

## AN OVERVIEW OF DICGC

The functions of the DICGC are governed by the provisions of “The Deposit Insurance and Credit Guarantee Corporation Act, 1961” (DICGC Act) and “The Deposit Insurance and Credit Guarantee Corporation General Regulations, 1961” framed by the Reserve Bank in exercise of the powers conferred by sub-section (3) of Section 50 of the said Act. As no credit institution is participating in any of the credit guarantee schemes administered by the Corporation, presently it is not operating any of the schemes and deposit insurance remains the principal function of the Corporation

### 2. HISTORY

The concept of insuring deposits kept with banks received attention for the first time in the year 1948 after the banking crisis in Bengal. The issue came up for reconsideration in the year 1949, but was held in abeyance till the Reserve Bank ensured adequate arrangements for inspection of banks. Subsequently, in the year 1950, the Rural Banking Enquiry Committee supported the concept. Serious thought to insuring deposits was, however, given by the Reserve Bank and the Central Government after the crash of the Palai Central Bank Ltd., and the Laxmi Bank Ltd. in 1960. The Deposit Insurance Corporation (DIC) Bill was introduced in Parliament on August 21, 1961. After it was passed by Parliament, the Bill got the assent of the President on December 7, 1961 and the Deposit Insurance Act, 1961 came into force on January 1, 1962.

Deposit Insurance Scheme was initially extended to functioning commercial banks only. This included the State Bank of India and its subsidiaries, other commercial banks and the branches of the foreign banks operating in India.

With the enactment of the Deposit Insurance Corporation (Amendment) Act, 1968, the Corporation was required to register “eligible co-operative banks” as insured banks under the provisions of Section 13 A of the DICGC Act.

The Government of India, in consultation with the Reserve Bank, introduced a credit guarantee

scheme in July 1960. The Reserve Bank was entrusted with the administration of the scheme, as an agent of the Central Government, under Section 17 (11 A)(a) of the Reserve Bank of India Act, 1934 and was designated as the Credit Guarantee Organization (CGO) for guaranteeing the advances granted by banks and other credit institutions to small scale industries. The Reserve Bank operated the scheme up to March 31, 1981.

The Reserve Bank also promoted a public limited company on January 14, 1971, named the Credit Guarantee Corporation of India Ltd. (CGCI). The credit guarantee schemes introduced by the Credit Guarantee Corporation of India Ltd., aimed at encouraging the commercial banks to cater to the credit needs of the hitherto neglected sectors, particularly the weaker sections of the society engaged in non-industrial activities, by providing guarantee cover to the loans and advances granted by the credit institutions to small and needy borrowers covered under the priority sector as defined by the RBI.

With a view to integrating the functions of deposit insurance and credit guarantee, the above two organizations (DIC & CGCI) were merged and the present Deposit Insurance and Credit Guarantee Corporation (DICGC) came into existence on July 15, 1978. Consequently, the title of Deposit Insurance Act, 1961 was changed to ‘The Deposit Insurance and Credit Guarantee Corporation Act, 1961’.

Effective from April 1, 1981, the Corporation extended its guarantee support to credit granted to small scale industries also, after the cancellation of the Government of India’s credit guarantee scheme. With effect from April 1, 1989, guarantee cover was extended to the entire priority sector advances.

### 3. INSTITUTIONAL COVERAGE

- (I) **All commercial banks** including the branches of foreign banks functioning in India, Local Area Banks and Regional Rural Banks are covered under the Deposit Insurance Scheme.

- (II) All eligible **co-operative banks** as defined in Section 2(gg) of the DICGC Act are covered under the Deposit Insurance Scheme. All State, Central and Primary co-operative banks functioning in the States/ Union Territories which have amended their Co-operative Societies Act, as required under the DICGC Act, 1961, empowering Reserve Bank to order the Registrar of Co-operative Societies of the respective States/Union Territories to wind up a co-operative bank or to supersede its committee of management and requiring the Registrar not to take any action for winding up, amalgamation or reconstruction of a co-operative bank without prior sanction in writing from the Reserve Bank, are treated as eligible co-operative banks. At present all co-operative banks, other than those in the States of Meghalaya and Mizoram\*, the Union Territories of Chandigarh, Lakshadweep and Dadra & Nagar Haveli are covered under the Scheme.

