undermining financial stability. When these institutions are resolved via general corporate insolvency law, there is normally an opportunity for shareholders and/or creditors to challenge the action. Many jurisdictions' general corporate insolvency laws allow a number of weeks for shareholders and/or creditors to make such a challenge, and additional weeks for a bankruptcy court judge to make a ruling on the challenge. In such cases, this introduces a de facto deposit moratorium, increasing the potential for contagion and depositor runs at other (and potentially all) institutions.

An SRR, therefore, is needed so that the resolution authorities can act in a timely manner, limiting contagion and maintaining financial stability. Such a regime would allow the resolution authority to deal with financial contracts, unsettled payment and securities transactions, and financial collateral, as well as appoint an administrator and/or liquidator. Moreover, a special insolvency law can allow the subrogation of the deposit insurance agency to the claims of depositors for the amounts it has paid them. An SRR can also be important in ensuring consistency between the supervisory and insolvency-related functions of the safety-net authorities. Reliance on an SRR places the decision-making in the hands of relevant experts, allowing them to move quickly. Shareholders and creditors should still have due process and an opportunity for judicial review;

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<sup>5</sup> This principle is consistent with the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions*, 2011.

however, any successful challenge must be limited to monetary compensation, and must not involve reversal of the supervisory or resolution authority's action(s).

The legal system may have a number of weaknesses that limit its effectiveness. For example, legal uncertainties can aggravate financial distress and lead to contagion or creditor flight. Weakness in the legal framework can undermine the effectiveness of the safety-net in general and the deposit insurance system in particular. Weaknesses may exist in laws governing property rights, creditor rights, bank insolvency and resolution. The impact of such weaknesses includes delays in decision-making, uncertainties about the finality of decisions, and informal dispute resolution, all of which can result in less than optimum recoveries in asset liquidation, thus increasing losses/costs to the deposit insurance system. Thus, a robust and effective legal framework is required to mitigate moral hazard.

The effectiveness of a legal system is often highlighted in reports by international organisations such as the IMF, World Bank and FSB. Local attorneys also have insight about the length of time cases take, the ability or authority of courts to reverse decisions by regulators, the credibility of the legal process, and the appropriateness of the legal system for modern financial markets.

#### ***5. The accounting and disclosure regime***

Sound accounting and disclosure regimes are necessary for the effective evaluation of risks by deposit insurance systems. Accurate, reliable and timely information can be used by management, depositors, the market and authorities to make decisions regarding the risk profile of an institution, and thereby increase market, regulatory and supervisory discipline. A sound accounting and disclosure regime includes comprehensive and well-defined accounting principles and rules that command wide international acceptance.

A system of independent audits ensures that users of financial statements have independent assurance that the accounts provide a true and fair view of the financial position of the financial institution. They also ensure that reports are prepared according to established accounting principles, with auditors held accountable for their work. The lack of strong accounting and disclosure regimes makes risk identification difficult. All financial safety-net participants, including the deposit insurer, need to have timely access to reliable financial information.

## **IV. Special Issues in Applying the Core Principles**

### **Islamic Deposit Insurance Systems**

The Islamic financial services industry has been growing at a rapid pace. This growth has not only been within Islamic nations, but also across the rest of the world. These developments have encouraged the establishment of Islamic deposit insurance systems (IDIS) in some jurisdictions, for the protection of Islamic deposits in accordance with Islamic principles and rules.

While the concept of IDIS is relatively new compared with conventional banking, there is an increasing need to provide deposit insurance coverage for the Islamic banking sector, and to establish such systems. Although the Core Principles set out in this document are generally applicable to guide the establishment of an effective IDIS, they do not specifically take into account Islamic requirements and the unique design features<sup>6</sup> of an IDIS. For this reason, a set of IADI Core Principles for Effective Islamic Deposit Insurance Systems will be developed in a separate document by IADI, in collaboration with the relevant Islamic standard setting bodies or organisations with similar mandates.

### **Multiple Deposit Insurance Systems**

A number of national jurisdictions have more than one deposit insurance system operating within their borders; these are referred to as multiple deposit insurance systems (MDIS). In some cases, MDIS have also been established at subnational or regional level within a national jurisdiction, and in others an MDIS might allow one type of bank to obtain supplemental coverage from more than one organisation within the same jurisdiction.<sup>7</sup>

Differences in objectives, mandates and design features among multiple systems can result in organisational complexities that can lead to inefficiencies and potential competitive concerns. Therefore, in situations where MDIS exist in the same national jurisdiction, appropriate information sharing and coordination arrangements need to be in place. This is of particular importance for ensuring effective public awareness about the different systems. It is also important to ensure that any differences in coverage across institutions operating within that jurisdiction do not adversely affect the overall deposit insurance system's effectiveness and financial stability.

