



ASSOCIATION OF SUPERVISORS
OF BANKS OF THE AMERICAS (ASBA)

Effective Deposit Insurance Schemes and Bank Resolution Practices

SEPTEMBER 2006

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Executive Summary

Since its inception, the Association of Supervisors of Banks of the Americas (ASBA) has strived to provide its members a forum where experiences, knowledge, ideas, and techniques can be discussed and shared. As part of its mission, ASBA undertakes research projects to promote sound banking supervisory practices throughout the Americas. Recognizing that many of ASBA's 34 members are currently establishing or enhancing their deposit insurance and bank resolution programs, ASBA commissioned the Working Group on Effective Deposit Insurance Schemes and Bank Resolution Practices to provide timely and effective guidance that may be useful to the organization's varied and diverse membership.

The paper, which draws from the rich and broad experiences and lessons learned by members of the Working Group, represents a first attempt to identify best practices and develop a set of recommendations that will promote sound deposit insurance and bank resolution principles throughout the Americas.

The paper is divided into three parts. The first part explores the various types of deposit insurance systems in place in seven member countries, identifies some of the practices that have worked well and proposes recommendations to strengthen deposit insurance systems. The second part focuses on the interrelationship between deposit insurance and the stability of the financial system, and highlights the importance of effective communication with the public and coordination among all safety net participants. The third part of the paper discusses bank intervention and failure resolution as practiced by several ASBA members. This last section explores the role deposit insurance agencies play, and should play, in bank resolutions and receiverships, discusses the most frequently used resolution alternatives, and recommends ways to promote effective and efficient bank resolutions programs.

Key Findings and Recommendations

Effective deposit insurance systems and bank resolution programs strengthen and contribute to the stability of financial systems. Thus, it is recommended that these systems be supported by laws and practices that empower supervisors and deposit insurance agents to properly evaluate banking risks and promptly take any necessary corrective measures. Bank supervisory authorities are strongly encouraged to adhere to the Core Principles for Effective Banking Supervision as they provide a solid foundation upon which to build effective deposit insurance and bank resolution systems.

Deposit insurance should be designed to protect small depositors who typically lack the financial acumen and sophistication to appropriately evaluate banking risks. A nation's deposit insurance system should be appropriately codified in law that, at a minimum, defines deposit insurance coverage and limits, the type of deposits that are insured, and the rights and responsibilities of the deposit insurer and insured financial institutions. Membership into the deposit insurance system should be mandatory for all financial institutions that accept small deposits. These institutions

should be licensed and supervised, and they should be required to periodically disclose reliable and relevant information to the public.

Deposit insurance coverage should be explicit, not implied by a general government-sponsored protection, and should be limited to an appropriate amount, so as to not exacerbate moral hazard problems.

Deposit Insurance Agencies (DIA) should be operationally independent, operate under a clear mandate that is aligned with broader public policy objectives, and supported by a legal system that recognizes the value of timely and effective bank resolutions. All DIAs, regardless of the scope of their mandate, should be empowered with basic rights that will allow them to operate effectively and contribute to the financial sector's stability. At a minimum, all DIAs should be able to establish the terms and conditions of membership; hold bank insiders accountable for bank failure; have access to bank-specific and depositor information; act as receiver or appoint a receiver; have access all necessary funding; and take part in deciding the most appropriate method of resolving a bank failure.

The DIA should be governed by an independent board of directors which is responsible and accountable for all aspects of the DIA's operations. The board, officers, and employees of the DIA should be afforded legal protection from personal and institutional liability for actions taken in good faith while performing their duties so that they can conduct their work with independence and without fear of undue legal actions. This legal protection must coexist in an environment where there is clear accountability at the individual and institutional level.

DIAs should develop effective communication strategies that provide timely, relevant, and easy-to-understand information to its stakeholders. Effective public awareness efforts can promote confidence in the banking system by informing depositors of their rights and responsibilities.

Effective interrelationships between safety net players are critical. Bank supervisors, DIAs, central banks, and others involved in financial safety nets, should share similar goals and their interactions should be guided by a clear division of powers and responsibilities.

Effective bank supervision, resolutions programs, and deposit insurance schemes require that all safety net participants have access to an adequate flow of information. Strong and cooperative relationships between safety net participants should be fostered. While recognizing that the amount and type of information needed by each safety net participant will vary depending on their powers and mandate, information sharing and coordination agreements, both formal and informal, that establish responsibilities and accountability, should be adopted. These arrangements should prove particularly useful to DIAs that lack the authority to independently evaluate or examine an insured institution.

DIAs and bank supervisors should work cooperatively to identify weak banks, take appropriate correction action to remedy problems, and develop appropriate resolution strategies as it becomes necessary. While licensing authorities, typically bank supervisors, should have the power to close a bank, the authority to suspend or terminate deposit insurance should rest solely with the DIA.

DIAs should be empowered with authorities to carry out resolution and receivership activities. The resolutions process may be considered the first phase of a failed bank strategy. The second phase may be considered the receivership process.

The resolutions process typically involves designing an effective disposition strategy that includes valuing a failed bank and designing an effective resolutions or disposition program that includes marketing the failed bank and soliciting and accepting bids for the sale of the bank or parts of the bank. During the resolutions process, each resolution alternative should be subject to a least-cost evaluation and

the option that proves least costly to the deposit insurer should be chosen unless extraordinary circumstances dictate otherwise.

The DIA should have a broad range of authorities, and the legal support to use them, that allow it to carry out timely and effective bank resolutions. To minimize disruptions to the normal functioning of the banking system and to minimize the loss of asset value typically associated with bank closures, DIAs should adopt resolution approaches that transfer the largest possible volume of assets in the briefest amount of time to healthy insured institutions. Likewise, depositors should be provided immediate access to their insured funds to promote confidence in the banking system and minimize disruptions to the provision of banking services. DIAs may increase the value and volume of assets transferred in the initial phase of a resolution through an effective marketing and asset packaging strategy. Interested bidders should be screened and once approved should be allowed to conduct independent due diligence of the failed bank before making an offer. Assets that can be transferred should be packaged with features designed to increase bidder interest. These features may include loss-sharing arrangements and put options. The bidding process may be confidential, as in a sealed-bid transaction, but the process by which the DIA evaluates and selects the offers should be transparent.

The DIA should operate under clear rules that define its role as receiver. The receivership process typically involves performing the closing function at the failed bank; liquidating any remaining failed bank assets; and distributing any proceeds of the liquidation to the deposit insurer, uninsured depositors, general creditors, and others with approved claims. The DIA's powers as receiver should be defined by specific statutory provisions that authorize the DIA to both expedite the liquidation process and to maximize the cost-effectiveness of the receivership process. Among these authorities, DIAs should, at a minimum, have the power to ratify and repudiate contracts; operate outside the regular corporate bankruptcy process; hire and fire bank employees and bank management; and request a stay of legal proceedings. As receiver, the DIA is responsible for reimbursing depositors in a timely manner. While individual practices vary across the Americas, depositor confidence and financial sector stability would best be served by ensuring that reimbursement and claims procedures, if any, are simple to understand and use. Insured depositors should be fully reimbursed within 30 days after the insured bank has been closed. Depositors should also be given the opportunity to appeal the deposit insurance determinations made by the DIA.

Introduction

The banking sector in the Americas comprises diverse approaches toward deposit insurance protection and failed bank resolutions in each of the five sub-regions: Central America, Caribbean, Southern Cone, Andean Region and North America. As mandated by ASBA's board, the Working Group on Effective Deposit Insurance Schemes and Bank Resolution Practices (Working Group) has evaluated the current status of deposit insurance schemes and resolution practices in seven countries in the region. This report reflects the combined experiences and practices of these seven members and is intended to provide timely and relevant information to banking authorities who are today designing, or redesigning, their nation's deposit insurance and failed bank resolutions systems. This report provides valuable insights from a number of members that have well-established deposit insurance schemes and resolution programs as well as members who are currently improving their systems. The central aim of the Working Group was to examine and analyze the various and diverse deposit insurance schemes and bank resolution processes practiced in the Americas, and develop a set of best practices and implementation guidelines that take into account differences among countries.

This report should be considered as ASBA's first step in the building of a more comprehensive set of experiences and best practices in the Americas. This report draws from the insights and experiences of members that employ a wide and diverse range of deposit insurance and bank resolution policies, approaches, and practices that may usefully be considered by members thinking about reforms in these areas. Because the authors recognize that each bank supervisor and deposit insurance agent operate in often unique environments, no single solution or formula is offered in this report. As is often the case, one size does not fit all. Rather, the report provides an assortment of prudent practices, policies, and approaches successfully used by some members that could be considered by other members when deciding how to best address their individual needs.

A primary policy objective among all countries is strengthening the safety and soundness of the financial system. This involves monitoring potential banking risks and establishing effective risk management policies, procedures, and institutional arrangements to properly identify, assess, and control risks and mitigate potential losses. However, deposit insurance schemes typically are not aimed at preventing or addressing systemic risks but rather resolving individual bank solvency problems. The experiences shared in this report should help banking supervisors as they conduct their analyses of the most effective deposit insurance and bank resolution institutional arrangements, policies, procedures, and best practices.

The first section of this report analyzes the conceptual groundwork and practical implications of deposit insurance schemes and includes a discussion on institutional aspects of a Deposit Insurance Agency (DIA). The second section focuses on the interrelationship between deposit insurance and the stability of the financial system, including an analysis of deposit insurance funding and the need for public awareness.

The third section focuses on policies, procedures, and best practices regarding problem bank intervention and resolution. This section discusses, among other topics, receivership powers, depositor rights and reimbursement programs, and cross-border resolution issues. The report contains nine Appendices with detailed and comparative information about deposit insurance practices in the Americas and 47 boxes with specific national experiences.

Deposit Insurance Schemes

The Region has witnessed a fair amount of banking crises in the past quarter century. Many of these involved the need to restore confidence in the financial system through massive transfers of public money to reimburse depositors, while others relied on explicit deposit insurance systems to restore and preserve financial stability. This report analyzes data from seven sample countries in the Region: Argentina, Bolivia, Guatemala, Mexico, Paraguay, Peru, and the United States. A list of the Deposit Insurance Agencies (DIA) can be found in Appendix No. 2.

2.1. Public Policy Objectives for Deposit Insurance Schemes

The public policy objectives for deposit insurance schemes include enhancing the safety and soundness of the financial system, improving the stability of the financial system, and protecting depositors.

2.1.1. Contributing to financial system stability

The primary objective of a deposit insurance scheme is to strengthen and maintain the soundness and stability of the financial system.

Regional and international experience suggests that legislation should ensure that deposit-taking financial entities are subject to oversight and examination by a specialized government agency to meet their legal obligations, including those aimed at maintaining the stability of the financial system.

Based on these fundamentals, the creation and operation of a deposit protection scheme that guarantees the recovery of bank deposits has proven to contribute to a healthier and more stable financial system and to improve the confidence of depositors and the public in the financial system.

The experience of many countries shows there was no specific organization engaged in providing deposit insurance coverage to banking institutions and depositors until specific legislation was enacted. This led to the public perception that blanket government coverage was implicit, thus generating expectations for potentially massive government bailouts.

International practice suggests that limited deposit insurance coverage typically provides a greater degree of legal certainty and predictability to depositors and taxpayers, as full and implicit coverage sometimes has unintended consequences that may be contrary to sound public policy.

Members of the Working Group agree that an explicit deposit insurance system allows banking institutions to, among other things, (i) better observe prudential standards, (ii) create a culture of risk management, and (iii) improve compliance with prudential regulations.

An explicit deposit insurance scheme also enables the prompt and orderly exit of failed entities, adding an important element of trust and certainty and promoting stability of the financial system.

These experiences suggest that a sound financial sector policy should strive to establish a system that provides for the protection of bank savings that includes explicit and limited deposit insurance protection.

2.1.2. Protecting less sophisticated depositors

Regional and international experience proves that a system for limited protection of bank savings, up to a certain amount, directly protects small and less sophisticated depositors who are generally not capable of accessing or understanding relatively sophisticated information provided to the market by banking organizations or supervisory agencies.

Accordingly, the Working Group considers that a deposit insurance system should primarily protect small depositors and that any institution that accepts deposits from these small depositors should participate in the deposit insurance system.

In some countries, protecting capital formation, savings, and investments is a constitutional mandate and a duty of government to the public. However, adhering to policies that promote the perception of unlimited government, and ultimately taxpayer, liability is contrary to sound public policy and raises moral hazard concerns.

2.2. Addressing Moral Hazard Issues

2.2.1. What is moral hazard?

Understanding the concept of moral hazard is useful for discussing deposit insurance schemes. Any arrangement that transfers normal business risks to a third party and that induces parties to disregard normal business risks (because transferring the risk spares them from having to suffer the consequences of their actions) creates what is referred to as moral hazard. Conventional wisdom suggests that in the absence of moral hazard, market participants are in a better position to realistically and efficiently assess risks.

2.2.2. Moral hazard in the financial system generated by a Deposit Insurance Scheme

A well-designed deposit insurance scheme (DIS) can contribute to the stability of a financial system. However, if improperly designed, the DIS can be a source of undue moral hazard. According to Asli Demirguc-Kunt and Enrica Detragiache,¹ many economists consider deposit insurance a source of moral hazard, as it can encourage institutions to invest in riskier assets and persuade depositors to place deposits with riskier institutions. While deposit insurance is needed to instill public confidence and enhance financial sector stability, regulators and supervisors must complement the mission of the DIS with robust supervisory programs that ensure that risk taking is appropriately supervised and that moral hazard is constrained.

Thus, while a DIS is responsible for fostering greater stability in the financial system and reducing the possibilities of runs on banks, it can also decrease stability by creating an environment that incentivizes insured financial institutions to take riskier positions. For example, banks that seek to exploit the protection offered by the DIS have great incentives to extend high-yield and presumably high-risk loans, especially when they are in trouble. Likewise, banks can maintain what could be considered artificially high liquidity positions by paying high rates of interest on their deposit products. Indeed, evidence suggests that troubled banks are most likely to pay the highest interest rates since this allows them to generate the liquidity necessary to survive and continue lending. Bank customers may also contribute to

¹ Asli Demirguc - Kunt and Enrica Detragiache. The Determinants of Banking Crises: Evidence from Developed and Developing Countries, date posted to database: October 20, 2002, World Bank and International Monetary Fund.

moral hazard. Emboldened by the protection offered by a DIS, depositors who are motivated by high yields are more likely to ignore the quality of an institution and its relative risk profile when selecting a bank. For these depositors, the only variables considered are the interest rate paid by the bank and the protection provided by the DIS. This behavior may be readily observable when there is 100 percent coverage of deposits or where experience shows that the government never closes a bank.

Likewise, some borrowers who believe that the bank will be unable to enforce repayment of its loans will often request additional credit, regardless of interest rate, because they are confident that they will never have to honor their debt obligations. This phenomenon tends to happen when the borrowing public is predisposed to exploit weak or troubled banks, when the bank enters into restructuring processes, when the possible closure of the bank is anticipated by the public, or when the public perceives that institutions in charge of recovering the failed bank assets are slow and inefficient.

2.2.3 How to mitigate moral hazard

This section highlights how sound corporate governance, market discipline, effective banking supervision, and decisive and prompt corrective action may all help mitigate the effects of moral hazard.

2.2.3.1 Corporate governance

Good corporate governance is critical for financial institutions to adequately identify and control risks and implement the most appropriate risk management systems and models. The corporate governance framework must be aligned with the financial institution's business model and strategies. Corporate governance forms the first line of defense against excessive risk taking. The Working Group has recognized that corporate governance in financial institutions is generally weak throughout the region and that ASBA members should place greater emphasis on promoting and ensuring sound corporate governance structures in their financial institutions.

Although not intended to be an exhaustive list, sound corporate governance principles should at a minimum address:

- > Experienced and Knowledgeable Bank Officers: For bank licensing purposes, the supervisory authority should satisfy itself that organizers, executive officers, and bank directors are sufficiently experienced and knowledgeable in banking matters and that their integrity and financial position are acceptable. The supervisory authority should also ensure that corporate affiliations, associations, or structures do not expose the bank to undue risks or hinder the effective supervision of its activities and operations.
- > Responsible Board Members: Board members must be reliable, honorable persons, who are knowledgeable and experienced in the banking and financial business as well as in the management of financial risks. The board is responsible for the overall condition of the bank and must ensure that all policies, systems, and processes needed to effectively evaluate, manage, and control risks are adequately implemented and enforced.
- > Accountability of Management: Board members and senior management are personally liable for damages and administratively and criminally responsible for their acts and omissions as they pertain to the fulfillment of their duties and authorities. They will be held personally liable, without limitations, for damages to the bank or to third parties for any act, resolution, or omission that contravenes legal or regulatory provisions or harms the bank in any way.

- > **Supervisory Limits:** The supervisory function performed by the supervisory/regulatory body in no way implies that such body, its authorities, officers, or staff, is responsible for the stewardship or management of the supervised institutions, nor does it guarantee the successful operations of such activities, which are the sole responsibility of the institution, its managers, directors, and shareholders.
- > **Internal Controls:** A sound internal control and audit system will periodically test the institution's adherence to institutional policies and regulatory requirements.

2.2.3.2 Market discipline

Transparency and market discipline are among the primary forces influencing the behavior of financial markets. Supervisory authorities play an important role in promoting market discipline by ensuring that meaningful information is disclosed internally to senior bank management and externally to the market. Bank supervisory authorities should issue regulations and encourage financial reporting policies that promote financial transparency and market discipline. Disclosures required by bank supervisors should, where possible, operate in concert with the reporting and disclosure requirements of securities regulators, accounting standardsetters, and others. Financial disclosures must often be made public, and companies traditionally make this information available through media outlets and have increasingly provided this information through the Internet. To the extent required by applicable laws, disclosures should include relevant information on the condition and activities of the financial institution.

These disclosures should provide financial market participants with the information needed to make informed decisions and enable an accurate valuation of bank assets, cash flows, and risk performance.

2.2.3.3 Effective supervision

Countries with a deposit insurance system in place, or countries in the process of implementing such a system, should attain a reasonable level of compliance with the Basel Core Principles for Effective Bank Supervision.

2.2.3.4 Early or prompt corrective actions

Bank supervisors should be equipped to proactively address weaknesses at the bank and banking system levels. The legal framework should authorize bank supervisors to take preventive supervisory measures, or prompt corrective actions (PCAs), to identify

As an example of market discipline, the U.S. Federal Deposit Insurance Corporation (FDIC) maintains the stability of the nation's financial system and limits the detrimental effects of moral hazard with an explicit and limited risk-based deposit insurance system by (1) examining and supervising financial institutions and

(2) managing the effective resolution of troubled financial institutions. The FDIC charges insured institutions risk-related premiums to ensure that banks with higher risk profiles pay higher premiums. To encourage market discipline, the FDIC also (1) requires financial institutions to regularly publish their financial statements,

BOX 1 –

Two Cases of Agency-Led Market Discipline

(2) publishes uniform bank performance reports, and (3) makes publicly available certain supervisory enforcement actions that depositors and other financial market participants can evaluate when considering the risks posed by an insured depository institution.

In Peru, the creation of a target resource fund was proposed for the Deposit Insurance Fund (FSD). Once the target fund is reached, including cost overheads to allow for sound management of the fund, FSD-insured institutions with the highest risk manage-

ment ratings, and therefore low risk exposures, are not required to pay deposit insurance premiums. Also under review is a proposal to limit insurance coverage on deposits registered within the last 15 days of a bank intervention or liquidation to avoid potential fraudulent deposits. Finally, the country's Superintendence of Banks and Insurance Companies is studying a proposed risk-related premium payment scheme that expands the current rate range to better reflect the risk levels of FSD-insured institutions.

and address financial or operational weaknesses that threaten the viability of a banking institution. PCAs should permit supervisory intervention and action while the financial institution is solvent and viable and therefore able to recover. Under certain PCA models, the bank supervisor is required to limit the bank's ability to conduct certain business activities, including restricting the payment of dividends or limiting growth when an institution's capital level falls below a certain level. The bank supervisor also has the authority to limit or restrict other business activities as the institution's condition worsens. Finally, the bank supervisor has the authority to inform the bank's management that it may be closed if specific conditions and practices do not improve within a certain time.

Some supervisory authorities have developed specific criteria for determining when a financial institution should be subject to special regulatory review or intervention under a PCA program. Criteria vary between jurisdictions and but may include some of the following:

- > The institution has incurred significant operating losses affecting its core capital base.
- > The capital ratio has fallen below a prescribed legal limit.
- > Liquidity, as measured by the ratio of high quality assets (cash, cash equivalents and low-risk exposures) to total deposits ratio, is unsatisfactory.

Additionally, as part of a PCA program, some jurisdictions require that a financial institution be subject to increased supervisory oversight. The supervisor will periodically review the bank's progress toward improved, or regular, operations that comply with regulatory standards (a process called "regularization" in this report). This regularization program may result from many weaknesses or unsound practices, including repeated noncompliance with written instructions and orders issued by the supervisory authority, submission of false information, or poor management practices that jeopardize the institution's solvency or viability.

Under a "regularization process," the institution must present to the supervisory authority a "regularization plan" in which the management of the institution commits to take all necessary measures, including but not limited to increasing capital, to improve its overall condition².

2.3 Situational Analysis, Conditions, and Implementation Considerations

2.3.1 State of the economy

Many observers and reports suggest that the optimal time for any country to create a deposit insurance scheme is when the economy and the financial system are stable and expanding, and financial institutions are adequately capitalized and profitable.

However, regional history shows that these ideal situations rarely exist. Typically during economic expansions, little consideration is given to adopting measures that would be useful during a recession or other economic hardship. Rather, legislators, government authorities, supervisors, and bankers have demonstrated that they prefer to adopt these types of measures immediately after a financial crisis.

2.3.2 Legal framework

Supervisory authorities need a strong legal framework to ensure financial stability. They should have the authority and the regulatory tools needed to achieve their objective of maintaining a sound and safe financial system. The legal framework should also equip the supervisory authorities to adhere to appropriate international standards as well as industry and supervisory best practices.

² Prompt corrective actions in Work Group member countries are discussed in Appendix No. 8.

In Argentina, the effects of global depression led to the banking and monetary reform of 1935, which provided a legislative basis for the central bank's supervision of its banking industry. By the 1970s, the country's economy began a chronic hyperinflationary cycle that led to a banking crisis in the early 1980s and enactment of a set of economic and monetary measures, such as the Convertibility Law, in the early to mid-1990s. The aftermath of the ensuing banking crisis of the 1990s resulted in the 1995 establishment of a banking capitalization fund and deposit guarantee fund aimed to avoid banking runs and as a way of increasing depositor confidence and enhancing the safety of the banking industry.

In Bolivia, after the liquidation of two banks in 1994, the Fund for the Development of the Financial System and Assistance to the Productive Sector (FONDESIF) was created, with the goals

BOX 2

Examples of Legislative Changes Following Financial Crises

of capitalizing institutions with solvency problems and injecting liquidity into the financial system. In December 2001, several changes to the banking law (LBEF) were made, particularly for the treatment of problem banks. The changes established a preventive process designed to avoid traumatic liquidations and created the deposit insurance scheme (FRF) as a mechanism to assist resolution processes.

In Mexico, the National Banking Committee (CNB) was created in 1924, complemented by a banking law in 1941 and the incorporation of insurance oversight in 1970. Following the 1982 financial crisis and nationalization of private banks, the CNB was divided into separate banking and insurance supervision agencies in 1989. The 1990 banking law allowed for private participation in the banking industry that, after the mid-

1990s banking crisis, led to regulatory changes and a stronger supervisory framework, which in turn resulted in a significant growth and internationalization of the country's banking industry.

In Peru, the Banking Superintendence was created in 1931 with the objective of supervising the then 16 financial institutions authorized to operate in the country. The scope of supervised entities was subsequently expanded in 1972 and 1981. The severe economic and banking crisis of the late 1980s led to the 1991 banking law and the 1991, 1993, and 1996 legislation on financial oversight, which framed the current institutional arrangements of the supervisory agency.

In the United States, the FDIC was established in 1933 at the height of the Great Depression when many banks could not meet their obligations.

Core Principles 1.3, 1.4, and 1.5 require suitable legal frameworks relating to the authorization of banking organizations and their supervision, powers to address compliance with laws and safety and soundness, and legal protection of supervisors. The U.S. legal framework clearly provides its bank supervisors the authorities necessary to carry out these principles.

