*Empowering Deposit Insurance Entities to Face Challenges posed by an Emerging Financial Landscape – Global and Indian Experience**

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Mr. Hiroyuki Obata, Deputy Governor, Deposit Insurance Corporation of Japan (DICJ), Japan, Mr. Carlos Isoard, Secretary General, International Association of Deposit Insurers (IADI), Switzerland, Mr. Jerzy Pruski, President, Bank Guarantee Fund (BGF), Poland, Mr. Fred S. Carns, Director, Federal Deposit Insurance Corporation (FDIC), USA, Mr. G. Gopalakrishna, Executive Director, RBI, distinguished delegates, ladies and gentlemen. At the outset, on behalf of the Reserve Bank, I extend a hearty welcome to all of you to India and especially to this fascinating state of Rajasthan. We thank IADI for agreeing to hold this conference jointly with Deposit Insurance and Credit Guarantee Corporation (DICGC). As you are aware, DICGC entered its Golden Jubilee year on January 1, 2011. This event is being hosted as a part of the Golden Jubilee celebrations of DICGC and, hence, holds a special significance for us.

Global Financial Crisis and Deposit Insurance

2. Recent global financial crisis has revealed that financial systems around the world rely on safety nets to reduce the adverse impact of financial crisis as also to prevent the re-occurrence of the crisis. During the global crisis, uncertainty triggered panic reactions and collapse of banks. Under these circumstances, deposit insurance emerged as an important part of financial safety net in arresting panic reaction. Governments across the globe took measures such as raising the deposit insurance coverage limits, providing blanket guarantees, *etc.* These measures restored the public confidence in banking systems. Thus, the importance of deposit insurance as a tool for preventing and mitigating the impact of financial crises as also for the smooth running of financial systems and maintaining financial stability has been fully appreciated.

3. The global financial crisis, thus, evoked rethinking on the role of deposit insurance systems and broader safety net issues. It is now widely felt that the important safety nets such as deposit insurance systems should play a more pro-active role in regulatory frameworks for early identification of bank failures and their effective resolution. In order to enable the deposit insurance systems to play their roles more effectively, a need has been felt for redesigning the deposit insurance systems with, *inter alia*, an increased role in bank resolutions. When individual institutions fail, rather than let depositors be rescued solely by insurance cover, which is anyway not comprehensive for larger depositors, it is more effective to involve the insurer in the process right from the beginning. This will give depositors, as a stakeholder group, a voice in the process, allowing them to better protect their interests, while simultaneously increasing the capacity of the insurance scheme.

4. In the light of the above, I am happy to note that this Conference has been held on the theme 'Role of Deposit Insurance in Bank Resolution Framework – Lessons from the Crisis' which is very relevant, appropriate and timely. The experts from a number of countries have made presentations on significant sub-themes, *viz.*, critical elements in bank resolution framework, country experiences, regulators' responses and international best practices. Various aspects have been covered in this Conference such as elements of insolvency framework, cross-border insolvency

*Valedictory Address by Dr. K.C. Chakrabarty, Deputy Governor, the Reserve Bank at the International Conference on 'Role of Deposit Insurance in Bank Resolution Framework – Lessons from the Financial Crisis' delivered on November 15, 2011 at Jodhpur. Assistance provided by Dr. A. Raravikar in preparation of this address is gratefully acknowledged.

framework, role of deposit insurance in bank resolution, country experiences, crisis framework, regulatory reform (Basel III), deposit insurers' response to financial crisis, review of global practices with respect to resolution framework, key attributes for bank resolution and core principles for effective deposit insurance systems and challenges to assessment of safety net framework. Several thoughts, views and experiences have been shared and discussed in this Conference by the experts and delegates, along with prescriptions for policymakers. I would like to summarise these.

Key Deliberations at the Conference

5. In this Conference, global regulatory reforms were overviewed and their impact on Asia, especially on Asian banks, was analysed. There is a need to create a buffer of capital, improve liquidity risk management of banks, reduce their reliance on short-term wholesale funding, promote resilience through incentives for banks to fund activities with more stable sources of funding, perform the micro and macro stress testing, and create stronger capital base. The relationship between macro-prudential policy framework and deposit insurance was discussed. The issues covered a macro-prudential perspective by deposit insurers, their specific role in financial stability, funding arrangements, deposit insurance premium, coverage, and cross-border co-ordination of deposit insurance. USA's (FDIC) experience revealed the need to restore discipline in the marketplace, allowing the failure of large financial entities if they become non-viable, necessity of cross-border co-operation for their orderly liquidation, strong capital base of banks and enforcing objective capital standards by supervisors. Other country experiences showed the need for strengthening the legal and operative tools of deposit insurers, making banking resolution simulation exercises, and regular monitoring of systemic institutions.

