

Form or construct available and suitable for a Deposit Insurance Scheme

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CONTENT

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II. Preconditions

III. Legal Regimes and Constructs

IV. Efforts in Mexico to strengthen its bank failure resolution scheme

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I. INTRODUCTION

- In different countries, adoption of deposit insurance may have resulted from a banking crisis, from privatization of state-owned institutions, or from other circumstances. These conditions generally had an important influence on the particular design features that were adopted.

II. PRECONDITIONS

- According to the *Core Principles for Effective Deposit Insurance Systems*, a deposit insurance system will be most effective if a number of external elements or preconditions are in place:

II. PRECONDITIONS

1. An ongoing assessment of the condition of the economy and banking system.
2. Sound governance of agencies comprising the financial system safety net.
3. Strong prudential regulation and supervision.
4. Well-developed accounting and disclosure regime and **legal framework.**

4.1. Well-developed legal framework

- Deposit insurance systems cannot be effective if relevant laws do not exist or if the legal regime is characterised by inconsistencies.
- There must be clarity of the roles and mandates of the relevant agencies.
- A well-developed legal framework should include a system of business laws, including: corporate, insolvency processes, contract, consumer protection, anti-corruption/fraud and private property laws.

Features to observe for a well-developed legal framework

- The legal system should have clear property rights.
- Laws should be in place under which the banking system and the deposit insurer can operate.
- Banking laws and regulations should be updated as necessary to ensure that they remain effective and relevant to a changing industry.
- A critical element of a sound legal regime is the ability to enforce laws.

Features to observe for a well-developed legal framework

- Information exchange between the deposit insurance system participants and the supervisor should be legally protected.
- A well-developed legal framework should consider the establishment of mechanisms for handling a bank failure that include a method for effective failure resolution in a timely manner (Special Resolution Regime), even if that authority does not lie specifically with the deposit insurer.

Special Resolution Regime

Three pillars of a Special Resolution Regime

The concrete design of bank insolvency regulations is always exposed to strong political influences. An efficient Special Resolution Regime is built on three pillars:

- Timely recognition of a looming illiquidity or insolvency;
- Timely initiation of preventive measures to secure existing assets and liquidity; and
- Timely exit or recapitalization of insolvent financial institutions.

Special Resolution Regime

An effective Resolution Regime must have a legal framework that includes the following:

- The resolution authority should have operational independence consistent with its statutory responsibilities, transparent processes, sound governance and adequate resources and be subject to rigorous evaluation and accountability mechanisms to assess the effectiveness of any resolution measures.
- The resolution authority and its staff should be protected against liability for actions taken and omissions made while discharging their duties in the exercise of resolution powers in good faith.

Special Resolution Regime

- Resolution authorities should have powers to do the following: i) operate and resolve the bank, including powers to terminate contracts, ii) override rights of shareholders of the bank in resolution; iii) transfer or sell assets and liabilities, notwithstanding any requirements for consent or novation that would otherwise apply.
- The resolution authority should have the capacity to exercise the resolution powers with the necessary speed and flexibility, subject to constitutionally protected legal remedies and due process.

Special Resolution Regime

- The legal framework governing set-off rights, contractual netting and collateralisation agreements and the segregation of client assets should be clear, transparent and enforceable during the resolution of banks, and should not hamper the effective implementation of resolution measures.

Special Resolution Regime

- The legislation establishing resolution regimes should not provide for judicial actions that could constrain the implementation of, or result in a reversal of, measures taken by resolution authorities acting within their legal powers and in good faith. Instead, it should provide for redress by awarding compensation, if justified.

Special Resolution Regime

Considering the powers described above, the following question arises: What should be the balance between the powers granted to the resolution authority to enable the efficiency and effectiveness of the resolution process while considering the detriment to the individual rights of shareholders and creditors, among others?

III. LEGAL REGIMES AND CONSTRUCTS

- The basic aim of a deposit insurance scheme is to strengthen the stability of the financial system by preventing runs on banks (preventive effect) and securing deposits up to a specified amount (curative effect).
- On the basis of the fundamental functions attributed to the deposit insurance scheme, it is possible to differentiate between four separate types of deposit insurance schemes, which differ with regard to their roles and powers, and also in their fundamental design.

III. LEGAL REGIMES AND CONSTRUCTS

- *The 'pay box' mandate*: the role of the deposit insurance institution is limited to the paying out of insured deposits.*

*22 participants in the 2010 IADI Annual Survey: Albania, Estonia, Hungary, Slovakia, Slovenia, Cyprus, Czech Republic, Isle of Man, Kenya, Moldova, Paraguay, Sweden, Trinidad and Tobago, Ukraine, Canada/Quebec, Gibraltar, Hong Kong, India, Republic of Armenia, Uruguay, Switzerland, The Netherlands).

III. LEGAL REGIMES AND CONSTRUCTS

- *The 'pay box plus' mandate, where the deposit insurer has additional responsibilities such as some specific resolution functions*.*

*Japan, Kazakhstan, Poland, Nicaragua, Bulgaria, El Salvador, Jamaica, Jordan, Korea, Philippines, Republic of Lithuania, Russian Federation, Serbia, Thailand, United Kingdom, Peru and Romania.

III. LEGAL REGIMES AND CONSTRUCTS

- The '*loss minimiser*' mandate: In addition to the settlement function, in this model the deposit insurance institution actively engages in the selection from a full suite of appropriate least-cost resolution strategies.
- The '*risk minimiser*' mandate: where the insurer has comprehensive risk minimization functions that include a full suite of resolution powers as well as prudential oversight responsibilities*.

*Germany, Australia, Bahamas, Bangladesh, Barbados, Canada, Chinese Taipei, Malaysia, Nigeria, United States, Canada/Nova Scotia, Canada/Saskatchewan and Norway).

Organizational Structures

- According to the 2010 IADI Annual Survey, the DISs of 34 participants are operated by a legally separate autonomous entity defined in law, while 11 systems are established within the central bank/supervisor. (Albania, Slovenia, Australia, Bahamas, Bangladesh, Cyprus, Kenya, Paraguay, India, Peru, and The Netherlands).
- Most of the DISs (31) are government legislated and administered. 15 jurisdictions are classified as under private administration (Canada/Nova Scotia, Canada/Prince Edward Island), Canada/Quebec, Canada/Saskatchewan, France, Germany, Gibraltar, Guernsey, Hong Kong, India, Indonesia, Norway, Peru, Republic of Armenia, Romania, Uruguay, Switzerland).

IV. EFFORTS IN MEXICO TO STRENGTHEN ITS BANK FAILURE RESOLUTION SCHEME

- Financial authorities have designed a comprehensive scheme (which is composed of three successive stages), a system of prompt corrective actions, the resolution process and a bank bankruptcy law. We have completed the first two.

“Prompt Corrective Actions”

- The first stage (2004), consists of the regime known as “Prompt Corrective Actions” which empowers the National Banking and Securities Commission (CNBV) to classify banks in different categories based on their capitalization ratio.
- This stage also established minimum corrective measures that the CNBV shall apply to institutions depending on the category in which they were classified, as well as other additional special measures.

"Banking Resolution Regime"

- The second stage (2006), clearly defines the role of financial authorities and the various processes and methods of resolution in cases where an institution's finances are deteriorated.
- We established with precision the actions to be carried out by financial authorities to be in a position to complete the resolution of a bank at the lowest cost and within a limited period.
- This scheme considers that the institution still has positive capital levels.

“Banking Liquidation”

- Mexican financial authorities are currently working on a Reform for Banking Liquidation.
- Therefore, work is underway to generate an amendment proposal for a liquidation applicable to banking institutions, that will allow a more efficient and expedited recovery of its assets, as well as to achieve an immediate depositor reimbursement process.

V. CONCLUDING REMARKS

- In many cases the establishment of a deposit insurance system is the beginning of an evolutionary process.
- Insufficient implementation of the preconditions can have a direct effect on the deposit insurer's ability to fulfil its mandate.

V. CONCLUDING REMARKS

- The legal constitution arrangements in the deposit insurance scheme structure are important safeguards for maintaining the operational independence of deposit insurers and fending off undue political and industry influence.
- In the absence of adequate checks-and-balances, such an arrangement may not be conducive to the fulfillment of the public policy objectives of the DIS.

V. CONCLUDING REMARKS

- A well-developed legal framework should include a system of business laws, including: corporate, insolvency processes, contract, consumer protection, anti-corruption/fraud and private property laws.
- The legal framework must enable the deposit insurance system to compel member banks to comply with their obligations to the deposit insurer.

V. CONCLUDING REMARKS

- A well-developed legal framework should consider the establishment of mechanisms for handling a bank failure that includes a method for effective failure resolution in a timely manner.
- The resolution authority and its staff should be protected against liability for actions taken and omissions made while discharging their duties in the exercise of its mandate in good faith.

V. CONCLUDING REMARKS

- The legislation establishing resolution regimes should not provide for judicial actions that could constrain the implementation of, or result in a reversal of, measures taken by resolution authorities acting within their legal powers and in good faith. Instead, it should provide for redress by awarding compensation, if justified.

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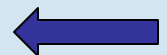


1. Ongoing assessment of economy and banking system

- To be effective, policymakers should seek to ensure that the deposit insurance system is instituted, consistent with both the country's economic and institutional settings and aligned with the public-policy objectives they are attempting to achieve.

1.1. Sound banking system

- In looking at the financial system, the issue is not just whether there are unsound institutions in the system but whether the banking system in its entirety is sound.

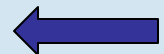


2. Sound governance of agencies comprising the financial safety-net

- The sound governance of agencies comprising the safety-net strengthens the financial system's architecture and contributes directly to financial system stability.
- The four major elements comprising sound governance are: operational independence, accountability, transparency and disclosure, and integrity.

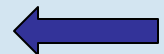
3. Strong prudential regulation and supervision

- The supervisory authority should have an effective licensing or chartering regime for new banks, conduct regular and thorough examinations of individual banks and have a framework that includes early detection and timely intervention.



4. Sound accounting and disclosure regime

- Sound accounting and disclosure regimes are necessary for an effective deposit insurance system. Accurate, reliable and timely information provided by these regimes can be used by management, depositors, the marketplace, and authorities to make decisions regarding the risk profile of a bank, and thereby increase market, regulatory and supervisory discipline.



Governance Structure and Legal Protection Framework of IADI Members

*IADI Executive Training Seminar
Seoul, Korea
November 13, 2012*

**Min Ho CHOI
General Manager
Korea Deposit Insurance Corporation**



Agenda

- 1. Concept of Governance & Legal Protection**
- 2. Importance of Ex-Ante Legislation**
- 3. Cases for Operational Independence & Insulatedness**
- 4. Cases for Transparency & Accountability**
- 5. Cases on Legal Protection**
- 6. Suggested Legal Protection Clauses**

1. Concept of Governance and Legal Protection

- **Concept of Governance**

- The processes, structures and information used in directing and overseeing the management of the deposit insurer.

- **Sound governance**

- enhances effectiveness in performance and strengthens the financial system's architecture and contributes directly to system stability
 - A sound governing body should be transparent, accountable, operationally independent, and insulated from undue political and industry influence (CP 5)

1. Concept of Governance and Legal Protection

- **Concept of Legal Protection**

- The governing body members, senior officers, and employees of a deposit insurance system should be provided with legal protection for decisions made, omissions, and actions taken in good faith while discharging the mandate of the deposit insurance system. (CP 13)

1. Concept of Governance and Legal Protection

- **Relationship between Governance and Legal Protection**

- The governing body members, senior officers, and employees should remain accountable in order to be eligible for legal protection.

Governance and legal protection are in a sense two sides of the same coin.

2. Importance of Ex-Ante Legislation

- **Ex-ante definitive legislation on governance and legal protection is vital in view of predictability by financial consumers.**
 - Explicitly written statutes get financial consumers ready to clearly predict and initiatively manage their problems during various situations.
 - Current deposit insurance laws need to be more refined, advanced, and detailed to provide financial consumers with more accurate programs and signal on their financial life.