#### 4. REGISTRATION OF BANKS

- (i) In terms of Section 11 of the DICGC Act, 1961, all new commercial banks are required to be registered by the Corporation soon after they are granted licence by the Reserve Bank under Section 22 of the Banking Regulation Act, 1949. All Regional Rural Banks are required to be registered with the Corporation within 30 days from the date of their establishment, in terms of Section 11A of the DICGC Act, 1961.
- (ii) A new eligible co-operative bank is required to be registered by the Corporation soon after it is granted a licence by the Reserve Bank.
- (iii) When the owned funds of a primary co-operative credit society reaches the level of Rs.1 lakh, it has to apply to the Reserve Bank for a licence to carry on banking business as a primary co-operative bank and is to be registered by the Corporation within 3 months from the date of its application for licence.

\* Since covered w.e.f. 1st July 2007

- (iv) A co-operative bank which has come into existence after the commencement of the Deposit Insurance Corporation (Amendment) Act, 1968, as a result of the division of any other co-operative society carrying on business as a co-operative bank, or the amalgamation of two or more co-operative societies carrying on banking business at the commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 or at any time thereafter, is to be registered within three months of its making an application for licence. However, a co-operative bank will not be registered, if it has been informed by the Reserve Bank, in writing, that a licence cannot be granted to it.

In terms of Section 14 of the DICGC Act, after the Corporation registers a bank as an insured bank, it is required to send, within 30 days of such registration, intimation in writing to the bank to that effect. The letter of intimation, apart from the advice of registration and registration number, gives details about the requirements to be complied with by the bank, viz., the rate of premium payable to the Corporation, the manner in which the premium is to be paid, the returns to be furnished to the Corporation, etc.

#### 5. INSURANCE COVERAGE

Under the provisions of Section 16(1) of the DICGC Act, the insurance cover was originally limited to Rs.1,500/- only per depositor for deposits held by him in "the same capacity and in the same right" at all the branches of the bank taken together. However, the Act also empowers the Corporation to raise this limit with the prior approval of the Central Government. Accordingly, the insurance limit has been enhanced from time to time as follows:

Effective from Date	Insurance Limit
January 1, 1968	Rs. 5,000/-
April 1, 1970	Rs. 10,000/-
January 1, 1976	Rs. 20,000/-
July 1, 1980	Rs. 30,000/-
May 1, 1993.	Rs. 1,00,000/-

## 6. TYPES OF DEPOSITS COVERED

The Corporation insures all bank deposits, such as savings, fixed, current, recurring, etc. except the deposits of (i) foreign Governments; (ii) Central/ State Governments; (iii) State Land Development Banks with the State co-operative banks; as also (iv) inter-bank deposits (v) deposits received outside India and (vi) deposit specifically exempted by the Corporation with the previous approval of the Reserve Bank.

## 7. INSURANCE PREMIUM

The Corporation collects insurance premia from insured banks for administration of the deposit insurance system. The premia to be paid by the insured banks are computed on the basis of their assessable deposits. Insured banks pay advance insurance premia to the Corporation semi-annually, within two months from the beginning of each financial half year based on its deposits as at the end of previous half year. The premium paid by the insured banks to the Corporation is required to be borne by the banks themselves and is not passed on to the depositors.

**Premium Rates\***

Date from	Premium (in Rs.)	Date from	Premium (in Rs.)
1-1- 1962	0.05	1-10-1971	0.04
1-7-1993	0.05	1- 4- 2004	0.08
1-4-2005	0.10		

\* Per assessable deposit of Rs. 100/-

For delay in payment of premium, it is liable to pay interest at the rate of 8 per cent above the Bank Rate on the default amount from the beginning of the relevant half-year till the date of payment.

## 8. CANCELLATION OF REGISTRATION

Under Section 15A of the DICGC Act, the Corporation has the power to cancel the registration of an insured bank if it fails to pay the premium for three consecutive half-year periods. However, the Corporation may restore the registration if the deregistered bank makes an appeal after paying all the default dues including interest, provided the bank is otherwise eligible to be registered as an insured bank.

