

Funds Management – Context, Set-up and Funds Flow Tracking

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**Investment Management for
Deposit Insurance Agencies**

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निक्षेप बीमा और प्रत्यय गारंटी निगम

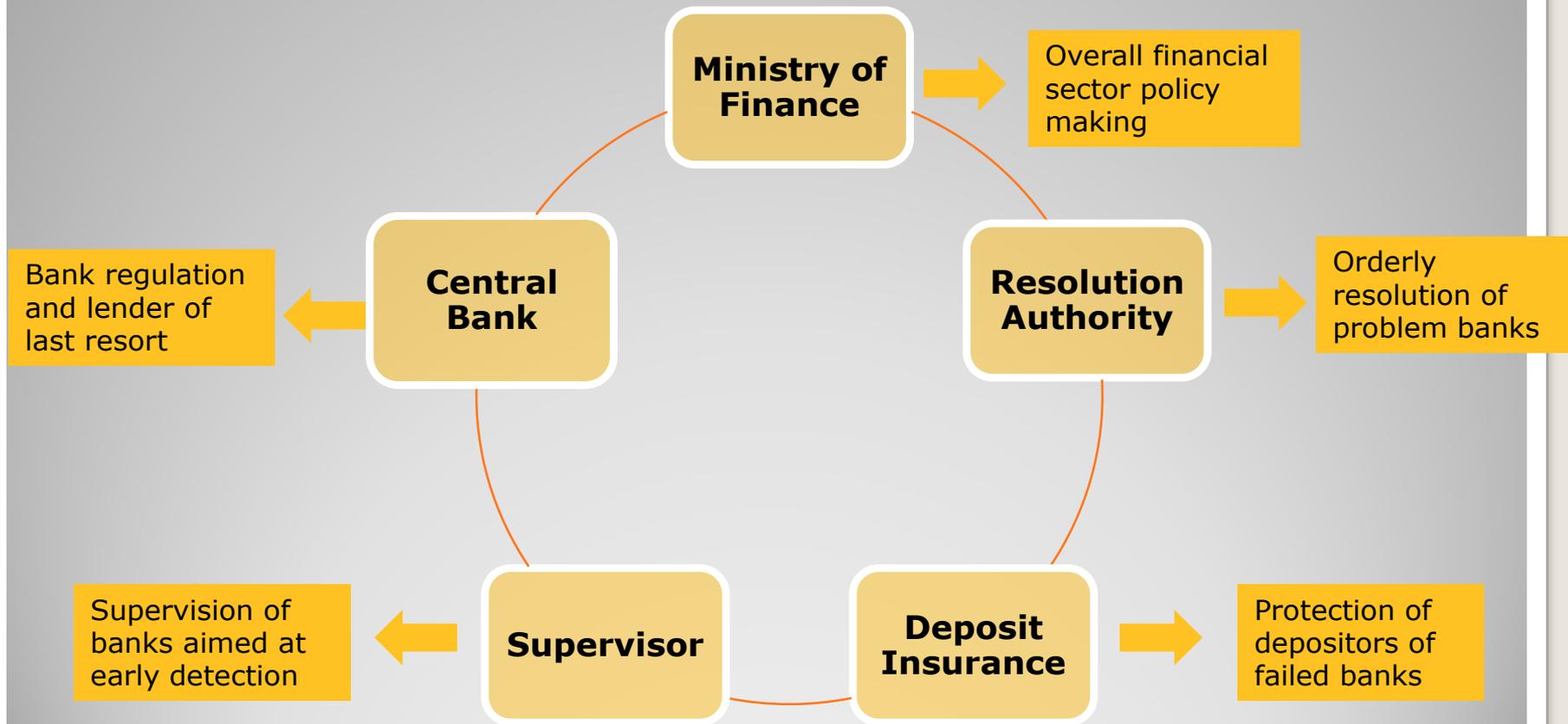
DEPOSIT INSURANCE AND CREDIT GUARANTEE CORPORATION

(भारतीय रिज़र्व बैंक की संपूर्ण स्वामित्ववाली सहयोगी Wholly owned subsidiary of the Reserve Bank of India)