2. Importance of Ex-Ante Legislation

- **Caution on excessive legislation**

- Excessive legislation can also be harmful

- » Interfering with citizens' privacy,
 - » Decreasing flexibility,
 - » Hindering smooth operation of deposit insurance system
 - » And retarding swift action against any urgent accidents

3. Cases for Operational Independence and Insulatedness

(1) Presence of an Independent Law

—The presence of an independent deposit insurance law in itself can be a symbol of operational independence of the deposit insurer and its insulatedness from undue political and industry Influence.

—If articles on deposit insurance are consolidated into another law(e.g. banking law), financial consumers' access to the articles on deposit insurance can be limited.

—So it's desirable to separate deposit insurance articles into an independent law.

3. Cases for Operational Independence and Insulatedness

(2) Composition of the Governing Body

—Clear stipulation on composition of the governing body is the first step toward operational independence of any deposit insurer and its insulatedness from undue political and industry influence

a. Number of members

—Large variance exists in the size of governing bodies, from 5 members (Albania, Bosnia & Herzegovina, Bulgaria, the Philippines and the US) to 13 members (Japan, the U.K.).

3. Cases for Operational Independence and Insulatedness

B. Higher authority that determines the governing body's composition

- President : Korea, Nigeria, the U.S.
- Government : the Russian Federation
- Legislature : Japan
- Cabinet or Prime Minister : Bulgaria, Canada, Thailand, Turkey, Ukraine, Vietnam
- Minister, and/or Governor of the central bank : Albania, Azerbaijan, Bosnia & Herzegovina, Hungary, India, Jamaica, Jordan, Malaysia, Philippines, Poland, Serbia, the UK, Zimbabwe

3. Cases for Operational Independence and Insulatedness

C. Representatives (ex-officio members) from the higher authority

- can be helpful for coordination and/or cooperation between the deposit insurer and the higher authority.
- But, they are not allowed to be chairman (to protect operation of the deposit insurer against bad influence from higher authority).
- Exceptions : DICGC of India (Governor of the Reserve Bank serves as ex-officio Chairman), JODIC of Jordan (Secretary of Finance serves as ex-officio Chairman)

3. Cases for Operational Independence and Insulatedness

(3) Terms

a. Variance

- 1 year (Hungary, Japan) to 6 years (the Philippines, Serbia, Turkey)

b. Renewal

- No limit (Bulgaria, Japan, Jordan, Korea, Malaysia, Serbia)
- 1 time renewal allowed (Azerbaijan, Bosnia & Herzegovina, India, Ukraine)
- 2 time renewal allowed (Jamaica, Thailand)
- No renewal allowed (the Philippines, Turkey)

4. Cases for Transparency and Accountability

(1) Ineligibility for Other Offices

- **Purpose of the 'Ineligibility for other offices'**
 - For transparent and accountable functioning, directors should avoid conflict of interest between the deposit insurer and its stakeholders.
- **Duration of Ineligibility**
 - Mostly effective during the time a director is in office
 - In the Philippines, ineligibility is extended by one year after the termination of a director's service
 - In Jordan and the U.S., ineligibility is extended by two years after the termination of a director's service

4. Cases for Transparency and Accountability

(2) Decision-making Process

- **Purpose of stipulation on the decision-making process**
 - Decision making processes should be systemically constructed and disclosed in advance for transparent and accountable functioning of deposit insurers.
- **Request of meeting**
 - In addition to periodic meetings, most governing body meetings are also to be held at the request of the chairman or a quarter of members.
- **Quorum**
 - In most cases, more than half members constitute a quorum for making resolutions.

4. Cases for Transparency and Accountability

(3) Qualification

- **Good qualification for governing body membership is essential for transparent and accountable operation of deposit insurers.**

Example

“The chairperson and members of the Fund council have to meet all of the following conditions : 1) possess full capacity to perform acts in law; 2) have higher education diploma; 3) no record of conviction for international offence or fiscal offence; 4) possess knowledge and expertise in the scope of banking.”(Article 6.2 of Bank Guarantee Fund Act of Poland)

5. Cases on Legal Protection

(1) General Legal Principles on 'Negligence' and 'Good Faith'

- In general, 'negligence' alone can be the basis for compensation in civil litigations.
- However, because so many uncertainties are inherent in a deposit insurer's mandates, especially financial resolution, that undifferentiated application of the 'negligence' principle can weaken its competence.
- Hence, we come to need another principle to ensure equity in case there are too strict rules on negligence.

5. Cases on Legal Protection

(1) General Legal Principles on 'Negligence' and 'Good Faith' (Cont'd)

'Good Faith' Rule

All the persons (directors, officers, employees, etc.) of deposit insurers should be provided with legal protection for their decisions, omissions, and actions while discharging the mandate of the deposit insurance system, if they are taken in good faith (without 'heavy negligence').

5. Cases on Legal Protection

(2) Legislation Cases for Legal Protection

- Currently, legislation on legal protection looks pretty underdeveloped,
- with only 5 cases (Albania, Bosnia & Herzegovina, Canada, Jamaica and the U.S.) found out of 22 deposit insurance laws surveyed.

6. Suggested Legal Protection Clauses (principles and exceptions)

(1) Suggested Legal Protection Clauses principles

The directors, officers, and employees et al., who did their basic duties during functioning, shall be exempted from their liabilities in case of meeting the following prerequisites.

- **[Public benefit]** The purpose of the business shall be to enhance national or other public welfare and those directors, officers, employees et al., involved shall not have chased personal profit for themselves or other particular individuals.

6. Suggested Legal Protection Clauses (principles and exceptions)

(1) Suggested Legal Protection Clauses

principles (Cont'd)

- [Justification]** The business shall be necessary and justified from every perspective of the deposit insurer's goals, legal requirements, government policies and public good.
- [Transparency]** The business shall be done transparently through detailed documentation as to the purpose, contents and process of the decision-making (Provided, That, this prerequisite can be eased if the situation is so urgent that public good can be damaged by the normal process).

6. Suggested Legal Protection Clauses (principles and exceptions)

(2) Suggested Legal Protection Clauses

Exceptions

The directors, officers, employees etc. shall not be exempted from their liabilities in case they fail to do their basic duties, or in any of the following cases:

6. Suggested Legal Protection Clauses (principles and exceptions)

(2) Suggested Legal Protection Clauses

Exceptions (Cont'd)

- Bad faith, or heavy negligence by the directors, officers, employees etc.
- Infringement on the essential part of laws or internal regulations due to arbitrary interpretation or enforcement thereof by the directors, officers, employees etc.
- Acceptance of an illegal or improper complaint and provision of special favor by the directors, officers, employees etc.
- Other illegal or improper deeds similar to the above-mentioned deeds by the directors, officers, employees etc.

**Thank you for your kind
attention**

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DEPOSIT INSURANCE SYSTEM'S ROLE IN POLICY AND RULE MAKING

2012 IADI EXECUTIVE TRAINING SEMINAR
Seoul, Korea November 13-15, 2012

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OUTLINE

- Introduction
- What is the role of the DIS
 - in setting coverage limits
 - in determining eligibility criteria
- Legal basis for assessments (assessment rate and assessment base) and authority to borrow
- DIS role in consumer awareness
- DIS role in advancement of financial inclusion and innovation

INTRODUCTION

- Core Principle #1
 - specify appropriate public policy objectives
 - formally specify and integrate them into the design of the deposit insurance system
 - recognize that the principal objectives for deposit insurance systems are to contribute to the stability of the financial system and protect depositors
- Core Principle #3 – DIS mandate should reflect public policy objectives
- Core Principle #4 – DIS powers support achievement of mandate and objectives

Collaborate with policy/rule maker

- Regular reporting to the Minister/Parliament
- Board of Directors composition
- Interagency Committees
- Establishing relevance
- International standards

Take small, incremental steps – DI's are creatures of crisis, crisis drives mandates and mandates may widen with each crisis

What is the role of the DIS in setting the limits (if any) for deposit insurance coverage and what considerations come into play in setting such limits?

What is, or could be, the role of the DIS in determining eligibility criteria?

Role of DIS in setting limits/eligibility criteria

- Role of DIS and other financial safety net agencies in policy making
- IADI Core Principle 5 – DIS should be:
 - Operationally independent
 - Transparent
 - Accountable
 - Insulated from undue political and industry influence
- Information-sharing framework is key

Role of DIS in setting limits/ eligibility criteria (cont'd)

- Canada: Key safety net participants:
 - **Bank of Canada**
 - *monetary policy, payments systems, lender of last resort*
 - **Financial Consumer Agency of Canada**
 - *consumer protection/education*
 - **Ministry of Finance**
 - *financial sector policy development/legislation*
 - **Office of the Superintendent of Financial Institutions**
 - *prudential regulation and supervision*
 - **Canada Deposit Insurance Corporation**
 - *deposit insurance and resolution*

Drivers: coverage limit/ eligibility criteria

- Drivers for setting/changing coverage limit and eligibility criteria:
 - Financial crisis
 - Financial stability
 - Public opinion
 - Evolving international practices

Considerations: limits and eligibility criteria

- Striking balance between depositor protection/financial stability and market discipline
 - ↑ coverage = ↑ moral hazard
 - IADI Core Principles 9 and 10
 - » Coverage should be limited but credible (no incentive to run)
 - » But significant portion should remain uncovered and exposed to market discipline

Considerations: limits and eligibility criteria (cont'd)

- Policy objective
 - who and what products to protect?
- Public awareness/communication
 - broader coverage = simpler to understand
 - level of coverage should be “capable of being quickly determined” (Core Principle 9)
- Ability to adapt (e.g. new products)
- Financial inclusion

Considerations: limits and eligibility criteria (cont'd)

- Ability to stack = ↑ coverage
- Uniformity: different coverage for different DTIs
 - Creates competitive distortions/confusion
- Funding (IADI Core Principle 11)
 - Available funding or mechanisms to protect depositors
 - Who pays
 - *Ex-ante* vs. *ex-post* funding
 - Target range/size of fund

- Legal basis for assessments of individual institutions, and the amount of flexibility, if any, provided by the legal regime to the DIS in setting the assessment rate and assessment base.
- What authority to borrow, if any, would be considered?

IADI Core Principle #11

- DIS should have available all funding mechanisms necessary to ensure prompt reimbursement including supplementary back-up funding for liquidity purposes
- Banks should ultimately pay the cost of deposit insurance
- If differential premiums systems are used, system should be transparent and appropriate resources must be in place.

CDIC experience

- 1967
 - \$10 million capitalization
 - Authority to borrow up to \$500 million from CRF
 - Authority to assess and collect premiums
- CDIC objects: [paybox] provide deposit insurance against loss by making payment, and accumulate, manage and invest a fund.

1983–1999: CDIC Act evolves

- Borrowing authority moves with failures
 - 1983 - \$1.5 billion
 - 1987 - \$3 billion
 - 1992 - \$6 billion
- Premium rates from low of 3.33 bp of insured deposits to 16.67 bp
- Objects by 1987: contribute to financial stability and minimize exposure to loss
- By 1999: debt retired and differential premiums introduced

Today's CDIC Act

- Borrow from markets as well as CRF
- Aggregate borrowings increased in 2009 to \$15 billion and formula introduced for increases
 - borrowing levels increases in lockstep with insured deposits (\$18 billion in 2011)
- Maximum premiums chargeable at 33 bp of insured deposits

Assessment Base

Insured Deposits

VS

Total Deposits

VS

Other

(e.g. assets less tangible equity)

Other assessment tools

- Cost recovery
 - Directives
 - Special and preparatory examinations
- Premium surcharge
- Penalties for non-compliance
- Incentives
- Minimum premium

BUILD IN FLEXIBILITY

The role of DIS in Consumer Awareness

Overview

- Role of DIS in Consumer Awareness?
- Should legal requirements be imposed on member institutions to carry out this awareness?