Registration of an insured bank may also be cancelled if the bank is prohibited from accepting fresh deposits; or its licence is cancelled or a licence is refused to it by the Reserve Bank; or it is wound up either voluntarily or compulsorily; or it ceases to be a banking company or a co-operative bank within the meaning of Section 36A(2) of the Banking Regulation Act, 1949; or it has transferred all its deposit liabilities to any other institution; or it is amalgamated with any other bank or a scheme of compromise or arrangement or of reconstruction has been sanctioned by a competent authority where the said scheme does not permit acceptance of fresh deposits. In the case of a co-operative bank, its registration also gets cancelled if it ceases to be an eligible co-operative bank.

In the event of the cancellation of registration of a bank, other than for default in payment of premium, deposits of the bank as on the date of such cancellation remain covered by the insurance.

## 9. SUPERVISION AND INSPECTION OF INSURED BANKS

The Corporation is empowered (vide Section 35 of the DICGC Act) to have free access to the records of an insured bank and to call for copies of such records. On Corporation's request, the Reserve Bank is required to undertake / cause the inspection / investigation of an insured bank.

## 10 SETTLEMENT OF CLAIMS

- (i) In the event of the winding up or liquidation of an insured bank, every depositor is entitled to payment of an amount equal to the deposits held by him at all the branches of that bank put together in the same capacity and in the same right, standing as on the date of cancellation of registration (i.e. the date of cancellation of licence or order for winding up or liquidation) subject to set-off of his dues to the bank, if any [Section 16(1) and (3) of the DICGC Act]. However, the payment to each depositor is subject to the limit of the insurance coverage fixed from time to time.
- (ii) When a scheme of compromise or arrangement or re-construction or amalgamation is sanctioned for a bank by a competent authority,

and the scheme does not entitle the depositors to get credit for the full amount of the deposits on the date on which the scheme comes into force, the Corporation pays the difference between the full amount of deposit or the limit of insurance cover in force at the time, whichever is less, and the amount actually received by the depositors under the scheme. In these cases also the amount payable to a depositor is determined in respect of all his deposits held in the same capacity and in the same right at all the branches of that bank put together subject to the set-off of his dues to the bank, if any, [Section 16(2) and (3) of the DICGC Act].

- (iii) Under the provisions of Section 17(1) of the DICGC Act, the liquidator of an insured bank which has been wound up or taken into liquidation, has to submit to the Corporation a list showing separately the amount of the deposit in respect of each depositor and the amount of set off, in such a manner as may be specified by the Corporation and certified to be correct by the liquidator, within three months (Typical claim settlement mechanism in Chart 1).
- (iv) In the case of a bank/s under scheme of amalgamation/ reconstruction, etc. sanctioned by competent authority, a similar list has to be submitted by the chief executive officer of the concerned transferee bank or insured bank as the case may be, within three months from the date on which the scheme of amalgamation/reconstruction, etc. comes into effect [Section 18(1) of the DICGC Act].
- (v) The Corporation is required to pay the amount payable under the provisions of the DICGC Act in respect of the deposits of each depositor within two months from the date of receipt of such lists prepared in accordance with issued guidelines and complete / correct in all respects. The Corporation gets the list certified by a firm of Chartered Accountants who conduct on-site verification.
- (vi) The Corporation generally makes payment of the eligible claim amount to the

liquidator/chief executive officer of the transferee/insured bank, for disbursement to the depositors. However, the amounts payable to the untraceable depositors are held back till such time as the liquidator/ chief executive officer is in a position to furnish all the requisite particulars to the Corporation.