Authorizing Banking Licenses. U.S. banking laws clearly identify the banking supervisor responsible for granting and withdrawing banking charters. Only the Office of the Comptroller of the Currency (national banks), the Office of Thrift Supervision (thrifts), and the individual states (state banks) have the authority to grant banking charters. Likewise, bank supervisors are clearly authorized to examine and supervise banks and evaluate compliance with laws and regulations.

Authority to issue prudential regulations. U.S. law also empowers supervi-

BOX 3

A Brief Introduction to the Supervisory Legal Framework in the United States

sors to issue prudential regulations and implement these regulations and policies consistent with safety and soundness principles. For example, the Prompt Corrective Action (PCA) requirements are codified in Section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o), and each Federal banking agency has issued regulations implementing the statutory requirements. The banking supervisors also are empowered to require information, as necessary, from banks and thrifts. For example, specific financial information is required on a quarterly basis, with additional information required from banks prior to or during an on-site examination.

Enforcing regulatory compliance. U.S. law allows supervisors to promptly

address compliance with laws or safety and soundness concerns in a number of ways. Supervisors may initiate enforcement actions when a bank's condition deteriorates or there is evidence of insider abuse or illegal activity. During an examination, supervisors have unrestricted access to bank files and apply subjective judgment when forming opinions. Also, supervisors are afforded legal protection while discharging their duties in good faith and will be protected against the costs of legal actions, which are generally defended by the U.S. government. The United States requires that deposit protection be provided by the FDIC, whose policies, procedures, and best practices are summarized in Appendix 3.

Bank supervisors are but one of many organizations within the country's safety net; the legal framework should clearly identify the division of powers and responsibilities for each safety net authority. These authorities should have a clear understanding of the scope of their mandates and should develop institutional arrangements that will facilitate a coordinated and orderly approach to bank supervision and oversight.

Over the last century, Regional member countries have enacted banking legislation upon which supervisory laws and regulations have been built. One area where specialized provisions and regulations are needed is that of deposit insurance as a protection for depositors, taxpayers, and the public; for maintaining public confidence in the banking system; and for strengthening the safety and soundness of the financial system.

In 1997 the Basel Committee for Banking Supervision issued the "Core Principles of Banking Supervision." These 25 principles establish an international standard on supervisory powers, independence, responsibilities, and limitations. The Basel Committee also identified a set of prerequisites that promote compliance with the Core Principles.

The Law for the Protection of Bank Savings (LPAB) enacted on January 19, 1999, establishes the legal framework for the Institute for the Protection of Bank Savings (IPAB). The LPAB: (i) defines IPAB's coverage of "guaranteed obligations," i.e., claims payable to depositors and creditors of a closed bank; (ii) sets the fees chargeable to insured banking institutions; (iii) describes the support and financial recovery programs for troubled institutions and the role of IPAB as receiver; (iv) sets the procedures to sell IPAB's assets; and (v) establishes IPAB's governing bodies.

BOX 4

Legal Framework for Deposit Insurance in Mexico

IPAB's governance and management is carried out by a Governing Board and an Executive Secretary, respectively. The Board is composed of seven members: (i) the Finance Minister, (ii) The Governor of the Central Bank (Banco de México), (iii) The President of the National Banking and Securities Commission (CNBV), and (iv) four independent members appointed by the Executive Branch of Government and approved by two thirds of the Senate.

IPAB's management is carried out by an Executive Secretary appointed by the Governing Board.

Additionally, to establish programs based on LPAB, IPAB is empowered to issue general regulations such as:

- > Fees commercial banks must pay to IPAB for the protection of bank savings.
- > Asset sales programs.
- > Guaranteed obligation programs.

Financial intermediation activities and the provision of financial services, as well as financial institutions, are covered by the Law on Banks and Financial Entities (LBEF). These provisions take precedence over other legal provisions on the same matters. The law contains prudential measures targeted at strengthening the solvency, soundness, and security of the financial system, and promoting prudent management of financial institutions.

BOX 5

Bolivia's Banking Legislation

Although there is no deposit insurance, the banking law established the Financial Restructuring Fund (FRF) as a mechanism to assist processes of resolution of financial intermediaries. FRF is a public legal entity with indefinite time duration. The fund's resources are made up of compulsory contributions by covered financial institutions. These funds

are administered by the central bank in a manner analogous to international reserves or the Fund for Liquid Asset Requirements (RAL). These funds cannot be confiscated or subject to precautionary measures, and they cannot be compensated or be part of any transaction. The use of these funds is restricted to assisting financial procedures as required by law.

Deposit Insurance S.A. (SEDESA) was established in 1995 by the Law of Commercial Societies to be in place for a period of 35 years. SEDESA is responsible for managing the Deposits Insurance Fund (FGD) that covers risks of bank deposits. The law complements depositors' protection provisions of the

Box 6
Argentina's Deposit Insurance Framework

Financial Institutions Law and stipulates that SEDESA funding should not commit any resources from the central bank or the national treasury. SEDESA shareholders include the national govern-

ment, represented by the central bank, with one Class A share, and the independently managed Caja de Valores S.A., with the remaining 999,999 Class B shares.

Paraguay's Deposit Insurance Fund (FGD) was created by Law 2334/03 to be managed by the central bank as an independent organization, although FGD shares the tax treatment of the central bank. FGD funds are to be used based on cost minimization, while the central bank de-

Box 7
Deposit Insurance in Paraguay

finies its investment and liquidity policies. FGD resources can only be used for (i) payment of covered insured deposits and (ii) providing finance to facilitate the

transfer of assets and liabilities of intervened banks to healthy financial intermediaries, using instruments such as temporary capitalization and subordinate bonds.

The operations of the financial system, including that of the Deposit Insurance Fund (FSD) is regulated by the banking Law (Ley General del Sistema Financiero). The regulatory framework is broadly consistent with the Basel Core Principles. FSD is a legal entity registered under private law, with the aim to protect deposits made in duly registered financial companies. FSD has been authorized to:

Box 8
Deposit Insurance in Peru

1. Extend insurance coverage as set by law;
2. Facilitate depositor protection, including the transfers of assets and liabilities of intervened companies; and
3. Enforce decisions made by the banking Superintendence (SBS) with the aim

of strengthening the capital base of financial companies, when an insured company has been defined as "under vigilance," with the agreement of the central bank and the ministry of the economy and finances.

As part of a regulatory framework aiming for a healthy financial system, the Banking and Financial Groups law (LBGF) established the creation and functioning of a deposit insurance fund to be called "Savings Protection Fund," or FOPA. The fund's objective is to guar-

Box 9
Guatemala's Deposit Insurance Framework

antee that small depositors in the national banking system and in authorized branches of foreign banks recover their deposits. All financial entities are re-

quired to contribute to the fund on a monthly basis, as established in LBGF legislation.

Due to the important insights that can be gleaned from US banking regulation and its history, Appendix No. 3 summarizes key prudential, supervision, accounting and disclosure provisions applied in the United States. The appendix highlights US banking regulators' compliance with the Core Principles of Bank Supervision, describes their supervisory policies and processes, and underscores US-specific supervisory and deposit insurance standards that may be considered best practices.

The deposit insurance scheme (DIS) of any country should be supported by a clear legal mandate that equips the DIS with the necessary authorities and tools to fulfill its mission. Based on a Region-wide initial assessment conducted by the Working Group, an effective DIS, as part of the financial safety net, should be supported by a legal framework that at a minimum meets the following requirements:

- 1 . Provides a strong, clear, and precise legislative and regulatory framework that supports banking supervision, deposit insurance, and receivership functions in their jurisdictions, in accordance with national legal structures, international standards (such as the Core Principles), and best industry practices.
- 2 . Identifies the roles, responsibilities, and authorities of each member of the financial safety net, which may include the bank supervisor, the central bank, the deposit insurance agency, and the receivership or resolutions agency. This would include ensuring effective communication, coordination, and information-sharing arrangements between the parties.
- 3 . Aims for a limited protection for depositors, ensures public confidence in the financial system, and maintains financial sector stability.
- 4 . Identifies the entry conditions for banks and defines the statutory basis of the deposit insurance application process.
- 5 . Identifies the funding and coverage of deposit insurance, limiting the government's liability in cases of bank failure and other coverage triggers.
- 6 . Provides stipulations to protect the acts of members of the financial safety net when pursuing their functions in good faith.

2.4 Powers of a Deposit Insurance Agency (DIA)

DIA's should be equipped with the legally established powers and authorities that are necessary to successfully carry out their missions. These powers should be clearly codified in regulation and may include the power to establish deposit insurance rules, resolve failed banks, or regulate and examine insured institutions. This section provides an insight into the legal framework and powers under which several ASBA members operate; recommends a set of powers and authorities all DIA's should have; and, also highlights the importance of providing legal protection to bank regulators, including DIA's, as recommended by the Basel Committee on Banking Supervision.

2.4.1 Legal authority

It is critically important that each country's laws specifically authorize the existence of a deposit insurance system. Further, the law should clearly address the powers, authorities, and responsibilities of the deposit insurance agency.

2.4.2 Powers and authorities of the Deposit Insurance Agency (DIA)

There are essentially two types of deposit insurance systems in the Region: government legislated and privately administered and government legislated and government administered.

GLPA - Government legislated and privately administered DIA's

National legislation usually defines the deposit insurance scheme and the nature and functions of the DIA. In the case of GLPA, the DIA's are created by legislative power, but their operations are governed by a board typically composed of directors representing the insured financial institutions and private-sector management. This is the case in Argentina, where SEDESA is a private sector company that administers the deposit insurance agency and its funds.

GLGA - Government legislated and government administered DIA's

A more traditional institutional framework is a DIA created and defined by the law and administered by a board composed of government representatives, typically including the central bank, the banking supervisor, and the department of finance. In GLGA cases, the DIA is usually managed by public sector employees.

TABLE 1
Selected countries in the Americas and DIA's Powers

Country	Deposit Insurance Agency (DIA)	Legal Authority	Powers of the DIA ³
Argentina	Seguro de Depósitos Sociedad Anónima (SEDESA)	1995 Law of Commercial Societies, Decree 540/95	<ul style="list-style-type: none"> • Deposit Insurance • Bank Resolution Funded by premiums, covers up to ARS30,000 / depositor/institution (approx. US\$10,000). GLPA.
Bolivia	Fondo de Reestructuración Financiera (FRF)	Banking and Financial System Law (Texto ordenado) – May 2004	<ul style="list-style-type: none"> • Bank Resolution FRF aims to assist banking resolution procedures through operations as defined by the law. In addition, to monitor the fund's investments by the central bank, the board executes legal actions as necessary. GLGA.
Guatemala	Fondo para la Protección del Ahorro (FOPA)	Banking and Financial Groups Law, June 2002	<ul style="list-style-type: none"> • Bank Resolution Provides institutional framework for FOPA, coverage GTQ 20,000 / depositor (approx. US\$ 2,640). GLGA.
Mexico	Instituto para la Protección al Ahorro Bancario –(IPAB)	Law for the Protection of Bank Savings (LPAB) January, 1999,	<ul style="list-style-type: none"> • Deposit Insurance • Bank Resolution Defines insurance coverage protected by IPAB, establishes premiums, assistance to problem banks, sales processes, and IPAB's governance. Coverage is defined in terms of Investment Units (UI). Coverage is limited to 4000,000 UIs (approx. US\$140,000). GLGA.
Paraguay	Fondo de Garantía de Depósitos (FGD)	Law 2334 of December 2003	<ul style="list-style-type: none"> • Deposit Insurance • Bank Resolution Central bank manages FGD, funded by premiums, covers up to 75 minimum monthly wages per depositor. GLGA.
Peru	Fondo de Seguro de Depósitos – (FSD)	Financial and Insurance Systems General Law. Banking and Insurance Superintendency Law No. 26702	<ul style="list-style-type: none"> • Deposit Insurance • Bank Resolution Defines coverage (s/ 74,231 per depositor, approx. US\$20,000), funding administration, and defines FSD operations. GLGA.
USA	Federal Deposit Insurance Corporation – (FDIC)	Federal Deposit Insurance Act (12 U.S.C. 1831)	<ul style="list-style-type: none"> • Bank Supervisor • Deposit Insurance • Bank Resolution Coverage \$100,000/depositor/institution for details see Appendix No. 3. GLGA.

3 Notes: GLPA - Government legislated and privately administered, GLGA - Government legislated and government administered.

Regardless of whether the private sector or the government administers the DIA, the Working Group recommends that the DIA should, at a minimum, be empowered to:

- a . Obtain bank information, including exam ratings and reports, directly from the bank or indirectly through supervisory authorities
- b . Hold bank insiders accountable for a bank's failure
- c . Establish terms and conditions of DIA membership
- d . Terminate a bank's insured status
- e . Act as receiver, or appoint a receiver
- f . In coordination with the bank supervisor, decide on the most appropriate form of failed bank resolution
- g . Reimburse depositor claims
- h . Access depositor information
- i . Set terms and conditions for DIA premiums, assessments, or other fees
- j . Obtain ordinary and emergency funding according to legal framework

If the DIA is authorized to supervise banks, the DIA and the other bank supervisors must conduct periodic on-site examinations of all insured institutions. A risk-focused supervisory program, that includes onsite examinations and offsite surveillance, should be designed to help concentrate supervisory resources on those areas posing the greatest risk to an insured institution. Supervisory activities should be designed and coordinated between agencies to minimize undue regulatory burden.

In limited circumstances and as permitted by law, the DIA should be authorized to provide financial assistance to a troubled bank. When this alternative is considered, it should be evaluated against the country's least-cost resolution requirements (see Section 4.1.2 – Least Cost Analysis.). For example, to the extent permitted by law, the DIA should be authorized to purchase or facilitate the acquisition of a troubled bank by a healthy bank. As a result of the purchase, whether it is carried out directly by the DIA or through a third party, the troubled bank's shareholders should lose their economic interests in and control of the bank.

The Working Group strongly supports the idea that the DIA should work closely with the bank supervisor to proactively identify and address weak banks and collaboratively recommend the closure of non-viable banks. The authority to close a bank or revoke its license should rest with the licensing or chartering authority, which in many instances is also the bank's supervisor. Where appropriate, the chartering authority of a weak bank should, after consultation with the DIA, close an insured institution and appoint the DIA as receiver of the failed institution, if the DIA is authorized to perform receivership activities in that jurisdiction. The DIA can independently, or in coordination with the chartering authority, develop the most appropriate resolution and receivership alternatives.

The decision to terminate deposit insurance should be the exclusive responsibility of the DIA. The DIA should be empowered to terminate deposit insurance when all other reasonable options have been exhausted and should have the power to appoint itself as receiver under limited circumstances. Self-appointment should be used sparingly, but may be appropriate when the primary supervisor is unwilling or unable to close a non-viable financial institution whose continued operation has been determined to increase the potential loss to the deposit insurance fund.

2.4.3 Legal protection

The Basel Committee's first Core Principle mandates that a suitable legal framework should legally protect bank supervisors from personal and institutional liability for

supervisory actions taken in good faith in the course of performing their supervisory duties. The Core Principles also provide that the supervisory authority and its staff should be adequately protected against the costs of defending their actions or omissions. Although this principle is designed to protect bank supervisors, in the Working Group's opinion, it should apply with equal force to deposit insurance agencies.

The degree of legal protection recommended by the Basel Committee is desirable so that bank supervisors can conduct their work independently and without fear of undue legal actions. This position was supported by the Financial Stability Forum in its September 2001 Guidance for Developing Effective Deposit Insurance Systems. This guidance states, "the lack of legal protection can reduce incentives to be vigilant...particularly in cases where mandates emphasize early detection, intervention, and closure of troubled banks."

The scope and breadth of legal protection offered to bank supervisors varies among jurisdictions. A 20-country World Bank study⁴ found that government employees in certain countries are protected by generic provisions designed to protect all government employees, while in other countries, such as Ireland and the United Kingdom, banking supervisors are specifically granted special legal protections. The research also found that some jurisdictions extend this protection to agents operating under the direction of the bank supervisor.

The Deposit Insurance Agency, its directors, officers, and employees, and other agencies involved in bank resolutions should be protected against civil and criminal liability for their decisions, actions, or omissions taken in good faith while discharging their duties. This legal protection should be codified in legislation and administrative procedures and, under appropriate circumstances, cover legal costs for those indemnified. This protection must exist in an environment with clear accountability at the individual and institutional level. At the individual level, those benefiting from this legal protection must comply with oaths of office, rules governing conflicts of interest, and codes of conduct. At the institutional level, rules regarding secrecy and confidentiality of all documents, information, and records must be implemented and enforced.

2.5 Structure and Organization of the Deposit Insurance Agency (DIA)

Due to the importance of its mandate and its role in a nation's financial safety net, the design and operations of a DIA should benefit from strong corporate governance and human resource policies. The DIA should be governed by a board of directors that is responsible for all facets of the organization's operations and policies. The DIA's operations should be adequately supported by well-trained managers and staff.

2.5.1 Governance

The DIA should be governed by a Board of Directors. Working Group members recommend, based on their experience, that the Board of Directors of a DIA should operate under a strong and clear-cut mandate. Reflecting practices and institutional arrangements exercised by ASBA's members, the Working Group has advised that the DIA should be led by a Board or Directors appointed by the country's President and ratified by its Congress. However, the group recognizes that many other appropriate institutional arrangements may exist in specific national circumstances, e.g., in countries with a parliamentary form of government. Board members should be qualified for their positions, have a clear understanding of their role in corporate

4 Statutory Protection for Banking Supervisors, by Ross S Delston, 2000, available at http://www1.worldbank.org/finance/html/statutory_protection.html

governance, and be able to exercise sound judgment about the affairs of the DIA. A strong corporate governance environment should also include provisions to afford legal protection to management and staff who discharge their duties in good faith. To promote ethical conduct and accountability, the DIA should report its performance to appropriate agencies of the government. Where the DIA is responsible for administering the deposit insurance funds, the board should exercise great care and stewardship of these resources.

Working Group members agree that to the extent permitted by each country's laws, the Board should be composed of representatives from the supervisory authorities, which may include the central bank, the treasury department, or ministry of finance. The Working Group acknowledges that certain DIAs in the region have board members representing and selected by the insured banking industry. In countries where this practice exists, insured banks and financial institutions have appointed at least two such representatives to the DIA's board of directors. For example, in Bolivia, the board of the Financial Restructuring Fund (FRF) is made up of three non-remunerated members designated by the ministry of finance, the central bank and the banking superintendence (SBEF), in addition to two non-remunerated syndics designated by banking and non-banking financial institutions. In Peru, three of six board representatives are appointed by financial entities. The other three members represent the supervisory agency, the central bank and the economy and finance minister. However, it is recognized that this practice may not be appropriate in all jurisdictions due to legal or other constraints.

The board of director's term of office varies among Working Group members. In general, board members are elected for a minimum of three years and to up to six years. In some cases, some jurisdictions permit reappointments without constraints.

The Board of Directors should be responsible for all aspects of the DIA's operations. While not intended to be a "checklist" of requirements, the Working Group observed that boards of directors strengthen the corporate governance of the organization when they do the following:

- a . Understand and execute their oversight role, including understanding the DIAs mission and objectives.
- b . Approve and oversee the overall business strategy of the DIA, including approval of the overall operating policies and risk management procedures.
- c . Set and enforce clear lines of responsibility and accountability throughout the organization.
- d . Establish an effective audit program.
- e . Approve the annual report, year-end audited financial statements, and annual budget.
- f . Establish the DIA's investment policies and guidelines.
- g . Approve the terms and conditions of credit lines obtained from the Treasury or other financing entity.
- h . Establish appropriate deposit insurance and resolution policies to ensure proper functioning of these activities. These may include:
 - i . Authorizing capital contributions aimed at capitalizing financial companies in which the DIA has an ownership interest.
 - ii. Defining the circumstances under which the DIA would take an ownership interest in a banking company.
 - iii.Approving guidelines and policies for the temporary management of companies in which the DIA has an ownership interest, as appropriate.
 - iv. Approving the conclusion of contracts and institution of legal actions.

The FDIC is accountable to the U.S. Congress. Reporting generally takes the form of an Annual Report, which includes the Government Accountability Office's (GAO) annual audit opinion. In addition, the GAO performs additional audits and reviews, as does the FDIC's Office of the Inspector General, which provides additional independent oversight. The Chair-

BOX 10

Accountability of DIAs in the United States and Argentina

man of the FDIC also testifies annually before the House and Senate banking committees.

In Argentina, a Control Commission supervises the DIA (SEDESA). Its supervision is the responsibility of three regular

trustees and three alternates. One regular and one alternate are selected by the central bank, and two alternates are selected by financial entities. All members hold their positions for three annual periods.

Ideally, the DIA should be responsible for managing all facets of its operations, including setting deposit insurance rates, and managing the deposit insurance fund and the agency's financial resources. However, in certain countries the DIA's financial management abilities are limited. Several DIAs in the Region are not authorized to directly manage the deposit insurance fund and the agency's financial resources. Instead the central bank or some other government authority is charged with this responsibility. Regardless of the arrangement, the deposit insurance fund and the DIA's financial resources should be prudently safeguarded, properly accounted and reported and, to the extent permitted, appropriately invested. The DIA, or the appointed financial steward, should have duties and obligations that at a minimum include:

- a) Setting fees to be paid by member institutions
- b) Collecting fees and making payments
- c) Projecting cash in- and out-flows
- d) Setting and reevaluating budgets
- e) Evaluating investment and liquidity objectives and performance
- f) Managing and maintaining a system of accounts and accounting records
- g) Preparing financial statements
- h) Establishing and maintaining borrowing lines and borrow funds when necessary

2.5.2 Human Resources

The DIA human resource policy should be consistent with its statutory duties. Employees should be recruited through an open and transparent hiring process. Employees should be held to the highest of ethical and professional standards, and employees of the DIA should be afforded similar working conditions, status, and benefits as those of the banking supervisory agency (e.g., Banking Superintendence) or those of the central bank.

The size of the work force should be aligned with the DIA's duties, scope of work, and available technologies. For example, reflecting improved banking and market conditions in the latter part of the 1990s, the FDIC's workforce was reduced significantly in the last decade (see Appendix 9). DIAs in the Region can have as few as four employees as in the case of Peru, or as many as 520 in Mexico, or 4,514 in the United States (see Appendix No. 9).

2.6 Determining Membership in a Deposit Insurance Scheme

When determining the scope of deposit insurance protection, each jurisdiction must consider many important issues. Among them is a clear determination of which types of institutions must be covered by deposit insurance. In the United States, for example, commercial banks and savings associations that accept retail deposits (deposits under U.S.\$100,000) must participate in the FDIC's deposit insurance protection program. A clear definition of an insured deposit must be established,

preferably within banking law. Another important issue that should be considered is whether financial institutions exist in a particular country that accept “small” deposits but are not typically considered “banks” in the traditional sense because of their other business activities. If deposit insurance regulations are indeed designed to protect small depositors, the regulations should ensure that institutions permitted to accept these deposits are covered by the nation’s deposit insurance program. In addition to clearly determining deposit insurance coverage limits, the DIAs should also consider whether deposits held by domestic offices of foreign-owned banks will receive equal deposit insurance protection.

2.6.1 Institutions covered by a Deposit Insurance Agency (DIA)

It is recommended that all financial institutions that accept deposits from “small” depositors be required to participate in an explicit and limited deposit insurance protection program. At a minimum, these institutions should also be required to:

- > Obtain an appropriate license (banking or otherwise) from the proper licensing authority;
- > Be supervised by the appropriate supervisory organization; and
- > Periodically disclose reliable economic and financial information to the public.

Membership in a DIA can include all licensed and supervised financial institutions or be restricted by national legislation or business practices (see Box No. 11).

2.6.2 Deposit insurance coverage for foreign-owned banks

Whether DIA’s coverage should extend to locally licensed foreign-owned banks is a question that often has been discussed in the Region. The working group believes

Argentina – Deposit insurance applies to deposits denominated in pesos and foreign currency at public or private financial entities authorized to operate by the central bank. National, provincial, and municipal governments provide guarantees to public banks licensed at each level of these jurisdictions. However, the fact that a financial institution has a national, provincial, or local license does not exclude or limit deposit insurance, and it does not exclude/limit the obligation of banks to contribute to the FGD.