6. According to some other presentations, deposit insurance should be the responsible resolution agency with financial accountability and core competencies. There should be contingency planning, collaboration of authorities, *ex post* funding scheme, consumer awareness, recovery and resolution plans, faster payouts, and regulatory reforms. Deposit insurer needs to have independence, quick responding ability, access to financial data, adequate funding, and legal protection. Key attributes of resolution regime were identified that would help the deposit insurers to meet their objectives. Concern was expressed on weakening of deposit insurance systems due to supervisory and regulatory lacunae, slow implementation of new measures, and apprehensions about increased moral hazards by governments.

7. FSB's work on resolution stressed the need for deposit insurers to be well-connected to all aspects of the resolution framework including information, tools, contingency planning, *etc.* In the context of cross-border insolvency, there should be a multi-pronged policy approach comprising increasing loss absorbency, strengthening the resolution regimes, market infrastructures and supervision. Discussions also hovered around addressing systemic risks, changing role and future directions for deposit insurers, their design features and organisational issues with implications for expanded resolution role. Finally, role of core principles was elaborated, along with assessment challenges.

8. The deliberations and discussions in this Conference have been fruitful and have certainly provided food for thought for the policymakers. I will now give you a snapshot of India's deposit insurance system, flag the issues in the context of the required further reforms and look at the way forward for the global deposit insurance systems.

India's Deposit Insurance System

9. In a country like India where there is a significant extent of financial exclusion and small depositors are worried about the safety of their funds, deposit insurance is critical for financial inclusion and plays the role of a catalyst therein. Deposit insurance also protects small depositors from strategic errors by management and wider systemic shocks. At the same time, other elements of financial safety-net framework including financial regulation/supervision also work towards promoting financial inclusion. It is surprising

that in India, there is inadequate awareness of the facility of deposit insurance. One reason for this could be that, in India, banks are perceived to be either too-big-to-fail or impossible to fail on account of the Government or the Reserve Bank backing. While this may be true for the public sector banks, it certainly does not hold good in the case of private sector banks, foreign banks operating in India and the large number of co-operative banks.

10. Let me give you a broad overview of the deposit insurance system in India. India's Deposit Insurance and Credit Guarantee Corporation (DICGC) was set up way back in 1962 as per the provisions of an Act of Parliament, *i.e.*, DICGC Act, 1961. It is the second oldest ongoing deposit insurance agency in the world. DICGC is a wholly-owned subsidiary of India's central bank, *viz.*, Reserve Bank of India. It is virtually a Pay-Box System as its role is limited to settlement of claims as per extant rules and regulations. Table 1 below would give you an idea of the magnitude of claim settlement operations of DICGC. DICGC's Mission is To contribute to financial stability by securing public confidence in the banking system through provision of deposit insurance, particularly for the benefit of the small depositors'. Its Vision is 'To be recognised as one of the most efficient and effective deposit insurance providers, responsive to the needs of its stakeholders'. All commercial banks and eligible co-operative banks are covered under deposit insurance. The number of banks registered with DICGC as on March 31, 2011 stood at 2,217. The insurance coverage is ₹ 0.1 million per depositor (about US$ 2,240). About 93 per cent of deposit accounts by number and 35 per cent of deposits by value are covered under insurance (Table 2). This coverage stands at 1.6 times India's per capita GDP as on March 31, 2011. The insurance premium is charged at a flat rate. It may be mentioned that the banking sector in India remained largely buffered from the recent global financial crisis and as such, post-global financial crisis, there is no change in the insurance coverage and the rate of premium.

Table 1: Bank Failures and Claims Paid by DICGC

Year	No. of Failed Banks*	Claims Paid (Amount in US$ million)
	1	2
2007-08	22	40
2008-09	30	45
2009-10	28	145
2010-11	28	89

* All the banks were urban co-operative banks. DICGC settles claims upon liquidation of a bank.

Table 2: Deposit Distribution *vis-à-vis* Insurance Coverage

Particulars	As at the end of 2010-11 (April-March)	
	Number of Accounts (in million)	Value (in ₹ billion)
	1	2
1 Deposits from ₹ 0 to ₹ 0.1 million	977	17,358 (389)
2 Deposits from ₹ 0.1 million to total	75	32,166 (720)
3 Aggregate Deposits	1,052	49,524 (1,109)

Notes: 1. Data in brackets are in US$ billion.
2. Maximum insurance coverage level is ₹ 0.1 million.

11. I would like to inform you that an Assessment Team comprising representatives of IADI and IMF visited DICGC in end-September 2010 to undertake a field test of the Draft Assessment Methodology for the Core Principles for Effective Deposit Insurance Systems. According to the Report of the team, DICGC is compliant or largely compliant with about half of the eighteen Core Principles for Effective Deposit Insurance Systems. In its 'paybox' function, the DICGC is fully or largely compliant on all core principles. However, weaknesses in the overall insolvency framework that are outside the control of the DICGC makes overall compliance with many core principles limited.