### **Financial Inclusion**

Although, in most jurisdictions, promoting financial inclusion does not fall explicitly within the mandate of the deposit insurer, deposit insurers should make efforts to stay abreast of financial inclusion initiatives and associated technological innovations occurring in their jurisdictions, particularly those affecting unsophisticated small-scale depositors. The involvement of deposit insurance in the promotion of financial inclusion, for example the extension of coverage to deposit-like stored value products, should be undertaken with the strong engagement of, and coordination with, supervisory authorities and other financial safety-net participants. In addition, public awareness

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<sup>6</sup> IDIS design features incorporate Shariah-based legal contracts, which specify relationships among the financial institutions that offer Islamic financial services, protect depositors/investment account holders and the deposit insurer. In addition, these features include permitted investments for IDIS funds and elements of Shariah prohibitions on, among other things, interest, uncertainty and gambling.

<sup>7</sup> It is not necessary for all deposit-taking institutions to be members of a single deposit insurance system. Different types of deposit-taking institutions can belong to different deposit insurance systems.



campaigns should adequately address what types of deposits and money transfer vehicles are covered by deposit insurance and what types are not, in order to minimise potential confusion among small-scale depositors and financial service providers alike.

### **Depositor Preference**

The treatment of depositors in the creditor hierarchy can have a profound impact on the costs incurred by the deposit insurer and the failure resolution regime more generally.

Depositor preference, particularly insured depositor preference, can reduce the costs of liquidation and depositor reimbursement (where subrogation is present for the insurer), including in cases where the insurer is expected to contribute to a resolution. It may also facilitate the implementation of resolution options, such as partial deposit transfers, the use of bridge institutions, and the conversion of debt to equity. In addition, the more uniform treatment of depositors across jurisdictions could contribute to more effective cross-border resolutions.

On the other hand, depositor preference could give rise to some potential unintended consequences. When depositors are given a higher relative priority, it increases the potential loss exposure of lower-ranking creditors. In response, non-deposit creditors could take action to better protect themselves, such as collateralising their claims or shortening terms of maturity. These actions could have profound implications for bank funding and could offset any positive benefits of depositor preference. Preference for the home jurisdiction's depositors over the depositors of failing foreign bank branches could also lead host authorities to act locally in order to protect their local depositors (i.e. ring fence assets).

In conclusion, jurisdictions considering introducing depositor preference, or changing their existing depositor preference arrangements, should weigh the advantages and disadvantages in the context of their legal and judicial framework and financial system structure.

## V. Core Principles and Compliance Assessment

### Principle 1 – PUBLIC POLICY OBJECTIVES

The principal public policy objectives for deposit insurance systems are to protect depositors and contribute to financial stability. These objectives should be formally specified and publicly disclosed. The design of the deposit insurance system should reflect the system's public policy objectives.

#### Essential criteria

1. The public policy objectives of the deposit insurance system are clearly and formally specified and made public, for example through legislation or documents supporting legislation.
2. The design of the deposit insurance system is consistent with the system's public policy objectives.
3. There is a review of the extent to which a deposit insurance system meets its public policy objectives.<sup>8</sup> This involves both an internal review conducted on a regular basis by the governing body and an external review conducted periodically by an external body (e.g. the body to which the deposit insurer is accountable or an independent entity with no conflicts of interest, such as an auditor general). Any review must take into consideration the views of key stakeholders.
4. If additional public policy objectives are incorporated, they do not conflict with the two principal objectives of protecting depositors and contributing to the stability of the financial system.

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<sup>8</sup> The timing of regular reviews will depend on jurisdiction-specific factors but should occur at least every five years, or more frequently as deemed necessary.

## Principle 2 – MANDATE AND POWERS

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

### Essential criteria

1. The mandate and powers of the deposit insurer are formally and clearly specified in legislation, and are consistent with stated public policy objectives.
2. The mandate clarifies the roles and responsibilities of the deposit insurer and is aligned with the mandates of other safety-net participants.<sup>9</sup>
3. The powers of the deposit insurer support its mandate and enable the deposit insurer to fulfil its roles and responsibilities.
4. The powers of the deposit insurer include, but are not limited to:
  - (a) assessing and collecting premiums, levies or other charges;
  - (b) transferring deposits to another bank;
  - (c) reimbursing insured depositors;
  - (d) obtaining directly from banks timely, accurate and comprehensive information necessary to fulfil its mandate;
  - (e) receiving and sharing timely, accurate and comprehensive information within the safety-net, and with applicable safety-net participants in other jurisdictions;
  - (f) compelling banks to comply with their legally enforceable obligations to the deposit insurer (e.g. provide access to depositor information), or requesting that another safety-net participant do so on behalf of the deposit insurer;
  - (g) setting operating budgets, policies, systems and practices; and

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9 Mandates can range from narrow “pay box” systems to those with extensive responsibilities, such as preventive action and loss or risk minimisation/management, with a variety of combinations in between. These can be broadly classified into four categories:

- a. A “pay box” mandate, where the deposit insurer is only responsible for the reimbursement of insured deposits;
- b. A “pay box plus” mandate, where the deposit insurer has additional responsibilities, such as certain resolution functions (e.g. financial support);
- c. A “loss minimiser” mandate, where the insurer actively engages in a selection from a range of least-cost resolution strategies; and
- d. A “risk minimiser” mandate, where the insurer has comprehensive risk minimisation functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases prudential oversight responsibilities.

(h) entering into contracts.