Bolivia – All banking and non-banking financial institutions licensed by the Superintendencia must contribute to the *Fondo de Reestructuración Financiera* (FRF). Legislation requires that FRF funds be used only for financial institution resolution procedures defined by law.

Guatemala – Twenty-five of the 26 banks supervised are covered by the *Fondo de Protección de Ahorros* (FOPA), and the

BOX 11 DIA Membership in Selected Countries

deposits of one state-owned bank are fully insured by the government.

Mexico – Coverage is extended to all financial institutions authorized by the Ministry of Finance to organize and operate as banking institutions.

Paraguay – All private sector, licensed financial institutions are required to be contributing members of Fondo de Garantía de Depósitos (FGD). Currently there are 12 banking and 12 financial companies as FGD members.

Peru – FSD membership is mandatory for all deposit-taking institutions authorized by the Superintendencia.

United States – The FDIC insures a variety of banks and savings associations headquartered in the United States that operate under bank or thrift charters (licenses) granted by a Federal or state-banking supervisor. At the Federal level,

the most common types of institutions are National Banks, Federal Savings Associations, and Federal Savings Banks. At the state level, some of the more common types of institutions are commercial banks, savings and loan institutions, savings banks, and industrial loan companies. Credit unions are insured by the National Credit Union Association (NCUA).

FDIC membership is mandatory for all depository institutions that accept retail deposits in the United States. National Banks and Federally chartered savings institutions are required by law to have FDIC insurance, and most state laws require retail depository institutions to have FDIC insurance. In a few states, the law may not expressly require depository institutions to have FDIC insurance, but the banking supervisor may require this as a condition of approval of the banking charter.

that issues concerning the coverage of foreign bank depositors, i.e., whether deposits held by foreign-owned banks with domestic operations, including subsidiary banks, branches, and agencies, should benefit from deposit insurance coverage in the same manner as domestic banks, should be considered when designing and implementing a deposit insurance framework.

ASBA members have taken different positions on this topic (see Box 12). The United States, for example, generally requires foreign banks to establish commercial banking subsidiaries in the U.S. in order to have access to deposit insurance, whereas other members extend deposit insurance coverage to foreign-owned branches as well as subsidiaries. In Mexico, deposit insurance applies to operations insured by IPAB by multiple banking institutions as stipulated in the Credit Institutions Law. This legislation defines multiple banking institutions as companies established in Mexico, which are duly authorized to provide banking and credit services by the secretary of finance and public credit (SHCP). These companies may be subsidiaries of foreign financial institutions, constituted in countries with which Mexico has formally agreed to allow the establishment of foreign subsidiaries. Therefore, it is necessary for a bank to be established in Mexican territory, under Mexican law, to benefit from deposit insurance.

2.6.3 Deposit insurance application requirements

Most countries in the Working Group's sample do not require banking organizations to apply for deposit insurance, with the exception of the United States. In the United States, the FDIC is solely responsible for granting deposit insurance coverage, but applicants generally apply for a banking charter (license) at the same time they apply for deposit insurance. The two applications are submitted simultaneously to the FDIC and the chartering authority, who communicates and coordinates the disposition of the applications. In many other countries in the Region, banks need to obtain their license at the national level, usually from the central bank or banking supervisor (e.g., Banking Superintendence), and are subject to mandatory and automatic membership in the deposit insurance scheme.

Argentina – Current rules state that deposit insurance covers deposits at all branches or subsidiaries of foreign-owned financial entities, as long as they are licensed by the central bank and contribute to the insurance agency (SEDESA). The current deposit framework does not differentiate between the treatment of domestic and foreign-owned banks.

Bolivia – All foreign bank subsidiaries and branches contribute to the FRF and benefit from its insurance coverage under terms similar to those applicable to domestic banks.

Guatemala – The savings protection fund (FOPA) ensures the protection of bank depositors. Insurance coverage is limited to Q 20,000, or its equivalent in foreign currency, per person or corporate body holding deposits in either a national private bank or a local branch of a foreign bank. FOPA membership is man-

BOX 12

Coverage of Foreign-Owned Banks in Individual Countries

datory for all foreign bank subsidiaries. With the enactment of the banking law in June 2002, all domestic banks and branches of foreign banks operating in the country must contribute monthly to the savings protection fund. Banks licensed after June 2002 must contribute to the fund as of the first month of operations.

Mexico – Foreign financial institutions can only invest in Mexico through subsidiaries. Financial authorities provide national treatment to subsidiaries of financial institutions under terms established in international treaties or agreements. Consequently, foreign subsidiaries are covered for deposit insurance purposes under the same terms granted to Mexican-owned banks.

Peru – Deposits of banks operating in Peru, whether foreign or domestically owned or of mixed ownership, are insured by the FSD. Deposits taken by subsidiaries of these banks in foreign countries are not covered by the FSD.

Paraguay – Law No. 2334/03 does not discriminate between deposits in foreign or domestic banks.

United States – With a few exceptions, foreign banks are required to have separately capitalized subsidiaries to conduct retail deposit-taking activities in the United States. These subsidiaries are subject to the same assessments, and their deposits are entitled to the same insurance coverage, as those provided for domestic banks.

Group A – Banks are not required to apply for DIA membership

Argentina – Once the central bank grants a license to a banking organization, insurance is mandatory for all deposits and no separate application process is required.

Bolivia – Once the financial institution obtains its license from the Banking Superintendence, it is automatically covered by the Deposit Insurance Law. When the institution commences operations, it begins contributing to the FRF and benefiting from its insurance coverage.

Guatemala – There are no deposit insurance application requirements, as contributions to FOPA are mandatory for all banks licensed in the country.

Mexico – Financial institutions are not required to apply for deposit insurance

BOX 13

Deposit Insurance Application Requirements in Selected Jurisdictions

coverage, as the IPAB was created to protect all bank depositors. Deposit insurance is mandatory for banks.

Peru – No FSD membership application is required for depository institutions authorized by the Superintendence. Membership is mandatory and automatic.

Paraguay – Current legislation mandates all nationally licensed financial institutions to be contributing members of FGD; institutions do not need to apply for membership. Any new entrants to the market will be required to become FGD members as soon as they are licensed.

Group B – Banks are required to apply for membership in deposit insurance schemes

United States – Institutions apply to the FDIC for deposit insurance coverage. The FDIC is solely responsible for the deposit insurance application, but newly formed institutions generally apply either to the state or Federal chartering authority for a banking charter (license) at the same time they apply for deposit insurance. The FDIC communicates and coordinates the disposition of the deposit insurance application with the relevant chartering authority.

3

Deposit Insurance and the Financial System

3.1 Scope of Deposit Insurance Coverage

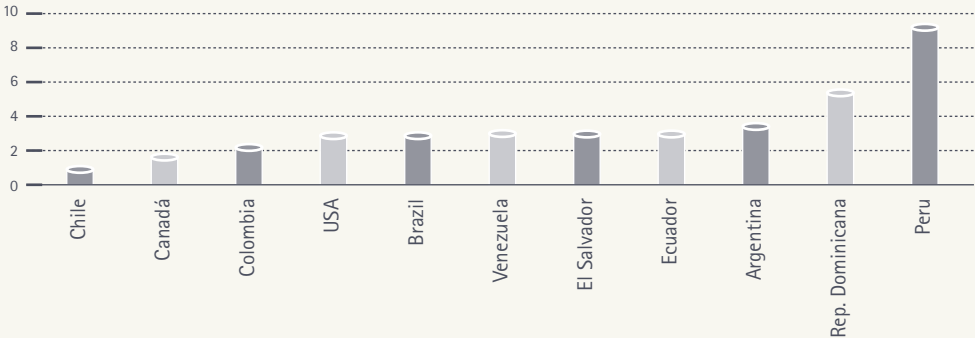
The Working Group recommends establishing a specific deposit insurance coverage amount per depositor per institution to encourage market discipline, prevent moral hazard issues and promote financial system transparency. The limit “per depositor per institution” means that the maximum coverage is applied in each insured bank. For example, if the limit is \$30,000 per depositor per institution and a customer has two deposits of \$30,000 each in two separately chartered insured institutions, the customer’s total coverage is not limited to \$30,000 but to \$60,000. The amount should be sufficient to promote a depositor’s trust. Peru has one of the highest coverage amounts per capita in the ASBA Region, with a maximum coverage almost ten times the country’s GDP per capita. Coverage in the United States and Brazil are slightly less than three times GDP, and in Chile, the amount is less than the GDP per capita (see Graph No. 1).

3.1.1 What is the amount of deposit insurance coverage limit in the Americas?

Coverage limits range from approximately U.S.\$ 2,640 in Guatemala, U.S.\$ 10,000 in Argentina, and U.S.\$ 20,000 in Peru, up to U.S.\$ 100,000 in the United States and Mexico (see Boxes 14 and 15).

A clear definition of insured deposits should be codified in banking regulation. The types of deposits covered should encompass all duly registered savings and checking accounts, fixed term deposits and similar deposits held by individuals or corporations. To avoid potential abuses, Argentina limits its coverage to deposits receiving an interest rate below a threshold determined by the central bank.

GRAPH 1
Insurance Deposit Coverage as a Multiple of GDP per capita



Source: SEDESA, Annual report 2002

3.1.2 Foreign deposit coverage

Deposits registered in a foreign jurisdiction and held outside the country are generally not covered by DIAs. Deposits made by foreigners in the local country and payable in the local country are usually covered by deposit insurance.

3.1.3 Uninsured liabilities and deposits held by insured banks

Certain liabilities and deposits are generally not covered by deposit insurance. These uninsured liabilities and deposits will typically include amounts exceeding the maximum insured level, but may also include liabilities booked and payable in

Argentina – Insurance will cover deposits on demand or fixed term up to ARS\$30,000 (approximately US\$ 10,000) according to Article 13 of Decree 540/95. The central bank can adjust the amount of insurance coverage when changes in economic and financial conditions warrant

Bolivia – The law does not specify a coverage limit by depositor. FRF is not deposit insurance, but a fund designed to assist banking resolution processes.

Guatemala – Articles 85 and 87 of the Law on Banks and Financial Groups set the coverage limit at Q20,000, or its equivalent in foreign currency, per person or institution. At US\$ 1 = Q. 7.57846, the limit is approximately US\$ 2,640.

Mexico – The coverage limit is 400,000 UDIs, equivalent to approximately 1 million pesos, per depositor and per institution (approximately US\$100,000). Coverage is indexed to inflation.

Paraguay – As defined by Art. 1c, deposits are insured to an amount equiv-

Box 14

Deposit Insurance Coverage Limits

alent to 75 minimum monthly salaries, currently G6,000 or approximately US\$13,613. Covered amounts may only exceed this limit and attain 100 percent of deposits when made as foreign trade guarantees or deposits made by justice system as custody in either civil or criminal cases.

Peru – As set forth in Article 153 of the Law, the FSD provides coverage up to S/. 62,000. This amount is adjusted quarterly based on the Wholesale Price Index. The current amount is s/.72.794 (approximately US\$ 22,000). The coverage limit is per depositor in each of the FSD member institutions.

United States At present, the basic coverage limit is \$100,000 per deposit and per institution; however, depositors can obtain separate insurance coverage for their interests in individual accounts, joint ownership accounts, certain types

of revocable and irrevocable trust accounts, pension and other employee benefit accounts, etc. Consequently, much more than \$100,000 can be insured at a single bank if the depositor has funds owned in different legal capacities and satisfies the FDIC's regulatory requirements. The basic US\$100,000 coverage limit is not indexed. Recently enacted legislation allows deposit insurance to be indexed to an appropriate price level to allow the coverage to keep pace with inflation. Note: The Federal Deposit Insurance Reform Act of 2005 increased the coverage limit for retirement accounts to \$250,000 and indexed this and the general deposit insurance coverage limit to inflation and allows the FDIC to increase the deposit insurance coverage limits every five years beginning January 1, 2011, if warranted (see Appendix 5 for more information).

Argentina – Deposits in both local and foreign currency are covered when registered as checking or savings accounts, fixed term deposits or other modalities determined by the central bank. Coverage will only consider deposits subject to an interest rate that does not exceed the central bank's published fixed reference rate.

Mexico – Under Mexican law, a banking deposit is defined as a transfer of ownership of money, denominated in pesos or foreign currency, to a depository institution (bank). The depository institu-

Box 15

Deposits Covered by Three Jurisdictions

tion is obligated to reimburse the money to the depositor.

The following deposits and credits are considered as guaranteed obligations:

1. Cash bank deposits including call deposits, savings deposits, and time deposits.
2. Loans and credits due by the institution.

Peru – No explicit definition of the term "deposit" exists in Peruvian legislation. The term "current account" is defined

(a contract whereby an institution commits to fulfilling a client's payment orders, up to the amount deposited in the account, or of the credit previously determined), as well as the characteristics of savings accounts. Regulations specifically indicate that deposits insured by the FSD are deposits made by named individuals and nonprofit organizations, and demand deposits are made by all other organizations, except financial institutions.

Are deposits held outside the country covered by the DIA?

Mexico – Regardless of where the deposits are held, the IPAB covers deposits up to the guaranteed amount, provided the deposits are held in a Mexican bank's branch. Deposits held in a bank's subsidiary or affiliate not covered by IPAB are excluded.

United States – Generally, deposits held outside the United States are not covered; however, deposits payable in a

Box 16

Coverage of Foreign Deposits

foreign branch of an insured bank would be insured if the deposits also are explicitly payable in a U.S. office of the bank.

Are deposits held within your country by overseas depositors covered by your country's DIA?

Mexico – The IPAB covers deposits up to the guaranteed amount regardless

of the nationality or residence of depositors.

Peru – The deposit insurance does not discriminate between resident and non-resident depositors.

United States – Yes, if held in insured depository institutions.

Argentina – Deposits not covered by the insurance system include:

1. Transferable fixed term deposits whose ownership was acquired by endorsement, even when the last endorser is the original depositor.
2. Deposits collected through systems offering additional incentives or additional motivation to the agreed upon interest rate, whichever the denomination or form adopted (insurance, tourism, services, drafts, etc.).
3. Deposits with agreed upon interest rates superior to those of reference, which are periodically disclosed by the central bank through Communication "B". These are determined by adding two annual percentage points to the moving average of the last five working banking days of passive interest rates which, as applied to fixed term deposits or demand deposits of up to \$100,000 (or its equivalent in other currencies) as identified by the central bank's regular survey.
4. Deposits of financial entities at other financial intermediaries, including fixed term certificates acquired through secondary negotiations.
5. Deposits by individuals linked directly or indirectly to the entity as per guidelines defined in the specific regulations.
6. Fixed term deposits of registered securities, acceptances, or other excluded operations.

Guatemala – FOPA does not cover deposits by individuals or corporations connected with the bank, including share-

Box 17

Uninsured Deposits in Selected Countries

holders, members of the board, managers, deputy managers, legal representatives and other bank staff members. An exception to this rule is constituted by deposits of founding shareholders of banking companies who were legally compelled to acquire shares in the entities, provided they do not work at the financial institutions.

Mexico – Claims not covered by deposit insurance include:

- I. Obligations in favor of domestic or foreign financial entities;
- II. Obligations in favor of "sister" entities of the banking institution, i.e., belonging to the same financial group.
- III. Registered liabilities in marketable securities, as well as bearer securities. Registered guaranteed operations in securities will be covered by IPAB, provided they have not been negotiated.
- IV. Obligations or deposits in favor of stockholders, directors or officials of the two highest hierarchical levels of the corresponding institution, as well as general proxies with administrative powers and general managers.
- V. Transactions that do not comply with legal, regulatory and administrative provisions or with sound banking practices and uses, as well as those where the holder acted in bad faith, and those related to felony or actions against the law.

Paraguay – Deposit insurance does not cover deposits made by the intervened institution's executives and directors, or any other individual or legal persons associated with the intervened bank, nor any other fraudulent, simulated, or illegal transactions.

- Peru** – The FSD does not insure
- a. Deposits made by non identified individuals.
 - b. Deposits made by domestic or foreign financial institutions.
 - c. Depositors who have acted as directors or managers of the depository institution during the two years preceding liquidation, or who participate in a financial group holding an interest of more than 4 percent in the depository institution, provided they have directly or indirectly participated in managing such institution.
 - d. Deposits made in violation of any legal provisions and those that, despite being formally considered as deposits, are essentially non-depository claims.

United States – Deposit balances that exceed the insurance limit are not covered by the FDIC's deposit insurance. In addition, liabilities booked in foreign offices of the insured institution are generally not covered by the FDIC's deposit insurance. The Federal Deposit Insurance Act defines the terms deposit and insured deposit. See Appendix 4 for more information.

foreign jurisdictions, certain claims by financial institutions, negotiable securities, shareholder and other bank insider deposits of the failed institution, as well as unlawful deposit transactions. Each country's regulations should clearly define accounts that are to be considered insured or uninsured liabilities. Members of the Working Group stress that by providing a clear definition of insured and uninsured deposits, legislators and regulators are promoting financial sector stability, reducing moral hazard, and enhancing market discipline.

3.2 Funding Arrangements for Deposit Insurance Schemes

Funding arrangements for deposit insurance schemes vary across the Americas. DIAs were often created in the aftermath of banking crises, leading government to provide the initial funding. For example, in the early 1930s the FDIC's establishment required \$289 million from the U.S. Treasury and the nascent Federal Reserve System. Today, the FDIC is funded through premiums paid by the insured institutions and income earned on its investments. In some cases, a DIA's operating budget is appropriated and managed by legislators. Mexico's Congress, for example, determines IPAB's annual budget. Other countries rely on private sector contributions, such as the Argentinean deposit insurance fund or the Bolivian FRF, which are funded by deposit-taking institutions.

3.2.1 Assessment and collection of premiums

A DIA must consider several important issues when defining its premium assessment and collections programs. Regional experience suggests that in certain situations it may be appropriate for DIAs to start with a flat rate as a percentage of the value of insured deposits. After at least five years, the DIA can then consider the benefits

Argentina – Financial entities are responsible for all contributions to the Deposit Insurance Fund. The Deposit Insurance Fund belongs to the national state as is the income generated by the Fund's investments.

Bolivia – FRF resources are generated by mandatory contributions from financial institutions licensed by the SBEF and are to be used solely for bank resolution procedures defined by law (LBEF). FRF resources are not subject to the control of the Office of the Comptroller General as they are not included under Article 3 of the SAFCO Law 1178. In the event that FRF resources are insufficient to support the resolution process, the central bank will provide the remaining funds from the Bolivian Treasury. Reimbursement of these funds will be carried out under the terms and conditions agreed between the Treasury and the FRF and charged to fees from FRF member institutions.

Guatemala – Start-up capital for the Savings Protection Fund (FOPA) was pro-

Box 18

Start Up Capital of DIAs

vided by the government, as defined by law and regulations applicable to the Fund. As at December 31, 2004, FOPA's total capital was Q.1,378.3 million (including government contributions from a US\$ 75 million loan granted by the World Bank and US\$ 68.4 million in long-term Treasury Bonds (Bonos Paz)).

Mexico – The Mexican Finance and Public Credit Secretariat (SHCP) established a budget item for the IPAB in accordance with the Federal Budget, approved by Congress, for the ASD to start operating.

Paraguay – FGD has been awarded an initial contribution of US\$50 million in negotiable government bonds, which can be rediscounted or otherwise used to provide liquidity as required. FGD also receives mandatory premiums from participating financial entities on a quarterly basis.

Peru – The central bank contributed US\$ 5 million toward the creation of the Deposit Insurance Fund.

United States – The Banking Act of 1933 created the FDIC and defined its organization, duties, and functions. The legislation provided for two deposit insurance plans: a temporary plan initiated January 1, 1934, and a permanent plan which took effect July 1, 1934. Capital necessary to establish the FDIC was provided by the U.S. Treasury and the 12 Federal Reserve Banks. The Treasury contributed \$150 million. Each Federal Reserve Bank was required to subscribe to Class B capital stock in an amount equal to one-half its surplus as of January 1, 1933. The \$150 million contributed by the Treasury and the \$139 million in capital stock purchased by the Federal Reserve Banks were fully repaid by the end of 1948.

and disadvantages of beginning to apply a risk-based premium system. The DIA should also consider the periodicity of its assessment and collection efforts. It is the Working Group's recommendation that DIAs periodically calculate total insured deposits, assess premiums semi-annually, and collect premiums from insured institutions at least quarterly. DIAs must also consider whether to use a target ratio, or a target range, as a benchmark of the level of the deposit insurance fund. This target ratio could be defined as the relationship between deposit insurance funds (on-hand) and total insured deposits. Once established, compliance with this target ratio should be evaluated periodically. The FDIC, as explained below, has until recently been required to maintain a Designated Reserve Ratio (target ratio) of 1.25 percent.

3.2.2 Funding arrangements that may be used by the DIA during emergencies or for liquidity purposes

The Working Group believes that in the case of an emergency, DIAs should have the authority and ability to promptly access funds to cover liquidity needs that arise from bank failures. The DIA may consider, for example, establishing a line of credit with the government's Treasury department, and any borrowings against this line should be repaid in a timely manner by assessing the insured institutions. Failure to swiftly access funds from government sources, large financial institutions, or the capital markets will severely limit the DIA's ability to resolve bank failures and can exacerbate a financial crisis.

Bolivia – The contributions of financial institutions to FRF are calculated on the daily average deposits of the preceding trimester. The central bank (BCB) automatically debits the amount of these contributions in any open accounts of the institutions with the central bank.

Guatemala – Contributions to the deposit insurance agency FOPA are paid monthly and are calculated as a twelfth of one per thousand of the average monthly deposits of the preceding month. As stipulated in the banking law (LBGF), a bank will cease to pay to FOPA when the bank's balance at the deposit insurance agency reaches 5 percent of deposits. If, for whatever the reason, a bank's balance with FOPA is less than 5 percent of deposits, the bank will be required to reinstate the payment of monthly dues to FOPA until such percentage is reached.

Mexico – Each month, the central bank collects premiums debiting the institution's accounts at the central bank and crediting the amount to IPAB's account. Premiums are calculated on banking liabilities. All funds collected by

Box 19

Assessment and collection of premiums

IPAB are required to be invested by IPAB in high liquidity government securities or deposits at the central bank. The DIA can only use these resources if duly authorized by its board. IPAB maintains in cash or banking deposits an amount deemed sufficient for its operations and administrative expenses.

Paraguay – Premiums paid by participating financial institutions are calculated from average quarterly deposits in each entity. Premiums attain 0.12 percent of the previous quarterly average in either local or foreign currency. When a financial institution reaches a net balance at FGD of 10 percent of total deposits in the system, and if agreed by the banking superintendent and the central bank's board, payment of FGD premiums can be waived.

Peru – Premiums are assessed and collected quarterly. The DIA is not required to maintain a minimum target level and ratio for the deposit insurance fund.

United States – Premiums are assessed semiannually but collected quarterly. Premiums are assessed against an institution's total domestic deposits adjusted for float. The FDIC has been required to maintain the ratio of the insurance fund to estimated insured deposits at a Designated Reserve Ratio (DRR) of 1.25 percent. However, the Federal Deposit Insurance Reform Act of 2005 establishes a range for the DRR of 1.15 percent to 1.50 percent and allows the FDIC to manage the pace at which the reserve ratio varies within this range. However, if the reserve ratio falls below 1.15 percent—or is expected to within 6 months—the FDIC must adopt a restoration plan that returns the deposit insurance fund to 1.15 percent within 5 years (see Appendix 5 for more information). The FDIC Board of Directors semiannually evaluates the funds adequacy and determines what premiums will be assessed for the next six months.

Bolivia – In the event that deposit insurance fund resources are insufficient to support any bank resolution process, the central bank will provide the funds needed from the Bolivian treasury. Reimbursement of these funds will be carried out under the terms and conditions agreed between the treasury and the FRF and charged to premiums from FRF member institutions.

Guatemala – For the purpose of covering any deficiencies at the deposit insurance agency (FOPA), or for an increase in coverage, the Bank of Guatemala (central bank), as administrator of the fund, may request from the executive branch of government, through the ministry of finance, financial contributions in amounts deemed sufficient for these purposes. Similarly, in specific cases and as strictly necessary, FOPA also will be supported by the banking capitalization fund (Fondo de Capitalización Bancaria),

Box 20

Funding a DIA during an emergency or for liquidity purposes

an institution established to assist in the process of strengthening the national banking system within the context of banking mergers, asset acquisition, and processes excluding assets or liabilities as mandated by the banking law (LBGF).