The role of DIS in Consumer Awareness

IADI's Core Principles

Principle 12:

"In order for a deposit insurance system to be effective, it is essential that the public be informed on an on-going basis about the benefits and limitations of the deposit insurance system"

The role of DIS in Consumer Awareness

Principle 12 – Key Underpinning Elements:

- Onus is primarily with the deposit insurer
- Depositor Awareness is an ongoing commitment

The role of DIS in Consumer Awareness

Highlights from CDIC's Experience

- Depositor Awareness Programs spearheaded by CDIC
- Some shared but limited responsibility with member institutions
- Long-term Public Awareness Campaign and Strategies since 1989

The role of DIS in Consumer Awareness

Principle 12 – key underpinning elements:

- Target Audiences
- Measurable Objectives
 - Awareness of DIS
 - Awareness of the coverage limit
 - Awareness of what is and isn't covered

The role of DIS in Consumer Awareness

Principle 12 – key underpinning elements:

- Wide variety of tools and channels
- Budget ...

... Longer-term commitment!

The role of DIS in Consumer Awareness

Principle 12 – key underpinning elements:

- Information to be communicated:
 - what's covered, what's not
 - member institutions
 - coverage limits
 - reimbursement process
- Emergency plans

Should legal requirements be imposed on members to carry out Consumer Awareness

IADI essential criterion #5: DIS “works closely with member banks”

Advantages:

- Maximizes awareness
- Ensures consistency of information

Disadvantages:

- Burden/cost to banks

Should legal requirements be imposed on members to carry out Consumer Awareness

CDIC Deposit Insurance Information By-law

- *Display CDIC membership decal/sign*
- *Display CDIC "Protecting Your Deposits" brochure*
- *Negative stamping of products not covered by CDIC and warning re mutual funds*
- *Restrictions around representations about insured deposits and status as member institution*

What are the legal concerns for the DIS in advancing financial inclusion and innovation?

Why are DIS interested in financial inclusion?

- Priority of G20 targeted in 2009
- 2010 Global Partnership for Financial Inclusion (GPIFI) launched to:
 - facilitate an efficient and effective information-sharing mechanism;
 - coordinate the various financial inclusion efforts;
 - provide systematic monitoring of progress over time;
 - mobilize financial support for activities as needed; and
 - launch and coordinate taskforces to address specific financial inclusion issues

GPII identified 9 key principles for success

- leadership;
- diversity of approaches;
- innovation;
- consumers protection;
- empowerment of consumers;
- cooperation of all actors;
- knowledge sharing;
- proportionality between risks and regulatory solutions; and
- a flexible, inclusive regulatory framework.

IADI implicated as relevant standard-setting body (SSB)

- To integrate financial inclusion into standards and guidance that can be effectively applied at the country level
- A **white paper** raising awareness and framing issues proposed a framework of three linked themes for the SSBs to consider
 - risks carried by financial exclusion;
 - changing nature and level of risk entailed by increased inclusion;
 - importance of considering country context.

Key Financial Inclusion Issues

- IADI is a voluntary association
- IADI is one part of a comprehensive financial safety net
- IADI's focus (and that of the Core Principles) is on banks and existing depositors
- Capacity of supervision
- Membership in deposit insurance systems
- Funding of deposit insurance systems
- Innovative "deposit-like" products
- Public awareness

Some next steps?

- Flexibility in legislation
 - Rules-based vs principles-based
- Keep policy makers / rule makers aware of potential DIS contribution / concerns
- Keep abreast of innovative delivery channels / products to ensure definition of deposit captures or excludes
- Focus on awareness and building trust in the system

QUESTIONS?

Canada Deposit Insurance Corporation

www.cdic.ca

DEPOSIT INSURANCE SCHEMES: A WELL DEVELOPED LEGAL FRAMEWORK AND SELECTED LEGAL ISSUES

13 – 15 NOVEMBER 2012

**EARLY DETECTION, TIMELY INTERVENTION,
AND ACCESS TO INFORMATION**

Alex Kuczynski

Director of Corporate Affairs, FSCS (UK)



OVERARCHING OBJECTIVES

- Understand the components of well developed structure
- Legal and insolvency framework
- Application of the mandate – when obliged to act
- Exercise of powers – when able to act
- Sound basis for decision making – evidence based
- Key questions and risks of challenge

KEY REFERENCES

- Core Principles for Effective Deposit Insurance Systems (June 2009)
- Handbook for the Assessment of Compliance with the Core Principles for Effective Deposit Insurance Systems (April 2011)
- FSB Key Attributes of Effective Resolution Regimes for Financial Institutions (November 2011)
- FSB Thematic Review on Deposit Insurance Systems (Peer Review Report) (February 2012)
- IADI Discussion Paper (draft, 10 January 2012)

CORE PRINCIPLES FOR EFFECTIVE DEPOSIT INSURANCE SYSTEMS

- Core Principle 15 – Early Detection and Timely Intervention and Resolution
- The deposit insurer should be part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks. The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well defined criteria by safety net participants with the operational independence and power to act.

HANDBOOK FOR THE ASSESSMENT OF COMPLIANCE WITH THE CORE PRINCIPLES FOR EFFECTIVE DEPOSIT INSURANCE SYSTEMS (1)

- Pre-Conditions
- Essential Criteria
 1. The deposit insurer is part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks (failure resolution framework).
 2. The failure resolution framework is established by law or regulation, and is effective at the early detection and timely intervention and resolution of troubled banks. The failure resolution framework is insulated against legal actions that aim at the reversal of early and timely decisions related to corrective procedures, interventions and resolutions of troubled banks.

HANDBOOK FOR THE ASSESSMENT OF COMPLIANCE WITH THE CORE PRINCIPLES FOR EFFECTIVE DEPOSIT INSURANCE SYSTEMS (2)

3. The safety-net participants have the operational independence and power to perform their respective roles in the failure resolution framework and a clearly defined early intervention mechanism exists (including resolution tools) to ensure that appropriate action is taken (to allow the orderly resolution of a troubled bank) by the responsible party without delay.
4. The failure resolution framework includes a set of criteria that are used to identify banks that are or are expected to be in serious financial difficulty and are used as a basis to initiate some form of early intervention or corrective action to reduce the likelihood that a resolution would be necessary. Such action should minimize losses to the deposit insurance fund.

HANDBOOK FOR THE ASSESSMENT OF COMPLIANCE WITH THE CORE PRINCIPLES FOR EFFECTIVE DEPOSIT INSURANCE SYSTEMS (3)

4. (Cont'd)

(a) The criteria are clearly defined in law or regulation and are well understood by banks and their shareholders; and

(b) The criteria will be country specific and may reflect concerns about a bank's capital, liquidity, and asset quality, among other factors.

- Additional Criteria

1. A mechanism exists to review decisions taken with respect to the early detection and timely intervention and resolution of troubled banks.

KEY ISSUES - COMMENTARY

- Early detection – and integration into safety net
- Timely decision to intervene
- Access to information is a tool (not a goal)
- Risk of legal action to halt (or reverse) decisions
- Effective resolution options (Annex 1)

MANDATES OF DEPOSIT INSURANCE SYSTEMS (1)

- FSB Thematic Review on Deposit Insurance Systems
- 4 categories:
 1. Narrow mandate systems that are only responsible for the reimbursement of insured deposits (“paybox” mandate) [Australia, Germany, Hong Kong, India, Netherlands, Singapore, Switzerland].
 2. A “paybox plus” mandate, where the deposit insurer has additional responsibilities such as resolution functions [Argentina, Brazil, United Kingdom]

MANDATES OF DEPOSIT INSURANCE SYSTEMS (2)

3. A “loss minimiser” mandate, where the insurer actively engages in the selection from a full suite of appropriate least-cost resolution strategies [Canada, France, Indonesia, Italy, Japan, Mexico, Russia, Spain, Turkey].
4. A “risk minimiser” mandate, where the insurer has comprehensive risk minimisation functions that include a full suite of resolution powers as well as prudential oversight responsibilities [Korea, United States]

IADI (DRAFT) DISCUSSION PAPER: EARLY DETECTION AND TIMELY INTERVENTION FOR DEPOSIT INSURANCE SYSTEMS (10 JANUARY 2012)

- 32 countries responded
- [8/32] have powers of early detection
- [10/32] can initiate corrective/intervention action
- [24/32] have direct access to data (50% by legal right)
- Split into 2 categories:
 - Paybox/paybox plus: Albania, Azerbaijan, Bahamas, Barbados, Brazil, Bulgaria, Columbia, Guatemala, Germany, Hungary, Italy, Jordan, Kenya, Philippines, Poland, Singapore, Thailand, Turkey (?), United Kingdom, Ukraine, Uruguay.
 - Loss/risk minimiser: Canada, Germany (?), Kazakhstan, Korea, Malaysia, Mexico, Nigeria, Quebec, Russia, Taiwan, USA

OBJECTIVES OF DETECTION AND INTERVENTION

- Financial stability and market confidence
- Depositor/consumer protection
- Payout and/or continuity options
- Preserve (and secure) franchise value
- Resource planning and preparation
- Minimise costs to DIS (and taxpayer)

REQUIREMENTS FOR EARLY DETECTION AND TIMELY INTERVENTION

- Access to information!
 - to plan/prepare intervention and assist decision making
 - must be unimpeded
- Clear mandate [Core Principle 3 – Mandate] [Key Attribute 2]
 - to know and understand role and objectives
- Established legal framework
 - to set out powers of intervention/action
- Clear role in safety net [Core principle 6 – Relationships with other safety net participants]
 - to know and understand (and agree) others' roles and objectives
- Independent decision making [Core Principle 5: Governance]
 - to make legally robust decisions (free from undue political or supervisory influence)

"PAYBOX"/"PAYBOX PLUS"

- Regulator/other responsible for early detection
- Contingency planning and preparation
- External "trigger" or own assessment
 - Regulator's determination
 - Court order
 - Deposit Guarantee Schemes Directive [determination of the competent authority or ruling of judicial authority which suspends depositors' ability to make claims]
- Access to data

PAYBOX/PAYBOX PLUS – EARLY DETECTION

- Role of paybox – clearly stated payout (and other) powers
 - Legislation
- Relationships with other players in the safety net
 - Memorandum of Understanding
 - developed roles and expectations
 - Contingency planning and simulations
 - tested relationships in crisis scenario
 - development of resolution options

PAYBOX/PAYBOX PLUS - TRIGGER

- Regulatory determination
 - clear decision
 - expected format and reasons
 - immediately effective
 - public
- Court Order
 - declaration of inability to pay
 - appointment of insolvency practitioner/process
 - immediately effective
 - public
- Own assessment
 - “unable or likely to be unable to pay”

PAYBOX/PAYBOX PLUS – ACCESS TO DATA

- Critical to deliver for payout
- “Single Customer view” file – key depositor information
 - identity, address, balance due etc
- Early access
 - to test (and cleanse) data
- Right of access
 - direct?
 - via regulator – discretionary?
- Receipt and retention of data
 - Data protection laws
 - Data security (and destruction)

“PAYBOX/PAYBOX PLUS” – LEGAL RISKS AND MITIGATION

- No right to early warning – risk of regulatory oversight/forbearance
 - legal right to supervisory reports
 - use of risk based funding/assessments supported by data
 - “watch list” reports
 - Memorandum of Understanding
- Ineffective “trigger” decision
 - clear legal test
 - automatic and immediate effect – and public
 - prior assessment of options
 - notice (and attendance) at Court hearing
- No right to data
 - Supervisor to supply (on request/or on demand)
 - joint/coordinated access
 - confidentiality
 - secure transmission and retention