PRESENTATION OUTLINE

- **Safety net framework**
- **Fund management**
 - **Conceptual framework**
 - **Indian context**
- **Investment management**
 - **Conceptual framework**
 - **Indian context**

FINANCIAL SAFETY NET FRAMEWORK



FINANCIAL CRISIS – EVOLUTION OF REGULATORY FRAMEWORK

- Review of deposit insurance systems and resolution frameworks
- Role of DIA in systemic crisis management (not only protecting depositors of failed individual banks but also stabilising the overall financial system)
- Increased role of DIS as resolution authority
- Crisis arrangements – enhanced interaction among Central Bank, Supervisor, Ministry of Finance and DIA

DI SYSTEM– DIFFERENT MANDATES

- Roles of DIAs differ:
 - Paybox
 - Paybox plus
 - Loss minimizer
 - Risk Minimizer
- For the deposit insurer agency to perform its role, it has to be backed by adequate fund.

CORE PRINCIPLE 11 ON FUNDING:

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

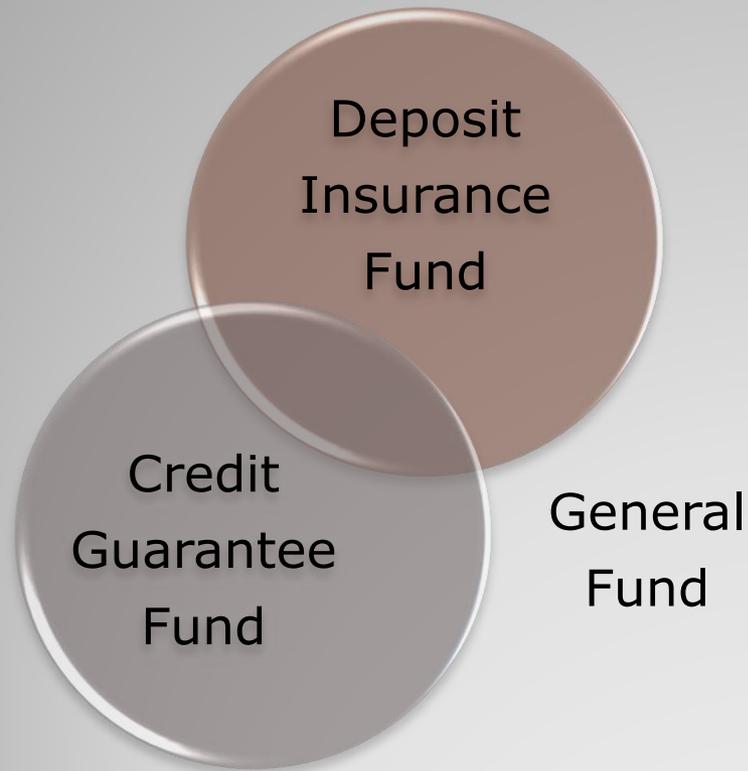
FUND MANAGEMENT

- **Type of Funds** – Ex-ante, Ex-post and Hybrid
- **Sources of Funds** –
 - Capital (initial contribution)
 - Premium from member institutions
 - Investment income
 - Share in recoveries
 - Lines of credit (from CB/MoF)
 - Borrowings
- **Use of Funds** –
 - Payouts
 - Resolution Funding
 - Operational Expenditure
 - Other (Taxes?)

A SNAPSHOT OF DICGC

- Founded in 1962
- Paybox mandate (credit guarantee mandate added in 1978 but has remained non-operational since 2003)
- Provides funding for mergers of banks
- Maintains three distinct funds
- Insurance limit of INR 0.1 mn fully protects 93% of accounts and covers 35% of deposit value
- Insures 2174 banks, including 2011 co-operative banks
- Claims largely originate from co-operative banks

FUND MANAGEMENT BY DICGC



- DICGC maintains three balance sheets
- DIF – Largest Fund
- CGF – Small fund; no schemes at present
- GF – Used for operational expenses
- Transfer between funds is permitted
- Limited explicit back-up funding