## Principle 3 – GOVERNANCE

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

### Essential criteria

1. The deposit insurer is operationally independent. It is able to use its powers without interference from external parties to fulfil its mandate. There is no government, central bank, supervisory or industry interference that compromises the operational independence of the deposit insurer.
2. The governing body of the deposit insurer<sup>10</sup> is held accountable to a higher authority.
3. The deposit insurer has the capacity and capability (e.g. human resources, operating budget, and salary scales sufficient to attract and retain qualified staff) to support its operational independence and the fulfilment of its mandate.
4. The deposit insurer is well-governed and subject to sound governance practices, including appropriate accountability, internal controls, transparency and disclosure regimes. The institutional structure of the deposit insurer minimises the potential for real or perceived conflicts of interest.
5. The deposit insurer operates in a transparent and responsible manner. It discloses and publishes appropriate information for stakeholders on a regular basis.<sup>11</sup>
6. The governing statutes or other relevant laws and policies governing the deposit insurer specify that:
  - (a) the governing body and management are “fit and proper” persons;
  - (b) members of the governing body and the head(s) of the deposit insurer (with the exception of ex officio appointees) is/are subject to fixed terms and the fixed terms are staggered;<sup>12</sup>

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<sup>10</sup> This document refers to a governance structure composed of a governing body such as a board of directors. There are significant differences across jurisdictions in the legislative and regulatory frameworks covering these functions. Some jurisdictions use a two-tier board structure, in which the supervisory function of the board is performed by a separate entity, known as a supervisory board, which has no executive functions. Other jurisdictions, by contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific governing body structure.

<sup>11</sup> Examples of appropriate information include reports on strategic objectives and plans, governance structure and practices, and annual reports that contain financial statements and describe activities during the reporting period.

- (c) there is a transparent process for the appointment and removal of the members of the governing body and head(s) of the deposit insurer. Members of the governing body and head(s) of the deposit insurer can be removed from office during their term only for reasons specified or defined in law, internal statutes or rules of professional conduct, and not without cause; and
  - (d) members of the governing body and employees are subject to high ethical standards and comprehensive codes of conduct to minimise the potential for real or perceived conflicts of interest.<sup>13</sup>
7. The deposit insurer is regularly assessed on the extent to which it meets its mandate, and the deposit insurer is subject to regular internal and external audits.
  8. The composition of the governing body minimises the potential for real or perceived conflicts of interest. In order to maintain operational independence, representatives of the other financial safety-net organisations that participate in the governing body do not serve as Chair or constitute a majority.
  9. The governing body holds regular meetings to oversee and manage the affairs of the deposit insurer (e.g. on a quarterly basis and more frequently as deemed necessary).

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<sup>12</sup> An arrangement whereby only a certain number of members of a governing body are appointed/elected in any given year. For example, a governing body may have 11 members serving staggered terms, where two new members are appointed each year.

<sup>13</sup> See also CP11, Essential Criterion 3.

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

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

### **Essential criteria**

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

## **Principle 5 – CROSS-BORDER ISSUES**

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

### **Essential criteria**

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



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

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

### **Essential criteria**

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

## Principle 7 – MEMBERSHIP

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

### Essential criteria

1. Membership in a deposit insurance system is compulsory for all banks, including state-owned banks (with or without explicit guarantees), and all banks are subject to sound prudential regulation and supervision.<sup>14</sup>
2. If, upon entry to a newly established deposit insurance system, a bank does not comply with all the supervisory or membership requirements and is allowed entry into the system, it is required to have a credible plan to address any deficiencies within a prescribed time frame (e.g. one year).
3. The conditions, process and time frame for attaining membership are explicitly stated and transparent.
4. If the deposit insurer is not responsible for granting membership in the deposit insurance system, the law or administrative procedures describe a clear and reasonable time frame within which the deposit insurer is consulted or informed in advance, and is given sufficient information about an application for a new licence.
5. When membership is cancelled upon the revocation or surrender of a bank's licence, immediate notice is given to depositors to inform them that existing deposits will continue to be insured up to a specified deadline.<sup>15</sup>
6. When membership is terminated by the deposit insurer, arrangements are in place to coordinate the immediate withdrawal of the bank's deposit-taking licence by the relevant authority. Upon termination, immediate notice is given to depositors to inform them that existing deposits will continue to be covered up to a specified deadline.

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<sup>14</sup> The determination of "sound prudential regulation and supervision" is made by ensuring that there is high compliance with the BCPs.

<sup>15</sup> See also Core Principle 10 "Public Awareness."