LOSS/RISK MINIMISER

- Responsible for detection
 - needs to be early
- Responsible for intervention/resolution
 - needs to be timely and effective
 - needs to be progressive
- Supervisors role?
 - Recovery and Resolution Plans
- Independent status/decision making of DGS
 - range/mix of objectives
- Access to data

LOSS/RISK MINIMISER – EARLY DETECTION

- Access to information [Key Attribute 12]
 - Direct right of access (whether supervisor or not)
 - Constant and transparent
 - Comprehensive: assets/trading and profitability/capital/liquidity/management/risk/counterparties etc
 - CAMELS ratings (FDIC/USA); PATROL (Italy), ORAP (France)
 - Sequence and range of early warning indicators
 - For detection AND intervention/resolution
- Powers to examine/direct management
- Early
 - Fixed (90 days)? (FDIC/USA – prompt corrective action c.2% capital)
 - Address risk of regulatory forbearance
 - Flexible period (breach of threshold conditions)

LOSS/RISK MINIMISER – TIMELY INTERVENTION

- Progressive intervention/range of measures (informal and formal)
 - management direction/oversight
 - recovery plans
 - resolution/insolvency (including Purchase and Assumption, Bridge Bank etc)
- Objectives (e.g. UK Banking Act 2009)
 - clear purpose and discretion to intervention

LOSS/RISK MINIMISER – RISKS AND MITIGATIONS

- If not supervisor, how to ensure access to all relevant data “without impediment”
 - statutory rights to demand access/disclosure
 - MoU with supervisor (e.g. CDIC/OFSI MoU)
 - adequate “gateway” for disclosure of confidential information – and ability to share within the safety net
- No fixed/qualitative trigger
 - exercise of judgement/discretion – need both guidance and clear evidence and sound reasons – and range of factors
 - independent decision making and governance
- Fixed quantitative trigger
 - clear formula – and undisputable data/evidence
 - potentially too early or too late if formula inflexible or too narrow (so need range of indicators)

KEY QUESTIONS FOR LEGAL ADVISERS – ACCESS TO INFORMATION

- Does the DIS have power to access information?
- Does the DIS have a clear gateway to receive (and retain) information?
- Is information clearly or widely defined?
- What other information is required?
 - macro level indicators
 - market based assessments
- Memorandum of Understanding – OSFI/CDIC (Canada)
 - 4 Stages: CDIC examination to preparation to voluntary support to control and insolvency
- Financial Stability Committee – Korea Deposit Insurance Committee
- If no legal right, are the powers to request data readily understood and effective?
- Can information be shared with safety net partners?

KEY QUESTIONS FOR LEGAL ADVISERS – EARLY DETECTION/TRIGGER

- If quantitative, is the trigger clear and capable of satisfaction from evidentially sound information? Is there any scope for interpretation of or challenge to the data? Is any time period prior to intervention clear?
- If qualitative, are the relevant factors and objectives for intervention clear? Can the decision maker act in accordance with recognised legal (or regulatory) guidance?
- Once made, is the nature and effect of the trigger clear to the public and safety net partners (e.g. DGS)?

KEY QUESTIONS FOR LEGAL ADVISERS – TIMELY INTERVENTION

- Is the range of resolution/payout measures clear?
- How can resolution be carried out? By administrative instrument or with court directions?
- Can the options be assessed against clear and objective criteria? Is there any risk of political or regulatory (or other) interference or influence?

KEY QUESTIONS FOR LEGAL ADVISERS – RISK OF CHALLENGE

- Challenge by directors, shareholders, creditors? Or levy payers/funders?
- Is the trigger subject to retroactive legal challenge?
- Is the intervention subject to retroactive legal challenge?
- No reversal by legal action [Key Attribute 5.5]
- Is there a clear document (audit) trail?
- Are the DIS and its directors/staff protected by legal/statutory immunity? [Core Principle 13 – Legal protection]
- Are there measures to compensate shareholders? Directors? Creditors?
- Do the powers to receive information apply cross border? Are the intervention/resolution measures recognised cross border? [Key Attribute 7]

LESSONS FROM EXPERIENCE

- Planning and coordination is **key**
- **Demand** all necessary data
- Prepare and **record** reasoned decision making
- Adhere to **publicly** stated objectives
- Accept **accountability** to higher authority (e.g. Public report to Parliament under UK Code of Practice)
- Provide **redress** for “worse off” creditors
- Risk of retroactive legal action or suit against DIS (or staff) is low!
- Counterparties to be “subject to adequate safeguards” [Key Attribute 4]
- Respect creditor hierarchy and “no creditor worse off” [Key Attribute 5]

ANNEX 1

KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES (1)

- 3.2** Resolution authorities should have at their disposal a broad range of resolution powers, which should include powers to do the following:
- (i) Remove and replace the senior management and directors and recover monies from responsible persons, including claw-back of variable remuneration;
 - (ii) Appoint an administrator to take control of and manage the affected firm with its objective of restoring the firm, or parts of its business, to ongoing and sustainable viability;
 - (iii) Operate and resolve the firm, including powers to terminate contracts, continue or assign contracts, purchase or sell assets, write down debt and take any other action necessary to restructure or wind down the firm's operations.

ANNEX 1

KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES (2)

- (iv) Ensure continuity of essential services and functions by requiring other companies in the same group to continue to provide essential services to the entity in resolution any successor or an acquiring entity; ensuring that the residual entity in resolution can temporarily provide such services to a successor or an acquiring entity; or procuring necessary services from unaffiliated third parties;

- (v) Override rights of shareholders of the firm in resolution, including requirements for approval by shareholders of particular transactions, in order to permit a merger, acquisition, sale of substantial business operations, recapitalisation or other measures to restructure and dispose of the firm's business or its liabilities and assets;

ANNEX 1

KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES (3)

- (vi) Transfer or sell assets and liabilities, legal rights and obligations, including deposit liabilities and ownership in shares, to a solvent third party, notwithstanding any requirements for consent or novation that would otherwise apply (see Key Attribute 3.3);
- (vii) Establish a temporary bridge institution to take over and continue operating certain critical functions and viable operations of a failed firm (see Key Attribute 3.4);
- (viii) Establish a separate asset management vehicle (for example, as a subsidiary of the distressed firm, an entity with a separate charter, or as a trust or asset management company) and transfer to the vehicle for management and run-down non-performing loans or difficult-to-value assets;

ANNEX 1

KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES (4)

- (ix) Carry out bail-in within resolution as a means to achieve or help achieve continuity of essential functions either (i) by recapitalising the entity hitherto providing these functions that is no longer viable, or, alternatively, (ii) by capitalising a newly established entity or bridge institution to which these functions have been transferred following closure of the non-viable firm (the residual business of which would then be wound up and the firm liquidated) (see Key Attribute 3.5);
- (x) Temporarily stay the exercise of early termination rights that may otherwise be triggered upon entry of a firm into resolution or in connection with the use of resolution powers (see Key Attribute 4.3 and Annex IV);

ANNEX 1

KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES (5)

- (xi) Impose a moratorium with a suspension of payments to unsecured creditors and customers (except for payments and property transfers to central counterparties (CCPs) and those entered into the payment, clearing and settlements systems) and a stay on creditor actions to attach assets or otherwise collect money or property from the firm, while protecting the enforcement of eligible netting and collateral agreements; and
- (xii) Effect the closure and orderly wind-down (liquidation) of the whole or part of a failing firm with timely payout or transfer of insured deposits and prompt (for example, within seven days) access to transaction accounts and to segregated client funds;

ANNEX 2

UK - CASE STUDY – SPECIAL RESOLUTION REGIME SRR

- Banking Act 2008
- 3 stabilisation options
 - : transfer to private sector purchaser
 - : transfer to a bridge bank
 - : transfer to a temporary public ownership

ANNEX 2

UK - CASE STUDY – SRR OBJECTIVES

- 5 Statutory Objectives
 - stability of the financial systems of the UK
 - public confidence in the stability of the banking systems
 - protection of depositors
 - protection of public funds
 - avoiding interference with property rights
- To be balanced as appropriate

ANNEX 2

UK - CASE STUDY – SRR TRIGGER

- FSA (regulator makes determination)
 - institution failing, or likely to fail, to satisfy threshold conditions
 - no reasonably likely that... action will be taken by or in respect of the banking institution that would enable it to satisfy the threshold conditions
 - no realistic prospect that able to continue as an authorised deposit taker
- Consult Bank of England and HM Treasury
- Threshold Conditions
 - legal status and location of offices; adequacy of resources; suitability (e.g. of management); etc

ANNEX 2

UK - CASE STUDY – EXERCISE OF POWERS

- Stabilisation of powers
- Assess against objectives
- Consult with HM Treasury and FSA
- Test of 'necessity'
 - public law restrictions
 - insolvency is the default option
- Code of Practice
 - guidance
 - legally obliged to have regard to Code

ANNEX 3

CANADA - CASE STUDY – INTERVENTION FOR FEDERALLY REGULATED DEPOSIT-TAKING INSTITUTIONS

- OSFI and CDIC
- Objective “to identify areas of concern at an early stage and intervene effectively so as to minimise losses to depositors for OSFI and the exposure of CDIC to loss”
- Wide range of discretionary intervention powers
- OSFI
 - regulates and supervises
 - risk based assessments
- CDIC
 - monitor institutions
 - : works through OSFI in usual course – discretion for problem institutions

ANNEX 3

CANADA - CASE STUDY – STAGES

- No significant problems
- Stage 1 – early warning
- Stage 2 – risk to financial viability or solvency
- Stage 3 – future financial viability in serious doubt
- Stage 4 – non-viability/insolvency imminent
- OSFI determine category

ANNEX 3

CANADA - CASE STUDY – CDIC EXERCISE OF POWERS (INTERVENTIONS) (1)

- Stage 1
 - not normally intervene
 - require additional information (or special examination)
 - premium surcharge
- Stage 2
 - formal report to institution not in compliance with CDIC by-law/policy of deposit insurance (copy to Minister)
 - Notice to and terminate policy of deposit insurance (copy to Minister)
 - preparatory examination
 - Court direction to comply with by-law/policy of deposit insurance

ANNEX 3

CANADA - CASE STUDY – CDIC EXERCISE OF POWERS (INTERVENTIONS) (2)

- Stage 3
 - restructuring transaction (acquire assets, make or guarantee loans or advances, make or guarantee a deposit)
- Stage 4
 - terminate/cancel policy of deposit insurance
 - initiate institution restructuring (FIRP)
 - winding up order
 - bridge bank/P&A/liquidation
 - publicise notice of termination or cancellation of policy of deposit insurance

ANNEX 3

CANADA - CASE STUDY – OSFI EXERCISE OF POWERS (INTERVENTIONS)

- classification
- supervision
- oversight of corrective measures and monitoring on an escalating basis
- impose capital requirements and business restrictions
- temporary control of assets
- request winding up order

ANNEX 3

CANADA CASE STUDY – INTER AGENCY ACTIVITIES

- Information sharing
 - copy intervention reports
 - meetings
- Contingency planning
 - coordinated implementation of intervention measures

ANNEX 4

MALAYSIA - CASE STUDY – PIDM

- Bank Negara Malaysia and PIDM
- Strategic Alliance Agreement
 - information sharing e.g. results of bank examinations, stress tests, risk ratings
- Financial Stability Executive Committee

ANNEX 4

MALAYSIA - CASE STUDY – CORRECTIVE ACTIONS AND TRIGGER

- Bank Negara Malaysia – corrective actions
 - supervisory letters, letters of undertaking, board resolutions
- Notification of non viability by Bank Negara Malaysia

ANNEX 4

MALAYSIA - CASE STUDY – PIDM POWERS

- Cease taking deposits
- Powers of resolution
 - acquire shares
 - assume control
- Stabilisation insurance
- Bridge bank
- Obligatory payment
 - winding up order
- No shareholder/creditor approval

Questions?