## **11. RECOVERY OF SETTLED CLAIMS**

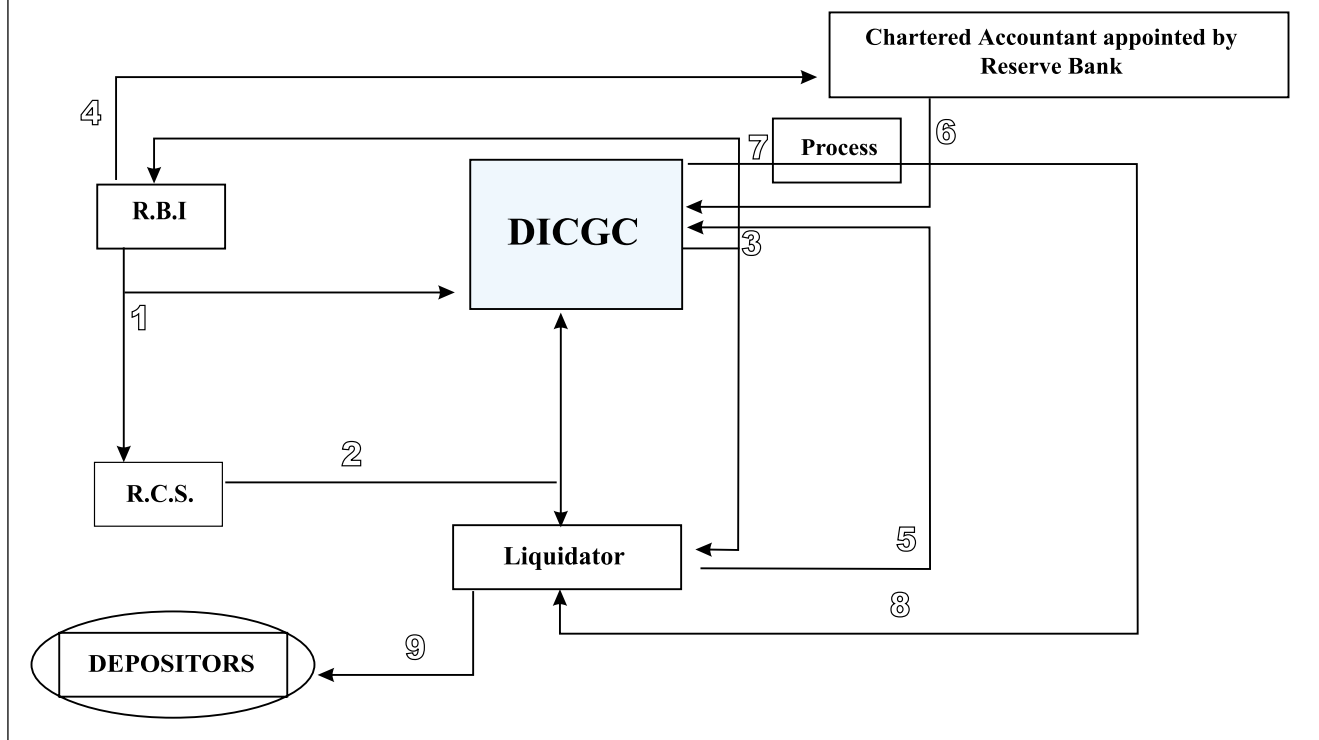
In terms of Section 21(2) of the DICGC Act read with Regulation 22 of the DICGC General Regulations, the liquidator or the insured bank or the transferee bank, is required to repay to the Corporation out of the amounts realised from the assets of the failed bank and other amounts in hand after making provision for the expenses incurred, as soon as such amounts are sufficient to form at least one per cent of the deposits.

## **12. FUNDS, ACCOUNTS AND TAXATION**

The Corporation maintains the following three distinct Funds viz. (i) Deposit Insurance Fund (DIF); (ii) Credit Guarantee Fund (CGF) and (iii) General Fund (GF). The first two funds are created by accumulating the insurance premia and guarantee fees, respectively and are applied for settlement of the respective claims. The authorised capital of the Corporation is Rs.50 crore which is fully subscribed to by the Reserve Bank. The General Fund is utilised for meeting the establishment and administrative expenses of the Corporation. The surplus balances in all the three Funds are invested in Central Government securities. Inter-Fund transfer of surplus is permissible under the Act.

The books of accounts of the Corporation are closed as on March 31 every year. The affairs of the Corporation are audited by an Auditor appointed by its Board of Directors with the previous approval of Reserve Bank. The audited accounts together with Auditor's report and a report on the working of the Corporation are required to be submitted to Reserve Bank within three months from the date on which its accounts are balanced and closed. Copies of these documents are also submitted to the Central Government, which are laid before each House

**Chart 1: Typical Mechanism of Settlement of Claims for Urban Co-operative Banks in India**



1. The Reserve Bank cancels the licence / rejects the application for licence of a bank and recommends its liquidation to the concerned Registrar of Co-operative Society (RCS) with endorsement to the DICGC.
2. The RCS appoints a Liquidator for the liquidated bank with endorsement to the DICGC.
3. The DICGC cancels the registration of the bank as an insured bank and issues guidelines for submission of the claim list by the liquidator within 3 months and requests Reserve Bank to appoint an external auditor [Chartered Accountant, (C.A)] for on-site verification of the list.
4. The Reserve Bank appoints C.A. and the DICGC conducts briefing and orientation session for C.A. to check the claim list.
5. The Liquidator submits the claim list for payment to the depositors (both hard and soft forms).
6. The external auditors (C.A.) submit their report on the aspects of the claim list.
7. The claim list is computer-processed and payment list is generated.
8. Consolidated payment is released to the Liquidator and further information is sought on incomplete/doubtful claims. The release of claims is announced through the website of the Corporation.
9. The liquidator releases the payment to the depositors.