Mexico – When an emergency situation arises affecting the solvency of any institution and IPAB does not have sufficient resources to cover the losses, the board immediately will inform the executive branch of government, and for such purpose may acquire financing. Total emergency funding may not exceed 6 percent of an average of the previous three years of total liabilities of insured institutions.

Paraguay – The government can issue bonds to finance future premiums when

FGD funds are insufficient to comply with its statutory duties.

Peru – The FSD may borrow on lines of credit directly from the treasury, approved by an emergency decree (Decreto de Emergencia), as well as from lines of credit secured by the treasury and approved by an emergency decree. All funding obtained by the FSD must be approved by the Board of Directors.

United States – The FDIC has the authority to borrow on a line of credit from the U.S. Treasury up to \$30 billion. Such borrowings must be repaid from assessments on insured depository institutions. FDIC also has statutory authority to borrow from the Federal Financing Bank of the U.S. Treasury which may be necessary for working capital purposes.

3.3 Public Awareness

Deposit Insurance Agencies must recognize the importance of effective public awareness and implement systems to ensure the public is appropriately informed. The DIA has the responsibility to inform government authorities, the public at large, investors, depositors, and other stakeholders in the financial system about the condition of the banking system. Effective public awareness efforts can promote confidence in the banking system by informing depositors of their rights and responsibilities and limit moral hazard by providing timely information on a bank's and the banking system's condition. The DIA's public awareness program should, at a minimum, achieve the following:

- > Disclose information about the mechanisms of deposit insurance and the working of a DIA.
- > Increase the public understanding of the scope and limits of deposit insurance.
- > Improve the image, brand, and credibility of the deposit insurance scheme.
- > Enhance the transparency of the financial markets.
- > Reduce the risks of moral hazard.
- > Promote best practices by consumers of financial services (e.g., depositors).
- > Avoid and mitigate potential consumer abuses by institutions which may not be insured.

Once implemented, the public awareness program should be subject to continuous evaluation. When evaluating the program's effectiveness, the DIA should gauge the stakeholder's satisfaction with the information that has been provided and measure the public's perceptions and understanding of deposit insurance.

3.3.1 Public perception

The Working Group believes a significant opportunity exists within the Region to improve the public's awareness of deposit insurance programs. Public awareness varies greatly among ASBA-member countries (see Box 21). This phenomenon requires further study, including

a careful review of each country’s public awareness practices to understand why the public’s perception may be poor. For example, consider a comparison of the approaches taken in Argentina and Paraguay. Argentinean law mandates that all bank liabilities and instruments disclose their insured status; this may be considered a more effective approach than Paraguay’s practice of requiring financial institutions to inform the public about that country’s deposit insurance system (see Box 22).

3.3.2 Responsibility for communications and disclosure

Given the importance of communicating with the public, the Working Group believes that a combination of public communication techniques and approaches should be considered. One effective communications tool is the mandatory use of official signs that inform the public about whether deposits made in that institution or location are insured and the degree of protection offered by that country’s DIA. This requirement should be contained in appropriate banking law, which calls for signs to be conspicuously placed wherever insured deposits are accepted. Other communication tools that should be considered are mandatory disclosures of deposit insurance protection in certain advertisements, publications, and public notices. DIAs should also explore using radio, television, newspapers, and other media to communicate the availability of deposit insurance in their particular country. DIAs may also consider establishing a freely accessible consumer helpdesk where questions about deposit insurance coverage can be confidentially discussed.

3.4 Institutional Issues and Interrelationships Between Financial Safety Net Players

The Working Group recognizes that many countries have adopted varying and sometimes unique bank supervisory and deposit insurance arrangements that are often the outgrowth of the particular institutional, legal, economic and financial situation of a country as well as that country’s history.

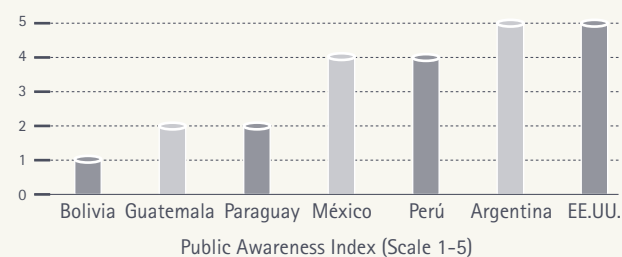
Depending on a country’s supervisory structure, multiple organizations may play important roles within the country’s financial safety net. In some countries the central bank may be the sole authority responsible for bank regulation and supervision and may also provide explicit or implicit deposit insurance protection. In other jurisdictions, many agencies, each operationally independent and accountable, may be responsible for supervising banks and addressing their risks. Similarly, powers of deposit insurance agencies (DIA) vary widely among countries. For instance, some deposit insurance agencies have powers limited to the collection of premiums and payment of insured depositors. Others have broad powers that permit the DIA to supervise banks, provide deposit insurance, and resolve failed banks.

BOX 21

Public Awareness about Deposit Insurance in Seven Jurisdictions

Answers to the following question: Using a scale of 1 through 5 (1 indicates little public awareness and 5 indicates strong public awareness), is the public aware that deposit insurance coverage is available to depositors?

Public Awareness Score in Seven Jurisdictions (Self Assessment)



Argentina – Central bank regulations mandate that in all documents representing liability operations (deposit certificates, deposit tickets, tickets from automatic cashiers, statement of accounts, etc.) the following legend should appear: “Deposits in pesos and in foreign currency are covered by \$30,000 insurance. In the case of financial operations bearing the names of two or more individuals, insurance coverage will be prorated among its bearers. In any case, total coverage by individual cannot exceed \$30,000 whichever the number of accounts and/or deposits. Deposits taken at interest rates exceeding the central bank’s reference rate and those benefiting from special incentives or promotions additional to the interest rate are excluded from coverage.”

In case of excluded products, the following disclosure should be inserted visibly at the front of the documents: “Deposit without insurance coverage,” except when these transactions are effected through automatic cashiers belonging to networks allowing operational interconnection of financial entities. Financial entities should make available to their customers the complete text of the legislation that established deposit insurance coverage, the regulatory decree, and regulations issued by the central bank. Financial entities should disclose any limitations to coverage when advertising deposits. At bulletin boards posting

Box 22

Public Awareness of Deposit Insurance and Disclosure

rates offered to the clientele, the scope of coverage should be visibly transcribed (eligible deposits, percentage and amount of deposit insurance coverage).

Every month, SEDESA should inform the public and the financial superintendence about current balances of the Deposit Insurance Fund.

Guatemala – According to Article 94 of the Law on Banks and Financial Groups, financial institutions are responsible for informing depositors about deposit insurance coverage.

Mexico – IPAB discloses information about deposit insurance using written press, radio, posters, information packets, surveys, e-mail, telephone hotline, information booths in bank branches, and IPAB’s web site.

Paraguay – All financial institutions are responsible for informing depositors about the deposit insurance system in the country.

Peru – The maximum coverage limit provided by the FSD is published daily in major newspapers. The public is informed by the Superintendence, through the media, when a bank is placed in receivership, but not when an institution is troubled or risks failure.

United States – FDIC-insured institutions and the FDIC inform depositors and other stakeholders about the deposit

insurance system and the rules governing insurance coverage for various types of deposit accounts. FDIC-insured institutions are required by law to display an official sign (one for banks and one for savings associations) indicating deposits are Federally insured to \$100,000 at each location where insured deposits are usually and normally received, with certain specified exceptions (12 U.S.C. 1828(a); 12 C.F.R. 328). Insured banks are required to include an official advertising statement in certain newspaper, television, radio and other media advertisements.

All FDIC-insured institutions are required to file quarterly Reports of Condition and Income (known as Call Reports) or quarterly Thrift Financial Reports (TFRs), and those reports are made available to the public. In addition, FDIC-insured institutions that hold publicly traded securities have certain obligations to disclose information about their financial condition in filings with the Securities and Exchange Commission. These filings, generally, are publicly available as are certain enforcement actions taken against insured institutions. Once an institution is closed, the FDIC issues a press release informing the public of the closure and indicating how depositors and creditors can receive payment or make claims against the institution.

3.4.1 Coordination with safety net players

Effective communication and coordination among safety net players is always critical, but is particularly relevant when a country’s supervisory structure involves many different institutions. Effective supervision requires all safety net participants to have access to appropriate economic and financial information. However, the amount and type of information needed by each participant varies depending on an entity’s powers and mandate. A deposit insurer mandated to operate as a pay box system, for example, should at least have information to be able to accurately collect premiums and reimburse depositors. Meanwhile, deposit insurers charged with minimizing loss exposure through proactive risk identification, assessment, and management must have access to timely and accurate information to facilitate the proper assessment of the financial condition of individual banks and the banking industry.

Bolivia – The regulatory framework does not expressly provide for systemic risk identification. However, Bolivia's experience has been that when a large financial institution was expected to fail, and its failure could significantly affect the entire financial system, the ministry of finance and the central bank, in coordination with the banking superintendence tried to prevent the institution's collapse. Among the actions taken were attempts to strengthen the institution's capital and liquidity management.

Guatemala – Institutions are supervised according to the risk they represent, as well as the extent of their compliance with applicable regulations. If any problems are observed, the law allows for mechanisms to mitigate risks posed to the financial system. These include, for example, 1) the central bank may act as a lender of last resort to address liquidity issues; 2) the banking capitalization fund may assist (via subordinated debt) by arranging a merger between banks, by acquiring assets, and processes of exclusion of assets and liabilities, in which the deposit insurance agency (FOPA) may

Box 23

Systemic Risks and Deposit Insurance

play a role by providing liquidity for less sophisticated depositors.

Mexico – When a bank's situation poses systemic risk, the IPAB Governing Board likely will provide recovery assistance.

Peru – At the Superintendence's request and with approval by the ministry of economy and finance and the central bank, the Deposit Insurance Fund (FSD) can make capital contributions to strengthen a financial institution placed under precautionary oversight, provided the original owners no longer control the institution. In the case of banks in receivership, the superintendence may request, on approval by the ministry of economy and the central bank, the creation of a bridge bank to be temporarily managed by the FSD until a new purchaser is found. The bridge bank can operate for a period of one to three years. During the 1998-2000 crisis, special bank bailout programs were implemented, including portfolio exchanges and capitalization of problem banks.

United States – In general, under the Federal Deposit Insurance Act (FDI Act) the FDIC's resolution options for troubled insured depository institutions are limited by a "least-cost requirement." The FDIC must satisfy its insurance obligations by using the resolution method that results in the least cost to the deposit insurance fund. The FDI Act also contains a "systemic risk exception" that provides the FDIC limited authority to avoid the least-cost requirement. This exception is intended for use, however, only in those instances where the failure of an institution could potentially disrupt the entire financial system. A decision to invoke the systemic risk exception must be made by the Secretary of the Treasury on the recommendation of two-thirds of the Board of Directors of the FDIC and the FRB, after consultation with the President of the United States. The FDI Act also allows the FDIC to recover any additional cost resulting from a systemic risk resolution by collecting a special assessment from banks or thrifts.

When seeking access to this information, the deposit insurer must not place undue burden on the industry or other safety net participants, avoiding any duplication of mandated functions.

Regardless of the type of information needed, be it bank-level or macro-level information, the information must be shared among financial safety net participants for the safety net to operate effectively. The following practices should be considered when establishing information-sharing arrangements among participants:

- > A clear division of powers and responsibilities should be established. Any conflicting mandates should be resolved.
- > Informal information sharing and coordination arrangements can be effective but often rely on the goodwill of the parties involved.
- > Formal information sharing and coordination arrangements, including those that are legislated, should clearly establish responsibilities likely to promote improved responsiveness and strong accountability.
- > Confidentiality of information exchanged among parties should be guided by legislation or agreement.

3.4.2 Institutions responsible for banking supervision

Different jurisdictions have arranged their regulatory and supervisory functions among different institutions, based on legislative mandate, history, and economic and financial circumstances. Appendix No. 6 describes the banking supervisory

function and insurance deposit institutional arrangements in seven countries: Argentina, Bolivia, Guatemala, Mexico, Paraguay, Peru and the United States.

3.4.3 Identifying systemic risks

The Region employs different approaches to supervise banks and identify, assess, and manage systemic banking risks. The central bank in several ASBA member countries is solely responsible for bank supervision, regulation, and related risk management. Other ASBA member countries use the central bank and a bank supervisor to conduct bank supervision to perform these functions. A third group of countries in the Region relies on several institutions to cooperatively supervise banks and identify and assess systemic risks in the financial system, while a fourth group is developing their own methods and institutional arrangements. History has shown that systemic risks can have catastrophic consequences for the financial system and for deposit insurance schemes. Prudent practices require countries to properly identify and address these risks using an appropriate blend of effective risk management arrangements and mechanisms.

3.4.4 Large and systemically important banks. Too Big to Fail

The concept of “too big to fail” is especially relevant in certain countries of the Americas where bank supervisors have to manage heavily concentrated banking sectors. “Too big to fail” is typically characterized by large and systemically important banking institutions. In some cases, these banks have been found to take undue risks with the expectation that government support will protect them from failure because of the important roles they play within the country’s financial system. Generally, the failure of large and systematically important banks may affect other financial institutions resulting in liquidity and payment system disruptions and a loss of confidence by depositors and other stakeholders throughout the system.

3.4.5 Lender of last resort policy

Many countries have traditionally relied on central banks as lenders of last resort. Significant banking crises in the Region during the past decade have caused governments and taxpayers to spend up to 20 percent of GDP on resolution activities, often while using lender of last resort functions. The ensuing inflationary and recessionary tensions created imbalances in those economies and taught central bankers and national government officials that the use of appropriate risk identification, assessment and management can be cost effective. The design and implementation of lender of last resort functions can benefit from the active participation of banking supervisors and deposit insurance agencies.

Bolivia – By performing its routine control and supervisory activities, the banking superintendence identifies any potential threats to the soundness and solvency of individual institutions and the financial system as a whole. An early warning system and on-site and off-site review processes, supported by a prudential regulatory framework, enables the superintendence to periodically assess the condition of each of the banks in the local financial system. The superintendence can then identify those institutions that could be entering a crisis phase and assess the impact their failure would have on the entire financial system. Should economic, political and social circumstances create an unstable environment and the threat of a systemic crisis arises, the superintendence coordinates with the central bank and other government agencies, such as the ministry of finance. In those cases senior staff identifies major areas of concern, agrees on support mechanisms and implements corrective strategies. Experience with financial crises during the past three years shows that such coordination efforts were effective, and problems were efficiently addressed.

Guatemala – As provided for in Article 133 of the Guatemalan Constitution, the Superintendence of Banks is charged with the oversight and examination of banks, credit institutions, financial institutions, surety companies, insurance companies and other organizations determined by

Box 24

Systemic Crises and “Too Big to Fail Banks”

law. The supervisory approach is risk-based and focused on adopting timely corrective measures to prevent interruptions to the operation of individual financial institutions and the entire financial system. The adoption of such measures is based on the coordination between the various departments of the supervisory institution. On-site audits performed by the bank supervision department can determine if banking organizations are vulnerable to potential problems, in the short or medium term, which would weaken their financial condition. This triggers a shift from a normal level of supervision (less on-site work, more off-site work) to a heightened level of supervision (more on-site work, less off-site work). However, the country has witnessed a significant number of bank failures in the last decade.

Paraguay – Law No. 2334/03 indicates that, if requested by the economics ministry and the central bank’s board and agreed by the banking supervisor, the President can use any of the temporary measures of Article 30 to resolve difficulties at financial entities that threaten the financial system. Among these measures, the government can increase its contributions to FGD as non-reimbursable loans for amounts required by FGD and with the central bank as a lender of last resort.

United States – The FDIC has a bifurcated supervision approach. Small community banks are generally supervised through a point-in-time examination, with examination frequencies dictated by guidance and an institution’s CAMELS rating. The larger, more complex institutions, generally defined as those with total assets greater than \$10 billion, are supervised through a series of targeted examinations under a continuous examination program that results in one annual report of examination. Each large / complex bank is assigned an examiner who generally determines, through a risk focusing process, the target areas to be reviewed during a given examination cycle. In general, under the Federal Deposit Insurance Act, the FDIC’s resolution options for troubled insured depository institutions are limited by a “least-cost requirement” and “systemic risk exception” discussed in Section 3.4.3. Ideally, the FDIC’s resolution programs would not differ for large banks when compared to smaller banks; however, in the many years since a large bank has failed, institutions have become more sophisticated, diversified and global. Resolution of one of these institutions would be increasingly complex and require significant levels of cooperation with international banking authorities.

Argentina – The central bank is empowered as lender of last resort to grant support to financial entities to address temporary illiquidity up to an amount equivalent to the entity's capital. When necessary, the central bank supplies the financial system with adequate liquidity as agreed by a majority of the central bank board. When extraordinary funding is granted, shareholders are required to commit, as a minimum, an amount of additional collateral equivalent to the capital of the entity and also are subject to the requirements established for the restructuring of financial entities. Official banks can be exempted from these requirements.

Bolivia – The central bank (BCB) law authorizes BCB to lend exceptional funds to financial institutions to meet urgent liquidity needs. Loans are extended for a period of 90 days and subject to renewal. The BCB board of directors sets credit and securities limits. BCB must consult with the Superintendence when considering financial institution loan applications. BCB is also the depository of liquid reserves needed to meet banks' minimum cash requirements and support the payment system. Interest rates applicable to liquidity credits are above market rate to encourage financial institutions to consider this as their last option after exhausting other funding sources. BCB support helps institutions withstand runs on banks resulting from an unstable political and social environment. During a recent liquidity crisis, the role of the BCB as lender of last resort was crucial. The

Box 25

Lender of Last Resort Function

liquidity support provided to financial institutions helped the financial system mitigate serious economic and social pressures. In addition, with the aim of preserving a stable and competitive financial intermediation system, the law authorizes the central bank to discount or guarantee assets, capitalize accruals, dispose of resulting shares, and execute credit transfers either in cash or fixed term. The law authorizes the central bank to acquire partially or in total, any rights of depositors in financial institutions paying in cash, credit, or term instruments, in duly qualified cases as agreed by its board of directors. In these cases, the collection of committed funds will need to be specified in a detailed plan.

Guatemala – Pursuant to Article 48 of Bank of Guatemala law, decree No.16-2002, the central bank is the lender of last resort. The central bank is authorized to extend credit to banking organizations solely to resolve temporary liquidity problems. This authority is based on the monetary, exchange and credit policy determined by the Monetary Board (Junta Monetaria). Article 133 of the Guatemalan constitution indicates that the Monetary Board is responsible for maintaining liquidity and solvency of the national banking system as well as for ensuring the stability and strength of domestic savings. The Bank of Guatemala is authorized to lend funds to banks, should li-

quidity problems arise as a lender of last resort policy.

Mexico – Banco de Mexico (the central bank) operates as reserve bank and lender of last resort by granting credit or purchasing bank securities. The central bank can grant loans to credit institutions to avoid disruptions in the payment system or grant loans to an individual institution undergoing liquidity problems.

Paraguay – In cases of temporary illiquidity, the central bank can grant loans to financial intermediaries at terms that do not exceed 90 days against credit or other negotiable, eligible, and guaranteed securities. If the affected bank requires an extension of this term, a majority of four central bank directors can approve the extension, provided an acceptable recovery plan is presented.

Peru – The central bank (BCR) is the lender of last resort, granting loans for monetary regulation purposes. As provided for in the General Law, Article 95, any bank accessing rediscounts for 90 of the last 180 days must be placed under close scrutiny. During this time, Article 58 states the BCR cannot lend to affected banks.

United States – The FRB acts as the sole lender of last resort and will provide liquidity in the case of a financial emergency. Banks can obtain low cost funds by borrowing from the FRB's discount window.

Bank Intervention and Failure Resolution

A critical function of banking supervisors and deposit insurance agencies (DIAs) is supervisory intervention in the normal functioning of the banking sector when a crisis, or potential crisis, develops. To prepare for such an event, bank supervisors and DIAs must develop and implement contingency plans that include provisions for dealing with bank failures. Countries in the Region have developed various approaches to crisis intervention and resolution, often developed in the aftermath of painful banking crises. Shared experiences have revealed that banking losses can be mitigated by (i) close monitoring and assessment of banking solvency, (ii) a clearly established early warning mechanism, and (iii) the ability to act in a timely and effective manner to control possible losses and avert banking crises. These guidelines may prevent possible deposit runs and mitigate the potential for insolvency or illiquidity spillover to other institutions, which can exacerbate tensions and increase the cost of resolution.

4.1 Deposit Insurance in Bank Intervention and Resolution

It is in the interest of deposit insurance schemes to promote mechanisms to prevent bank failures or mitigate costs of bank insolvency. However, a policy of zero bank failures would not be appropriate as such a policy would increase moral hazard. When appropriate, DIAs should work cooperatively with other bank supervisory authorities to identify potential vulnerabilities in the insured financial system. DIAs should also collaborate with other supervisory authorities to mitigate potential losses once weak banks have been identified. The DIA's advice should reflect the legal framework in each jurisdiction, access and availability of sufficient financial resources, and the need for coordinated and swift action.

4.1.1 Role of Deposit Insurance Agency in Bank Resolution and Prompt Correction Actions

A country's banking supervisors working in concert with the DIA should be duly authorized in law to determine when to close a bank. When dealing with a weak or problem bank, the appropriate supervisory authority should first exhaust all reasonable means to prevent further deterioration of the bank through intensified supervisory activities. If these pursuits are unsuccessful or the bank's condition renders supervisory efforts ineffective, supervisory authorities and the DIA should consider a resolutions program that may ultimately involve the intervention and the receivership of the insured institution.

An insured bank's primary supervisor or its chartering or licensing agency, depending on the country's laws, should have the authority and ability to close a member institution and appoint the DIA as the receiver. These actions should be considered under several conditions, including: (i) being classified as "critically undercapitalized," (ii) holding assets insufficient to meet obligations, (iii) engaging in unsafe or unsound banking practices, (iv) engaging in willful violation of a cease-and-desist order, (v) concealing or tampering with books and records, (vi) money

launders, (vii) the voluntary cessation of insured status, or (viii) failing to pay one or more liquid and payable liabilities.

When the DIA does not have supervisory powers, the banking supervisor is generally responsible for addressing weaknesses in banks before they are closed. The supervisor should keep the DIA fully informed of all developments affecting insured banks and, in particular, those that may result in a bank closure so that the DIA can make appropriate plans as authorized by law. Effective communication among all safety net participants (i.e., supervisor, party insured, and central bank) must be maintained throughout the process. Information provided by the supervisor must be kept confidential.

Based on the Region's experience it is recommended that, in compliance with national legislation and regulations, the supervisor, in coordination with the DIA, should be empowered to decide if a bank should be under a resolution process when the bank is determined to be:

- > undercapitalized (to be defined by each jurisdiction),
- > operating in an unsafe or unsound condition or engaging in unsafe or unsound practices,
- > unable to meet its previously agreed recapitalization plan, or
- > sufficiently noncompliant with laws, regulations, and written agreements or orders issued by bank supervisory authorities.

In Argentina, the deposit insurance agency SEDESA can perform capitalization transactions, non-reimbursable contributions, or loans to financial institutions that: (i) are subject to a regularization and financial restructuring plan; (ii) acquire assets and assume liabilities for the payment of deposits received by another financial institution, when such actions are necessary to compensate any insufficiency in assets in respect to transferred deposits; and (iii) absorb or acquire financial institutions within a restructuring plan. SEDESA is also authorized to sign contracts with the option of selling all or part of the transferred assets, with financial entities which acquire assets and assume the obligation of repaying depositors of another financial institution.

In Bolivia, although there is no deposit insurance, the banking law (LBEF) includes a preventive mechanism known as a process of "regularization." When a supervised financial institution participates in any of the specific activities defined by the law, the banking superintendence (SBEF) will notify the board and its executives about the initiation of regularization, or restructuring, naming the causes

BOX 26

DIAs, Bank Intervention, and Bank Resolution

for such action. The financial entity will be required to develop and present in ten working days or less a restructuring plan which addresses the causes for this action. The "regularization period," which may not extend beyond three months of the non-objection by the superintendence (SBEF), must establish the conditions, procedures, goals, and measuring indicators to verify its compliance. The non-presentation, or rejection, of a restructuring plan will be deemed sufficient cause for intervention when the processes of resolution or legally enforced liquidation take place, as mandated by the banking law (LBEF).