SOURCE AND USE OF FUNDS IN DIF

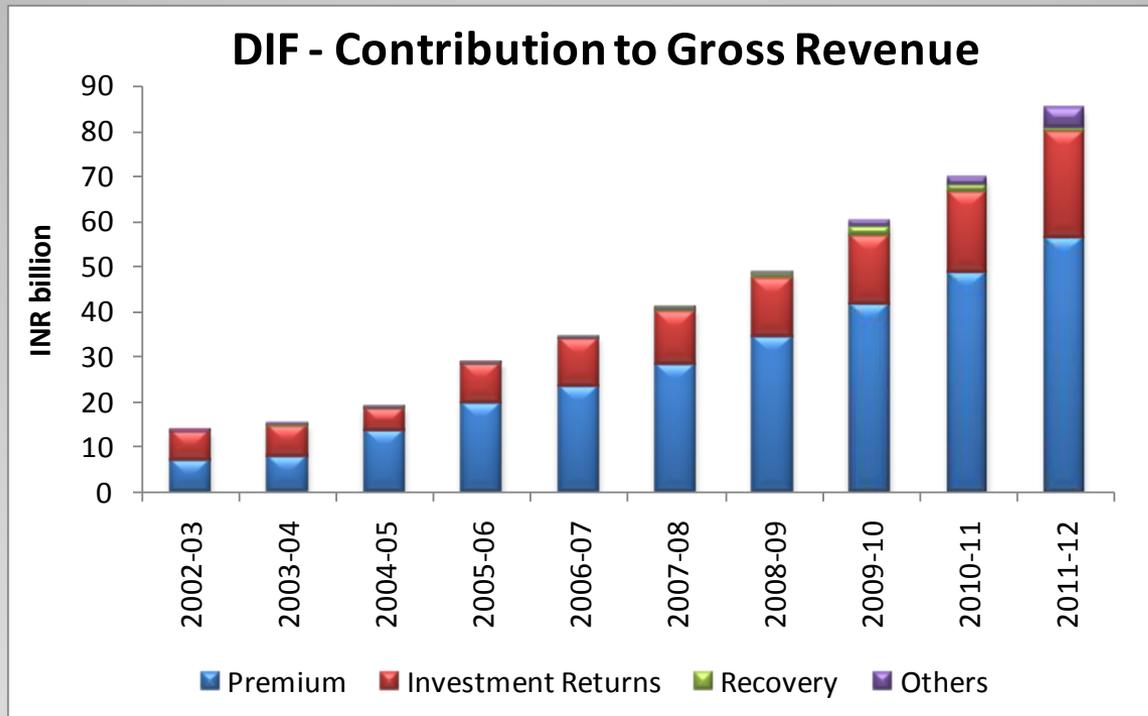
SOURCE OF FUNDS

- Premium from insured banks
- Recoveries
- Coupon (Interest) received from existing investments
- Income from Reverse Repo transactions
- Any capital gains from rebalancing activity

