Navigating Emerging Challenges for Deposit Insurers and Fortifying Crisis Preparedness[1]

Mr. Alejandro Lopez, President, International Association of Deposit Insurance (IADI), Dr. Eva Hupkes, Secretary General, IADI, Mr. M. Rajeshwar Rao, Deputy Governor, Reserve Bank of India (RBI), distinguished representatives of the IADI and the Asia Pacific Regional Committee (APRC) Secretariat, chief executive officers (CEOs) and officials of deposit insurance agencies, delegates from central banks, eminent speakers and panellists, invitees representing banks in India, and my colleagues from the Deposit Insurance and Credit Guarantee Corporation (DICGC) and the Reserve Bank of India (RBI), good morning to you all.

On behalf of the IADI APRC, it is my privilege to welcome each one of you to Jaipur and to this Conference being hosted by the DICGC after a gap of nearly 13 years - the last one was held in November 2011 at Jodhpur, a city not far from here. Founded in 1727 by Maharaja Sawai Jai Singh (the second) II, Jaipur is unique for its historic significance and is renowned worldwide for its architecture, culture, history, and art. It is famously known as the Pink City due to the distinctive colour of its buildings, which were painted pink to welcome the Prince of Wales in

[1] Keynote Address delivered by Michael Debabrata Patra, Deputy Governor, Reserve Bank of India (RBI) at the International Association of Deposit Insures (IADI) Asia Pacific Regional Committee (APRC) International Conference hosted by Deposit Insurance and Credit Guarantee Corporation (DICGC) on August 13, 2024 at Jaipur Rajasthan, India. Valuable comments received from Anup Kumar, Kirtan Singh Ningwal, Dhaval Sanghvi, Ishan Katyal, Prithviraj Harish, Shobhit Agarwal, Arun Vishnu Kumar and editorial help from Vineet Kumar Srivastava are gratefully acknowledged.

1876. Jaipur is home to several UNESCO World Heritage sites. It is also one of India's first planned cities.

Over the next two days, our DICGC team has designed sessions with topically relevant themes that we hope will capture your interest and engage your involved participation. We shall crystal gaze into the outlook for deposit insurance in the context of newer financial technologies, including central bank digital currencies (CBDCs) and tokenised deposits. We shall also delve into climate-related financial risks and the imperative of putting in place crisis preparedness and business continuity management procedures and policy frameworks. We believe these discussions are timely as they would enable us to make deposit insurance more resilient and future ready. I am sure that the ideas, knowledge and experiences shared during the conference will shine light on the path that lies ahead for practitioners in this increasingly multi-faceted field.

It is globally accepted that the deposit insurance function is critical to the design and effective functioning of a robust financial safety net in an economy. It operates in conjunction with and enhances the efficacy of the functions of prudential regulation, supervision, lender of last resort (LOLR)/ emergency liquidity assistance (ELA) and resolution. Together, they instil public confidence in the financial system and anchor financial stability on an enduring basis. This assumes critical relevance in the context of the hurtling pace at which the financial landscape is evolving across many dimensions. Let me begin with deposit insurance crossing over the virtual frontier.

2. Digitalisation of Finance

The digitalisation of financial services brings a variety of opportunities for deposit insurers to fulfil their mandate in more efficient and effective ways, including modernisation in reimbursement, supervision, resolution and in communication. Digitalisation also goes hand in hand with significant economies of scale. Yet as the experience with banking sector stress in some jurisdictions in March 2023 showed, it could also amplify and accelerate the materialisation of financial stability risks in the form of episodes of extreme volatility induced by the interaction of online banking and individual depositors coordinating through social media to fuel deposit outflows. In fact, digital financial products and services are confronting deposit insurers with fundamental questions regarding the fulfilment of their mandate – the potential coverage of new financial products; assessing and pricing associated risks; the increased relevance of beneficiary accounts through e-money issuers; and the involvement of third parties. Moreover, new business models give rise to new risks or may increase the relevance of existing risks. Digitalisation also entails cybersecurity risk. The unavailability of essential technical infrastructure or unscrupulous activity against such infrastructure has the potential to significantly impair deposit insurers' business continuity.

Two digital innovations in currencies and payment systems merit special attention as both have implications for deposit insurance. The first one is central bank digital currency (CBDC) – legal tender or fiat currency issued by a central bank in a digital form. The major advantages of CBDCs are the finality of transactions (settlement risks is eliminated as there is no bank intermediation), and real-time and cost effective globalisation of payment systems. In the medium term, adoption of CBDCs by unbanked people could enhance financial inclusion. As an increasing number of central banks face the risk of large-scale use by the public of private or digital instruments that may not be backed by or denominated in the domestic currency, CBDCs may assist in mitigating this risk by being a central bank liability and a form of digital cash. To the public, they would be an alternative to central bank issued cash and – to a certain extent – to private money, such as bank deposits.