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Early Detection & Timely Intervention Taiwan Experience

Robert L.I .Chen

Executive Vice President

14 November 2012

CDIC



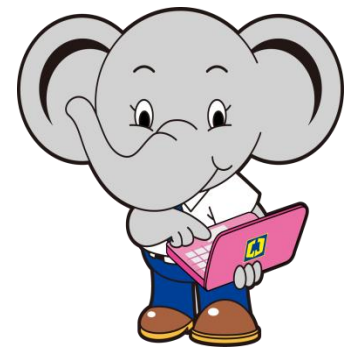
Contents

- **Overview of Information Sharing Mechanism**
- **Overview of CDIC's Risk Management Mechanisms**
 - **Early Detection**
 - **Timely Intervention**
- **Conclusion**



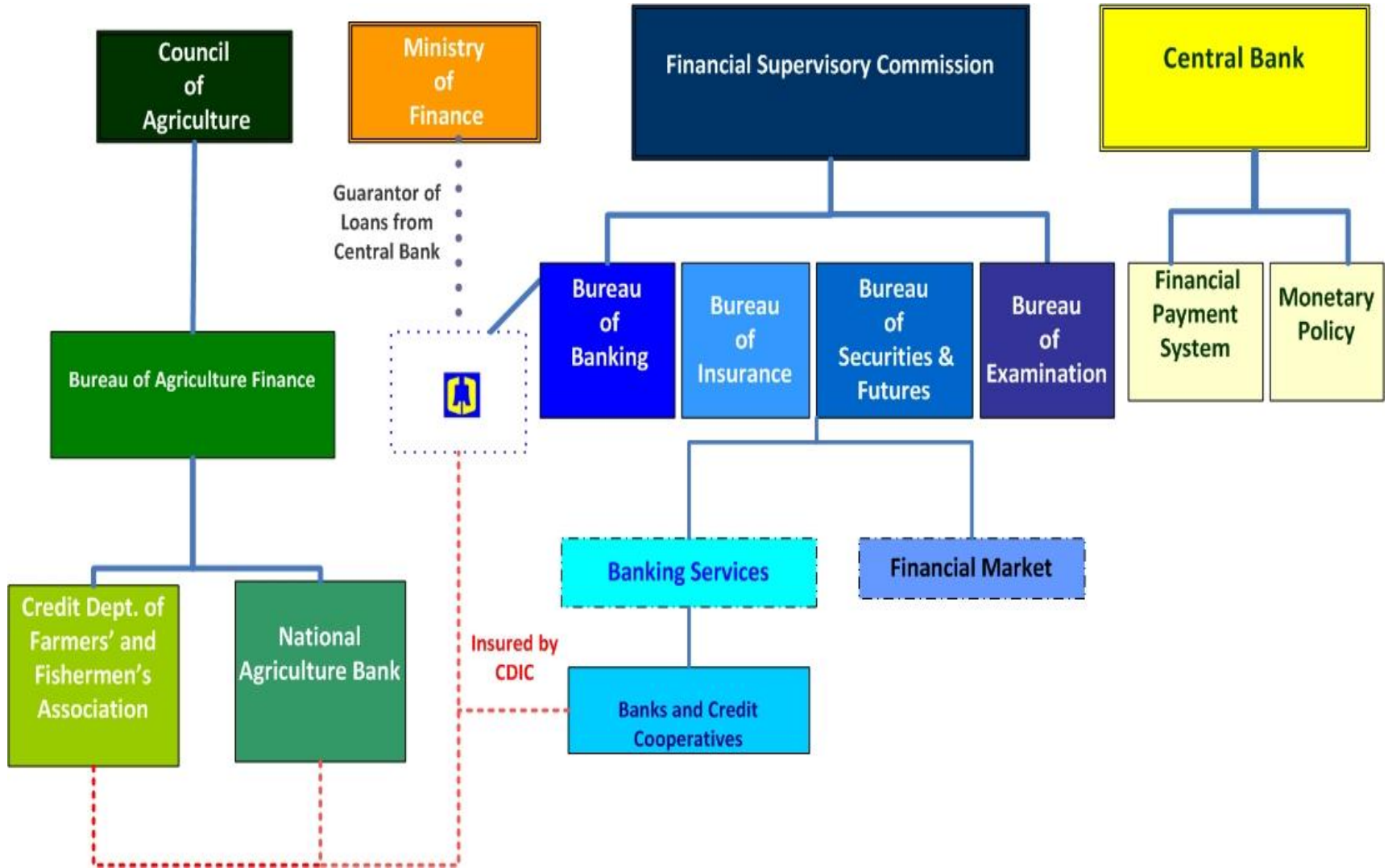


Overview of Information Sharing Mechanism





Financial Safety Net in Taiwan





Financial Safety Net & Its Liaison Team





Information Sharing Legal Basis

- *Financial Supervisory Commission Organization Act § 8*
 - *Where FSC monitoring, regulatory or examination operations are connected with the operations of the Central Bank or any other government agencies, FSC shall promulgate rules to govern the implementation operations thereof.*
 - ✓ *Operational Guideline for Businesses of Financial Supervisory Commission Connecting with the Central Bank or Other Government Agencies*





Information Sharing Legal Basis_(cont.)

▪ Deposit Insurance Act § 22

- *In the event where there are needs for CDIC to collect and analyze the financial information or business information relating to FIs for the purpose of insured risk control, the CDIC shall obtain such information through the information sharing mechanism established by the competent authority.*
- *If the above information is insufficient, CDIC may require FIs to submit additional information in an accurate manner.*
- *CDIC shall establish coordination mechanisms with the competent authority, for the purpose of handling business crises of insured institutions or any major event affecting financial order.*

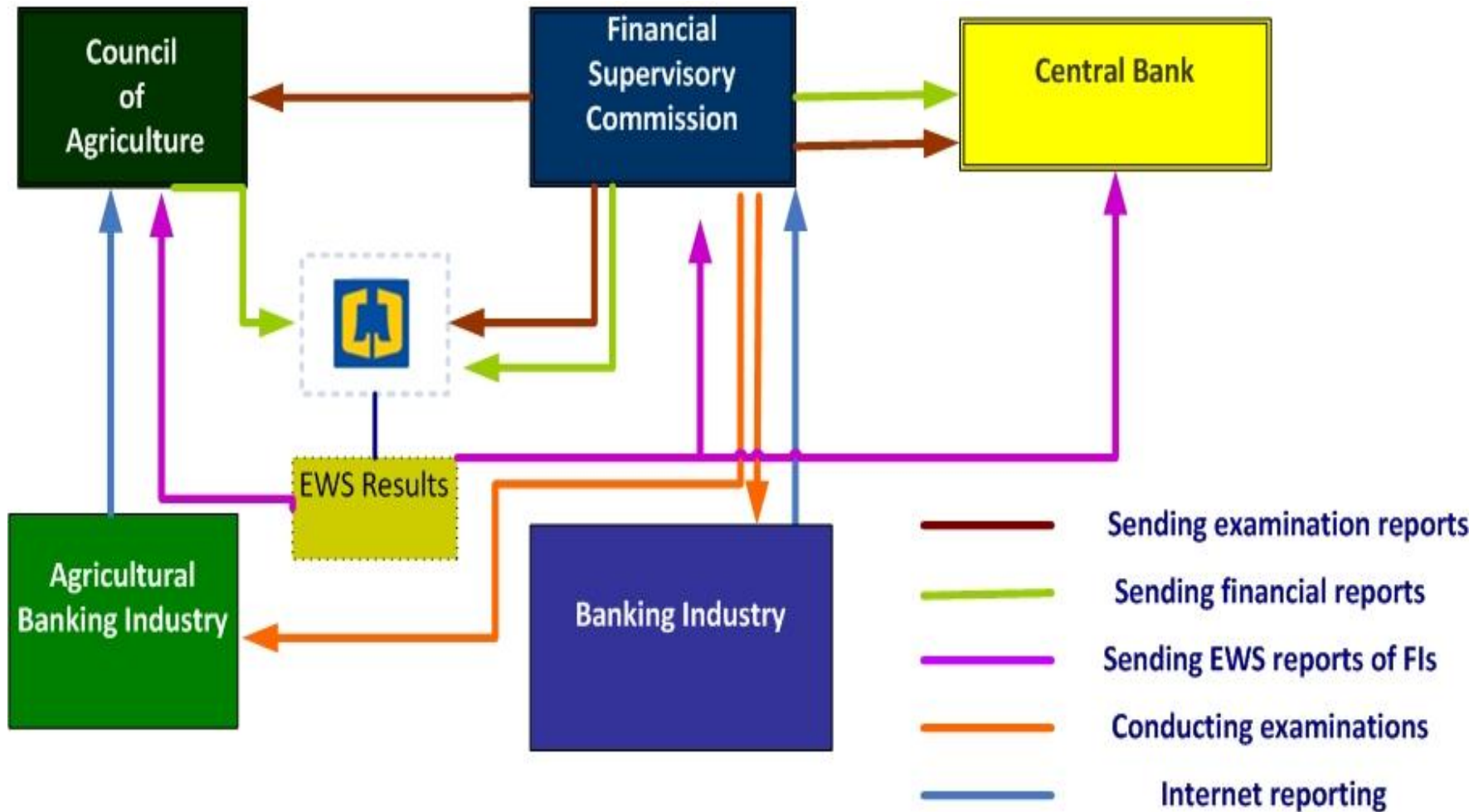


Single-Window Reporting System

- Legal arrangements are needed among financial safety net players (*FSC Organization Act § 8*)
- Defining accountabilities & responsibilities among financial safety net players
- Allocating cost & human resources
- Standardizing data format, information exchange platform, data collecting and reporting system to share information
- Establishing a cross-agency team to review the system periodically

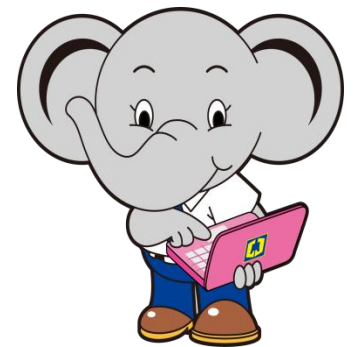


Single-Window Reporting System (cont.)