APPLICATION OF FUNDS

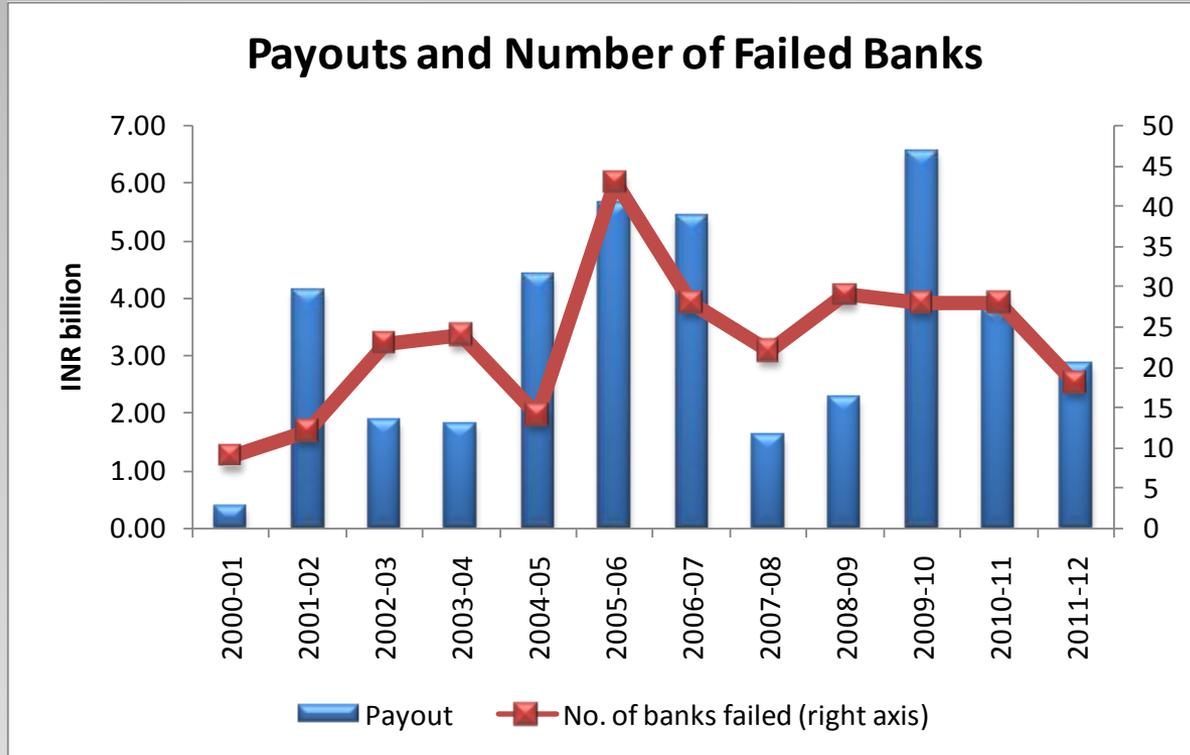
- Settlement of Claims
- Tax Payments:
 - Income Tax
 - Service Tax
- Operational expenses
- Any capital losses from rebalancing activity

DIF – CONTRIBUTION TO REVENUE



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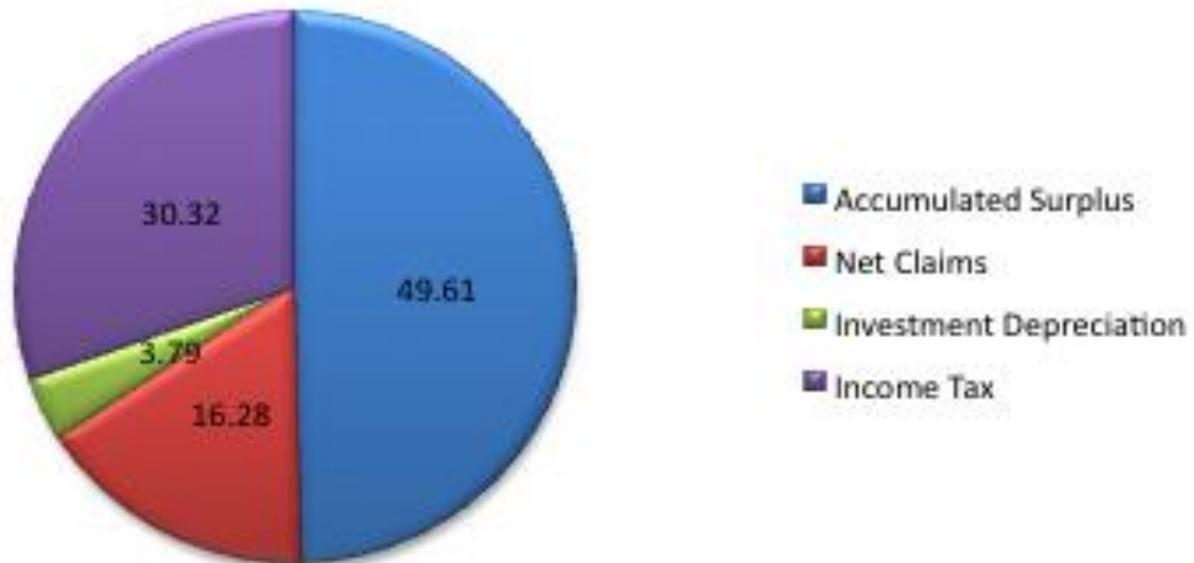
TREND IN CLAIMS