## Principle 8 – COVERAGE

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

### Essential criteria

1. Insured deposits are clearly and publicly defined in law or regulation and reflect the public policy objectives. This definition includes the level and scope of coverage. If certain types of deposits and depositors are ineligible for deposit protection, they are clearly specified, easily determined and do not affect the speed of reimbursement.<sup>16</sup>
2. The level and scope of coverage are limited and are designed to be credible, so as to minimise the risk of runs on banks and do not undermine market discipline. The level and scope of coverage are set so that the large majority of depositors across banks are fully protected while leaving a substantial proportion of the value of deposits unprotected.<sup>17</sup> In the event that a substantial proportion of the value of deposits is protected, moral hazard is mitigated by strong regulation and supervision, as well as by the other design features of the deposit insurance system.<sup>18</sup>
3. The deposit insurer applies the level and scope of coverage equally to all its member banks.
4. The deposit insurer does not incorporate co-insurance.
5. The level and scope of coverage are reviewed periodically (e.g. at least every five years) to ensure that it meets the public policy objectives of the deposit insurance system.
6. In the event of, or prior to, a merger or amalgamation of separate banks that are members of the same deposit insurance system, depositors of the merged or amalgamated banks enjoy separate coverage (up to the maximum coverage limit) for each of the banks for a limited but publicly stated period, as defined in

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<sup>16</sup> In particular, some specific types of deposits may be excluded or considered ineligible for protection. These may include: interbank deposits; deposits of government departments and of regional, provincial, and municipal governments and other public bodies; deposits of individuals who are regarded as responsible for the deterioration of an institution, including deposits belonging to the directors, managers, large shareholders, and auditors of banks; and bearer deposits.

<sup>17</sup> For additional guidance on setting coverage limits, scope and foreign currency deposits coverage, see: IADI, *Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage*, 2013.

<sup>18</sup> Strong regulation and supervision is demonstrated by a high level of compliance with the BCPs.

law or regulation. Merging banks must be held responsible for notifying the affected depositors, including informing them of the date on which the separate coverage will expire.

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

## **Principle 9 – SOURCES AND USES OF FUNDS**

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

### **Essential criteria**

1. Funding for the deposit insurance system is provided on an ex ante basis. Funding arrangements are clearly defined and established in law or regulation.
2. Funding the deposit insurance system is the responsibility of the member banks.
3. Initial “start-up” or “seed” funding (e.g. from government or international donor organisations) is permitted to help establish a deposit insurer. Any start-up funding provided by a government should be fully repaid before the deposit insurer reduces any or all bank premiums.
4. Emergency funding arrangements for the deposit insurance system, including pre-arranged and assured sources of liquidity funding, are explicitly set out (or permitted) in law or regulation. Sources may include a funding agreement with the government, the central bank or market borrowing. If market borrowing is used it is not the sole source of funding.<sup>19</sup> The arrangement for emergency liquidity funding is set up in advance, to ensure effective and timely access when required.
5. After establishing an ex ante deposit insurance fund:
  - (a) the target fund size is determined on the basis of clear, consistent and transparent criteria, which are subject to periodic review; and
  - (b) a reasonable time frame is set to achieve the target fund size.
6. The deposit insurer has responsibility for the sound investment and management of its funds. The deposit insurer has a defined investment policy for its funds that aims at ensuring:
  - (a) the preservation of fund capital and maintenance of liquidity; and
  - (b) that adequate risk management policies and procedures, internal controls, and disclosure and reporting systems are in place.
7. The deposit insurer may hold funds in the central bank. The deposit insurer establishes and complies with rules to limit significant investments in banks.

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<sup>19</sup> Where applicable (e.g. in the European Union), deposit insurers may borrow from each other's funds.

8. Where the deposit insurer is not the resolution authority, it has the option, within its legal framework, to authorise the use of its funds for resolution of member institutions other than liquidation.<sup>20</sup> In such situations the following conditions are met:
- (a) the deposit insurer is informed and involved in the resolution decision-making process;
  - (b) the use of the deposit insurer's funds is transparent and documented, and is clearly and formally specified;
  - (c) where a bank is resolved through a resolution process other than liquidation, the resolution results in a viable, solvent and restructured bank, which limits the exposure of the deposit insurer to contribute additional funding in respect of the same obligation;
  - (d) contributions are restricted to the costs the deposit insurer would otherwise have incurred in a payout of insured depositors in a liquidation net of expected recoveries;
  - (e) contributions are not used for the recapitalisation of resolved institutions unless shareholder's interests are reduced to zero and uninsured, unsecured creditors are subject to parri passu losses in accordance with the legal claim priority;
  - (f) the use of the deposit insurer's funds is subject to an independent audit and the results reported back to the deposit insurer; and
  - (g) all resolution actions and decisions using the deposit insurer's funds are subject to ex post review.
9. Should deposit insurer income/revenue (e.g. premiums received, recoveries from failed banks and interest accrued on investment funds) be taxed by the government, it is at a rate which is neither punitive nor disproportionate to other corporate taxation, nor unduly hinders the accumulation of the deposit insurance fund. Any remittances to the government by the deposit insurer are limited to repayment of government-provided start-up funding and government-provided liquidity funding.
10. If the deposit insurer uses differential premium systems:<sup>21</sup>

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<sup>20</sup> Such use may be compulsory under national law.

<sup>21</sup> See IADI, *General Guidance for Developing Differential Premium Systems*, 2011.

- (a) the system for calculating premiums is transparent to all participating banks;
- (b) the scoring/premium categories are significantly differentiated; and
- (c) the ratings and rankings resulting from the system pertaining to individual banks are kept confidential.