of the Parliament. The Corporation follows mercantile system of accounting and it adopted the system of actuarial valuation of its liabilities from the year 1987 onwards.

The Corporation has been paying income tax since the financial year 1987-88 and fringe benefit tax since 2005-06. The Corporation is assessed to Income Tax as a 'company' as defined in the Income Tax Act, 1961.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

### 1. DEPOSIT INSURANCE – IMPORTANT ISSUES

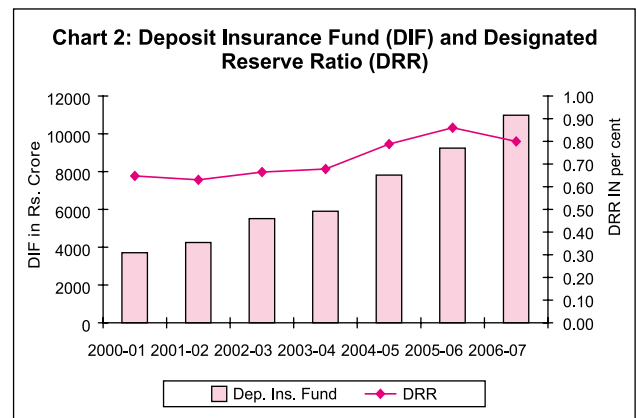
#### 1.1 Financial Stability

The rapid advances in technology and consolidation coupled with the expansion of banking activities into new areas and related risk continually challenges the role of deposit insurer as also other elements of the financial safety net. DICGC contributes to the stability of the Indian financial system by protecting depositors against the loss of their eligible deposits in insured banks in the event of their failure. Although deposit insurance can provide stability and safety net, its vulnerability to moral hazard is well known. Accordingly, as insurer of bank deposits, the Corporation must continually evaluate and effectively manage the adequacy and the viability of the deposit insurance funds.

#### 1.2 Target Funding

To achieve the objectives of protecting depositors and maintaining the stability of the financial system, deposit insurance agencies must have access to adequate liquid funds. The access to funds can be obtained either by building a reserve or by having the power to obtain funds when needed. Establishing a fund has many advantages. It provides the deposit insurance agency with a safe and liquid source of funds to reimburse depositors. To determine whether a given level of funding is sufficient, deposit insurers need to compare the potential needs or losses with the resources that will be available. Many Deposit Insurance Systems find it useful to set a target level for the fund (usually expressed as a percentage of total or insured deposits) that would allow it to attain and retain financial viability. The target provides an indication of the premium that exceeds its target level, or to be raised to replenish a depleted fund. The greater the exposure of the deposit insurance agency, greater must be its target level of funding. In setting the target level of funding the Deposit Insurer needs also to consider its risk exposure in terms of its portfolio of insured institutions. Target funding varies across countries (Box 1).

The Corporation builds up its Deposit Insurance Fund (DIF) through transfer of excess of income over expenditure each year. This fund is used for settlement of claims of depositors of banks taken into liquidation/ reconstruction/ amalgamation etc,. The current size of the DIF (including surplus) is Rs.10,978.82 crore as on March 31,2007 representing 0.80 per cent of the insured deposits (Chart 2). Significantly, the cumulative settlement of claims (i.e. the amount of claims paid/provided for since the inception of the Deposit Insurance Scheme) in respect of co-operative banks has increased steeply by as much as 32 times during the last six year period from Rs.71.99 crore as on March 31, 2001 to Rs.2298.50 crore as on March 31, 2007. Keeping in view the high incidence of claims following failures of several co-operative banks over the last few years and emerging trends, it is considered expedient to have a target fund ratio of 5% in Indian context. The international norm for Reserve / Fund ratio is around 2%.