In Guatemala, as a consequence of the suspension of a banking institution's operations, the banking law establishes the nomination of an exclusion board for assets and liabilities (Junta de Exclusion de Activos y Pasivos), with the authority, among others, to: (i) enact the exclusion of assets in the balance of the suspended entity and transfer all assets to a fiduciary trust administered by an institution des-

ignated by the banking superintendence; (ii) exclude from liabilities those deposits covered by the deposit insurance agency FOPA, and labor-related liabilities; (iii) transfer these liabilities to one or several banking institutions, who will receive as a counterpart an amount equivalent to such liabilities in certificates of participation, issued by the fiduciary fund. The amount of excluded assets should be equivalent or in excess of that of excluded liabilities. The deposit insurance agency FOPA can, when required by the Exclusion Board, make contributions to the fiduciary fund, and can buy at face value certificates of participation, provided that in no case these payments exceed the amount of total insured and covered deposits. If the above mentioned procedure is not possible, the exclusion board may request the central bank, as the administrator of the deposit insurance agency FOPA, to pay covered deposits, either directly to the depositors, or through other banks in the financial system.

Some member countries have enacted regulations that require Prompt Corrective Action (PCA) by bank supervisors and DIAs. These regulations and their implementing rules often define mandatory and discretionary actions that supervisors are expected to take as a bank's condition deteriorates. Often, PCA rules will contain prescribed supervisory responses to specific capital levels (see Appendix No. 8).

4.1.2 Least Cost Analysis

When assessing different bank resolution options, DIAs and, where appropriate, bank supervisors, should determine which option will result in the least cost to the deposit insurance fund. Factors to be considered when estimating least costs may include (i) collecting available assets, and possibly selling these assets at a market value, which may be higher than the liquidation or book value; (ii) the market value of franchises or other non tangible assets; and (iii) the ability to pass losses to non-insured depositors and other creditors of the bank.

4.1.3 Resolution methods. Legal and financial implications

The resolution process, as the term used in this report, typically involves valuing a failing or failed bank, marketing it, and soliciting and accepting bids for the sale of the bank or parts of the bank. It is recognized, however, that some authorities in the Region use the term "resolution" to describe supervisory actions taken by banking authorities while the bank is open to effect changes at the bank to prevent or minimize the risk of failure.

In Mexico, the National Commission of Banking and Securities (CNBV) is authorized to declare the intervention as a matter of urgency, when CNBV declares that irregularities can risk the stability or solvency of an institution, or endanger the interests of the public or depositors. The declaration of intervention is made by the board of governors and implies the designation of an individual person who will be in charge of the institution as an intervention manager. When CNBV considers, within its faculties of inspection and vigilance, that an institution is susceptible of being intervened, it must inform the deposit insurance agency IPAB about the financial position of the institution. The meeting of the board of governors of CNBV to discuss an intervention is attended by IPAB's board members, with the aim to assist CNBV on such a decision. As an alternative to closing an institution, IPAB may take over management of the banking institution through a "precautionary manager," provided there is demonstrable evidence of financial and institutional viability of the institution, and financial and institutional support has been duly authorized for the benefit of the banking institution.

In Peru, with the approval of the SBS, the FSD may make capital contributions to a member bank if it takes control of the company, or it may appoint and authorize another licensed financial company to purchase the bank. Alternatively, SBS may approve a cash contribution from the FSD to facilitate the total or partial transfer of the assets and liabilities of one banking institution to another. With the approval of the SBS and agreement from the Ministry of Economy and Finances and the central bank, the FSD also may appoint a licensed bank to acquire part or all of the assets or liabilities of the company, subject to the intervention regulations (i.e., bridge bank).

In the United States, the FDIC works closely with other Federal and state banking agencies when an institution is distressed. The FDIC can initiate a variety of enforcement actions. Actions can be informal, such as a resolution by the insured institution board to remedy specific defects identified during the last examination. Actions also can be formal, such as a cease-and-desist order enforceable in court. Enforcement actions can affect almost any aspect of bank operations that threatens

the safety and soundness of the institution. Most institutions with a composite CAMELS rating of "3" or worse are subject to some enforcement action. In the most extreme case, the FDIC can terminate deposit insurance; insurance generally is required to maintain a banking license. The FDIC also can cancel or terminate deposit insurance using its receivership powers. This can occur if an enforcement action fails to bring about the desired results, or when the primary supervisor is unwilling or unable to close a financial institution whose continued operation is viewed as increasing the potential loss to the deposit insurance fund. The termination of insurance does not automatically result in the closure of the bank and the appointment of a receiver under Federal law. However, the termination of insurance typically will result in the prompt closure of the bank. A bank is closed by the primary supervisor who names the FDIC as receiver. The closed bank is then resolved either through a variation of the purchase and assumption transaction, by transferring the insured deposits to another insured institution, or by direct payment of deposit insurance to the insured depositors.

Guatemala – The Monetary Board must suspend the operations of a bank or financial company when the bank suspends the payment of its commitments or incurs a net worth deficiency of more than 50 percent of required capitalization. Likewise, the Monetary Board can immediately suspend bank operations in the following cases: (i) non-presentation of a restructuring plan for return to required capitalization levels, (ii) final rejection of the restructuring plan by the banking superintendence, (iii) non-compliance with the restructuring plan, (iv) other reasons evidenced by a report of the banking superintendence. The revocation of the license to operate, and the instruction to the superintendence to request the bankruptcy before the judicial authorities, are also legal attributions of the Monetary Board.

Mexico – The National Commission of Banking and Securities (CNBV) and the deposit insurance agency (IPAB) are legally allowed to request to the judicial authority the declaration of bankruptcy of a multiple banking institution. The decision to revoke a bank's license belongs to the finance ministry with concurrence of CNBV and the central bank. If a bank is undercapitalized, CNBV may request a capital restoration plan. If the bank does not meet the capital adequacy standards established in the approved capital restoration plan, the plan may be revoked by the finance ministry, and consequently

Mexico – Through a determination made by the banking law (LPAB), a banking institution should remain operational if this option is reasonably less costly than the payment of guaranteed obligations.

Paraguay – The central bank's board decides on the most effective mechanism to resolve a bank, per the banking superintendence's request, by considering (i) the entity's assets assessment, (ii) the need to reimburse depositors, and (iii) the least costly use of the DIA's funds.

Peru – In accordance to the Regulations

BOX 27

Who Determines if a Bank Has Failed and Should Be Closed?

the institution may be liquidated or declared bankrupt. In addition, as a result of a technical study on IPAB, the deposit insurance agency is authorized to financially assist a banking institution with the aim of maintaining its operations when that option is reasonably less costly than the payment of covered liabilities.

Paraguay – The central bank can intervene if a financial entity meets any of the following conditions: (i) the bank has suspended payments on more than one liability for internal and unjustified cause; (ii) solvency levels are reduced to less than 50 percent of required levels; (iii) the restructuring plan submitted by the bank is rejected by the superintendence, or the superintendence of the central bank has agreed to terminate the previously submitted plan; or (iv) the central bank decides to suspend the bank's license, in accordance with Law 489/95.

Peru – The banking superintendence (SBS) determines if a bank will be closed. Intervention by SBS occurs when the following factors exist (as stated in Articles 103 and 104 of the Law): (i) the bank cannot meet its financial liabilities; (ii) when non-compliance with agreed commitments on the recovery plan or with the superintendent's decisions; (iii) exposed positions to credit and market risk represent more than 25 times the

institution's total paid capital; (iv) the bank has lost more than 50 percent of its capital.

United States – Most typically, the agency that issued the banking license can close an insured institution and appoint the FDIC as its receiver. The most common reasons for deciding to close an institution are classification as "critically undercapitalized," having assets insufficient to meet obligations, engaging in unsafe or unsound banking practices, willful violation of a cease-and-desist order, concealment or tampering with books and records, money laundering, or the voluntary cessation of insured status. The FDIC has back-up authority to close a member financial institution. The FDIC also can cancel or terminate deposit insurance as a last resort using its receivership powers. This can be done in the event of the failure of previously prescribed enforcement actions, or where the primary supervisor is unwilling or unable to close the financial institution whose continued operation is viewed as increasing the potential loss to the deposit insurance fund. Once a bank becomes critically undercapitalized, it has 90 days to recapitalize or it could be closed. A critically undercapitalized position will lead to failure unless this condition is satisfactorily remedied.

BOX 28

Use of Least Cost Analysis in Banking Resolution

for Special Regimes in the Financial System and the Insurance System (Res. SBS 455-99), to define the DIA's participation and the possible transactions to be implemented, the supervisor must consider at least the following criteria: (i) lowest net use of the fund's resources; (ii) shortest delay in waiting time for depositors; (iii) least loss value of the bank assets submitted to receivership; and (iv) least difficulties in asset assessment.

United States – By law, the FDIC must select the resolution transaction that poses the least cost to the deposit insurance fund. The factors considered include (i) selling/collecting assets for more than their estimated liquidation value, (ii) "premiums" paid to acquire the deposit franchise, and (iii) the ability to pass losses on to the uninsured depositors.

The next step in the resolution process is determining which bid is least costly to the deposit insurance fund, working with the acquiring institution(s) throughout the closing process, and/or ensuring the payment of insured deposits in the event there is no acquirer.

This resolution process may take place before the bank has failed or is otherwise closed. In this context, this report describes the DIA's ability to use a number of resolution techniques, including purchase and assumption transactions, open bank assistance, bridge banks, and trust arrangements.

4.1.3.1 Deposit Payoff

The direct deposit payoff by the DIA is the simplest resolution method but also the least recommended, because it tends to be the most costly resolution option. Direct payoffs should only be attempted when other banking resolutions mechanisms are not available, or when direct payoff is the least costly option for the deposit insurance agency. The payment of deposits is described in more detail in section 4.3.

4.1.3.2 Purchase and assumption (total and partial)

In a typical purchase and assumption (P&A) transaction, a healthy insured bank acquires a failed bank's assets and liabilities. In many cases, a healthy bank purchases

In Bolivia, the process of resolution consists of acts by the Superintendence aimed at: (i) excluding privileged liabilities of first and second degree, as registered in the financial statements of the intervened institution; (ii) excluding the assets of the failed institution by an amount equivalent to first and second lien liabilities. These assets are excluded according to their book value, net of provisions, reserves and other legal adjustments; (iii) providing instructions to the intervention superintendent to formalize the transfer of first lien liabilities to another adjudicated financial intermediary, which will receive as a counterpart the previously mentioned assets and/or first degree participations in a specified fiduciary trust ; and (iv) determining the financial intermediaries that will be assigned the assets and liabilities.

In Guatemala, the banking superintendence has developed a bank resolution scheme based on excluding assets and liabilities (EAP), a process that divides the institution into two parts (the good bank and the bad bank), whose operations have been suspended by the monetary authority. In order to implement the legal framework and achieve a greater efficiency, a handbook has been developed

BOX 29

Purchase and Assessment of Failed Bank's Assets and Liabilities

("Manual de Exclusión de Activos y Pasivos") that details the basic procedures to be followed, from preparatory activities for EAP to the request for bankruptcy to the judicial authority.

In Mexico, the P&A scheme is not specifically regulated by law; however, in certain particular cases during the 94' – 95' crisis, a certain number of operations were undertaken, which resulted in the segregation of assets and liabilities. In some of those cases, the bank was divided in two—the good bank and the bad bank. The good bank was capitalized by the original shareholders and a strategic partner, and the bad bank was absorbed.

In Paraguay, legislation requires that, in the case of bank resolution, as many deposits as possible be transferred to other licensed and solvent financial institution(s). The selection of the institution(s) should be made by competitive bid. This process can be complemented, as needed, with DIA financing or DIA loan guarantees, as long as the net loss to DIA is smaller than if DIA paid directly under a least cost basis. The DIA can also trans-

fer other assets to licensed, solvent institutions to compensate for any payment to depositors.

When an institution is in an intervention regime in Peru, the banking supervisor (SBS) may transfer all or part of the bank's assets and liabilities to another institution. To exclude assets from the balance sheet (as outlined by the general law during the intervention regime), SBS will consider transfer feasibility, asset liquidity, the possibility of obtaining better prices when transferring assets or liabilities, and the difficulties in assessing the assets. Also, an excluded asset must be assessed in compliance with current accounting standards and adjusted to net value. SBS may carry out asset assessment analyses and charge the cost to the institution placed in receivership.

In the United States, P&As are typically designed with economic incentives to encourage acquirers to assume a greater volume of the failed institution's assets. The FDIC's Resolutions Handbook offers a description of the many types of P&As offered in the United States.

some or all of the assets, and assumes some or all of the liabilities of a failed institution, including all insured deposits. P&A transactions are very effective and employed often by the FDIC and by a number of other DIAs in the Region. P&As can be less disruptive than deposit payoffs to the local economy. The volume and type of assets and liabilities that are transferred in a P&A transaction will vary. For example, in most cases most of a failed bank's performing assets will be purchased outright, while others, including nonperforming loans, may be sold using special incentives like "put options" and "loss-sharing" arrangements whereby the DIA may absorb future losses on a specific set of assets that were transferred as part of the P&A.

4.1.3.3 Open bank assistance

The DIA or other agency may, in some cases, be authorized to provide open bank assistance (OBA) to a weak or technically insolvent bank. Typically, under an OBA, a bank in danger of failing receives assistance in the form of a direct loan, an assisted merger, or a purchase of assets by the DIA. OBA is not done in some jurisdictions, as it often conflicts with a country's least-cost requirement and may prolong a banking crisis by not allowing weak banks to fail.

4.1.3.4 Bridge Bank

A bridge bank may be defined as a temporary bank established and operated by the DIA, or an equivalent authority, until a final resolution for a failed bank is reached. A bridge bank transaction may be considered a type of purchase and assumption resolution method in which the DIA acts temporarily as the acquirer. This provides uninterrupted service to bank customers and gives the DIA additional time to evaluate and market the institution. Bridge bank transactions are typically reserved for situations in which more time is needed to permit the least costly resolution of a larger or more complex institution. For example, in Peru, a bridge bank is authorized during an

Bolivia – In 2004, the government, working through a second tier institution where it holds the majority interest, capitalized the balance it held in a bank to return the bank to required capital levels and allow the institution to continue operating. Considering that the role of the government as a shareholder cannot extend over time, as the legal framework limits this option to two years before such shareholdings must be transferred to the private sector, this mechanism could also be considered as open bank assistance. The banking superintendence (SBEF) did not assume management of the institution, but continued to apply the same supervision procedures to this bank as to all other financial intermediaries.

Mexico – In terms of the banking law (LPAB), the deposit insurance agency (IPAB) can on its own, or as requested by the National Commission of Banking

BOX 30

Provision of Open Bank Assistance

and Securities (CNBV), financially assist an institution to provide liquidity or enhance its solvency. Assistance can be made through subscriptions of shareholdings or subordinated liabilities, assumption of liabilities, granting of loans, or the acquisition of assets, in accordance with the law. Assistance can only be provided when: (i) a technical study has been developed by a third party and IPAB agrees with its justification for the viability of the institution and the effectiveness of the assistance; (ii) as a consequence of the technical study it is considered convenient that the institution maintains its operations, as this option seems reasonably less costly than the payment of guaranteed liabilities; (iii) a restructuring program of the requesting

institution is presented to the deposit insurance agency; (iv) guarantees are provided, as stipulated in the banking law, or IPAB acts in such a manner that the shareholders of the institution absorb the same cost as if the assistance had not been granted; and (v) the board approves the granting of the assistance based in the aforementioned elements.

Peru – The Peruvian DIA (FSD) may participate under the Supervisory Regime by providing capital and assuming temporary control, or by making it easy for another acquiring or assuming institution to assume control. Also, during the receivership, the FSD may make a cash contribution to facilitate the transfer of assets and liabilities to another bank; this contribution cannot exceed the amount of the deposits covered.

intervention regime. In such cases, the DIA creates a temporary company which acquires all or part of the assets and liabilities. To date, however, this scheme has not been used in Peru. The DIA must receive instructions from the banking superintendence (SBS) and approval from the central bank and the ministry of economy and finance in order to make any capital contributions and create a bridge bank.

4.1.4 Use of trusts

Trusts primarily have been used in good bank-bad bank schemes, i.e. “good” or performing assets are segregated from “bad” or non-performing assets and transferred to a trust. This method is used to facilitate the sale of a bank unit and increase the recovery value of segregated assets.

4.1.5 Resolution process

There are many different ways that failing and failed banks are resolved in the Region. Bank supervisors and DIAs are advised to consider the following basic principles when designing their bank resolution programs.

- > Equip authorities responsible for bank resolution with a set of tools and alternatives, and full legal support to use them.
- > Avoid rapid losses in asset value by designing a resolutions program that transfers the largest possible volume of assets to a healthy insured institution

In Bolivia, the use of fiduciary trust funds occurs in two instances: (i) within the process of resolution, which implies the creation of two trust funds (one to manage the autonomous net worth constituted by the assets excluded from the financial statements of the intervened institution and to pay for the participations issued by such trust fund, and the other to administer non-excluded assets and liabilities); (ii) when a judicially enforced liquidation takes place, the Superintendent in charge of the intervention transfers the totality of the assets, as registered in the balance sheet of the intervened institution, to a trust fund,

BOX 31 Use of Trusts

whose purpose is to manage, collect, and sell assets in such a way that the assets or results of this trust fund can be used toward unpaid liabilities.

In Guatemala, the problem bank is divided into a “good bank” and a “bad bank.” The good bank, or new business unit, is created by excluding and transferring privileged liabilities (deposits and employment liabilities in accordance to the banking law – LBGF) and assets that retain some economic value. Under this framework, a solvent bank (receiving

bank) is responsible for the transferred liabilities and receives certificates of participation in the trust fund. Assets from a problem bank are transferred here to be managed and recovered. The remaining assets (those that are not transferred) compose the bad bank; these assets are transferred to a judge and will be resolved under the bankruptcy mechanism.

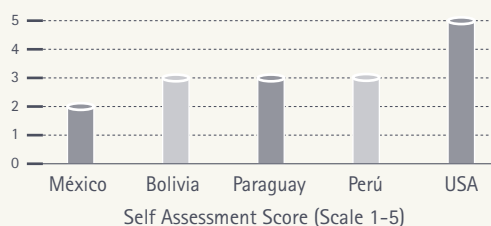
In Peru, during a receivership regime, the DIA is authorized to transfer all or part of the liabilities covered to a trust.

BOX 32

Self-Assessment of Bank Resolution Tools Availability

Using a scale of 1 to 5 (1 indicates insufficient resolution tools, and 5 indicates full range of resolution tools), four member countries assessed whether the DIA or other supervisory authorities have the sufficient tools to resolve bank failures.

Self Assessment: Availability of Resolution Tools



thereby maintaining sound assets within the private sector and the country's insured financial system.

- > Allow depositors immediate access to their money. Any interruption in deposit flows should be kept to a minimum.

4.1.6 Notification of bank failure

The Working Group discussed the issue of who should be responsible for notifying the bank that it is near failure and may be placed in receivership, and concluded that this duty should fall on the primary supervisor, after consultation with the DIA. Other issues that should be considered include the timing of this notice, whether the decision can be appealed, and whether the bank will be allowed time to resolve weaknesses before being placed in receivership.

4.1.7 Analysis of amounts and types of assets and liabilities

Bank supervisors and DIAs in the Region perform assessments of bank assets and liabilities in accordance with national legislation, regulation, and accounting guidelines. For example, in the United States, the FDIC will begin analyzing the depositor information as soon as possible before the bank fails to estimate the number of insured and uninsured depositors and the total amount of deposits that are potentially uninsured. Once the institution fails, FDIC staff will fully review depositor information to identify insured deposit amounts and the amount of any uninsured claims. The FDIC will assess a bank's assets to determine value and marketability.

4.1.8 Asset valuation

Asset valuation of weak banks should be performed using appropriate valuation and accounting standards and accounting best practices. The Working Group recognizes that some ASBA member countries value assets at their estimated market

Bolivia: The banking law defines why and how the Superintendent (SBEF) should decide to place a bank in receivership and assign a receiver. The receiver assigned by SBEF applies resolution procedures or judicially enforced settlement, until SBEF revokes this mandate. SBEF may suspend a receivership bank totally or partially for a period of 30 days, which may be extended only one time—when resolution for receivership is disclosed in the press. During the receivership, the rights of the shareholders, partners or associates, and other creditors of the institution are automatically suspended, as are those of the directors, internal control bodies, administrators, managers, and associates.

Guatemala: Within five days after assets and liabilities are transferred, the exclusion board submits a written report to the monetary board regarding the results of the procedure. Upon request

BOX 33

Notification of Bank Failure

from the bank superintendent, the monetary board then has five days to revoke the institution's license. Within 15 days after the report is received, the monetary board instructs the bank superintendent to request a court decree declaring the institution bankrupt.

Mexico: The National Banking and Securities Commission (CNBV) and the Deposit Insurance Agency (IPAB), within their competencies, can request a bankruptcy declaration of a multiple banking institution.

Paraguay: If a financial institution is found responsible for legal causes of resolution, the central bank's board will decree the beginning of resolution within 24 hours, establishing the mechanisms for divesting assets and reimbursing depositors covered by FGD insurance.

Peru: The superintendence (SBS) is the only entity that regulates and supervises banks. The DIA receives instructions from SBS (Article 151° of the General Law).

United States: If the bank is "critically undercapitalized" the primary bank supervisor is responsible for formally notifying the bank and its board of directors that it has a specified period within which to recapitalize itself or risk being closed. However, the primary supervisor is not obliged to give notice if the bank is already insolvent, if it engages in risky or illegal behavior, or if its continued operation presents a risk to the deposit insurance fund. While bank management can file a challenge to the closure of the institution and to the appointment of a receiver in Federal court, such challenges rarely have been successful.

prices; however, several other jurisdictions use book values or other national accounting standards.

Assessing the value of a failed bank's assets is but one step in the process of resolution. Another important phase is marketing and selling the assets and liabilities of a failed institution.

4.1.9 Resolution structure

4.1.9.1 How to market a failed institution

Designing a resolution structure typically requires assessment of the failing bank's business and operations. This involves evaluating its strengths and weaknesses, valuing its assets, understanding its deposit account composition, and developing disposition and sales alternatives for bidders. For example, in the United States, the FDIC typically offers a range of transaction alternatives (e.g., purchase and assumption variations, whole bank or asset/deposit parcels, insured deposits only, etc.) to interested and capable bidders. The FDIC then evaluates the submitted bids and selects the bid that poses the least cost to the deposit insurance fund.

4.1.9.2 Types of assets to be offered to potential bidders

The DIA acting as resolution agency should carry out the resolution, determining:

- > whether to market the failed institution as a whole or in parts;
- > the types of assets offered to prospective purchasers;
- > how to package saleable assets; and
- > the price at which assets should be sold (e.g., book value, fair market value, liquidation value, reserve prices).

4.1.9.3 How to package saleable assets

The Working Group members believe that failed bank assets should be appropriately packaged with features designed to increase bidder interest in order to maximize the value of the sale and the volume of the transactions. While some jurisdictions permit incentives, other countries prohibit them.

4.1.10 Marketing of a failing institution and disclosure of information

Once the resolution structure has been determined, the failing bank is typically marketed for sale. Several models can be used for this purpose, including alternatives that offer varying degrees of disclosure and public communication about the value

Bolivia – Banking law (LBEF) establishes that when assets are excluded in a resolution process, book value, net of provisions, reserves, and any other adjustment outlined by the supervisor (SBEF) must be considered.

Guatemala – The superintendence performs an audit of the bank's balance sheet, assessing compliance with applicable accounting and regulatory standards. The price of the assets transferred to the trust fund reflects accounting standards, book value, netting of provisions, reserves, and any other adjustment outlined by the superintendence (SB).

BOX 34

"Problem Bank" Asset Valuation

Paraguay – Once resolution has been decreed, the banking superintendence will immediately assess the entity's assets within the resolution mechanisms chosen by the central bank. Certain assets will be excluded, according to book value, net of provisions, reserves or other means to establish their "real" or market value.

Peru – In supervision or receivership regimes, the banking superintendence (SBS) determines the net value of the

bank's assets and, therefore, the bank's equity, according to national provisioning rules for assets, prudential rules, and accounting standards. The SBS can contract asset valuation services charging the bank under receivership.