## **Principle 10 – PUBLIC AWARENESS**

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

### **Essential criteria**

1. The deposit insurer is responsible for promoting public awareness of the deposit insurance system, using a variety of communication tools on an ongoing basis as part of a comprehensive communication programme.
2. In the event of a bank failure, the deposit insurer must notify depositors, as appropriate and as described in law, via media such as press releases, print advertising, websites and other media outlets, of the following details:
  - (a) where, how and when insured depositors will be provided with access to their funds;<sup>22</sup>
  - (b) the information that an insured depositor must provide in order to obtain payment;
  - (c) if advance or interim payments are being made; and<sup>23</sup>
  - (d) whether any depositors will lose funds, and procedures whereby uninsured depositors can make claims to the liquidator for their uninsured portion.
3. The public awareness programme or activities convey information about the following:
  - (a) the scope (i.e. which types of financial instruments and depositors are covered by deposit insurance, and which are not);
  - (b) a list of which banks are members and how they can be identified;
  - (c) deposit insurance coverage level limits; and
  - (d) other information, such as the mandate of the deposit insurer.
4. The objectives of the public awareness programme (e.g. target awareness levels) are clearly defined and consistent with the public policy objectives and mandate of the deposit insurance system.

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<sup>22</sup> For example, whether there is an assuming/agent bank to assume deposits and reimburse or otherwise make them available, or whether reimbursement is provided through the failed bank's facilities.

<sup>23</sup> For example, in the case of unavoidable prolonged delays, such as a "surprise" bank failure where there has been no opportunity for preparation.



5. The deposit insurer sets a long-term strategy to meet its public awareness objectives, and makes budget allocations to build and maintain a target level of public awareness about deposit insurance.
6. The deposit insurer works closely with banks and other safety-net participants to ensure the consistency and accuracy of the information provided to depositors and to maximise awareness on an ongoing basis. Law or regulation requires banks to provide information about deposit insurance in a format/language prescribed by the deposit insurer.
7. The deposit insurer monitors, on an ongoing basis, its public awareness activities and arranges, on a periodic basis, independent evaluations of the effectiveness of its public awareness programme or activities.
8. Depositors in jurisdictions affected by cross-border banking arrangements conducted through foreign bank branches or subsidiaries are provided with clear information on the existence and identification of the deposit insurer legally responsible for reimbursement, and the limits and scope of coverage.

## **Principle 11 – LEGAL PROTECTION**

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

### **Essential criteria**

1. Legal protection is specified in legislation and provided to the deposit insurer, its current and former directors, officers and employees and any individual<sup>24</sup> currently or previously retained or engaged by the deposit insurer, for decisions made and actions or omissions taken in good faith in the normal course of their duties.
2. Legal protection precludes damages or other awards against such individuals and covers costs, including funding defence costs as incurred (and not just reimbursement after a successful defence).
3. The operating policies and procedures of the deposit insurer require individuals with legal protection to disclose real or perceived conflicts of interest and to adhere to relevant codes of conduct, to ensure that they remain accountable.
4. Legal protections do not prevent depositors or other individual claimants or banks from making legitimate challenges to the acts or omissions of the deposit insurer in public or administrative review (e.g. civil action) procedures.

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<sup>24</sup> A contractual indemnity in an individual's contract of employment or engagement with the deposit insurer and/or private insurance is not a substitute for legal protection defined in legislation or recognised in law.

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

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

### **Essential criteria**

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

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

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

#### **Essential criteria**

1. The deposit insurer is part of an effective framework within the financial safety-net that provides for the early detection of, and timely intervention in, banks in financial difficulty before the bank becomes non-viable.<sup>25</sup>
2. Safety-net participants have the operational independence and power to perform their respective roles in the framework for early detection and timely intervention.
3. The framework includes a set of clearly defined qualitative and/or quantitative criteria that are used to trigger timely intervention or corrective action. The criteria:
  - (a) are clearly defined in law, regulation or agreements;
  - (b) include safety and soundness indicators such as the institution's capital, asset quality, management, earnings, liquidity and sensitivity to market risk; and
  - (c) are reviewed periodically, and the procedure for this review is formalised.

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<sup>25</sup> The degree of implementation and effectiveness of an early detection and timely intervention framework is determined through an assessment of the BCPs and KAs where applicable.

## **Principle 14 – FAILURE RESOLUTION**

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

### **Essential criteria**

1. The deposit insurer has the operational independence and sufficient resources to exercise its resolution<sup>26</sup> powers consistent with its mandate.
2. The resolution regime ensures that all banks are resolvable through a broad range of powers and options.
3. Where there are multiple safety-net participants responsible for resolution, the legal framework provides for a clear allocation of objectives, mandates, and powers of those participants, with no material gaps, overlaps or inconsistencies. Clear arrangements for coordination are in place.
4. Resolution and depositor protection procedures are not limited to depositor reimbursement. The resolution authority/ies has/have effective resolution tools designed to help preserve critical bank functions and to resolve banks. These include, but are not limited to, powers to replace and remove senior management, terminate contracts, transfer and sell assets and liabilities, write down or convert debt to equity and/or establish a temporary bridge institution.
5. One or more of the available resolution methods allows the flexibility for resolution at a lesser cost than otherwise expected in a liquidation net of expected recoveries.
6. Resolution procedures follow a defined creditor hierarchy in which insured deposits are protected from sharing losses and shareholders take first losses.
7. The resolution regime does not discriminate against depositors on the basis of their nationality or residence.
8. The resolution regime is insulated against legal action that aims at the reversal of decisions related to the resolution of non-viable banks. No court can reverse