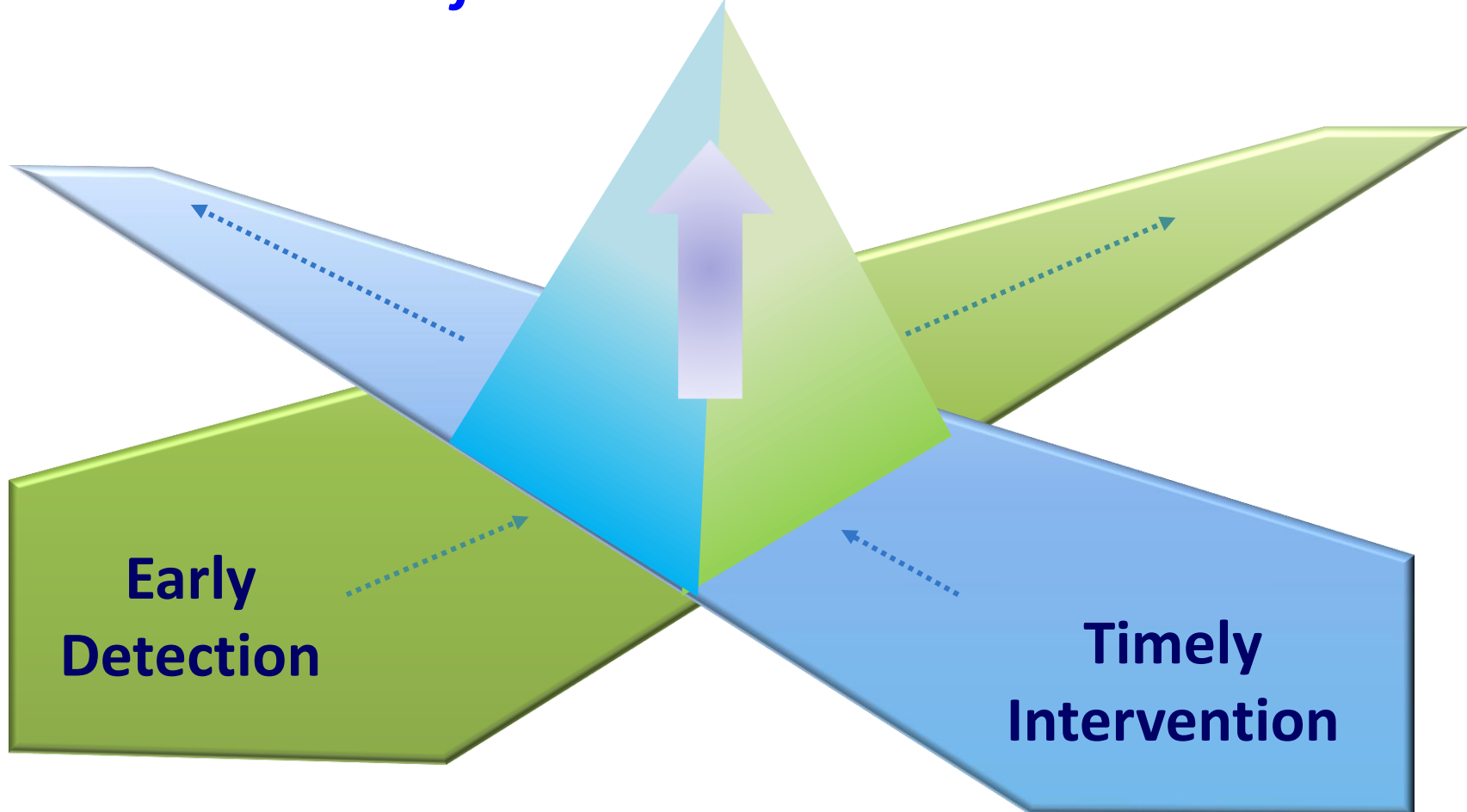
Overview of CDIC's Risk Management Mechanisms





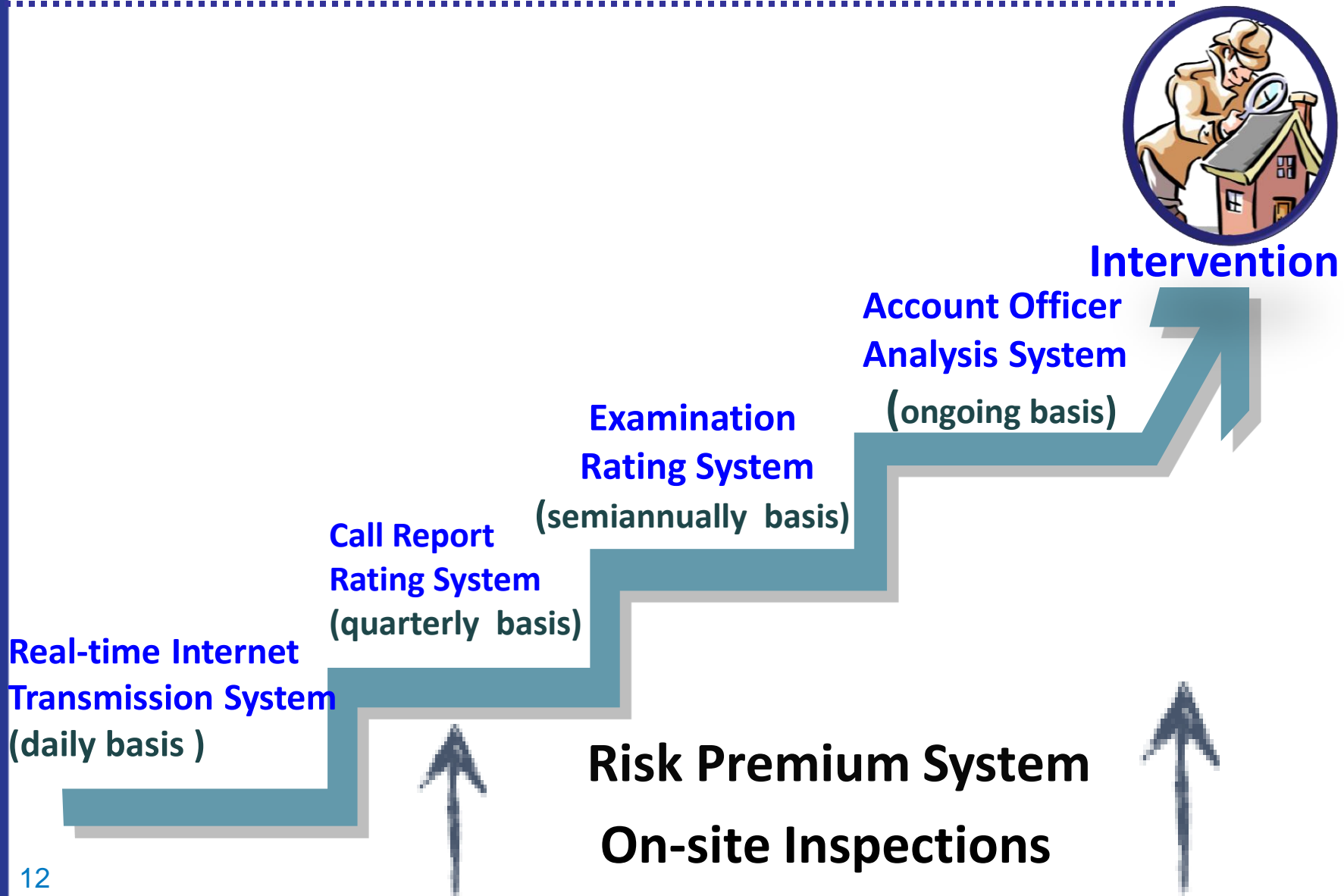
Two Pillars of Risk Management

*Supporting a sound and stronger
financial markets*





Early Detection





Financial Early-warning System (EWS)

- Objectives
 - Detecting risk signs in the early stage
 - Determining priority, scope and frequency of examinations
 - Assigning composite scores for a differential premium system
 - Used as an effective risk-minimizing tool



Framework of EWS





Real-time Internet Transmission System

- Financial institutions transmit major financial information to CDIC on a daily basis
- CDIC can promptly discover and respond to warning signals

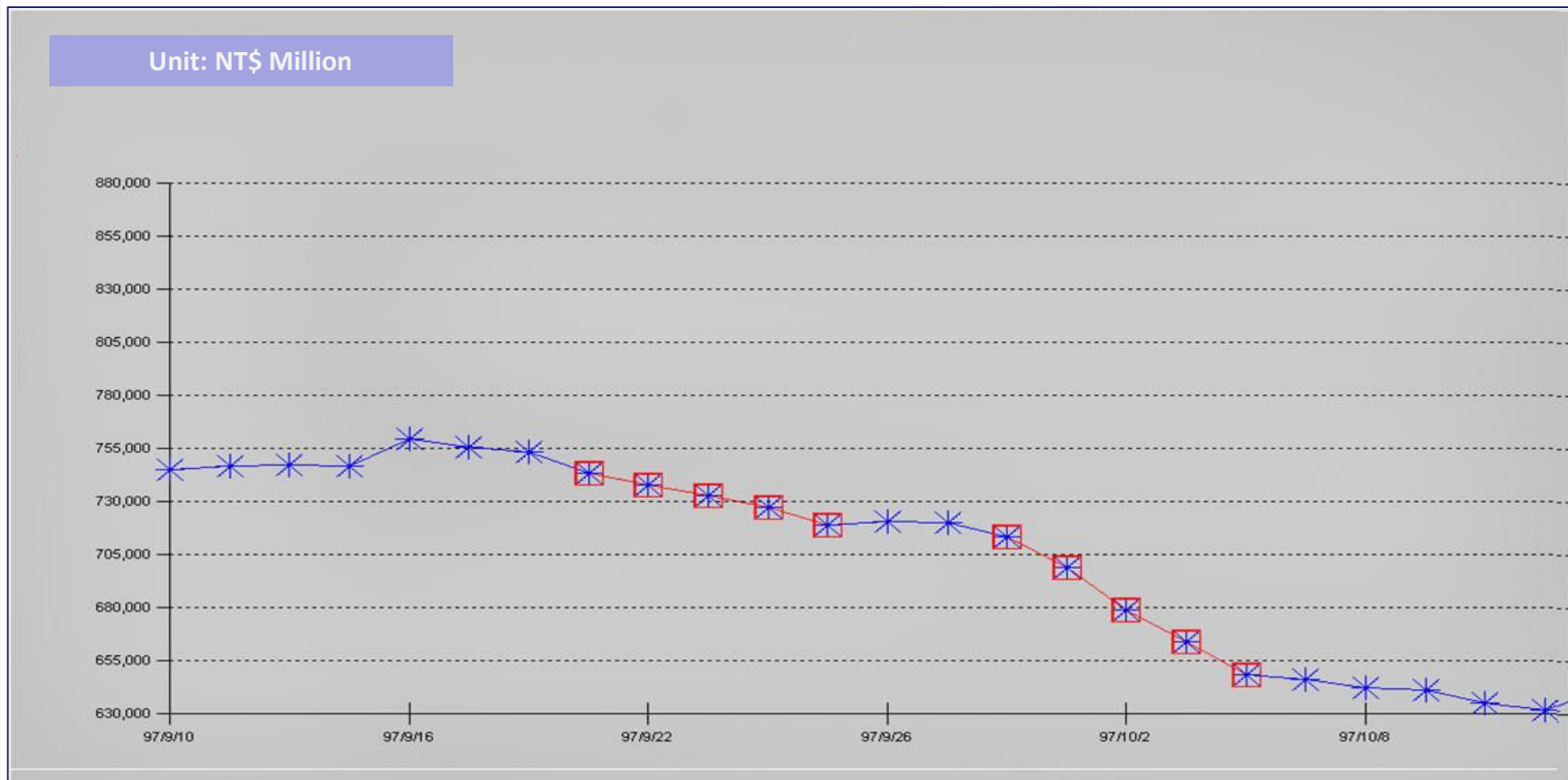




Real-time Internet Transmission System (cont.)

Case: 1

- Detection of operational abnormalities in deposits at the financial institutions





Real-time Internet Transmission System (cont.)