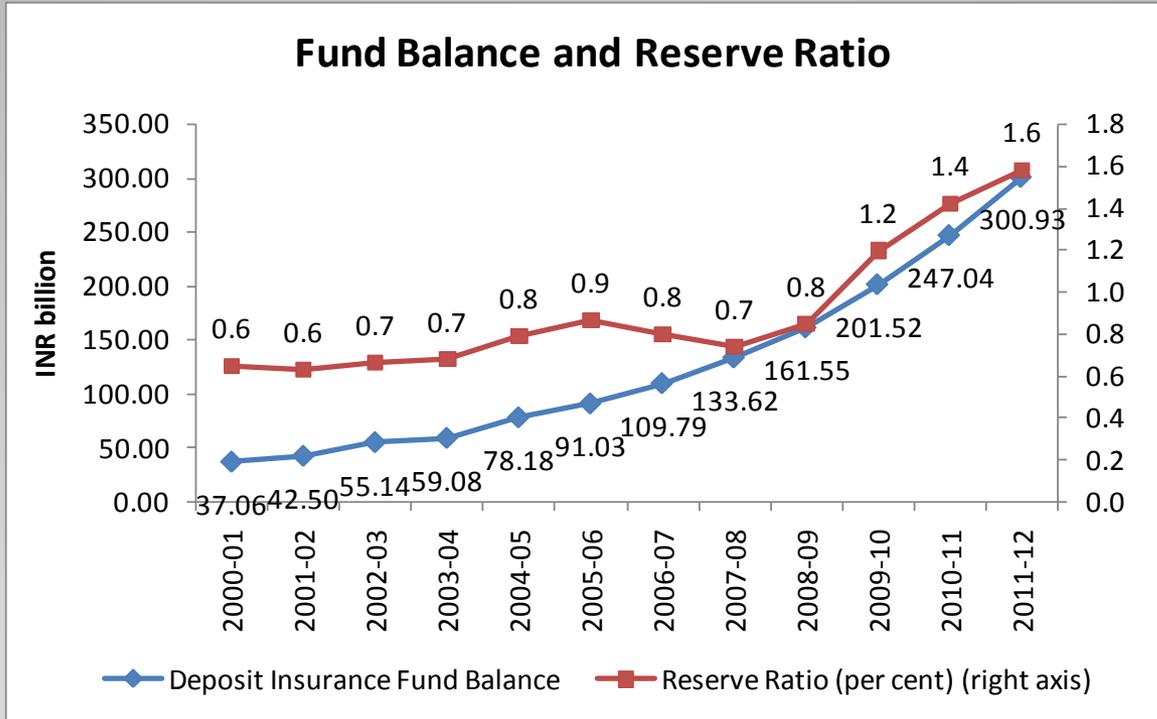
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DIF – DISPOSAL OF REVENUE

DIF - Disposal of Gross Revenue (%)



DIF – FUND ADEQUACY



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OPTIMAL SIZE OF FUND / TARGET RESERVE LEVEL

- Normal situations
 - Establish how large a reserve is appropriate
 - Target level should be adequate to at least cover the potential losses of the insurer under normal circumstances
 - Should factor in:
 - Composition of member banks (number, size, complexity of banks)
 - Liabilities of members and exposure of insurer to them
 - Probabilities of failures
- Crisis situation
 - Over-reliance on back-up funding from government (essential for maintaining depositor confidence) – budgetary limits?
 - Issue of bonds (backed by government guarantee?)

OBJECTIVES OF INVESTMENT MANAGEMENT BY DICGC

To invest the Corporation's Funds in manner which will provide for:

- ❑ Maximum security; while meeting
- ❑ Cash flow demands of the institution; with
- ❑ High returns on investment

In accordance with

- ❑ provisions of the DICGC Act/Regulations
- ❑ Sound and acceptable business practices

MARKET AND INSTRUMENTS

- **Market:**

Overnight Funds

- **Instruments:**

Reverse Repo

- Done on an anonymous, electronic dealing system provided by CCIL
- Telephonic deals, reported via PDO-NDS, an RBI package

- **Rationale:**

Temporary surplus funds are invested for overnight tenor, since the G-Sec market follows a T+1 settlement cycle, while in the overnight market, settlement is on T+0 basis