12. On the eve of its Golden Jubilee, DICGC has initiated measures to enhance public awareness on deposit insurance through printing of brochures and posters and communication to the insured banks to spread awareness by displaying information about DICGC in all bank branches. The Corporation is also trying to roll out depositor-centric tools such as Integrated Claims Management System (ICMS) for capturing more accurate and up-to-date information on deposits that would aid in faster settlement of claims.

Reforms in Deposit Insurance system

13. I now turn to the reforms required to be made in India's deposit insurance system and flag the issues

therein. First, the recent crisis has shown that deposit insurers should play a proactive role in regulatory frameworks for early identification of bank failures and their effective resolution with the aim of protecting their funds and maintaining public confidence. Therefore, it is necessary to broaden the mandate of DICGC from pay-box (to pay the claims of depositors to the extent and in the manner stipulated in the law) to attending all aspects of bank resolution, not only as part of the liquidation process, but in monitoring of banks, prompt corrective action and finding and implementing the least cost method of resolution of troubled banks. This would lead to faster settlement to depositors, lower costs and higher speed of resolution with associated benefits for the stability of the financial system. The ultimate way out is to put in place a clearly defined bank solvency regime and a properly designed resolution process. Second, the Reserve Bank should have powers to resolve a bank before insolvency. A special bank resolution legislation is needed to expand resolution powers. Also, a legislation is needed for appointment of temporary administrator. Third, for depositors of failed banks to maintain confidence in banking system, it is essential to provide depositors quick access to their funds. Therefore, DICGC needs to look into ways to expedite reimbursement to depositors. This requires technology upgradation, including the adoption of CBS by all urban co-operative banks (UCBs) and an effective interface between the DICGC and banks' Core Banking Solutions (CBS) to access depositor databases. Moreover, deposit insurers should be informed sufficiently in advance of the conditions under which a reimbursement may be required and be provided with access to depositor information in advance. Fourth, it is necessary to increase the coverage limit that has remained unchanged at ₹0.1 million since 1993. The increase in deposit insurance coverage has also been alluded to in the recent Damodaran Committee report on Customer Service. Fourth, due to the dual nature of control over co-operative banks and low level of technology deployed in these banks, there are delays in receiving information regarding depositors. Also, there are delays in appointment of liquidators. DICGC, currently, has little powers over liquidators to expedite the collection of information. The process can be expedited if liquidators provide the information within a shorter time-frame. Therefore, it will be beneficial to grant DICGC the power to appoint and monitor liquidators. Fifth, for maintaining depositor confidence, the deposit insurer should have sufficient funds available to fulfill its mandate. The financial position of DICGC needs to be strengthened with appropriate arrangements for back-up funding. About half of the premium income of DICGC, which is its main source of funds, is paid as income tax to Government. Since DICGC is a non-profit organisation serving social obligations of protection of small depositors, it should be exempted from payment of tax, as is done globally. The tax exemption would enable DICGC to build up its fund base and thereby provide higher coverage to depositors and even pass on the benefits to insured banks by reducing the rate of premium, after the desired reserve ratio is attained. Sixth, global crisis has shown that deposit insurer *does* need assistance from Government/central bank in case of any systemic crisis and the required amount is unpredictable. The back-up funding to DICGC from the Reserve Bank is a small amount (₹50 million). Therefore, it would be ideal if availability of back-up support can be made unlimited and with a quick approval process. Seventh, DICGC has been having a flat rate premium system. This could be replaced by a risk-based differential premium system. The latter would reduce moral hazard and bring greater fairness in the premium assessment process.

14. For redesigning India's deposit insurance system by making many of the requisite reforms as discussed above, it would be necessary to make thorough changes in the DICGC Act. A Working Group on Reforms in Deposit Insurance, including Amendments to DICGC Act has been set up by us which would be looking into these aspects.

Global Deposit Insurance Systems: Policy Issues and the Road Ahead

15. The session on 'Critical Elements in Bank Resolution Framework' presented, apart from elements on insolvency framework, the cross-border insolvency framework and role of deposit insurance in bank resolution. For prevention/insulation of an economy

from financial crisis, deposit insurance systems across the globe need to be a more integral part of the overall safety-net framework. In this context, there is a need to broaden the mandate of deposit insurers for effective resolution of banks of all sizes, as also to initiate preventive action and risk minimisation. It is also necessary to give powers to deposit insurers to fulfill their mandates. An effective bank resolution process with participation of deposit insurers would facilitate the ability of deposit insurers to meet their obligations, minimise resolution costs as well as disruption in markets, maximise recoveries on assets, reinforce discipline through legal actions and set up flexible mechanisms such as those facilitating bank acquisitions.