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<sup>26</sup> In this document “resolution” refers to the disposition plan and process for a non-viable bank. Resolution may include the liquidation and reimbursement of insured deposits, the transfer and/or sale of assets and liabilities, the establishment of temporary bridge institutions, and the write-down and/or conversion of debt to equity of the non-viable institution. Resolution may also include the application of procedures under insolvency law to parts of a firm in resolution, in conjunction with the exercise of resolution powers. A jurisdiction’s resolution regime may involve multiple resolution authorities. The specific resolution powers assigned to a deposit insurer may vary depending on the deposit insurer’s mandate.

such decisions. The legal remedy for successful challenges is limited to monetary compensation.

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

## Principle 15 – REIMBURSING DEPOSITORS

The deposit insurance system should reimburse depositors' insured funds promptly, in order to contribute to financial stability. There should be a clear and unequivocal trigger for insured depositor reimbursement.

### Essential criteria

1. The deposit insurer is able to reimburse most<sup>27</sup> insured depositors within seven working days. If the deposit insurer cannot currently meet this target, the deposit insurer has a credible plan in place to do so.
2. To be credible, the reimbursement plan:
  - (a) has a clear time frame for implementation (e.g. within two years);
  - (b) is supported by relevant laws, regulations, systems and processes (e.g. intervention and resolution manuals); and
  - (c) has clear and measurable deliverables.
3. In situations where reimbursement is triggered and there may be extended delays in reimbursements, the deposit insurer may make advance, interim or emergency partial payments.
4. In order to provide depositors with prompt access to their funds, the deposit insurer:
  - (a) has access to depositors' records at all times, which includes the authority to require banks to maintain depositor information in a format prescribed by the deposit insurer in order to expedite insured depositor reimbursement;
  - (b) has the authority to undertake advance or preparatory examinations (e.g. on-site and independently or in conjunction with the supervisory authority) on the reliability of depositor records, and has tested member institution's IT systems and data to ensure the capability to produce such records; and
  - (c) has a range of reimbursement options.<sup>28</sup>
5. The deposit insurer has the capacity and capability to promptly carry out the reimbursement process, including:

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<sup>27</sup> The term "most" is used to recognise that there may be some types of deposits which would be operationally difficult to reimburse within seven working days, such as trust accounts with multiple beneficiaries.

<sup>28</sup> These may include: cheque payments, electronic transfers, payment agents, cash payments, and the transfer of deposits through closed-bank P&A transactions.

- (a) adequate resources and trained personnel (in-house or contractors) dedicated to the reimbursement function and supported with reimbursement documentation or manuals;
  - (b) information systems to process depositor information in a systematic and accurate manner;
  - (c) pre- and post-closing activities specified in closing documentation or manuals; and
  - (d) scenario planning and simulations, including simulations on bank closings with supervisory and resolution authorities.
6. A review (e.g. post mortem) following a bank failure is performed to determine and analyse elements of the reimbursement process (including the resolution procedures where applicable) which were successful or unsuccessful.
  7. An independent party conducts a periodic audit of the reimbursement process to confirm that appropriate internal controls are in place.
  8. If set-off of insured deposits against past due claims (e.g. debt service and arrears) or matured loans is applied, such application is timely and does not delay prompt reimbursement of insured depositors' claims or undermine financial stability.
  9. Working arrangements and/or agreements are in place with relevant clearing and settlement system agencies and liquidators, to ensure that transit items are dealt with in an appropriate, consistent and timely manner.<sup>29</sup>
  10. In cases where the deposit insurer does not have the authority to act as a liquidator, the liquidator is obliged by law or regulation to cooperate with the deposit insurer to facilitate the reimbursement process.

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<sup>29</sup> For more extensive guidance on ensuring prompt reimbursement, see: IADI, *Enhanced Guidance for Effective Deposit Insurance Systems: Reimbursement Systems and Practices*, 2013.



## **Principle 16 – RECOVERIES**

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

### **Essential criteria**

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

## Annex I

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

This Annex presents guidance and a format for compliance assessment and the structure of the assessment reports.<sup>30</sup>

#### Compliance Assessment

The primary objective of an assessment should be to evaluate compliance with the Core Principles, after taking into account the national structural, legal and institutional features of each jurisdiction's deposit insurance system(s). 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 criteria for each Core Principle. The essential criteria are the only elements on which to gauge full compliance with a Core Principle. Assessments by external parties follow a five-grade scale as follows:<sup>31</sup>

- **Compliant:** When the essential criteria are met without any significant deficiencies.<sup>32</sup>
- **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.

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<sup>30</sup> This format was recommended by the IMF and the World Bank for use by assessors in the context of Financial Sector Assessment Program (FSAP) or Offshore Financial Center Program (OFC) missions. In order to maintain comparability and consistency, the format was also recommended for standalone assessments or self-assessments by a jurisdiction. See BCBS *Core Principles For Effective Banking Supervision*, 2012.