#### 1.3 Premium Collection

The most important source of deposit insurance fund is premium from the insured banks. In practice, two dominant approaches are in vogue for collection of premium, viz. fixed premiums or risk-adjusted premiums. Among these two approaches the latter is generally considered superior on the canons of fairness in assessment and mitigation of moral hazard.

In order to sensitise the banks to improve their risk profile, it is considered necessary to develop differential premium system whereby banks will be charged premium in accordance with their credit risk profile as also to bring fairness in levying premium.

### Box 1: Target Fund Ratio

A deposit insurance fund should, in principle, be large enough to reduce the probability of the fund's insolvency to an acceptable minimum, given the inherent constraints faced by the deposit insurer. One of the major difficulties of a deposit insurer is estimating probability of loss, which may be lower in the immediate future when the economy and depository institutions are healthy. Thus DIS fund should not only be able to deal with **expected losses**, i.e. the average losses to the fund, but it should also have a **volatility reserve** to absorb **unexpected losses**. A wide range of factors need to be taken into account for the target reserve ratio approach. These include characteristics of the banking sector such as the number and size of banks, the liabilities of member banks and the risk exposure of the insurer to them, the likelihood of failures and the characteristics of losses typically experienced by the insurer.

Many countries find it useful for the deposit insurance agency to set a target level for the fund (usually expressed as a percentage of total or insured deposits) that would allow it to attain and retain financial viability and avoid the financial deficiencies that lead to forbearance for troubled banks and/or insolvency of the fund. When the insurance system is new, the target will be initially set after forecasting the income and expenses (including outlays to compensate depositors of failed banks) of the fund. The target then provides an indication of the premium that need to be set, and subsequently whether they should be reduced when the fund exceeds its target level, or raised to replenish a depleted fund. Setting an appropriate target demands a realistic assessment of the condition of the banking industry, the size and timing of the financial demands that are likely to be placed on the fund, the system's ability to borrow when necessary, and the industry's ability to pay the necessary premium without prejudicing its profitability, solvency, and liquidity.

In USA, FDIC Reform Act of 2005 has been amended where fixed DRR of 1.25 per cent has been replaced by a

range of 1.15 per cent to 1.50 per cent and allows the FDIC to manage the reserve ratio within this range. If the reserve ratio falls below 1.5% or is expected to do so within six months, the FDIC must adopt a restoration plan that provides DIF to return the reserve ratio to 1.15% within five years. FDIC Act 2005 generally mandates dividends to the industry of one-half of any amount above the 1.35% level and of all amounts in the fund above the 1.50% level.

In Canada, DIS does not have any target with respect to the size of the fund. The CDIC Act provides that CDIC shall maintain a fund, the Deposit Insurance Fund, to which all premium received by the Corporation shall be credited. There is, however, no obligation on CDIC to have a positive amount in the fund and CDIC has often operated in a deficit position. Currently, CDIC has a general provision for future losses of \$500 million. The provision is calculated on an annual basis and represents CDIC's estimate of the potential cost associated with the failure of certain high risk members and of insuring deposits generally. It may also be mentioned that although CDIC has a provision for loss, it does not have a fund and its possible size.

Country-wise target funds set by their respective deposit insurance system is set out in Table 1.1. As can be observed from the table that Italy and the United Kingdom have small targets for covering administrative expenses in their ex post schemes, but small size does not reflect on the adequacy of the capital resources of the system in these countries. The target in funded systems ranges from a low of 0.4 per cent of all deposits in Poland to the very high levels of 20 per cent of insured deposits in Kenya. The level of accumulation actually achieved by most countries falls below the targeted level. Funding deficiencies are not universal, however, Ukraine reports a healthy balance of 10 per cent of insured deposits in its fund, Tanzania approximates the target for its fund, and the United States' balance in its funds exceeds their targets.

Table 1.1

Country	Legal Mandate/Fund Target	Country	Legal Mandate/Fund Target
Argentina	5% of total deposits.	Romania	10% of personal deposits.
Brazil	5% of guaranteed deposits	Slovak Republic	1.5% of insured deposits
Germany	Yes. 3% of loans.	Spain	1.0% of deposits.
Greece	A reasonable level.	Sweden	2.5% of total deposits.
Hungary	Informally 1.5% insured deposit	Taiwan	<5% of insured deposit deposits.
Italy	0.4-0.8% of covered deposits: for deposits: for administrative expenses	Tanzania	3% of total deposits
Kazakhstan	Yes T 500 million.	United Kingdom	£5m-£6m for administrative expenses.
Kenya	20% of insured deposits.	United States	By law: Range of 1.15% - 1.50% of insured deposits.