United States – Marketable assets are priced by the FDIC at their estimated market values. Troubled assets may be valued at estimated market values or estimated liquidation values.

and attractiveness of the failed institution. The main objective of disclosing information to interested investors is to enhance transparency and maintain the DIA's credibility. A second objective is to provide information about the bank's assets and liabilities that will attract potential purchasers.

4.1.11 Bidder due diligence

Prospective investors should be allowed to conduct independent due diligence before making an offer. As appropriate, interested investors are screened and qualifying investors are selected to participate in the bidding process.

For example, in Bolivia, during the orientation session, the superintendent explains the contents of the resolution for receivership and provides all necessary information to interested institutions. In the United States, approved bidders conduct independent due diligence before submitting a bid. Generally, bidders are given access to information on a consolidated basis, such as the characteristics of a pool of assets, but do not have access to information not relevant to the valuation of assets.

4.1.12 Bid submission

Offers for the failed bank can be made by prospective investors using a variety of methods, such as open-bids or sealed bid. DIAs should follow the highest

In Guatemala, banking assets are not offered directly to the receiver but are transferred to a trust fund at their economic value. The selling price should ensure payment of certificates of participation.

In México, IPAB, the national DIA, determines the asset packaging and sales strategy that will result in the highest recovery value.

In Paraguay, all eligible financial institutions (licensed, solvent, well managed, and with prudentially acceptable plans if they purchase the assets and liabilities) who show an interest, are invited to submit offers to the banking superintendence.

In Peru, if the superintendence (SBS) decides to exclude assets from the failed

BOX 35

Marketing a Failed Bank

bank's balance sheet, it must consider transfer factors such as transaction feasibility, asset liquidity, obtaining the best prices during the transfer, and ensuring the least difficulty in assessing assets and carrying out the sale.

In the United States, the FDIC typically offers bidders the opportunity to bid on the whole bank or on selected parts. The FDIC offers failing bank assets/deposits in pools of comparable assets. If the bank is large, and there is sufficient bidder interest and adequate time to prepare the infrastructure, this will be the most cost-effective approach.

The FDIC attempts to identify buyers for the failing bank's more attractive assets (performing) at the time of the resolution and sets aside the most problematic assets (non-performing) for disposition after the resolution. The FDIC offers these assets in homogenous pools to broaden the list of interested bidders and allow these bidders to review the pools. The most attractive assets should sell at fair market value, and the more problematic assets should sell at or above the liquidation value. The FDIC relies on an open and fair competitive bidding process to sell these assets.

In Guatemala, it is possible to offer incentives, such as using resources from the FOPA fund to ensure liquidity for the sale of guaranteed deposits. This not only provides liquidity, but also an equity support (as subordinated debt) to balance requirements for implicit capital. The receiving bank has the authority to request that the acquired assets be guaranteed with the liquidity provided by FOPA. An additional incentive regards

BOX 36

Incentives and Similar Features in Packaging Failed Banks

resources to be obtained from the Banking Capitalization Fund (FCB), which is part of the banking resolution scheme.

In Peru, providing incentives or similar features to entice bidders is not a possibility.

In the United States, under certain circumstances, the FDIC can and may

offer additional features, such as loss sharing or limited put options, to increase bidder interest and preserve asset values in pre-specified asset pools. A full description of the types of asset packages offered by the FDIC may be found in the FDIC's Resolution Handbook.

professional, governance and transparency standards as well as enforce national rules and regulations in receiving and processing the bids.

4.1.13 Selecting the best offer

Several different criteria can be used to select the best offer. Best practices suggest that, at a minimum, the criteria should (1) be clearly, accurately, and fully disclosed from the early stages; (2) be in writing; (3) be in compliance with international and national standards; (4) require bidders to provide proof of their financial and operational health and solvency (before and after the acquisition); and (5) require bidders to provide an offered price.

4.1.14 Customer access to funds

The final step in the resolution process takes place when the bank is closed, and the assets and deposits are transferred. In most cases, the DIA will transfer the assets and deposits to the acquirer. It may also pay insured depositors, create a bridge bank, or apply any number of resolution alternatives, as discussed below.

4.2 Special Receivership Powers

4.2.1 Contract ratification or repudiation

DIA's may be empowered by the legal system with special authorities that allow it, as receiver, to conduct its business in an effective and timely manner. Among

In **Bolivia**, the superintendence (SBEF) invites a minimum of three interested financial institutions, as potential buyers, to an orientation session, in a process designed to choose the financial intermediaries that will participate in the resolution process.

In **Guatemala**, access to information about the institution placed in receivership is restricted until the institution is closed. However, when the institution is closed, the receiving bank has full access to the information package. The receiving bank can then ratify the receiving or offer agreement, and to subscribe the liability transfer contract with the Exclusion Board.

In **Mexico**, IPAB designs the failing

BOX 37

Divesting the Assets and Liabilities of a Failed Institution

bank's marketing strategy. By law, the market is open to institutions other than banks. However, the financial expertise of some of the prospective investors is considered. To date, only banks (either domestic or foreign owned) have participated in the bidding process.

In **Peru**, a bidding process determines the institution that will acquire the assets and/or liabilities excluded from the balance of an institution placed in receivership. When the institution placed in receivership is a licensed bank, institutions within the financial system and the na-

tional development bank (COFIDE) may participate in the process.

In the **United States**: (i) the FDIC designs the marketing strategy, (ii) prior to the resolution, the FDIC markets failing bank assets and deposits only to other FDIC-insured financial institutions that have been pre-approved by their primary supervisor; (iii) the FDIC prepares full and complete marketing packages describing the characteristics of the assets and deposits available for sale; and (iv) prior to bidding, the FDIC requires a signed confidentiality agreement.

Bolivia: Proposals must be submitted within 48 hours after the conclusion of the orientation meeting, which is called by the Superintendence for information purposes and includes at least three financial institutions.

Mexico: Banks are sold under published rules (*bases de licitación*) that establish how bids are made. In the past, biddings have been carried out through

BOX 38

Submission of Bids for the Sale of Failed Institutions

sealed bid procedures. Bids should be presented together with requested information which includes: (i) financial statements; (ii) fit and proper requirements for prospective investors; (iii) by-laws, if applicable; (iv) a purchasing plan, including financing schemes; and (v) a five-

year operation plan.

United States: Before the resolution, bids generally are submitted as sealed and final bids. However, after the resolution, bids for asset sales may be submitted through an open bidding process.

these authorities, the DIAs should, at a minimum, have the following receivership powers:

- > Contract ratification.
- > Contract repudiation.
- > The ability to hire and fire bank employees and bank management.
- > The ability to operate outside the regular corporate bankruptcy process.
- > Other powers or authorities such as:

In **Bolivia**, the bid is awarded at the same time that proposals are received and opened. Bids are submitted in two envelopes—envelope A providing evidence of minimum solvency and other requirements, and envelope B containing only the offered price. Only the B envelopes of those bidders with acceptable A envelopes are opened during a session attended by representatives of all bidders to identify the highest and winning bidder. A committee of representatives from the ministry of finance, the central bank, and the superintendent determine the winning bid.

In **Guatemala**, the superintendent (SIB) requests that every bidder makes a

BOX 39 Selecting the Best Offer

proposal specifying the amount it wants FOPA to contribute or the amount of deposits it will take. Consequently, the bank requiring fewer subsidies from FOBA or taking the most deposits is pre-qualified. Once an offer is pre-qualified and thus accepted, SIB gives pre-qualified bidders the opportunity to improve the economic value of the winning bid. If a better offer is submitted, the first bidder will be given priority, provided the amount of this bid equals the best offer received.

In the **United States**, the best offer is

determined by applying the “least cost” test to the bids. The least cost process requires the FDIC to choose the least cost bid or the alternative in which the total amount of the FDIC’s expected expenditures (including any immediate or long-term obligation and any direct or contingent liability for future payment) is the least costly to the deposit insurance fund of all possible methods for resolving the failed institution. In most cases, the FDIC will receive at least one bid that is less costly than the estimated cost of liquidation.

A. *When do depositors in failed banks have access to their deposits?*

Experience in **Mexico** shows that when payment of insured deposits operations have been made, depositors have had access to their funds in eight days, on average, after reimbursement forms were presented. In the **United States** depositors typically have had access to their funds by the next business day.

B. *What happens to the assets that are not transferred to an acquiring institution?*

Bolivia: The remaining balance of the institution placed in receivership (assets and liabilities not excluded in the resolution process) is transferred into a settlement trust fund created by the receiver for mandatory judicial liquidation.

Mexico: Assets are segregated to other vehicles and sold by the IPAB.

Peru: Non-transferred assets are liquidated.

BOX 40 Customer Access to Insured Deposits when Banks are Closed and Sold Select Questions and Answers

United States: Assets are managed by a receivership operated by the FDIC and offered to a larger universe of bidders.

C. *What happens to the deposits that are not assumed by another bank?*

Mexico: To date, all deposits have been assumed by the purchasing bank.

Peru: Any deposits not covered by the FSD are collected at the time of the liquidation.

United States: The FDIC sends a check to depositors for the insured balance in their accounts.

D. *What claims, if any, do depositors with uninsured balances have against the DIA or the failed bank?*

Mexico: Depositors with outstanding or non-guaranteed liabilities have the

right to receive payment, in conformity with the hierarchy determined by the law in cases of liquidation (administrative guidelines) or bankruptcy (determined by judge).

Peru: Depositors not covered by the DIA must collect their credit from the bank’s liquidation.

United States: Uninsured depositors share the proceeds from the receivership estate with the FDIC. The claims of the FDIC and the uninsured depositors must be fully satisfied before any receivership dividends can be paid to the bank’s creditors, unsecured debt holders, or stockholders.

- Representation and management of the institution;
- Exercise the powers corresponding to the Institution's Board of Directors and its CEO including general powers of attorney for acts of ownership and management;
- Authorize the acquisition of liabilities, investments, acquisitions, sales, in general, any expenditure carried out by the institution;
- Suspend the operations that put the solvency, stability or liquidity of the institution in danger;
- Grant and revoke powers of attorney.

4.2.2 Bypassing traditional commercial bankruptcy process

Under certain circumstances, legal and contractual processes related to the sale of closed banks by a DIA can bypass regular commercial bankruptcy processes. This difference in treatment of bankruptcies results from the need for a clear, swift, and strong procedural framework for the timely resolution of banks, as this can affect the stability, safety, and soundness of the financial system.

In certain jurisdictions, the powers of bank supervisors often take priority over bankruptcy rules and regulations. For example, in Bolivia, once the SBEF has issued a resolution for receivership, sales of shares by current stockholders are not valid, and any other legal blocking attempt by other financial intermediaries is not permitted. The legal framework for mandatory liquidations of financial intermediaries is ruled by LBEF.

In Peru, the process to address banking bankruptcy is ruled by the General Act and thus does not fall under the legal framework applicable to other types of companies. The main difference with this regimen is that SBS directs the settlement process instead of the creditors. An additional difference is that there is an order of priority liens for different collection that prioritizes depositors over other type of creditors.

4.3 Reimbursing Depositors

A common practice is for the DIA to pay the covered insured amount to each insured depositor. This payment may be made directly by the DIA or facilitated through an intermediary. When the DIA transfers insured deposits to a healthy institution, the healthy institution acts as the DIA's agent and makes payments to the failed institution's insured depositors.

In Bolivia, the banking law establishes that: (i) Legal acts authorized, assigned, or ordered by the superintendent and the receiver, regarding transferring assets and privileged obligations from the institution placed in receivership, do not require any judicial authorization, nor can they be reputed as ineffective in relation to the creditors of the institution placed in receivership. Neither a court judgment nor administrative resolution can suspend the acts that are carried out during the receivership. No acts of disposal, such as

BOX 41

Contractual Aspects of Receivership

seizures or preventive measures of any kind, can be placed on assets of the institution placed in receivership until its license to operate has been revoked, or the asset transfer ordered by the superintendent and the operations is carried out by the receiver.

In Peru, the SBS assumes control of the bank temporarily until the bidding. The winning licensed institution will then take over the process.

In the United States, the FDIC, in its receivership capacity, has the ability to enforce or repudiate contracts, to sell/collect assets, to void fraudulent conveyances, to delay court actions involving the failed bank; it also has additional statutory defenses. These powers were granted to speed the liquidation process and preserve value for the deposit insurance fund.

It is recommended that a DIA should be given an express legal mandate to pay insured depositors, within the least possible time, once the intervention of a financial entity is announced. The time frame should not exceed 30 days.

4.3.1 Filing claims

Procedures for DIAs to reimburse insured depositors vary across the Region. Reimbursements can be made directly as cash issued to insured depositors or by transferring insured deposit amounts to another insured financial institution. Peru stipulates that its DIA contracts the services of a licensed bank to pay insured coverage to deposits, on behalf of the DIA. The amount paid is limited by coverage restrictions addressed earlier in this report.

The requirements for depositors to file a claim vary across jurisdictions. Depositors in Mexico must complete a form and submit an application, while those in the United States typically do not have to file any claims.

All countries specify the information that must be communicated to insured depositors of a failed bank about the process for reimbursement, but the methods vary. While FDIC sends notices by mail and provides similar information through various media outlets, Mexico publishes the procedures in the national gazette and on the IPAB's website, and Peru requires that banks make information about the process available to deposit insurance claimants.

4.3.2 Reimbursement timelines

The time frames for DIAs or their agents to reimburse depositors varies. Reimbursements begin almost immediately after bank closure in the United States. In Peru payments are to begin ten working days after the DIA provides the list of insured depositors, and in Mexico payment is to begin within 90 days from the date the DIA becomes a receiver or manager of the failed banking institution.

4.3.3 Appealing decisions

The process by which depositors may appeal the DIA's reimbursement also varies within the Region. In most countries, depositors can appeal decisions to their DIAs

It may be useful to consider describing how the deposit payoff concept is practiced among members. For example, in **Guatemala**, when an exclusion of assets and liabilities is not possible, the central bank, as an administrator of the deposit insurance agency (FOPA), when requested by the exclusion board, can pay insured deposits either directly to the covered depositors or through other banks in the system. When the exclusion of assets and liabilities is possible, the deposits are transferred to a solvent bank, which acquires the commitment to pay depositors as required, regardless of whether those deposits are guaranteed by FOPA. As a last step, the process aims to cover as many depositors as possible, or all of them, in the best scenario.

BOX 42 Deposit Payoffs

In **Paraguay**, when circumstances do not permit any other form of bank resolution, or upon recommendation from the banking superintendent, the central bank can authorize direct payment to depositors. In this case, FGD will assume priority status in the bank's liquidation.

In the **United States** a deposit payoff can generally take two forms: a straight deposit payoff and an insured deposit transfer. In the former, the FDIC determines the insured amount due each depositor and prepares a check for that amount. Arrangements are made either for the depositors to come to the bank and get the checks, or for the FDIC to

mail the checks to the depositors. In an insured deposit transfer, the FDIC also determines the insured amount due each depositor. Arrangements are then made with a healthy institution that is willing to act as agent for the FDIC to pay insured deposits to customers of the failed institution. The FDIC transfers insured deposit accounts and secured liabilities of the failed bank or thrift, along with an equal amount of cash or other assets, to the healthy institution. Service to customers with insured deposits is uninterrupted. Each of these transactions is discussed on the following pages.

within specified time frames (e.g., within 60 days in Peru). After this stage, the only recourse is usually litigation.

Depositors should be afforded an opportunity to appeal the decisions made by the DIA. In particular, a transparent and well communicated appeals process should be established so a depositor may formally question the deposit insurance determination made by the DIA.

4.4 Depositor Priority and Rights of Set-off

4.4.1 Depositor and other creditor ranking in priority

Each legal framework within the countries sampled for this report establishes a priority for claims to be paid when an institution fails or is declared bankrupt. The order of priority needs to respect national rules and regulations, but best practices suggest that priority should be established as follows: 1. Expenses incurred by the

Mexico: IPAB pays insured depositors' liquid and redeemable guaranteed obligations when a bank is liquidated or when a bankruptcy is declared. On the date when IPAB publishes liquidation or bankruptcy proceedings, IPAB also publishes the detailed payment procedure of the guaranteed obligations. Depositors then submit individual requests for payment by completing forms available at other banks, or at the IPAB's website. IPAB then proceeds to pay the balance owed to each individual depositor, considering the amount of principal and interest, up to an amount equivalent to 400,000 UDIs (approximately US\$140,000) per natural or legal person. In the event that a person has more than one account in the same banking institution, and the account's total balance exceeds the maximum amount mentioned above, IPAB only pays the guaranteed amount, dividing it on a pro-rata basis

BOX 43

Procedures Used by DIA for Reimbursing Depositors

by the number of accounts. IPAB pays the insured deposits within 90 days from the date when IPAB becomes a receiver of the banking institution. In all cases, IPAB publishes payment procedures of all guaranteed obligations. With the sole purpose of paying guaranteed liabilities, IPAB can claim the collection rights in the case of liquidation or bankruptcy of the banking institution, with all privileges due to persons to whom these payments were made, and up to the amounts paid.

Peru: Healthy and licensed financial institutions are invited to bid for the service of paying insured deposits. The winning bid is determined on the basis of factors that include the institution's risk classification, how quickly the institution can collect information about insured depositors, and the extent of the

institution's branch network in the area previously served by the closed institution. Once the winning bid is chosen, FSD transfers an amount to cover the insured deposits. The date and place where insurance beneficiaries can collect their coverage is posted in major, national newspapers.

United States: The FDIC reimburses insured depositors—pays deposit insurance—in one of two ways. The first option is by transferring the insured portion of a depositor's account to another FDIC-insured financial institution, either by a purchase and assumption or by an insured deposit transfer transaction. The second option is by a payout of the insured portion of the deposit accounts in the form of check payments sent to the depositors

Mexico – Within 60 days after the date of the publication of the banking resolution, depositors can request payment using forms available at licensed banks or on the DIA's (IPAB) website.

Peru – No filing requirement exists; payment is made by the DIA through a banking service contractor.

United States – Depositors typically are no longer required to file a claim to receive deposit insurance payments. If a depositor has a deposit(s) in an amount

BOX 44

Requirements for Depositors to File a Claim

that may exceed the deposit insurance limit(s), the depositor may have to complete paperwork or submit documentation to the FDIC to complete the deposit insurance determination process. In return for accepting a payment of deposit insurance, the depositor agrees to subrogate his rights to the liquidation proceeds of the closed financial institution, up to the

amount of the insured deposit, to the FDIC. This happens when the insured depositor uses the account transferred to the new financial institution, withdraws insured deposits from the new financial institution, or accepts a direct payment of deposit insurance by cashing the deposit insurance payment check issued by the FDIC.

receiver, 2. Depositors, both insured and uninsured, 3. Other Creditors, 4. Subordinated Debt Claimants, and 5. Shareholders.

4.4.2 Set-off requirements during bank resolution or liquidation

Legal practices in each jurisdiction determine the order of priority of claims and set-off requirements during bank resolution or liquidation. In some countries, mutuality is recognized (e.g., when a depositor is also a borrower), which can lead to a “netting” of claims. Other countries limit set-off to liquid, callable, and mature claims.

4.5 Cross-border Issues

4.5.1 Responsibility as home supervisor

As home supervisor, each country should consider plans to coordinate the resolution of domestic failing banks that have foreign subsidiaries or branches with host supervisors. For example, in the United States, in developing resolution plans for potential failures of U.S. banks with foreign operations, the FDIC anticipates close

Mexico – In the event of a disagreement over the calculations of insured deposits carried out by IPAB, the depositor can file a claim for the insured amount. IPAB will subrogate collection claims during liquidation or bankruptcy of the institution, with the privileges accorded to persons receiving such payments, and up to the amounts paid, with a preference over other claims on unpaid, guaranteed liabilities. Additionally, depositors may

BOX 45

Appealing DIA Decisions

appeal the DIA’s decision through administrative procedures established by law.

Peru – If a depositor does not appear on the list developed by the banking superintendence (SBS), he or she may submit to SBS a claim certified by a notary public within 60 days after the list of insured depositors is published.

United States – The depositor may ask the FDIC to review the initial deposit insurance determination, or the depositor may submit additional pertinent information for the FDIC to review. The depositor may also seek legal remedies.

Bolivia – In first place (no ranking occurs within these categories): Deposits made by the private sector in current account, on sight, thrift, and fixed-term transactions made with other financial intermediaries and the deposits made in violation of legal or regulatory standards are excluded; Cash commands made by the private sector, including foreign trade prepayments, tax collections and tax withholdings, drafts, transfers with contracts legally subscribed, duly documented and recorded on the financial statements of the institution placed in receivership before it was so placed; Legal deposits. In second place: Deposits of the public sector on current account, on sight, thrift, and fixed term; Obligations with the central bank; Obligations with foreign financial intermediaries; Obligations with funds or institutions where the government has a ma-

BOX 46

Claimants on Failed Bank Priorities or Set-Off

jectivity participation of capital; Tax obligations of the financial intermediary placed on receivership.

Guatemala – Deposits guaranteed by the FOPA are considered privileged liabilities (along with employment liabilities,) and are paid before those of other creditors.

Mexico – According to LPAB law, the deposit insurance agency (IPAB) is required to pay guaranteed claims following the procedures previously mentioned. The priority of creditor claimants for the payment of their credits will be determined as required by the legal procedures for liquidation and bankruptcy.

Peru – The law states a preference for paying the obligations of an institution

being liquidated. The depositors are in second place after all employment obligations are paid.

United States – After the insured deposits are paid, the priority of claims paid by the failed bank receivership occurs in this order: 1. Administrative expenses of the Receiver; 2. Depositors (both the FDIC as subrogate for the insured depositors and any uninsured depositors); 3. General Creditors; secured creditors are reimbursed via the sale of collateralizing instruments; 4. Subordinated debt holders; 5. Stockholders Claimants in a higher priority class have their recognized claims reimbursed 100 cents on the dollar before any monies are paid to the claimants of a lower priority class.

coordination with the host supervisors and insolvency authorities to maximize the value of the failed bank's operations. Under U.S. law, the FDIC would seek to resolve the U.S. bank along with its foreign branches as a unified resolution.

4.5.2 Responsibility as host supervisor

As host supervisor, each country should coordinate the resolution of the failure of a foreign-owned bank with insured banking subsidiaries or branches in its jurisdiction.

For example, in the United States, as part of the development of resolution plans for potential failures of foreign banks with U.S. operations, the FDIC anticipates close coordination with the home supervisors and insolvency authorities to maximize the value of the failed bank's operations. Under U.S. law, however, the FDIC must marshal an insured foreign bank's assets and pay creditors of the U.S. insured branch before returning any excess assets or monies to the home insolvency authority. As a result of these legal provisions, the Working Group anticipates that separate resolutions will be necessary for insured branches of foreign banks. If the U.S. operation of the foreign bank is conducted through a subsidiary, however, the resolution of the subsidiary's operations would proceed the same as that of any other U.S.-chartered institution.

The FDIC has not had recent experience with the resolution of U.S. operations of foreign banks. The resolution of Bank of Credit & Commerce International (BCCI), which principally involved the New York (NY) State banking operations of the foreign bank, was the most significant resolution of a foreign bank's U.S. operations. That resolution was conducted under New York State law, which provided for the payment of creditors of the New York office of BCCI before the return of excess funds to the home country authorities. All creditors of the New York office of BCCI received full payment of their claims.

Bolivia – Bolivian law does not forbid or allow for a set-off arrangement during a bank resolution or liquidation. However, the civil code indicates that when two individuals are reciprocally debtors and creditors, both liabilities are extinguished by compensation (netting); a judicial process is required before a judge can recognize this compensation. Consequently, albeit banking regulations do not explicitly refer to this fact, it is possible that by voluntary and mutual agreement a netting between a depositor's savings and his or her liabilities can be agreed upon.

BOX 47

Set-Off Requirements during Bank Resolution or Liquidation

Guatemala – If the depositor is also a bank lender, both balances are set off only for the amounts that are liquid, callable, and mature.

United States – Mutuality must exist (that is, the owner of the deposit and the loan must be the same party) for a set-off to be considered. One common form of set-off used by the FDIC is a dollar-for-dollar reduction of an outstanding loan balance by the amount of any deposits deemed to be above the deposit

insurance limits. Years ago, the FDIC regularly used set-off to reduce any loan balances (whether performing or non-performing) by the amount of insured deposits. This approach was abolished due to its adverse impact on the liquidity of the depositors and the local community and the need for these depositors to quickly locate, evaluate, and secure alternative financing.