<sup>31</sup> This scale is used for external assessments in the Basel Committee's Core Principles Methodology (Banking Supervision), available at [www.bis.org/publ/bcbs130.htm](http://www.bis.org/publ/bcbs130.htm).

<sup>32</sup> In order to achieve a "Compliant" grade it is not always necessary to achieve compliance on all essential criteria for each Core Principle. For example, if a 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 "Compliant". Assessors must exercise judgment in these situations.

- **Non-compliant:** No substantive implementation of the Core Principle.
- **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 in compliance and the commentary that should accompany each criterion 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 jurisdiction-specific factors.

Assessors should pay close attention to the adequacy of the operating environment, and include their opinion on gaps and weaknesses in the environment and actions that policymakers could take to mitigate those weaknesses. The assessment of compliance with individual Core Principles could flag those Core Principles which are likely to be primarily affected by external conditions considered to be weak, after factoring in specific jurisdictional circumstances, mandate and structures of the deposit insurance system. However, assessors should not undertake to assess compliance with the operating environment themselves. Instead, wherever possible, assessors should rely on the results of recent IMF/World Bank FSAP reports and, where relevant, FSB peer reviews. 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” rating to the operating environment review. Recommendations with regard to the operating environment 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 and identifying Core Principles that may or may not be applicable in all types of arrangements of deposit insurance systems, a “Handbook Guide for Assessors” has been developed. This document includes supporting guidance to assist assessors in applying the criteria to specific jurisdictional settings and structures. The Handbook will be updated over time to take into account the experiences and lessons learned in conducting compliance assessments.

### **Use of the 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 or Technical Assistance (TA) projects; (iii) peer reviews, for example those conducted within IADI regional committees or through the FSB peer review process; and (iv) reviews conducted by private third parties such as consulting firms. IADI will be active in interpreting the Core Principles and

providing training; this includes guidance on best practices during the assessment process.

In 2013, IADI established the Self-Assessment Technical Assistance Program (SATAP) to enable jurisdictions to request an independent onsite review and validation of their self-assessment results by a team of IADI experts. Such objective evaluations will be very helpful to jurisdictions in preparing for upcoming FSAP reviews.

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 beneficial that the parties be made up of suitably qualified persons, including individuals with experience of working in a deposit insurance system and dealing with bank failures. A fair assessment of the deposit insurance system also requires the genuine cooperation of all relevant authorities. The process of assessing each of the 16 Core Principles requires a judgmental weighting of numerous elements, which 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 made with reference to the legislative and accounting structure of the relevant jurisdiction. 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 must also be effective enforcement of and compliance with those laws and regulations on the part of regulators, 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.

### **Assessment Report**

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.
- An overview of the institutional and macroeconomic setting and market structure.
- A review of the operating environment for effective deposit insurance systems.
- A compliance table, summarising the assessment results (Table 1).
- A recommended action plan providing Principle-by-Principle recommendations for actions and measures to improve the deposit insurance system and practices (Table 2).

- A detailed Principle-by-Principle assessment, providing a description of the system with reference to a particular Principle, a grading or “assessment”, and a “comments” section (Table 3).
- A section for authorities’ comments.

## Compliance Assessment and Summary Tables

**Table 1**  
**Summary of Compliance with the IADI Core Principles for Effective Deposit Insurance Systems**  
**Detailed Assessments**

Core Principle	Grade	Comments
Reference Core Principle 1	C, LC, MNC, NC, NA <sup>33</sup>	
Repeat for all 16 Core Principles	C, LC, MNC, NC, NA	

**Table 2**  
**Recommended Action Plan to Improve Compliance with the IADI Core Principles for Effective Deposit Insurance Systems**

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

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

<b>Table 3</b>	
<b>Core Principles for Effective Deposit Insurance Systems Detailed Assessment Table</b>	
Core Principle 1: (repeat verbatim text of Core Principle 1)	
Description	
Assessment	C, LC, MNC, NC, NA
Comments	
For each Essential Criterion:	
Description	
Assessment	C, LC, MNC, NC, NA <sup>34</sup>
Comments	
Repeat for all 16 Core Principles	

### **Practical considerations in conducting a compliance assessment**

In addition to the format for conducting a compliance assessment, the following practical considerations should be taken into account:

1. The assessor should have access to a range of information and interested parties. This may include published information, more sensitive information (i.e. 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. The assessor should also meet with a range of individuals and organisations, including other financial 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.

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

Assessors should set out the range of information required from the authorities involved and, at the initial meeting with the individuals involved, should explain how the assessment will proceed. This should include the process to be followed in the assessment for the review of the operating environment.

2. The assessment of compliance with each Core Principle requires the evaluation of a chain of related requirements, such as laws, prudential regulation and supervisory guidelines. The assessment must ensure that the requirements are in practice or can be put into practice. For example, policymakers must ensure that the deposit insurer has the necessary operational independence, skills and resources to fulfil its public policy objectives.
3. In addition to identifying deficiencies, the assessment should also highlight positive features and key 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. Depending on the materiality of cross-border banking, it is also important that the assessor is able to judge whether information sharing occurs between deposit insurers and other safety-net participants in different jurisdictions.