- **Market:**

G-Sec

- **Instruments:**

- Dated securities from GoI
- Treasury Bills from GoI
- Special securities from GoI such as Oil Bonds, Fertiliser Bonds
- Cash Management Bills from GoI
- Done on electronic platform

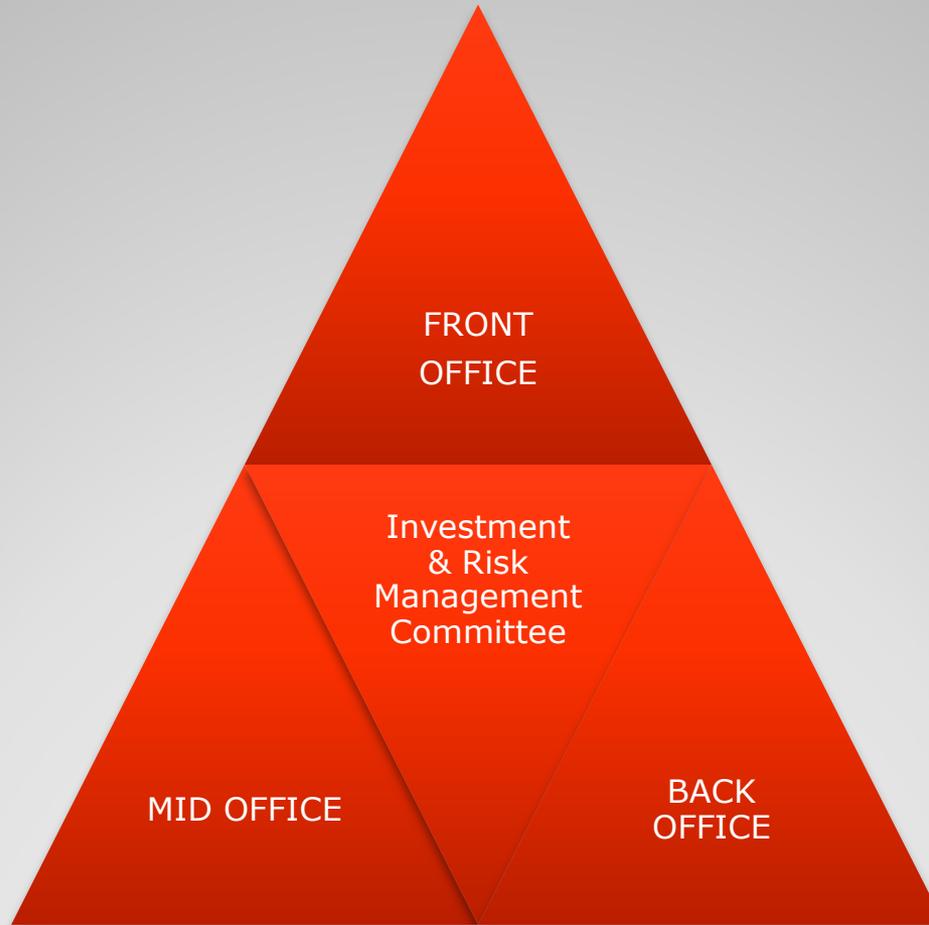
- **Rationale:**

In accordance with Sec. 25 of the DICGC Act

INVESTMENT MANAGEMENT GUIDELINES & RISK MANAGEMENT FRAMEWORK

- Approved by the Board every year
- Provide overall guidance to treasury operations and clarify concepts
- Lays down the policy for investing corporation's funds
- Identification and measurement of risk, risk mitigation strategy, continuous tracking