Case: 2

- Detection of abnormal changes in the amount of deposits and loans of a credit department of farmers' associations

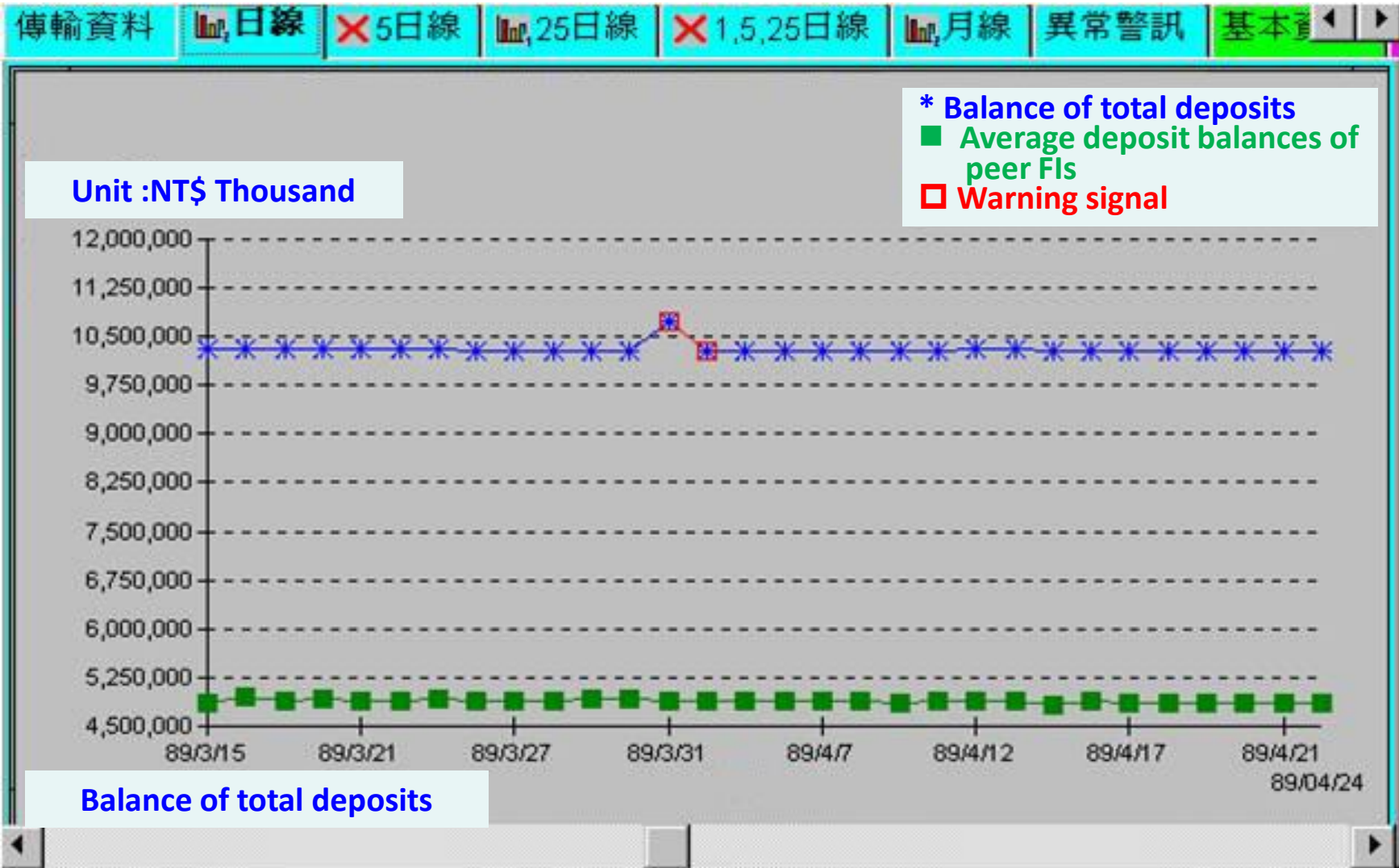
Unit :NT\$ Thousand

| Item Date | Loan | | Deposit | |
|--------------|-----------|----------|------------|----------|
| | Amount | Movement | Amount | Movement |
| March 30 | 6,623,045 | — | 10,281,919 | — |
| March 31 | 7,084,482 | 461,437 | 10,743,977 | 462,058 |
| April 1 | 6,615,247 | -469,235 | 10,286,530 | -457,447 |



Real-time Internet Transmission System (cont.)

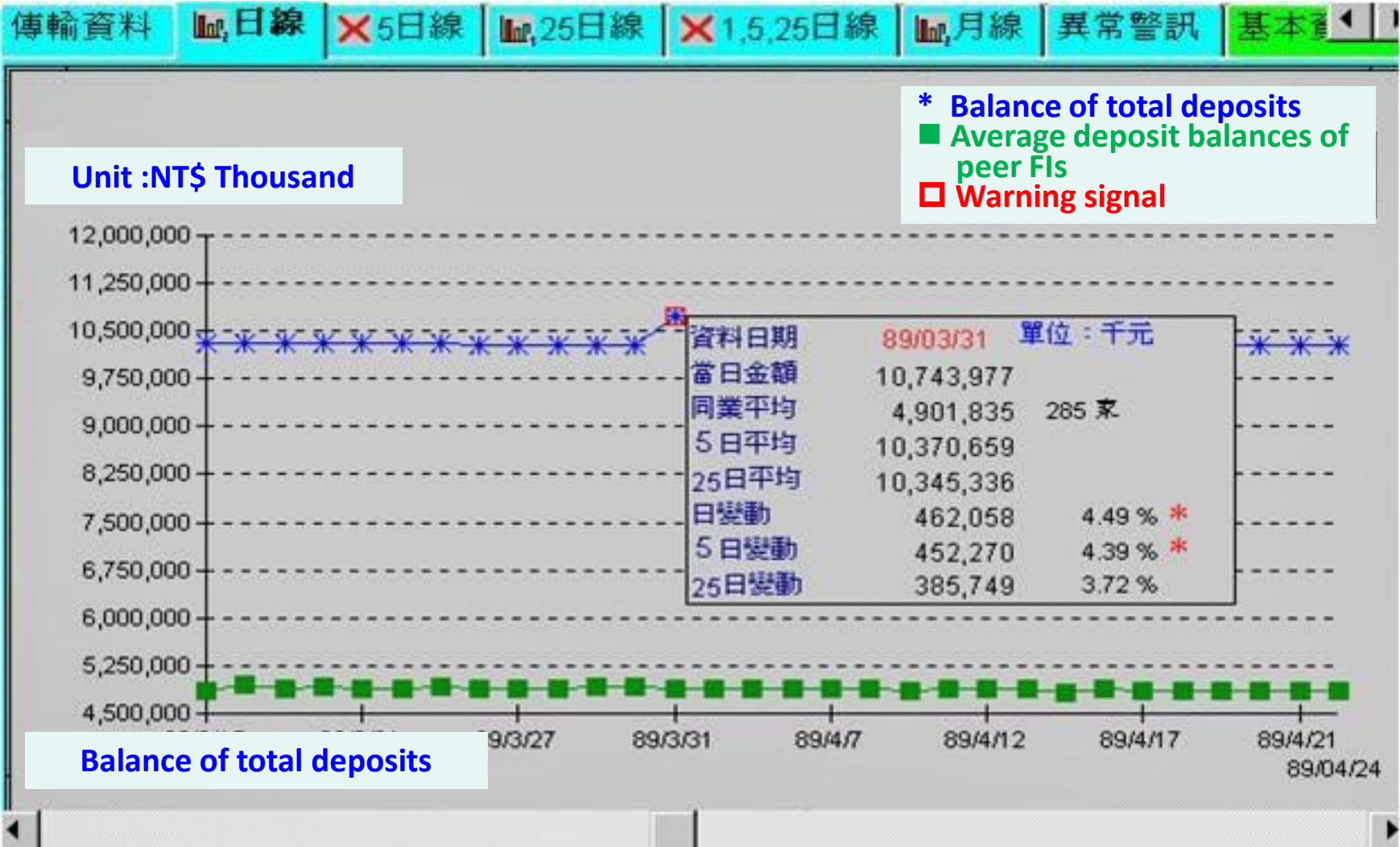
Case: 2





Real-time Internet Transmission System (cont.)

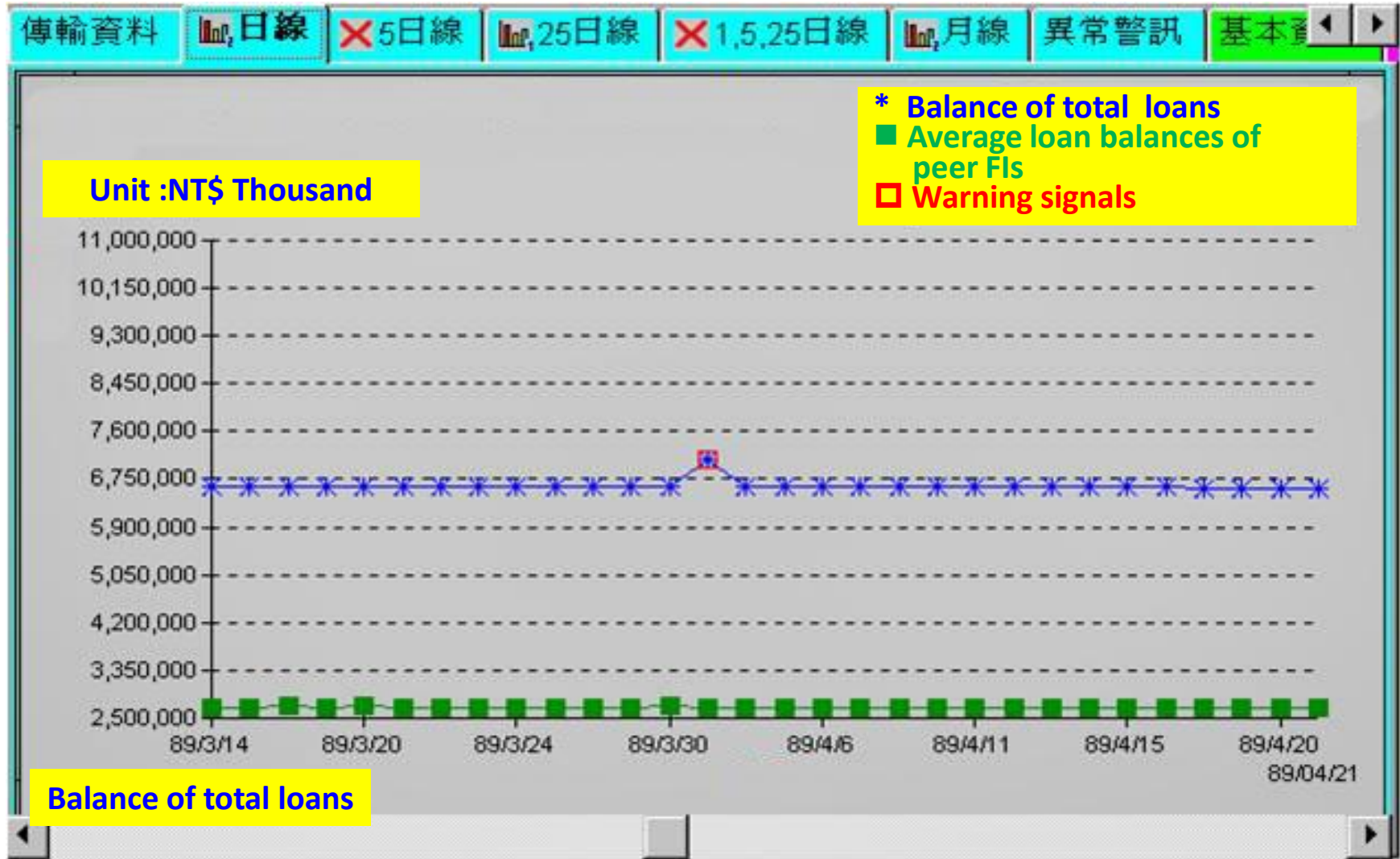
Case: 2





Real-time Internet Transmission System (cont.)