16. It is imperative to create an enabling national legal architecture for effective and timely functioning of the failure resolution framework, which would permit orderly liquidation of banks and timely payout and transfer of insured deposits. Deposit insurer should have effective resolution tools designed to help preserve critical bank functions, achieve transfer of accounts or assets/businesses and/or maintain continuity of banking services. It would be necessary to establish such resolution procedures which will allow flexibility for resolution at a lesser cost than otherwise likely during depositor reimbursement due to liquidation. It is essential to equip the deposit insurer with the powers to provide for transfer of insured deposits to stronger banks. Resolution procedures should clearly ensure that banks' shareholders take first losses. Deposit insurers should share in the proceeds of recoveries.

17. A framework needs to be in place for close co-ordination and information sharing (on routine basis as also regarding banks in financial difficulty) among the deposit insurer and other financial system safety-net participants. Such information should be accurate and timely. Regarding cross-border issues, while ensuring confidentiality, all relevant information should be exchanged between deposit insurers in different jurisdictions and possibly between deposit insurers and other foreign safety-net participants, when appropriate. Depositors in the jurisdictions affected by cross-border banking arrangements should be provided with information on deposit insurance system legally responsible for reimbursement and the limits and scope of coverage. Where a deposit insurer perceives a real risk that it may be required to protect depositors in another jurisdiction, it should have contingency planning that allows for cross-border arrangements or agreements.

18. With increasing global financial integration, consistency in the basic principles that guide deposit insurance is essential to maintaining a level playing field internationally. In this context, information exchange among deposit insurers gains importance. Today, there are a large and growing number of cross-border financial institutions functioning across multiple deposit insurance jurisdictions. There is a need for clarity regarding the obligation of each deposit insurer in respect of each cross-border institution. While the 'Core Principles for Effective Deposit Insurance Systems' state that the deposit insurance already provided by the home country system should be recognised in the determination of levies or premium, there is a need for a firm and shared understanding on this.

19. Sessions on country/regional experiences by US, Europe, Asia and Latin America show that there is a large diversity in the deposit insurance systems, legal frameworks, efficiency, mandates, economic and banking environments in these economies. My view is that diversity does not mean adversity. The deposit insurance systems across the globe should make earnest efforts to comply with IADI's Core Principles on Effective Deposit Insurance Systems. Core Principles outline the guiding framework for deposit insurance systems and incorporate inherent flexibility. Compliance to them does not forbid countries from making their own tailor-made systems. The presentations and discussions in this Conference on cross-country experiences would certainly help all of you to utilise this knowledge in attaining your goals.

20. The Session on Regulators' Response covered the Crisis Framework, Basel III – Global Perspective and Challenges to Implementation, and Deposit Insurers' Response to Financial Crisis. The regulator's policies/

actions should always be such that they facilitate the deposit insurer's job, which will ultimately help in preventing/curing the crisis as also attain financial stability and inclusion. Well-crafted regulatory reforms will always make the financial systems immune, adaptable and complementary to deposit insurers' aims and operations. Close and continuous co-ordination between the two is a *sine qua non.* As regards deposit insurer's response to financial crisis, I would like to say that a deposit insurer, in collaboration with the regulator, should develop an advanced sensory system for early detection of crisis and excellent contingency planning with adequate funds on demand so as to nip the crisis in the bud and safeguard depositors' interests. The adequacy of deposit insurance funds and the financial strength of deposit insurers to meet their obligations during financial crises requires specific attention in the light of the global events of the recent past.

21. The Session on Bank Resolution Framework – International Best Practices has covered global practices with respect to bank resolution, key attributes for bank resolution and Core Principles. These international best practices would act as good benchmarks for you. You would know what is best and where do you stand and then, accordingly, how far you have to march ahead and in which direction.

Conclusion

22. I conclude with an appeal to all of you to work upon your deposit insurance systems to make them ideal by creating an environment comprising good bank regulation and supervision, sound governance of safety net agencies, strong legal framework and strong accounting and disclosure regimes. Avoid moral hazards, have a specified mandate and necessary powers, build up sound governance, have appropriate interaction with other safety net participants, make banks' membership compulsory, build up strong and quick funding mechanisms, create public awareness and make the resolution process effective.

23. I am sure that this Conference has given you valuable inputs and the knowledge gained through the discussions on crucial aspects in this Conference will be utilised by all the delegates for attaining the best outcomes in their countries so as to make their safety nets and deposit insurance systems ideal and insulating their economies from any financial and systemic disturbances in future. My best wishes for all your endeavours.