#### References

Financial Stability Forum (2001), 'Guidance for Developing Effective Deposit Insurance Systems', September.  
Garcia, G.G.H(2000), 'Deposit Insurance – Actual and Good Practices', IMF Occasional Paper No. 197, Washington DC.

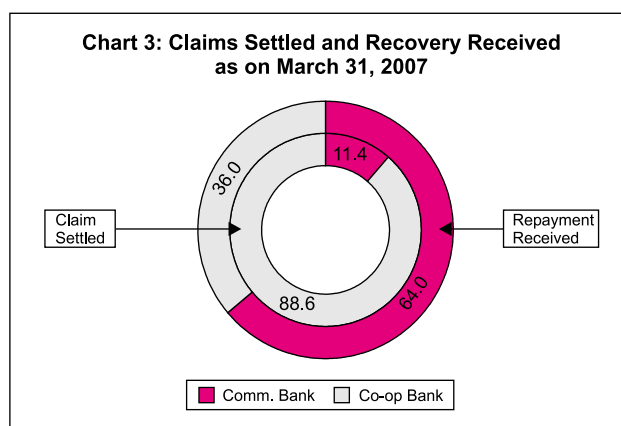
## 1.4 Recovery Performance

As a general principle, a deposit insurer should have all powers necessary to fulfill its mandate which relate to enforcement and intervention, failure resolutions and optimization of recoveries. Existing deposit insurance systems demonstrate that deposit insurers under the pay-box system have no role in failure resolution process or the process of liquidation, while under the extended mandate the insurer, depending on the statutory provisions, assumes added rights/responsibilities of acting as liquidator/receiver, has the powers to inspect, finance, have a say in the appointment of liquidators etc. Internationally, under the pay-box system, the realisation of an institution's assets is carried out by a Liquidator or an Administrator under the country's bankruptcy laws. No special strategy is adopted by the deposit insurance system in this regard (UK, Czech Republic, Brazil etc.). However, in certain countries the laws of the land empower the deposit insurers to assume the role of liquidators/receivers (Federal Deposit Insurance Corporation, USA, Canada Deposit Insurance Corporation, Philippine Deposit Insurance Corporation, Kazakhstan Deposit Insurance Fund, Central Deposit Insurance Corporation, Taiwan etc); to carry out the process of liquidation through subsidiary organizations/ contractors/ virtual organisations (Deposit Insurance Corporation of Japan, Federal Deposit Insurance Corporation, USA, Canada Deposit Insurance Corporation,) etc. While outsourcing this job or while utilizing the services of professionals in the form of a virtual organization the insurers manage the process through specific contracts. There is an element of incentive built in the process. Performance requirements are also outlined in the appointment agreements.

As per the provisions of the DICGC Act, out of the recoveries realized from the sale of assets of failed / liquidated bank, the liquidator after making provision for expenses i.e., taxes, dues of workers, salary and other current payments to employees, is required to repay to the Corporation. DICGC follows a 'Pay Box' system with practically no say in the closure process of failed institutions. However, in respect of commercial banks there is a well established system of monitoring the process of amalgamation/ liquidation by the regulatory department in the RBI. In the case of commercial banks, sections 45 (Q) and 45 (R) of the Banking Regulation Act, 1949, confer on the Reserve

Bank the powers to inspect and call for returns/ information from commercial banks placed under liquidation. With regard to co-operative banks, the liquidators are appointed by the Registrar of Co operative Societies (RCS) of the state concerned.

As of March 31, 2007 only 5.12 per cent of the total claims settled since inception have been recovered by the Corporation. While recovery from commercial banks in respect of claims settled worked out to 28.76 per cent, that in respect of co-operative banks was only 2.08 per cent. As of March 31, 2007, co-operative banks accounted for 88.6 per cent of total claims settled, while commercial banks accounted for 11.4 per cent. Against this, while commercial banks accounted for 64.0 per cent of the total recovery, co-operative banks accounted for 36.0 per cent only (Chart 3).