## Annex II

### IADI Steering Committee and Joint Working Group Members

#### IADI Steering Committee

<b>Chair</b>	<b>David Walker</b> Canada Deposit Insurance Corporation
<b>Coordinator</b>	<b>Vijay Deshpande</b> Federal Deposit Insurance Corporation United States
<b>Argentina</b>	<b>Alejandro Lopez</b> Seguro de Depósitos Sociedad Anónima
<b>Bulgaria</b>	<b>Rossen Nikolov</b> Bulgaria Deposit Insurance Fund
<b>Canada</b>	<b>Joshua Lattimore</b> Canada Deposit Insurance Corporation
<b>Colombia</b>	<b>María Inés Agudelo</b> Fondo de Garantías de Instituciones Financieras
<b>France</b>	<b>Thierry Dissaux</b> Fonds de Garantie des Dépôts
<b>Germany</b>	<b>Dirk Cupei</b> Association of German Banks  <b>Jan Nolte</b> Association of German Banks
<b>Hungary</b>	<b>András Fekete-Györ</b> National Deposit Insurance Fund
<b>India</b>	<b>Kumudini Hajra</b> Deposit Insurance and Credit Guarantee Fund
<b>Japan</b>	<b>Katsuyuki Meguro</b> Deposit Insurance Corporation of Japan
<b>Jordan</b>	<b>Jumana Hamed</b> Jordan Deposit Insurance Corporation

<b>Kazakhstan</b>	<b>Bakhyt Mazhenova</b> Kazakhstan Deposit Insurance Fund
<b>Korea</b>	<b>Keehyun Park</b> Korea Deposit Insurance Corporation
<b>Malaysia</b>	<b>JP Sabourin</b> Malaysia Deposit Insurance Corporation
	<b>Kevin Chew</b> Malaysia Deposit Insurance Corporation
<b>Mexico</b>	<b>Raúl Castro</b> Instituto para la Protección al Ahorro Bancario
<b>Nigeria</b>	<b>Ade Afolabi</b> Nigeria Deposit Insurance Corporation
<b>Poland</b>	<b>Anna Trzecińska</b> Bank Guarantee Fund
<b>Switzerland</b>	<b>Patrick Loeb</b> esisuisse
<b>United Kingdom</b>	<b>Alex Kuczynski</b> Financial Services Compensation Scheme
<b>United States</b>	<b>David Hoelscher</b> Federal Deposit Insurance Corporation
<b>Zimbabwe</b>	<b>John Chikura</b> Deposit Protection Corporation

**Members-At-Large or Observers**

<b>Chinese Taipei</b>	<b>Yvonne Fan</b> Central Deposit Insurance Corporation
<b>Indonesia</b>	<b>Salusra Satria</b> Indonesia Deposit Insurance Corporation
<b>Kenya</b>	<b>Rose Detho</b> Deposit Protection Fund Board
<b>Mexico</b>	<b>Eugenia Kuri</b> Instituto para la Protección al Ahorro Bancario
<b>United States</b>	<b>Maisha Goss-Johns</b>

**Secretariat**

Federal Deposit Insurance Corporation

**Poland**

**Tomasz Ozimek**  
Bank Guarantee Fund

**United States**

**Taryn Jones**  
Federal Deposit Insurance Corporation

## Joint Working Group

### I. IADI Representatives

<b>Chair</b>	<b>David Walker</b> Canada Deposit Insurance Corporation
<b>Coordinator</b>	<b>Vijay Deshpande</b> Federal Deposit Insurance Corporation United States
<b>Colombia</b>	<b>María Inés Agudelo</b> Fondo de Garantías de Instituciones Financieras
<b>Jordan</b>	<b>Jumana Hamed</b> Jordan Deposit Insurance Corporation
<b>Malaysia</b>	<b>JP Sabourin</b> Malaysia Deposit Insurance Corporation
	<b>Kevin Chew</b> Malaysia Deposit Insurance Corporation
	<b>Yee Ming Lee</b> Malaysia Deposit Insurance Corporation
<b>Poland</b>	<b>Anna Trzecińska</b> Bank Guarantee Fund
<b>United Kingdom</b>	<b>Alex Kuczynski</b> Financial Services Compensation Scheme
<b>United States</b>	<b>David Hoelscher</b> Federal Deposit Insurance Corporation
<b>Zimbabwe</b>	<b>John Chikura</b> Deposit Protection Corporation

### II. EFDI Representatives

<b>Germany</b>	<b>Dirk Cupei</b> Association of German Banks
<b>Hungary</b>	<b>András Fekete-Györ</b> National Deposit Insurance Fund
<b>Luxembourg</b>	<b>Joseph Delhaye</b> Association pour la Garantie des Dépôts Luxembourg

**Switzerland**

**Patrick Loeb**  
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**III. International Organisations**

**Basel Committee on Banking Supervision**

**Karl Cordewener**

**Nik Faris Nik Sallahuddin**

**European Commission**

**Sven Gentner**

**Financial Stability Board**

**Eva Hüpkes**

**International Monetary Fund**

**David Parker**

**Sven Stevenson**

**World Bank**

**Claire McGuire**

**David Scott**

**Jan Nolte**

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