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- > Financial and Insurance System General Law (Texto Concordado)- Peru, February 2004
- > Banking and Financial System Law (Texto ordenado) – Bolivia, August 2004
- > Law of Commercial Societies – Argentina, April 1995
- > Financial Entities Law – Argentina, October 2003
- > Central Bank Organic Letter Law – Argentina, September 2003
- > Bank Deposit Insurance System Law (Texto Actualizado)- Argentina, February 2002
- > Federal Deposit Insurance Act (12 U.S.C. 1831)
- > Federal Tort Claims Act, 28 U.S.C

Abbreviations

DIA:	Deposit Insurance Agency
CNBV:	Comisión Nacional Bancaria y de Valores (México)
FDIC:	Federal Deposit Insurance Corporation (USA)
FFIEC:	Federal Financial Institutions Examination Council (USA)
FGD:	Fondo de Garantía de los Depósitos (Argentina)
FOPA:	Fondo para la Protección del Ahorro (Guatemala)
FRB:	Junta de la Reserva Federal / Federal Reserve Board (USA)
FRF:	Fondo de Reestructuración Financiera (Bolivia)
FSD:	Fondo de Seguro de Depósitos (Peru)
GAAP:	Generally Accepted Accounting Principles
GAO:	Government Accountability Office (USA)
IF:	Institución Financiera / Financial Institution
IFs:	Instituciones Financieras / Financial Institutions
IPAB:	Instituto para la Protección al Ahorro Bancario (México)
LBEF:	Ley de Bancos y Entidades Financieras (Bolivia)
LBGF:	Ley de Bancos y Grupos Financieros (Guatemala)
LIC:	Ley de Instituciones de Crédito (México)
LPAB:	Ley de Protección al Ahorro Bancario (México)
OCC:	Office of the Comptroller of the Currency (USA)
OTS:	Office of Thrift Supervision (USA)
PCA:	Pronta Acción Correctiva (Prompt Corrective Action)
SEC:	Securities and Exchange Commission (USA)
SEDESA:	Seguro de Depósitos Sociedad Anónima (Argentina)
SSD:	Sistema de Seguro de Depósitos / Deposit Insurance Scheme
SBEF:	Superintendencia de Bancos y Entidades Financieras (Bolivia)
SBS:	Superintendencia de Banca y Seguros (Peru)
SEFC:	Superintendencia de Entidades Financieras y Cambiarias (Argentina)

APPENDIX

APPENDIX 1

Members of the Working Group

Association of Supervisors of Banks of the Americas (ASBA)

Working Group on Effective Deposit Insurance Schemes and Bank Resolution Practices

Chairman:

Steven Fritts

Federal Deposit Insurance Corporation (USA)

Members:

Country	Institution	Representative
Argentina	Banco Central de la Rep. Argentina SEFC	Gabriel del Mazo
Bolivia	Superintendencia de Bancos y Entidades Financieras	Efraín Camacho Ugarte
Guatemala	Superintendencia de Bancos	Byron Vinicio Méndez Castillo
México	Comisión Nal. Bancaria y de Valores	César Mondragón
Paraguay	Superintendencia de Bancos	Nelson Velaztiquí
Perú	Superintendencia de Banca y Seguros	Juan Klingenberger Lomellini
United States	Federal Deposit Insurance Corporation	Steven Fritts

Work Group Technical Secretary:

Guillermo Romano Rivero - ASBA

Acknowledgement. – John di Clemente and Galo Cevallos from the FDIC actively collaborated in the edition and revision of this report.

APPENDIX 2

Deposit Insurance Agencies (DIA) Included in the Report

Country	ASBA Member	Deposit Insurance Agency (DIA)
Argentina	Banco Central de la Rep. Argentina - Superintendencia de Entidades Financieras y Cambiarias	Seguro de Depósitos Sociedad Anónima (SEDESA)
Bolivia	Superintendencia de Bancos y Entidades Financieras – (SBEF)	Fondo de Reestructuración Financiera (FRF) (*)
Guatemala	Superintendencia de Bancos	Fondo para la Protección del Ahorro (FOPA)
México	Comisión Nacional Bancaria y de Valores – (CNBV)	Instituto para la Protección al Ahorro Bancario –(IPAB)
Paraguay	Banco Central del Paraguay - Superintendencia de Bancos	Fondo de Garantía de Depósitos (FGD)
Perú	Superintendencia de Banca y Seguros – (SBS)	Fondo de Seguro de Depósitos – (FSD)
United States	Federal Deposit Insurance Corporation – (FDIC)	Federal Deposit Insurance Corporation – (FDIC)

(*) The Financial Restructuring Fund (FRF) is not a deposit insurance agency, but a mechanism to assist in resolution processes.

APPENDIX 3

Prudential Regulation, Supervision, Accounting, and Disclosure in the United States

1. Prudential regulation and supervision

This appendix summarizes key prudential, supervision, accounting, and disclosure provisions currently applied in the United States.

The United States closely adheres to the Basel Committee's Core Principles for Banking Supervision. For example, the U.S. deposit insurance application process is based on statute and requires the coordination of the chartering agency and the insurer before a proposed new bank is approved, as required by principle 3. The U.S. government also empowers the FDIC to review and approve significant transfers of ownership of a depository institution, as provided by principle 4.

The FDIC has the power under Section 10(b) of the Federal Deposit Insurance Act to examine any affiliate of any depository institution to determine the relationship or the effect the relationship has on the institution, as required by principle 20. Part 325 of the FDIC's Rules and Regulations includes minimum capital requirements and Prompt Corrective Action (PCA) powers, as related to principle 6. U.S. supervisors primarily use on-site examinations to review and assess the soundness of most institutions, with offsite analysis performed to identify significant changes in financial condition or other matters of supervisory concern, as required by principle 16. Principle 18 empowers banking organizations to collect information for the purpose of reviewing and analyzing banks on an individual and consolidated basis. Insured banks provide this information in the form of the quarterly Call Report. Thrifts must complete and submit a Thrift Financial Report. These data can be analyzed by individual bank, groups of banks, or in the aggregate for the entire banking industry.

In accordance with the Basel Core Principles, some of the U.S. best practices include:

- > the statutory basis of the deposit insurance application process,
- > the ability of the insurer to examine affiliates to determine the effect on the financial institution,
- > risk-focused examination procedures, and
- > Prompt Corrective Action powers.

The deposit insurance application process requires the insurer to review seven criteria for acceptability:

- > Financial History and Condition
- > Adequacy of Capital Structure
- > Future Earnings Prospects
- > General Character of Management
- > Risk Presented to the Insurance Fund
- > Convenience and Needs of the Community to be served
- > Consistency of Corporate Powers.

As recognized by the Core Principles, a supervisor must be able to determine what effect an affiliated organization has on a particular banking organization. The powers in Section 10(b) of the FDI Act grant this power to the FDIC.

Although these powers are not used in most examinations, they can be an extremely powerful supervisory tool. The PCA requirement of Part 325 includes a framework of actions that provides the supervisor with the powers necessary to address undercapitalized institutions. Institutions are placed into a particular PCA category based on the level of undercapitalization.

Supervisory actions become increasingly severe as the institution falls into lower capital categories. These actions may be mandatory or discretionary, depending on the action and severity of the capital shortage, and range from submission of a written capital plan to the assignment of a receiver. These powers enable the FDIC to address severe capital shortages before a failure is imminent, reduce the risk to the insurance funds, and help minimize expenses related to a closure.

The bifurcated examination approach, discussed under Section 10, question C, represents another best practice and provides for differing risk-focused examination approaches for smaller, less complex community banks and those holding assets over \$10 billion.

2. Accounting

U.S. depository institutions follow accounting standards set forth in Generally Accepted Accounting Principles (GAAP).

Section 37 of the Federal Deposit Insurance Act requires that "the accounting principles applicable to reports or statements required to be filed with the Federal banking agencies by all insured depository institutions shall be uniform and consistent with generally accepted accounting principles."

The statute permits the Federal banking agencies to depart from this standard only in instances where the agencies determine that the application of U.S. GAAP would be "inconsistent" with producing depository institution financial statements, which meet the following objectives specified in Section 37:

- > Result in financial statements and reports of condition that accurately reflect the capital of such institutions;
- > Facilitate effective supervision of the institutions; and
- > Facilitate prompt corrective action to resolve the institutions at the least cost to the insurance funds.

Currently, no regulatory reporting instructions are inconsistent with U.S. GAAP. However, in some instances, U.S. GAAP allows a financial statement preparer to choose among alternatives. In certain areas, the Federal banking agencies limit the GAAP options that U.S. deposit institutions may use in preparing financial statements. These areas are listed in the Instructions for the Preparation of Consolidated Report of Condition and Income (Call Report instructions) and include:

- 1) Non accrual rules in the Glossary entry for "Non accrual Status,"
- 2) Treatment of impaired collateral-dependent loans in the Glossary entry for "Loan Impairment,"
- 3) Glossary entry for the "Allowance for Loan and Lease Losses" which references the 1993 Interagency Policy Statement on this subject,
- 4) Separate entity method of accounting for income taxes of bank subsidiaries of holding companies in the Glossary entry for "Income Taxes,"
- 5) Push down accounting rules in the Glossary entry for "Business Combinations," and
- 6) Treatment of property dividends in the Glossary⁵ entry for "Dividends."

The Call Report instructions contain specific reporting guidance that falls within the range of acceptable practice under GAAP. These instructions have been adopted to achieve safety and soundness and other public policy objectives and to ensure comparability.

The limitations apply only to financial statements filed with the Federal banking agencies. U.S. depository institutions may generally use any acceptable alternative set forth in U.S. GAAP when preparing financial statements for other purposes.

3. Disclosure

Financial statement disclosure requirements are set forth in U.S. GAAP and in the rules and regulations of the U.S. Securities and Exchange Commission (SEC).

The SEC has enforcement authority over public companies and takes action against public companies for providing false or misleading information, including accounting fraud. This authority includes the ability to impose monetary penalties on public companies and persons associated with them.

SEC staff routinely reviews annual and quarterly reports and other filings that publicly held companies make under Federal securities laws. Through this review process, the staff determines if these companies are meeting their disclosure requirements and seeks to improve the quality of the disclosure, including requesting amendments to previously filed reports. These reviews also can lead to enforcement actions by the SEC against public companies or their auditors.

5 The link to the Glossary is: <http://www.fdic.gov/regulations/resources/call/crinst/305gloss.pdf>

The SEC requires public companies to disclose meaningful financial and other information to the public. Only through the availability of timely, comprehensive, and accurate information can the public make sound investment decisions. The SEC is concerned that the practice of selective disclosure leads to a loss of investor confidence in the integrity of capital markets. Therefore, in 2000, the agency adopted rules that require a public company or a person acting on the company's behalf to simultaneously or promptly disclose to the public any material nonpublic information disclosed to market insiders. In general, market insiders include securities dealers, securities analysts, investment advisors, mutual funds and other investment companies, and other market professionals who may trade on the basis of the information.

Market discipline for public companies is generally regarded as robust because of the number of analysts, rating agencies, and others that review disclosures. Share prices of public companies tend to suffer if disclosures do not satisfy best practices of other companies in the same industry. In addition, shareholders may initiate private litigation if they believe a company in which they own stock has provided false or misleading information.

Public financial institutions must comply with the SEC's reporting and disclosure requirements. The SEC also has established certain financial disclosure requirements for banking organizations that focus on lending, investing, and deposit-taking activities. These disclosures are typically included in Management's Discussion and Analysis of Financial Condition and Results of Operations.

In addition to SEC public reporting requirements, extensive financial data on U.S. depository institutions also are publicly available, regardless of whether these institutions are publicly or privately held or organized as a mutual institution.

All FDIC-insured depository institutions and bank holding companies submit quarterly prudential reports to the Federal banking agencies.

Banks supervised by the FDIC, the Office of the Comptroller of the Currency (OCC), or the Federal Reserve Board (FRB) file Reports of Condition and Income (Call Reports). Savings associations supervised by the Office of Thrift Supervision (OTS) file Thrift Financial Reports (TFRs).

In addition, bank holding companies supervised by the FRB with more than \$150 million in consolidated assets or with more than one bank subsidiary file quarterly consolidated reports. These reports include:

- > Balance sheets,
- > Income statements,
- > Changes in equity capital, and
- > Supporting schedules that provide more detailed information on assets (including past-due and non accrual loans and loan charge-offs and recoveries), liabilities, off-balance sheet items, and regulatory capital.

Except for a few specific items, the information collected in these prudential reports is publicly available and can be accessed on the FDIC's Web site (www.fdic.gov for banks and savings associations) and the FRB's Web site (www.federalreserve.gov for bank holding companies)

In addition, since 1993, all FDIC-insured institutions with \$500 million or more in total assets are required to file an annual report with the FDIC, their primary Federal banking agency (if other than the FDIC), and their State supervisor, if any. This annual report must include:

- > Audited financial statements that comply with GAAP;
- > A statement of management's responsibilities for preparing the institution's annual financial statements, for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and for complying with designated safety and soundness laws and regulations;
- > An assessment by management of the effectiveness of the internal control structure and procedures for financial reporting as of the end of the fiscal year, and the institution's compliance with the designated laws and regulations during the fiscal year; and
- > An attestation report prepared by the external auditor on the effectiveness of internal control over financial reporting.

The audited financial statements can be consolidated statements of an institution's parent holding company. With certain exceptions, the other requirements also may be satisfied at the holding company level. Each institution is expected to make its annual report publicly available. These annual reports also are available from the Federal banking agencies.

APPENDIX 4

Definitions of Deposits and Insured Deposits in the United States

Section 3(l) of the Federal Deposit Insurance Act (12 U.S.C. 1813(l)) defines the term "deposit," which is generally defined as the unpaid balance of money or its equivalent received or held by a bank or savings association in the usual course of business and for which it has given or is obligated to give credit.

Clauses (1) to (5) of section 30(l) define "deposit" as follows:

- (1) the unpaid balance of money or its equivalent received or held by a bank or savings association in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank or savings association, or a letter of credit or a traveler's check on which the bank or savings association is primarily liable: Provided, That, without limiting the generality of the term "money or its equivalent," any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable, or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such bank or savings association for collection,
- (2) trust funds as defined in this Act received or held by such bank or savings association, whether held in the trust department or held or deposited in any other department of such bank or savings association,
- (3) money received or held by a bank or savings association, or the credit given for money or its equivalent received or held by a bank or savings association, in the usual course of business for a special or specific purpose, regardless of the legal relationship thereby established, including without being limited to, escrow funds, funds held as security for an obligation due to the bank or savings association or others (including funds held as dealers reserves) or for securities loaned by the bank or savings association, funds deposited by a debtor to meet maturing obligations, funds deposited as advance payment on subscriptions to United States Government securities, funds held for distribution or purchase of securities, funds held to meet its acceptances or letters of credit, and withheld taxes: Provided, That there shall not be included funds which are received by the bank or savings association for immediate application to the reduction of an indebtedness to the receiving bank or savings association, or under condition that the receipt thereof immediately reduces or extinguishes such an indebtedness,
- (4) outstanding draft (including advice or authorization to charge a bank's or a savings association's balance in another bank or savings association), cashier's check, money order, or other officer's check issued in the usual course of business for any purpose, including without being limited to those issued in payment for services, dividends, or purchases, and
- (5) such other obligations of a bank or savings association as the Board of Directors, after consultation with the Comptroller of the Currency, Director of the Office of Thrift Supervision, and the Board of Governors of the Federal Reserve System, shall find and prescribe by regulation to be deposit liabilities by general usage, except that the following shall not be a deposit for any of the purposes of this Act or be included as part of the total deposits or of an insured deposit:
 - (A) any obligation of a depository institution which is carried on the books and records of an office of such bank or savings association located outside of any State, unless--
 - (i) such obligation would be a deposit if it were carried on the books and records of the depository institution, and would be payable at, an office located in any State; and
 - (ii) the contract evidencing the obligation provides by express terms, and not by implication, for payment at an office of the depository institution located in any State;
 - (B) any international banking facility deposit, including an international banking facility time deposit, as such term is from time to time defined by the Board of Governors of the Federal Reserve System in

- regulation D or any successor regulation issued by the Board of Governors of the Federal Reserve System; and
- (C) any liability of an insured depository institution that arises under an annuity contract, the income of which is tax deferred under section 72 of the Internal Revenue Code of 1986.

Section 3(m) of the Federal Deposit Insurance Act (12 U.S.C. 1813(m)) defines the term "insured deposit" as follows:

- (1) IN GENERAL--Subject to paragraph (2), the term "insured deposit" means the net amount due to any depositor for deposits in an insured depository institution as determined under sections 7(i) and 11(a).
- (2) In the case of any deposit in a branch of a foreign bank, the term "insured deposit" means an insured deposit as defined in paragraph (1) of this subsection which--
- (A) is payable in the United States to--
- (i) an individual who is a citizen or resident of the United States,
 - (ii) a partnership, corporation, trust, or other legally cognizable entity created under the laws of the United States or any State and having its principal place of business within the United States or any State, or
 - (iii) an individual, partnership, corporation, trust, or other legally cognizable entity which is determined by the Board of Directors in accordance with its regulations to have such business or financial relationships in the United States as to make the insurance of such deposit consistent with the purposes of this Act; and
- (B) meets any other criteria prescribed by the Board of Directors by regulation as necessary or appropriate in its judgment to carry out the purposes of this Act or to facilitate the administration thereof.

APPENDIX 5

Background on Insurance Premiums in Select Jurisdictions

United States – At present, the FDIC uses a risk-based premium system that assesses higher rates on institutions that pose greater risks to the Bank Insurance Fund (BIF) or the Savings Association Insurance Fund (SAIF). The FDIC assigns each institution to one of nine risk categories using a two-step process based first on capital ratios (the capital group assignment) and then on other relevant information (the supervisory subgroup assignment). Capital group assignments are made in accordance with Section 327.4(a)(1) of the FDIC's Rules and Regulations, using the method agreed upon by the Federal Financial Institutions Examination Council (FFIEC) Surveillance Task Force for calculating capital ratios.

The method uses data reported in an institution's Report of Income and Condition (Call Reports), Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks, or Thrift Financial Report, for the preceding September 30, for the January 1 to June 30 semiannual period and the preceding March 31, for the July 1 to December 31 semiannual period. No changes to capital ratios are considered, except amendments to the previously mentioned reports.

Capital Categories:

- > **Group 1** - "Well Capitalized." Total Risk-Based Capital Ratio equal to or greater than 10 percent, and Tier 1 Risk-Based Capital Ratio equal to or greater than 6 percent, and Tier 1 Leverage Capital Ratio equal to or greater than 5 percent.
- > **Group 2** - "Adequately Capitalized." Not Well Capitalized and Total Risk-Based Capital Ratio equal to or greater than 8 percent, and Tier 1 Risk-Based Capital Ratio equal to or greater than 4 percent, and Tier 1 Leverage Capital Ratio equal to or greater than 4 percent.
- > **Group 3** - "Undercapitalized" neither Well Capitalized nor Adequately Capitalized.

Capital groupings for insured branches of foreign banks are:

- > **Group 1** - "Well Capitalized." The insured branch maintains the pledge of assets required under 12 CFR 346.19, and the branch maintains the eligible assets prescribed under 12 CFR 346.20 at 108 percent or more of the average book value of the insured branch's third party liabilities for the quarter ending on the capital group cut-off date.
- > **Group 2** - "Adequately Capitalized." Not Well Capitalized, and the insured branch maintains the pledge of assets required under 12 CFR 346.19, and the branch maintains the eligible assets prescribed under 12 CFR 346.20 at 106 percent or more of the average book value of the insured branch's third party liabilities for the quarter ending on the capital group cut-off date.
- > **Group 3** - "Undercapitalized." Neither Well Capitalized nor Adequately Capitalized.

Supervisory subgroup assignments for members of the BIF and the SAIF are made in accordance with section 327.4(a)(2) of the FDIC's Rules and Regulations, which provides as follows: "...each institution will be assigned to one of three subgroups based on the [FDIC's] consideration of supervisory evaluations provided by the institution's primary Federal regulator. The supervisory evaluations include the results of examination findings by the primary Federal regulator, as well as other information the primary Federal regulator determines to be relevant. In addition, the [FDIC] will take into consideration such other information (such as state examination findings, if appropriate) as it determines to be relevant to the institution's financial condition and the risk posed to the BIF or SAIF."

Based on consideration of several factors, the FDIC assigns a supervisory subgroup to each BIF or SAIF institution for each semiannual assessment period. These factors include FDIC review of the results of the last examination; review of other written findings resulting in a composite rating change by the primary supervisor; review of the results of independent, joint or concurrent FDIC examinations finalized before the cut-off date; time elapsed since the last examination; results of offsite statistical analysis of reported financial statements; and analysis of other pertinent information.

Supervisory Subgroup Descriptions

- > **Subgroup A** - This subgroup consists of financially sound institutions with only a few minor weaknesses and generally corresponds to the primary Federal supervisor's composite rating of "1" or "2."
- > **Subgroup B** - This subgroup consists of institutions that demonstrate weaknesses, which, if not corrected, could result in significant deterioration of the institution and increased risk of loss to the BIF or SAIF. This subgroup assignment generally corresponds to the primary Federal supervisor's composite rating of "3."
- > **Subgroup C** - This subgroup consists of institutions that pose a substantial probability of loss to the BIF or the SAIF unless effective corrective action is taken. This subgroup assignment generally corresponds to the primary Federal supervisor's composite rating of "4" or "5."

The cut-off date for assessment periods beginning January 1 is the preceding September 30 and for assessment periods beginning July 1, the cut-off date is the previous March 31.

The FDIC Board of Directors reviews premium rates semiannually. As of January 1, 1993, when the risk-based assessment system was introduced, each bank and thrift paid an annual assessment rate of between 23 and 31 cents per \$100 of assessable deposits. After the BIF reached the Designated Reserve Ratio (DRR) of 1.25 percent at the end of May 1995, the Board approved a reduction in assessment rates for BIF members to a range between 4 and 31 cents per \$100 in assessable deposits. In November 1995, the Board approved a new assessment rate structure for the BIF, with a range between 0 and 27 cents per \$100 in assessable deposits, effective January 1, 1996.

The Deposit Insurance Funds Act of 1996 provided for the capitalization of the SAIF at the target DRR of 1.25 percent by means of a one-time special assessment on SAIF-member institutions. In December 1996, the Board lowered SAIF assessment rates to a range between 0 and 27 cents per \$100 in assessable deposits, which is identical to the rate schedule previously approved for BIF members.

What is the current premium/assessment rate structure?

The risk-based assessment schedule for BIF and SAIF-insured institutions ranges from 0 to 27 basis points.

	Supervisory Subgroup		
Capital Group	A	B	C
1. Well Capitalized	0 bp	3 bp	17 bp
2. Adequately Capitalized	3 bp	10 bp	24 bp
3. Undercapitalized	10 bp	24 bp	27 bp

Note: Basis points (bp) are cents per \$100 of assessable deposits (annual rate).

Mexico – All banks are assessed at a fixed rate.

The Governing Board of IPAB may establish the ordinary fees for the Institutions, based on the risk to which they are exposed, according to their capital adequacy level, and other general indicators. These are determined in regulations issued by IPAB's Governing Board.

Such regulations state that the banks shall pay on a monthly basis premiums for an amount equal to the twelfth part of four per thousand, on the monthly average of the daily deposits.

Premiums, called ordinary fees, may not be lower than four per thousand of deposits.

If IPAB does not have sufficient resources to face its obligations, the Governing Board can set extraordinary premiums, which should not exceed in one year three per thousand on the total amount of deposits in each bank.

The sum of the ordinary and extraordinary fees cannot exceed, on an annual basis, eight per thousand of the total amount of bank's deposit liabilities.

Peru – Premiums paid by FSD member institutions are based on the risk ratings assigned by a minimum of two rating agencies on a semiannual basis. Each risk-rating category is assigned an annual premium

rate ranging from 0.45 percent for institutions with the least risk to 1.45 percent for institutions falling in the highest-risk category.

The current premium rate structure is as follows:

Category A: 0.45 percent Annual Rate and 0.1125 percent Quarterly Rate

Category B: 0.60 percent Annual Rate and 0.1500 percent Quarterly Rate

Category C: 0.95 percent Annual Rate and 0.2375 percent Quarterly Rate

Category D: 1.25 percent Annual Rate and 0.3125 percent Quarterly Rate

Category E: 1.45 percent Annual Rate and 0.3625 percent Quarterly Rate

Calculations are based on insured deposits.