The impact of CBDC on deposits and hence deposit insurance is largely unknown as of today. The operating models and design features of each individual jurisdiction's CBDC will be a crucial factor in expanding our understanding of the balance of risks. For deposit insurers, factors of key interest would be the degree of replacement of bank deposits by CBDC, the division of labour between central and commercial banks and the degree of privacy attached to CBDC usage. They also need to contend with the possibility that during crises triggering depositor panic, CBDCs could be perceived as a safe haven, thus rendering bank deposits, particularly uninsured deposits, more prone to withdrawal and hence the risk of bank runs. Given the inherent links between such systems and the objectives and operations of deposit insurers, it is expected that the topic of CBDC will continue to grow in relevance for deposit insurers and the IADI, warranting the need to keep abreast of developments and policy deliberations as they emerge.

Second, the digital payments space is undergoing a silent revolution. In over 70 countries today, domestic payments reach their destination in seconds at near-zero cost to the sender or the recipient with the growing availability of instant payment systems (IPS).[2] Deposit insurers are having to re-evaluate operational risks posed to depositors and member banks from the emergence of these 24/7 payment systems. While digital innovations can ease cross-border supply of financial services, they can also increase the likelihood of deposit insurers exposed to member banks with a significant share of non-domestic depositors and additional

[2] https://www.bis.org/about/bisih/topics/fmis/nexus.htm

challenges in the case of a payout following bank default. In fact, the increasing ambit of cross-border banking activities makes cross-jurisdiction cooperation between deposit insurers and other financial safety net participants all the more relevant.

3. Tokenised Deposits

The growing adoption and utilisation of blockchains and distributed ledger technology has given traction to tokenised deposits or digital representations of traditional bank deposits hosted on a secure blockchain. Tokenisation and unified ledgers are also central to the Bank for International Settlement's (BIS's) vision for "Finternet"[3]. Deposit tokens can be of two types: 1) bearer-like instruments which are transferable; and 2) non-transferable claims which are settled in central bank money or wholesale CBDC. From the user's perspective, tokenised deposits should be inter-operable with different systems, provide the same level of trust and confidence as other forms of money and should also comply with the "singleness of money"[4] – the same value as other forms of money. Tokenised deposits may have various use cases across domestic and cross-border payments, trading and settlement, and for cash collaterals. In fact, by being programmable, they can be used seamlessly in smart contracts, merging payment information and payment value to provide "atomic" settlement[5]. Overall, tokenised deposits may provide benefits of increased liquidity, cost effectiveness, improved accessibility (24x7), fractional ownership and quick settlements. The BIS's Project Agora[6]

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[3] https://www.bis.org/publ/work1178.htm
[4] https://www.bis.org/publ/bisbull73.htm
[5] Blockchain equivalent of delivery versus payment (DvP). Tokens and assets for which payment is made are transferred simultaneously.
[6] https://www.bis.org/press/p240403.htm

(Greek for “marketplace”) will explore how tokenisation can enhance the function of the monetary system.

Regulatory and financial stability issues associated with tokenisation include the potential to amplify bank runs in times of stress; the legal architecture required to ensure that tokenised deposits are treated as traditional deposits for various purposes, including for deposit insurance; operational risks and cyber security concerns; and technology solutions for ensuring seamless payments and resolution of troubled banks.

Deposit insurers must remain in readiness for tokenised deposits by reflecting on how to modify their mandates and coverage, considering that tokenised deposits are essentially claims on issuing banks like other forms of deposits. Moreover, the risks posed by tokenised deposits have to be modelled for determining fund size and premium rates. They will also have a bearing on the choice of modalities for resolution and claim processing, with different banks using different technologies as also the possibility that tokenised deposits could be held by depositors who are not KYC compliant and not clients of issuing banks. Consequently, verification of the authenticity and genuineness of claims may prove to be a testing challenge.

4. Climate Change-related Financial Risks

2023 was the warmest year in recorded history and 2024 may eclipse it. Climate change is overwhelming us, imperilling humanity and the planet. Green swan events due to climate change are likely to recur with rising intensity. Threats to financial stability through physical risks and transition risks are already impacting the balance sheets and operations of banks and other financial intermediaries from the rising incidence of economic costs and financial losses from severe climate events. As economies transition towards net zero targets, banks may be even more severely impacted by transition risks from policy changes, technological developments and investor and consumer preferences influenced by environmental, social and governance (ESG) goals. It is against this backdrop that the Basel Committee on Banking Supervision (BCBS) has issued 18 principles for effective management and supervision of climate related financial risks. Some central banks and regulators are engaged in the design and conduct of climate stress tests with a view to informing the framing of monetary policy strategies and regulatory and supervisory approaches for climate-related financial risk management among regulated entities.