ORGANISATION OF TREASURY



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RISK PARAMETERS

Duration of long-term portfolio

- Tracks CCIL CASBI Index

Modified duration

- Measure of interest rate sensitivity

Concentration risk

- Concentration in top 4 securities not to exceed 20% of entire portfolio

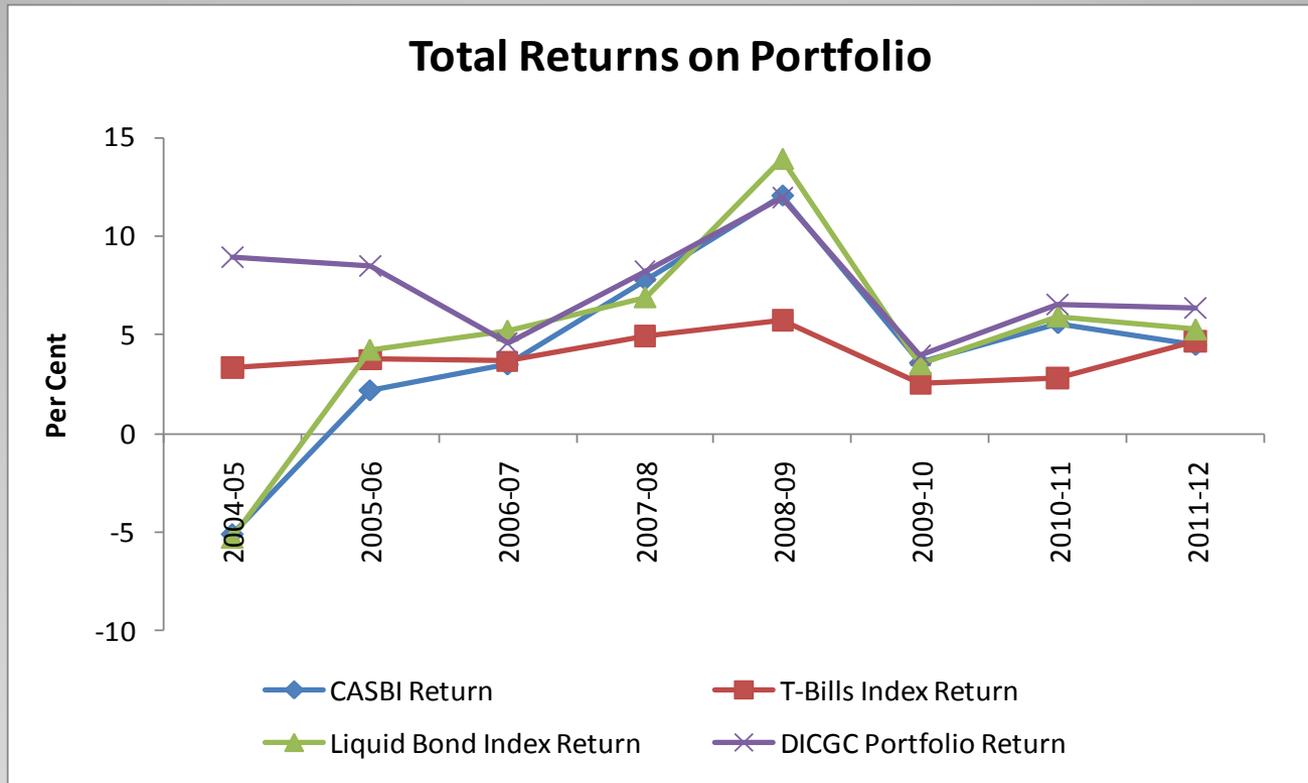
Market risk
(VaR/Standardised duration method)