Bolivia – Contributions to the FRF are calculated based on total deposits as included in the financial statements of each of the contributing financial institutions, according to the balance of the daily average of deposits of the previous quarter. These contributions are to be deposited in the FRF account at the Central Bank of Bolivia beginning on January 1, 2002. The quarterly rates for contributions to the FRF are: 0.15% for the first year, 0.45% for the second year, 1.00% for the third year and 1.25% for the fourth year and all subsequent years. Contributions to the FRF are accounted for as expenses.

When the contribution rate of a given financial institution reaches 5 percent of the amount registered under total deposits in its financial statements, the Central Bank may exempt the institution from its payment obligation, unless FRF resources have been fully committed to resolution procedures.

Argentina – Financial entities must pay the FGD premiums in three categories: a regular monthly contribution and an additional amount based on the bank's risk level, plus any advances that could be required by the central bank (BCRA).

The regular contribution is equivalent to 0.015 percent of the monthly average of daily deposit balances, either in local or foreign currency, as registered during the previous second month.

The additional contribution should not exceed the regular contribution and is determined by consideration of certain risk factors:

- > The risk qualification assessed for the entity, according to an evaluation by the Superintendence of Financial and Exchange Institutions.
- > Any capital in excess of the minimum capital adequacy requirements.

The quality of the active portfolio is measured by: i) minimum provisions required according to the risk levels, risks of uncollectible exposures, and ii) the assets included in capital adequacy calculations, weighted according to risk levels and legal requirements.

APPENDIX 6

Questions and Answers on Banking Supervision and DIA's Powers in Seven Countries (Argentina, Bolivia, Guatemala, México, Paraguay, Peru, United States)

A. Argentina

The following are questions on the nature and scope of the DIA.

To what extent is the DIA authorized to perform bank examinations?

Only the BCRA, through the Superintendence of Financial and Exchange Entities (SEFC), examines banking organizations.

How can the DIA evaluate a bank's condition using offsite surveillance?

SEDESA is required to: 1) communicate its opinion to the Superintendence of Financial Entities about any entities which, in its judgment, have commercial or credit policies that may present heightened risk, and 2) give the Superintendence, when required, its opinion about applications for operations or transformation under consideration by the Central Bank (article 22 of Decree 540/95).

Has the DIA direct access to information from banks?

SEDESA can obtain information directly from banks, but in practice this information is obtained through the SEFC.

B. Bolivia, Guatemala, Paraguay, and Peru

Discuss the extent to which the DIA is authorized to perform bank examinations.

DIA's in Peru, Guatemala, and Bolivia are not authorized to lead independent bank examinations of insured banks.

Only the Superintendence of Banks and Insurance (SBS), the Superintendence of Banks (SB), and the Superintendence of Banks and Financial Entities (SBEF) may conduct independent examinations.

Has the DIA direct access to information from banks?

If concerns arise about FSD-insured deposits, the DIA in Peru has access to information from banks.

C. Mexico

Discuss the extent to which the DIA is authorized to perform bank examinations.

IPAB is not authorized to perform bank examinations. Only The National Banking and Securities Commission (CNBV) can examine banks. IPAB may participate in examinations led by other supervisory authorities.

Does the DIA develop a coordinated supervisory approach with fellow bank supervisors?

IPAB may request the Commission to conduct inspection visits to determine if an institution's financial, accounting, and legal situation corresponds to the goals established in the corrective program.

IPAB staff may also participate, upon request, in the inspection visits carried out by the CNBV to evaluate information provided by the Institution. In this case, IPAB staff will cooperate with staff from the CNBV.

The CNBV informs the IPAB about an institution's financial condition which it deems susceptible to be intervened. IPAB must also inform the Commission of any irregularities it may identify in an institution.

D. United States

Who is authorized to perform bank examinations?

An insured institution's charter will determine what bank regulatory agency conducts examinations?the FDIC, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Reserve Board (FRB), or the state chartering authority, or some combination. The FDIC performs safety

and soundness examinations of state-chartered insured institutions that are not members of the FRB and examines institutions to determine compliance with the Community Reinvestment Act and other consumer protection legislation and regulations. In its role as the deposit insurer, the FDIC is empowered to examine other institutions that may represent a heightened risk to the insurance funds.

Discuss the extent to which the DIA may lead independent examinations of the insured bank.

The FDIC regularly examines certain insured institutions and has the legal authority to examine any insured institution. Much of the examination responsibility is exercised by other Federal banking agencies as well as state agencies. The examination activities of the Federal agencies are coordinated by the Federal Financial Institutions Examination Council (FFIEC), and most states have adopted examination standards similar to the Federal standards. The FDIC has access to all examination ratings and examination reports of the other Federal and state supervisory authorities.

To what extent is the DIA authorized to evaluate a bank's condition using offsite surveillance?

Should an insured institution fail an early warning test, FDIC case managers are responsible for reviewing and reassessing the institution's risk profile. In addition, case managers are responsible for reviewing the risk-related premium classification of selected institutions and monitoring any concerns that arise during the course of an on-site examination.

Does the DIA have direct access to information from banks?

The FDIC receives quarterly financial reports from all insured institutions—either from the institution or the institution's primary Federal supervisor. In addition, bank examinations conducted every 12 to 18 months generate data on the quality of the loan portfolio. These data are transmitted to the FDIC by the examining agency. At larger institutions, the larger loans are reviewed annually by an interagency team that includes FDIC examiners.

To what extent does the DIA develop a coordinated supervisory approach with fellow bank supervisors?

The FDIC works closely with other regulatory authorities, particularly the state banking agencies. As appropriate, the FDIC works closely with other agencies, such as the FRB and the Securities and Exchange Commission. The FDIC also cooperates with the OCC in the oversight of the largest U.S. banks through the dedicated examiner program. This cooperation minimizes duplication of work and burden on financial institutions and promotes information sharing among supervisory agencies.

Is the DIA a party to supervisory agreements with or enforcement actions against banks initiated by other bank supervisors?

The FDIC is generally consulted about, and may often be a party to, the agreement or action initiated by other bank supervisors, but FDIC participation is not always required.

Has the DIA entered into information-sharing and coordination arrangements, formal and informal, with other bank supervisors?

The FDIC coordinates with the other Federal banking supervisors and the state banking agencies and is a member of the FFIEC. On January 29, 2002, the FDIC Board of Directors adopted an agreement with the OTS, the OCC, and the FRB that enables the FDIC to examine insured depository institutions that represent a heightened risk to the deposit insurance funds. The Federal Deposit Insurance Act provides that the FDIC Board can authorize special examinations of any insured depository institution when such an examination is necessary for insurance purposes. The FDIC has long considered it a top priority to examine all insured banks and thrifts as needed to assess their financial condition and degree of risk to the insurance funds. This agreement establishes an improved process for determining when the FDIC will use its authority to examine any insured institution and provides for enhanced coordination and cooperation of the agencies' supervisory efforts.

The interagency agreement also provides for the establishment of an FDIC dedicated examiner program for the eight largest banking organizations. Because of their size and market share, these eight "large insured depository institutions" potentially expose the deposit insurance funds to substantial risk. The

FDIC is not the primary supervisor for these banking organizations; however, the FDIC's dedicated examiners serve as the FDIC's primary points of contact for oversight of these institutions. Pursuant to the agreement, to the fullest extent possible, the FDIC will continue to rely on results of the work performed by the primary Federal bank supervisors in assessing the condition and risk management practices of these institutions. The dedicated examiners are provided access to supervisory personnel and information, including risk assessments, supervisory plans, and reports of examination, and are invited to participate in certain examination activities.

To what extent does the DIA rely on information provided by third parties, including supervisory authorities, audit firms, rating agencies, and others to assess the condition of insured banks?

The FDIC uses information from a range of third parties for offsite review and on-site examinations but does not rely exclusively on this information to assess the condition of insured banks. The FDIC relies on information, such as reports of examination, provided by other bank supervisory authorities.

When authorized to lead independent bank examinations of insured banks, discuss the extent to which the DIA shares examination findings with other bank supervisors.

The FDIC shares examination findings with other banking supervisors as appropriate. As an example, the FDIC examines state nonmember banks, which are also supervised by the states. The FDIC provides a copy of its examination report to the relevant state banking authority. In addition, as appropriate, FDIC examination reports are provided to other supervisors, such as the Federal Reserve Board (FRB) when there is a holding company, as the FRB is the supervisor for bank holding companies. As the insurer, the FDIC receives reports of examination for all banks under the supervision of other supervisors. Inquiries from foreign bank supervisors are considered on a case-by-case basis after receipt of a formal request for information.

When authorized to lead independent bank examinations of insured banks, discuss the extent to which the DIA submits its report directly to the bank.

Examination reports are submitted directly to the bank's board of directors.

When authorized to lead independent bank examinations of insured banks, discuss the extent to which the DIA makes its report publicly available.

Reports of examination are not publicly available. All examination reports and findings are subject to the strict confidentiality restrictions contained in Part 309 of the FDIC's Rules and Regulations.

When authorized to lead independent bank examinations of insured banks, discuss the extent to which the DIA considers the examination findings when assessing premiums.

The FDIC considers examination ratings when assessing premiums, as discussed in Section 8.

Do all bank supervisory authorities adhere to a uniform set of examination policies, practices, and procedures? This includes, for example, a uniform risk-classification (e.g., CAMELS rating), credit scoring/classification definitions, etc.

Yes. The FFIEC is composed of the FDIC, the FRB, the OTS, the OCC, and the National Credit Union Administration. The FFIEC is instrumental in standardizing examination ratings and policies, including a uniform system addressing the ratings for bank safety and soundness examinations and definitions for loan classifications. In addition, much of the bank examination training is offered through the FFIEC, which further promotes uniform application of examination approaches, policies, regulations, and the examination format.

APPENDIX 7

Definition of Terms for Bank Intervention and Bank Resolution

Bank Failure. A bank does not meet minimum capital adequacy requirements; therefore, there is a need to provide assistance to the failed bank or close it.

Bank Closure. A bank license is revoked and is liquidated or becomes bankrupt. Usually, the legal framework includes voluntary dissolution and special regulations governing intervention and liquidation.

Bank Intervention. The supervisor replaces a banking institution's management to standardize and bring its operations to normalcy when the institution negatively affects the stability of the financial system or poses a risk to depositors. On a temporary basis, intervention is carried out through an appointed receiver. A special regime, whose triggers are specified by law, allows for enforcing a bank to stop its operations, limits the powers of the shareholders general assembly and board, and allows the supervisors to assess a bank's net worth and have the authority to transfer part or all of its assets and liabilities to another financial institution.

Bank Resolution. Bank resolution may take the form of liquidation or bankruptcy.

As defined, these terms refer to the closing of a financial institution by its chartering authority, which rescinds the institution's charter and revokes its ability to conduct business. This is usually done because the institution is insolvent, critically undercapitalized, or unable to meet deposit outflows.

APPENDIX 8

Prompt Corrective Action (PCA) in Selected Member Countries

United States. – The PCA capital definitions are detailed below. If a bank is undercapitalized, it must submit an acceptable capital plan to its primary regulator. Restrictions, such as limiting dividend payments and growth, apply when a bank is considered undercapitalized.

Prompt Corrective Action Categories

	Leverage	Tier 1 Risk-Based	Total Risk-Based
Well Capitalized	>= 5% and	>= 6% and	>= 10%
And is not subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure			
Adequately Capitalized	>= 4% * and	>= 4% and	>= 8%
And does not meet the definition of a well capitalized bank. *or a Leverage ratio of = 3% if the bank is rated a composite 1 and is not experiencing or anticipating significant growth ^a			
Undercapitalized	< 4% * or	< 4% or	< 8%
* or < 3% if the bank is rated composite 1 and is not experiencing or anticipating significant growth			
Significantly Undercapitalized	< 3% or	< 3% or	< 6%
Critically Undercapitalized	Tangible equity capital ratio that is <= 2%		

Can a breach of your country's PCA requirements trigger a supervisory response that can lead to bank closure? Please answer and explain.

In the United States, PCA requirements can trigger a supervisory response that could result in closure. Essentially, a financial institution deemed critically undercapitalized (less than 2 percent tangible equity capital ratio) may be appointed a receiver or a conservator, which is effectively a closure. This is done within 90 days of the institution becoming critically undercapitalized. Within these 90 days, the bank is given the opportunity to recapitalize.

Mexico

The CNBV is empowered by the Credit Institutions Law (LIC) to classify banks based on their capital adequacy standards. The LIC and secondary regulation issued by the CNBV establish the minimum corrective actions the CNBV must impose (based on the classification) as well as additional special corrective actions the CNBV could mandate. The chart below summarizes prompt corrective actions applicable to each capital classification:

I (>10%)	II (8%-10%) At the minimum	III (7%-8%) At the minimum	IV (4%-7%) At the minimum	V (<4%) At the minimum
<p>No coercive measures exist</p>	<p>- As established by LIC law. Additional - Define the actions to be undertaken to avoid a deterioration of the capitalization ratio. - Present a report on the classification of the institution to a higher hierarchical officer at the institution headquarter, in the case of a foreign owned subsidiaries. Contract out the services of external auditors or other specialized auditors</p>	<p>- As established by LIC law. Additional - Abstain from agreeing on compensation increases for staff, except when salary increases had been authorized earlier, respecting labor rights - Limit the authorization of new operations that in the opinion of CNBV may cause an increase in risk exposed assets and or provoke further deterioration in the capital ratios. - Carry out all necessary actions to counteract or minimize the effect of the institution's operations with people associated with the financial group, to which the institution belongs, or with a third party, which may imply a transfer in benefits or resources causing a financial impact, and which CNBV may have identified in the course of its inspections and vigilance functions. - Abstain from operations with parties associated with the same corporate group the institution may belong to, in the opinion of CNBV.</p>	<p>- Apply for authorization from CNBV to undertake new investments in non-financial assets, open branches, or carry out different operations than those usually performed by the institution, if and when, at the end of these operations such investments or activities do not require an authorization by the Secretary of Finance and Public Credit (Secretaría de Hacienda y Crédito Público), or the Central Bank (Banco de México) within its competences. Additional - Substitute employees, advisors, commissioners or external auditors, as the institution is supposed to designate. However, these measures do not preclude CNBV's rights as defined under article No. 25 of the LIC law to determine the discharge of board members, directors, commissioners, managers, fiduciary delegates and other staff members with legal powers in the institution. - Carry out all necessary actions to reduce the exposure to risks derived from operations that differ significantly from the policies and usual operations of the institution, and that, in the opinion of CNBV, generate a high market risk. Additionally, the CNBV may require the institution to abstain from high market risk operations. - Modify the institution's policies in respect to interest rates paid over deposits and liabilities whose yields exceed the risk levels usually assumed under such operations, and which the CNBV may have identified, without precluding the sanctions established in article 106 of the LIC law.</p>	<p>- Those established for categories II, III, and IV.</p>

Rules

Can breach of your country's PCA requirements trigger a supervisory response that can lead to bank closure? Yes, in the event that the implementation of corrective actions does not allow the regaining of minimum capital levels by the bank, the Finance Ministry (SHCP) may revoke the license of the banking institution.

Paraguay

All institutions regulated by Law 861/96 (Ley General de bancos, Financieras y Otras Entidades de Credito) must submit a restructuring plan that is acceptable to the banking superintendence when one or more of the following conditions occur:

- (i) There is a deficiency in legal reserve, which exceeds statutory levels established by the central bank.
- (ii) Prudential limits have been exceeded during more than ten consecutive days.
- (iii) Losses have been incurred during two consecutive quarters, with a forecast for the next semester that could imply a reduction in regulatory capital, and that if the trend continues could lead to solvency levels below minimum requirements.
- (iv) An insolvency level below regulatory minimums during more than five business days.
- (v) When the institution has been forced by circumstances to apply to the central bank as lender of last resort, with the exception of central bank regulated facilities.
- (vi) Reiterated non-compliance with recommendations or mandatory resolution issued by the banking superintendence and/or the central bank's board.
- (vii) Submission of fraudulent or false information to the banking superintendence.
- (viii) Offers and/or commitments to pay deposit interest rates significantly higher than those of the market, or similar financial institutions, when those liabilities might affect the financial stability of the institution.
- (ix) When the superintendence reclassifies credit risks previously classified by the institution at levels that exceed those defined by current regulations.
- (x) When the superintendence resolves to decree so based on evidence that the institution's actions jeopardize the safety of public deposits or the entity's liquidity and minimum solvency levels.

If the superintendence, within five days after the restructuring plan has been submitted, rejected the plan, the institution has two business days to re-submit the plan. Non-presentation of the plan, or rejection of the plan by the superintendence, will be deemed cause for resolution.

If the restructuring plan submitted by the institution's legal representatives is accepted, the plan will be deemed legally in force, mandating its strict enforcement by the institution in all of its terms.

Restructuring periods cannot exceed 90 consecutive days from the date of approval of the plan by the superintendence. The superintendence can terminate the plan before the maximum term if the intermediary institution satisfactorily demonstrates that all conditions that led to the restructuring were remedied. During the restructuring period, the financial institution is not allowed to, directly or indirectly, distribute any benefits or pay any dividends. The institution is prohibited from accepting any liabilities, intermediate in promotional lines of credit, or increase personnel. During this time, the superintendence intensifies its supervision, while authorized supervisors can participate in board meetings or similar, without any voting or speaking rights.

Peru

Non-compliance with capital requirements requires an institution to be assessed by the supervisor (Article 95 of the General Act). When the situation is very serious, the company is placed in receivership (Article 104 of the General Act).

The Superintendent's office assigns every company in the financial or insurance system to a special category when the following occur:

- a) Non-compliance with the obligation of Article 63 (The capital deficit must be covered during the next quarter);
- b) Actual equity or capital stock falls below the minimum capital demanded;

- c) Loans are granted to their own shareholders to cover the company's capital requirements; and
- d) False information is provided to the Superintendent's office or to the Central Bank, or there are suspicions of fraud or significant tampering with the financial position.

]The Supervisory Regime lasts no more than 45 days The Regime may be extended for another 45 days if the situation does not improve.

During the Supervisory Regime, the company's management maintains its power and authority. The company must submit a financial recovery plan that satisfies the Superintendent's Office within seven working days following the decision to submit the company to the Supervisory Regime. This plan will contain the prudential rules that the SBS deems adequate. Within the following seven working days of referred plan's approval, an agreement must be signed to formalize it. In addition, the company must show, in the periods established in the agreement, an improvement in its financial position, which must necessarily include capital contributions in cash.

Guatemala

The adoption of corrective measures is done in accordance with the findings of the on-site and off-site supervisors. As often the latter guides the former, it is possible to determine whether banking entities could, in the short to medium term, present problems which may reflect a deterioration of the financial position and consequently require these entities to change their supervision from "normal" (less onsite, more extra situ work) to special supervision (more onsite, less extra situ supervision).

Typically, institutions under special supervision have structural rather than temporary problems, often as a result of low-quality credit portfolios, with an effect on their profitability and solvency. In many cases they are not in compliance with applicable prudential standards, inaccurately presenting a supposed positive financial position.

In this setting, the Banking and Financial Groups Law includes corrective measures designed to provide help to the concerned banking institutions in developing restructuring plans. Banks are placed in the special supervisory category when they present conditions such as:

- Equity deficiencies of up to 50 percent of required capital.
- Continuous non-compliance with applicable legal and regulatory resolutions and with the instructions of the Banking Superintendent.
- Deficiencies in the legal reserve for two consecutive months or three different months in a one-year period.
- Management practices that the Bank Superintendent feels are putting the institution's liquidity and solvency in serious danger.
- Submitting information that the Bank Superintendent considers untrue or fake.

Time to execute the restructuring plan approved by the Banking Superintendent will not exceed three months from approval date. During the restructuring period, the supervisor may appoint a delegate with the right to veto decisions adopted by the bank that could prevent plan implementation.

If the regularization plan is not submitted, or definitely rejected, or not complied with, the Monetary Board could stop the institution from operating, and consequently, it could be legally liquidated.

Implementing a restructuring plan within the process prescribed by the Bank and Financial Groups Law does not necessarily lead to closing operations at the banking institution. If the bank complies with the measures to restructure its financial situation, as stated in the framework of the plan and in the appropriate period of time, the bank will not be closed.

Bolivia

Article 112 of the banking law (LBEF) provides the legal structure for addressing a bank crisis. In addition to early warnings, it provides the legal framework for the supervisor to require financial intermediaries to implement preventive and prompt corrective actions before the bank is placed in receivership or faces legal, forceful liquidation.

Early warnings included in the Law were originally proposed by this supervisory entity taking into consideration that i) increasing losses diminish equity and, usually, when measures have not been taken on time, they turn into insolvency; ii) when the quality of the records deteriorates it puts the financial institution's capability to respond to its depositors at risk; and iii) bad management practices may put at risk a financial institution's stability.

Prompt corrective action regulations include:

- > Procedure to begin a restructuring process. This process begins when SBEF has identified specific causes or when the financial intermediary submits these to SBEF. A financial intermediary is considered to be in a restructuring process in one or more of the following situations:
 - a) Primary capital was reduced by between 30 percent and 50 percent in a 12-month period.
 - b) The coefficient of capital adequacy is less than legally required.
 - c) Legal reserve deficiencies are higher than the 1 percent required during two consecutive periods or four discontinued periods within one year.
 - d) When the ratio of first quality assets in regards to the total deposits received by the institution is less than 0.8 to 1.2, as set by SBEF. First quality assets are made up by the direct portfolio category 1 and 2, cash, temporary investments, commodities, and permanent investments in securities that have a rating with investment grade.
 - e) When there has been repeated non-compliance with the written instructions and orders issued by the Superintendent.
 - f) If the intermediary has submitted false financial information or fake documents.
- > The Restructuring Plan should be submitted within ten days. The Restructuring Plan must include the necessary measures to correct the problems that originated the process, goals that can be verified, a detailed action chronogram, and a business or internal restructuring plan, if necessary.
- > To follow up the bank's actions, regulations specify the reports that must be submitted during the restructuring process.

The regulations specify that the regularization process will end, even if before the original timeframe, when the financial institution proves that it has overcome the issues that originated the process, or when the institution satisfactorily resolves the causes for being placed in receivership. Such causes include:

1. Cessation of payments due to non-payment of one or more liquid obligations payable on demand.
2. The loss of equal or more than 50 percent of the primary capital.
3. A shortage of more than 50 percent of the coefficient level of equity adequacy.
4. Non-submission or rejection of the restructuring plan.
5. If during the plan's execution, the financial intermediary carries out operations that clearly make it non-viable.
6. If upon the restructuring plan's maturity, the issues that originated the restructuring have not been sufficiently and satisfactorily met.

APPENDIX 9

Facts on financial systems and DIAs in participating countries

Country	DIA	Mandate	Staff	No. of Financial Institutions Insured by DIA	Total Deposits, in US\$bn (Dec-05)	Total Insured Deposits, in US\$bn	% of Total Deposits	Insurance Fund, in US\$ bn	% of Insured Deposits
United States	FDIC	Bank Supervisor, Insurance, Bank Resolution	4,514 (1)	8,832	7,141.0	3,892.6	55%	48.6	1.3%
Mexico	IPAB	Insurance, Bank Resolution (2)	520	28	184.8	130.4	71%		
Peru	FSD	Insurance, Bank Resolution	4	42	16.1	6.4	40%	0.11	1.7%
Argentina	SEDESA	Insurance, Bank Resolution		90	44.6			0.4	
Paraguay	FGD	Insurance, Bank Resolution	4	26	1.8	0.5	29%	0.012	2.3%
Guatemala	FOPA	Insurance, Bank Resolution	7	25	8.8	2.0	23%	0.200	10.0%
Bolivia	FRF (3)	Bank Resolution	0	51	3.7			0.035	0.9%

Note: A blank cell means no available information

Note (1): Distribution of FDIC Employees among Functional Lines

USA - FDIC: 4,514 employees as of year-end 2005.

a. Bank supervision - 2,788

b. Managing failed bank resolutions - 239

c. Managing the agency's deposit insurance activities - 20

d. Other (finance, IT, admin, legal, legislative affairs, public affairs, etc.) - 1,286

Note (2): IPAB's mandate includes the administration and liquidation of operations derived from banking rescue

Note (3): The Financial Restructuring Fund (FRF) is not a deposit insurance agency, but a mechanism to assist in resolution processes