From the point of view of deposit insurance, climate risks are different from traditional risks in the sense that effective insurance schemes and hedging tools are not available. Furthermore, modelling these risks is challenging due to evolving green taxonomy and non-availability of data on greenhouse gas (GHG) emissions, particularly on emissions down the value chain or scope 3 emissions. Nonetheless, as the frequency and severity of natural disasters increase and morph into financial stability considerations, it is crucial for deposit insurers to prepare for actively assessing and addressing the potential impact of climate change on the institutions they oversee. In fact, the IADI's surveys show that the majority of deposit insurers expect the relevance of ESG to increase, with implications for net claim outflows and resolution costs. Fund management by deposit insurers may need an overhaul, incorporating climate friendly avenues such as sovereign green bonds which are increasingly gaining traction.

Some of the options that deposit insurers can explore are climate risk-based premiums, climate stress testing of funds, and building in elements of sustainability into fund management, risk monitoring and resolution plans.[7] Additionally, collaboration and knowledge-sharing among deposit insurers, regulators and industry stakeholders can help establish best practices and enhance resilience in the face of climate risk while ensuring the stability of financial systems.

5. Enhancing Crisis Preparedness and Business Continuity Management

It is evident that in addition to traditional risks, the new risks that have been set out earlier make it imperative for deposit insurers and other financial safety net participants to put in place frameworks for crisis preparedness and management that enhance their ability to manage the failure of deposit taking institutions while mitigating potential contagion effects. Crises tend to propagate quickly and hence must include augmented provisions of emergency liquidity assistance and pre-emptive interventions in troubled institutions.

The IADI's Core Principle 6 on "Deposit Insurer's Role in Contingency Planning and Crisis Management" suggests contingency planning and crisis management policies and procedures to ensure effective responses to bank failures and other catastrophic events. Moreover, as pointed out therein, system-wide crisis preparedness strategies and management policies should be the joint responsibility of all safety net participants and co-ordination between them is essential. Core Principle 4 also emphasises the strengthening of relationships with other safety net participants. Core Principle 9 recommends that emergency funding arrangements for the deposit insurance system – including pre-arranged and assured sources of liquidity funding – may be explicitly set out (or permitted) in law or regulation, including market borrowing. Deposit

[7] IADI Survey Brief on The Role of Climate in Deposit Insurers' Fund Management, 2023.

insurers should actively implement these guidelines and formulate toolkits to address emerging risks.

6. Conclusion

In closing, I would like to address the environment in which deposit insurance operates in India in the context of these new challenges. India has started a pilot for wholesale CBDC (e₹-W) starting November 01, 2022 and retail CBDC (e₹-R) starting December 01, 2022. India is also leveraging its digital public infrastructure to be in the forefront of the digital revolution sweeping the world. The Unified Payments Interface (UPI) provides immediate money transfer through mobile devices round the clock 24*7*365 and brings access to multiple bank accounts and various financial services under a single app. India is also engaged in interlinking UPI with fast payment systems (FPS) of other countries to make cross-border payments instant and efficient. The RBI has joined the Project Nexus, a multilateral international initiative conceptualised by the Innovation Hub of the BIS to enable instant cross-border retail payments by interlinking FPSs of Malaysia, Philippines, Singapore, Thailand and India. Turning to the climate, the Government of India has announced that the net zero target to be achieved by 2070 along with other climate goals ahead of net zero. The RBI has issued a framework for acceptance of green deposits and a disclosure framework on climate-related financial risks in 2024 which envisages climate-related disclosures. The Government of India has also been issuing sovereign green bonds.

These developments are defining milestones in the DICGC’s journey of six decades. Under its “paybox plus” mandate, the Corporation is authorised to make interim payment of claims within a stipulated timeline to depositors of banks placed under restrictions on deposit withdrawals (even before liquidation or amalgamation). As on March 31, 2024 interim payments were made to 376,661 depositors amounting to ₹5359 Crores (approximately USD 640 Million). The DICGC's coverage includes 1997 banks comprising 140 commercial banks and 1,857 cooperative banks – the largest number of deposit-taking institutions covered by deposit insurance in the world, second only to the US. Currently, the deposit insurance coverage limit (₹500,000 or approximately USD 6,000), fully protects 97.8 per cent of deposit accounts and 43.1 per cent of deposit value. In the context of the emerging challenges, the DICGC is prioritising risk management, including contingency planning and crisis management frameworks. Digital transformation of all operations is underway. Public awareness campaigns are being refashioned and stepped up. Work on ESG policy is being prioritised alongside a strong focus on climate risk.

The global financial landscape is changing rapidly. For deposit insurers and other financial safety net participants, it is a race to stay ahead of the curve amidst these tectonic shifts. I am sure that your deliberations over the next two days will enhance our collective understanding of the emerging challenges so that we adapt, prepare and remain relevant and meaningful in inspiring public confidence and preserving financial stability.

I wish the Conference all success.

Thank You.

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