- Quantification of market risk is set at higher of that arrived by 2 methods

Investment fluctuation reserve

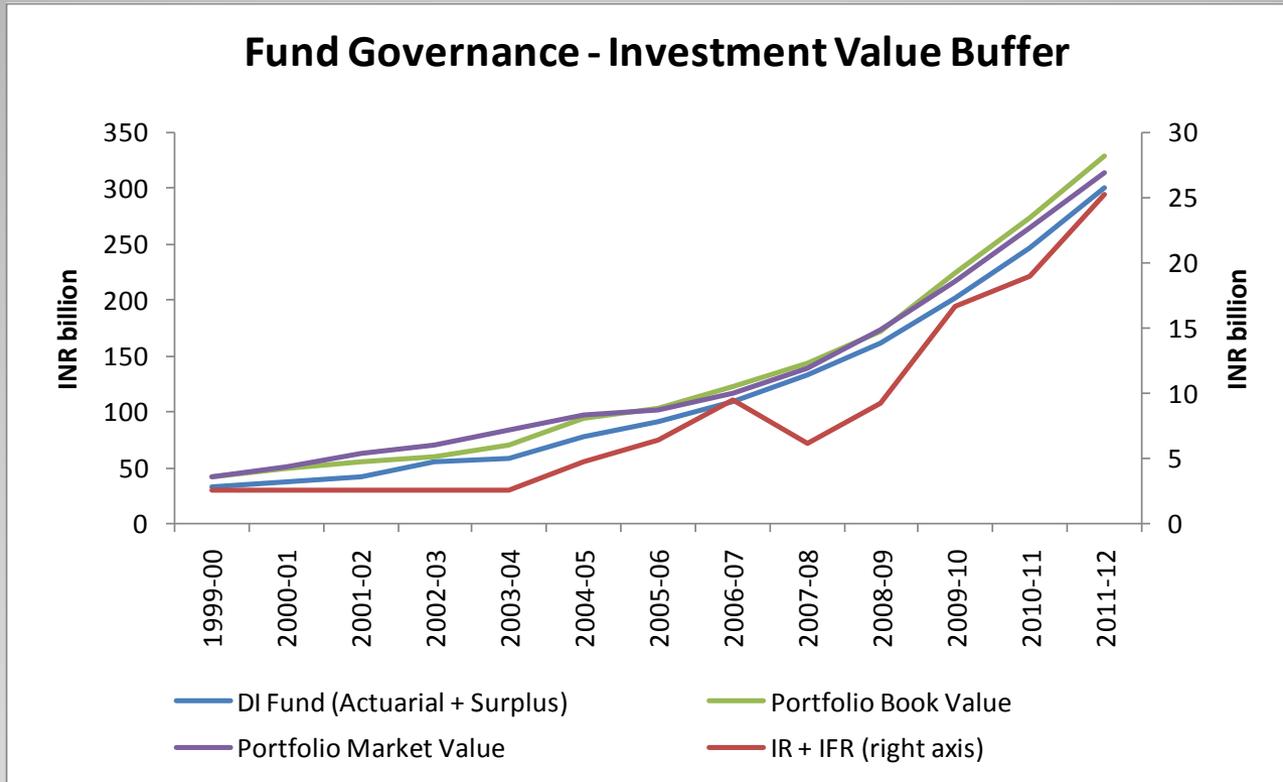
- IFR cushion maintained against market risk

INVESTMENT VALUE BUFFER



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INVESTMENT VALUE BUFFER



IR: Investment Reserve
 IFR: Investment Fluctuation Reserve

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ACCOUNTABILITY AND GOVERNANCE

- Precluded from taking speculative position
- Day-to-day audit of treasury transactions
- Checks and balances at various levels
 - Head of treasury
 - CEO level – Treasury dashboard (part of MIS)
 - Investment Committee – Monthly review
 - Board and Audit Committee – Quarterly review
 - Statutory audit - Annual

LIMITATIONS OF INVESTMENT MANAGEMENT FRAMEWORK

- Conservative stance – limits earnings potential
- Narrow pool of instruments
- Illiquidity in G-sec market
- Low maneuverability (directive to work on fully-invested basis)

ONGOING CHALLENGES FOR DICGC

SHORT-TERM

- Implementation of risk-based premiums
- Faster settlement of claims – IT solutions (unique customer view?)
- Information sharing with central bank – MoU
- Estimation of actuarial liabilities / target fund size
- Enhanced public awareness

MEDIUM TERM

- Broader reforms in deposit insurance (Working Group, Financial sector legislative reforms commission)
- Focus on 3 things – (i) Efficiency in payouts, (ii) Financial strength of DICGC, (iii) Broader mandate (incl. resolution)

CHALLENGES FOR FUND MANAGEMENT – SUMMARY OF POINTS

- Develop and sustain fund raising capabilities
 - Especially in the case of systemic crises
 - Quick access to large amount of money
- Fund management in normal times
 - Appropriate target size of reserve fund
 - Feasible differential premium scheme
- Investment management framework
 - Balance between liquidity and profitability
 - Portfolio management within tolerable risk parameters
 - Accountability for performance

THANK YOU
QUESTIONS?

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