State-wise analysis of cumulative deposit insurance claims settled by the Corporation reveal that Gujarat, Maharashtra and Andhra Pradesh together account for 93 per cent of total claims settled. The state of Gujarat alone accounts for nearly 74 per cent of the claims settled. While the position of recovery in some states like New Delhi, Kerala and MP is more or less satisfactory and ranges between 19.2 per cent and 97.0 per cent, the position of recovery in the states of Maharashtra, Gujarat and Andhra Pradesh is poor, ranging between 0.18% and 9.06%.

## 1.5 Risk Minimization

A deposit insurer with risk-minimizer mandate achieves it by controlling the entry and exit of member institutions, assessing and managing its own risk. Sometimes it may also provide financial assistance to resolve failing banks in a manner that minimises its losses.



In general, pay-box systems do not have authority over the entry and the exit of member institutions. However, some countries (viz., Cyprus, Sweden and Tanzania) with pay-box systems, have this authority. On the other hand, some deposit insurance systems like Jamaica, Quebec and Taiwan also have the power to terminate the insured status of a member institution. Further, risk minimizing deposit insurers generally have control over entry into the deposit insurance system (e.g. applications and licensing), one of the exceptions being Canada. Prior to 2005, CDIC had the authority to grant membership for both

federal and provincial institutions. However, Canada's role in applications for federal institutions was revoked in 2005 leaving it with only the authority to approve new provincial member applications.

The Deposit Insurance and Credit Guarantee Corporation does not have the authority over the entry and exit of the member banks. It has only a narrow mandate of "pay-box" system unlike FDIC (USA), PDIC (Philippines) etc. It has to go a long way in order to adopt the role of risk-minimizer. Important pre-requisites for adoption of role of risk-minimizer are provided in Box: 2.

### **Box 2: Pre-requisites for Risk-minimization**

It is generally observed that the risk minimizing deposit insurers have wide set of powers and authorities over the lifecycle of the member institutions to fulfill their mandate and minimize their exposure to risk. Despite the dissimilarities in their mandatory roles and public policy objectives, the set of powers of various systems are almost identical in this respect. The deposit insurers in this category usually have the following powers:

#### **a. Authority to enter into contract or set business regulations.**

Unlike other types of deposit insurers, most of the risk minimizers have the authority to enter into contract and to set up their own business regulations.

#### **b. Authority over entry and exit of member banks**

With the exception of CDIC (Canada), risk minimizing deposit insurers have authority over entry and exit of member institutions.

#### **c. Authority to access depositors' records**

Consistent with their responsibilities and public policy objectives as insurer and receiver of failed institutions, risk minimizers have adequate and timely access to depositors' information directly from member institutions.

#### **d. Authority to decide on funding sources**

Most of the risk minimizers have the authority to determine their sources of funds, borrowing limits and the levels of premium or levies.

#### **e. Access to member institution information**

The risk minimizing deposit insurers have direct access to member institutions' information. They receive directly periodic reports for regular off-site examinations and have the authority to request additional information or to conduct intense and focused examination of troubled institutions.

Risk minimizers have also access to regular examinations and reports of other regulators.

#### **f. Enforcement and intervention**

Given the broad functions of risk minimizing deposit insurers, deposit insurers have the authority to conduct on-site examinations or reviews and the authority to take enforcement actions against member institutions including the right to cancel or terminate the deposit insurance of any member institution. With the exception of CDIC (Canada) risk minimizing deposit insurers generally also have the authority to set standards or guidance for member institutions.

#### **g. Power to determine the resolution method of a failed bank**

Risk minimizing deposit insurers are the receivers of failed insured institutions and the responsible entity for liquidation and assets disposition. They have the authority to decide on the appropriate form of failure resolution; the authority to undertake formal liquidations, purchase of assets and assumption of liabilities and other forms of failure resolutions. As for the financial assistance for member institutions, risk minimizers have the authority to provide different forms of financial assistance, including granting direct loan, guaranteeing deposits and loans provided by third parties beside the authority to extend open bank assistance.

#### **h. Recoveries Optimization**

The liquidation powers in the countries that have risk minimizing deposit insurance system belong to the insurer. Risk minimizers assume the role of the legal receiver or liquidator of failed member institutions and are responsible for claims and recovery of assets. They act directly as a liquidator of failed member institutions or they might appoint a liquidator to follow up the liquidation process.