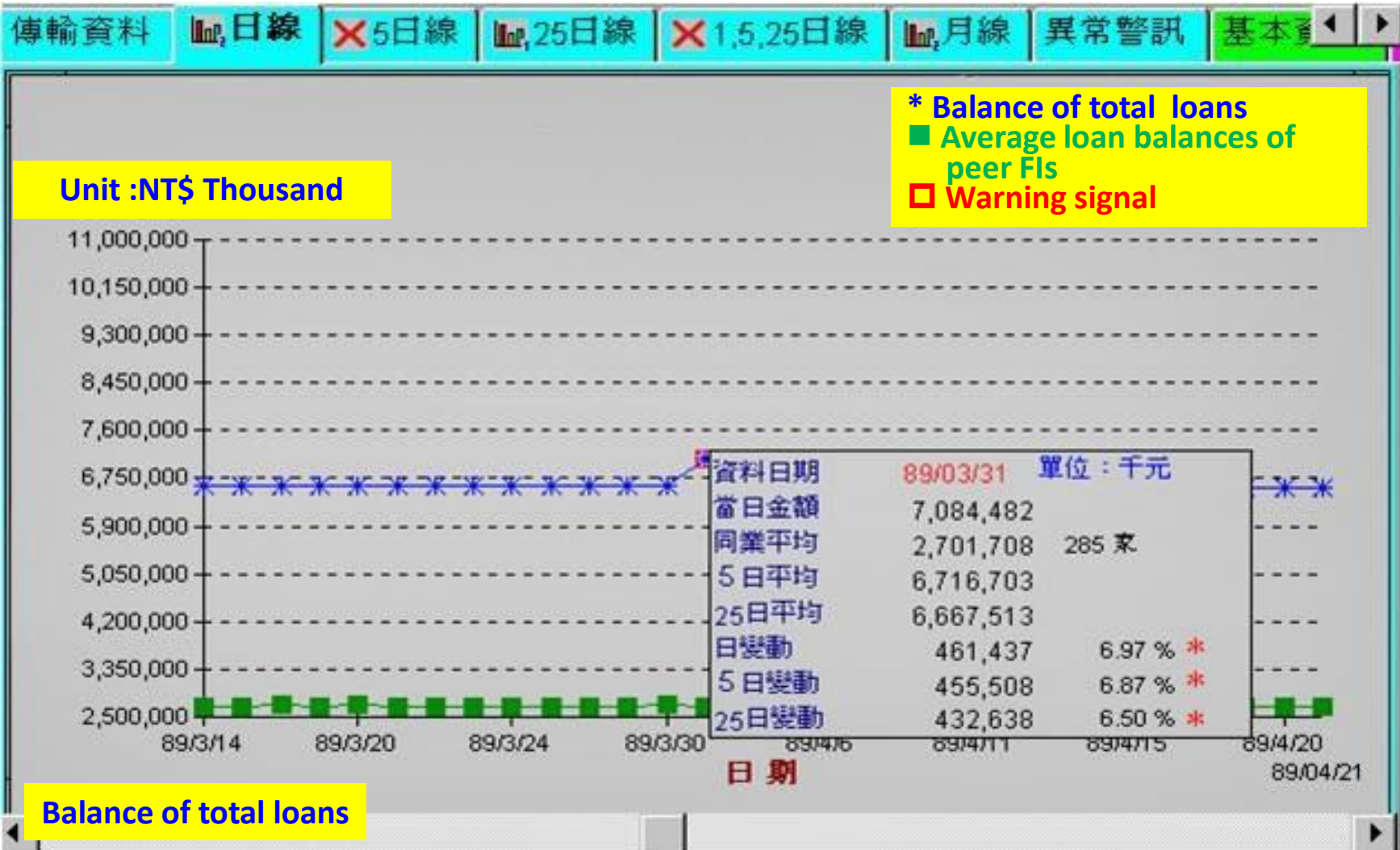
Case: 2





Real-time Internet Transmission System (cont.)

Case: 2





Real-time Internet Transmission System_(cont.)

- **Analyze the reasons for abnormality and confirm the warning signal**
- **Account officers detected that the insured institution increased the loans and deposits at the same time to artificially manipulate the NPL ratio at the end of the quarter**



Call Report Rating System

- Call reports from insured institutions
- Analyzing CAMELS + other factors
- Rating results: A,B,C,D,E
- Off-site data appraisal; Subjective
- Quarterly
- Applied in: Differential Premium System

On-site inspection



Examination Rating System

- **Reports of Examination from Banking Examination Agencies**
- **Analyzing CAMELS + other factors**
- **Rating results: A,B,C,D,E**
- **On-site appraisal; Objective**
- **Applied in: Examination Frequency**

Differential Premium System



Account Officer Analysis System

- **Dispatching personnel to further monitor the operational conditions of financial institutions**
- **Coordinating closely with the competent authorities**





Comparison Profiles on EWS Subsystems

| Subsystem | Examination Rating System (ERS) | Call Report Rating System (CARRS) | Internet Transmission Surveillance System (ITSS) | Account Officer Analysis System (AOAS) |
|-----------------------------|--|--|--|---|
| Items | | | | |
| Main Purposes | <ul style="list-style-type: none"> • Differential Premium • Early Interventions • Examination Reference • Supervisory Admin. | <ul style="list-style-type: none"> • Differential Premium • Early Risk Detection • Trend Evaluation | <ul style="list-style-type: none"> • Monitoring & Intervention • Moral Hazard Prevention | <ul style="list-style-type: none"> • Insurance Risk Assessment • Risk Concentration & Exposure Analysis |
| Data Sources | Examination Reports from Banking Examination Agencies | Call Reports from Members | Daily Data from Members | Examination Reports and Up-to-Date Data |
| Frequency of Reports | Semiannually | Quarterly | Daily, Weekly & Monthly | Monthly, Quarterly or Annually Depending on Cases |
| Rating Results | A,B,C,D,E | A,B,C,D,E | Warning Signals | Insurance Risk Assessment |
| Models | CAMEL Model | CAMEL Model | Linear Moving Average | Insurance Risk Estimate |
| Indicators | CAMELSO | CAMELSO | Specific Items from Balance Sheets | Adversely Classified Assets |
| Information Sharing | FSC, CBC, COA and local governments | FSC, CBC, COA and local governments | 1.FIs 2.Related supervisors | |



Comparison Profiles on EWS Subsystems (cont.)

| Subsystem Items | Examination Rating System (ERS) | Call Report Rating System (CARRS) | Internet Transmission System(ITS) | Account Officer Analysis System (AOAS) |
|---|--|--|--|---|
| Outcomes | <ul style="list-style-type: none"> • Exception List • Semi-Annually Report | <ul style="list-style-type: none"> • Exception(Warning) List • Quarterly Report | <ul style="list-style-type: none"> • Warning List | <ul style="list-style-type: none"> • Analysis Report |
| Strength of System | <ul style="list-style-type: none"> • On Site Appraisal • Objective | <ul style="list-style-type: none"> • Regularly Monitoring | <ul style="list-style-type: none"> • Early detection | <ul style="list-style-type: none"> • Risk Oriented |
| Weakness of System | <ul style="list-style-type: none"> • Low Examination Frequency | <ul style="list-style-type: none"> • Appraisal of Asset quality depending on FIs • Off Site Data | <ul style="list-style-type: none"> • Time Consuming • Heavy Workload | <ul style="list-style-type: none"> • Subjective • Off Site Analysis |
| Future Development | Based on the economic cycles to revise the System regularly | Based on the economic cycles to revise the System regularly | Revised regularly | Revised regularly |
| Differential Premium System Indicators | Composite Score | Composite Score | — | — |



Differential Premium System

- The first Asian country to adopt differential premium system in 1999
- The new modified system has been implemented from Jan. 2011
- It's part of CDIC's risk management mechanisms
- Reflecting the operational risk and financial status of FIs in their risk-based premiums
- Providing incentives for FIs to improve their premium grading



Differential Premiums Grading for FIs

Premium rate for domestic banks and local branches of foreign banks

| CSRPRS \ CAR | 65.0 and over | 50.0 to under 65.0 | Less than 50.0 |
|---|------------------|--------------------|------------------|
| $\geq 12.0\%$ or $\geq 1.5 \times$ the minimum CAR | Grade 1 0.05% | Grade 2 0.06% | Grade 3 0.08% |
| $\geq 8\%$ but $< 12\%$ or \geq the minimum CAR but $< 1.5 \times$ the minimum CAR | Grade 2 0.06% | Grade 3 0.08% | Grade 4 0.11% |
| $< 8\%$ or $<$ the minimum CAR | Grade 3 0.08% | Grade 4 0.11% | Grade 5 0.15% |

Note:

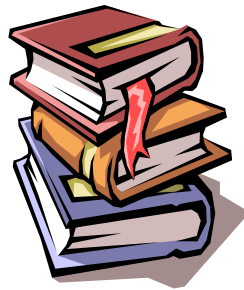
•CSRPRS: Composite Score of the Risk-based Premium Rating System

29 •CAR: Capital Adequacy Ratio



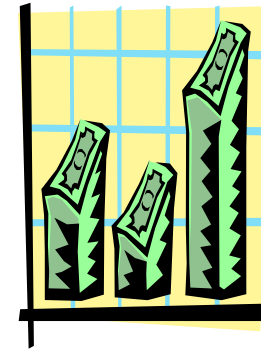
On-site Inspection of Call Report Data

Legal Basis



Inspection
Emphasis

Call Report
Data



- Deposit Insurance Act
- Revised Implementation Scheme for the Deposit Insurance Premium System

- File format
- Data type
- Data content



Occasions of Conducting On-site Inspection

- Significant differences in reporting
- Call report data differences in examination or CPA reports
- Member institutions with bad records of reporting inaccurate data
- The call report rating varied more than 2 grades



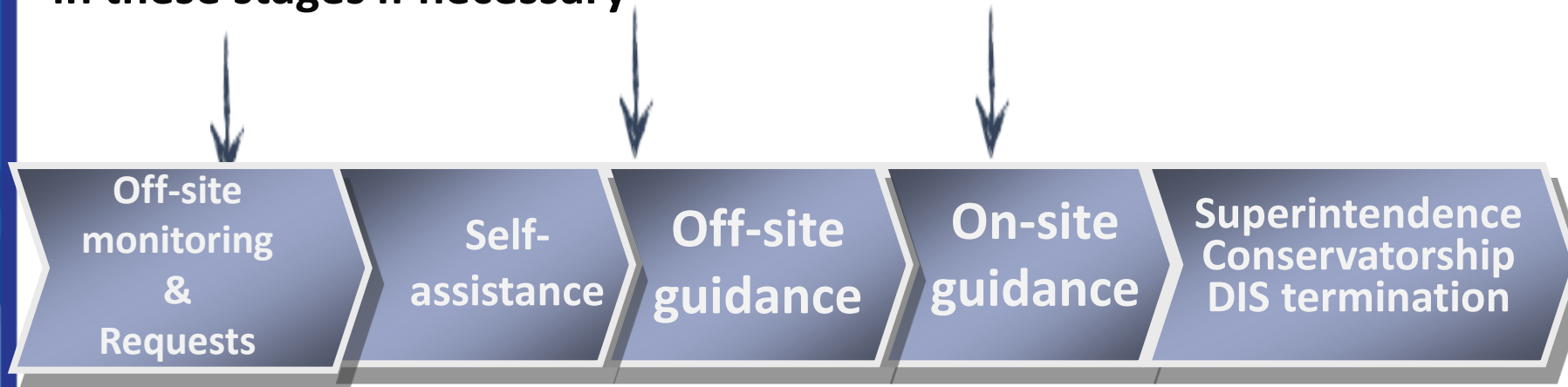
Occasions of Conducting On-site Inspection (cont.)

- If the following significant risk events occurred between the standard dates of call reports and premium calculation:
 - Management fraud
 - Big losses from investments or loans
 - Others
- **Actions after inspection**
 - Recalculate composite score
 - Recharge the insurance premium
 - Charge punitive premiums
 - Notify the supervisory authorities
- **Case closed if all records are in order**



Timely Intervention

CDIC has authority to issue warning notices to FIs
in these stages if necessary



In accordance with Banking Act



CDIC's authority & special inspection authority



Off-site Monitoring and Requests

- **Assigning account officers to assist unsound FIs to make improvements by following steps**
 - Heightening control on changes of call-reporting and Internet transmission report on a daily basis
 - Participating in supervision and guidance meetings convened by the competent authorities
 - Informing the competent authorities, sending letters to request FIs whose operating conditions are worse to make adjustments
 - Interview with the head of unsound FIs for discussing ways to make improvements
 - Conducting special reports and regularly monitoring changes



Self-assistance & Off-site Guidance Mechanisms

- **Self-assistance by problem financial institutions**
 - Recapitalization or self-improvement plan
- **Off-site guidance by CDIC**
 - Asking FIs to provide related data
 - Attending board of director meetings and other important meetings
 - Reviewing meeting resolutions and minutes
 - Assisting in speedy completion of capital reduction, recapitalization or consolidation plans





On-site Guidance

- *Banking Act § 61-1*
- **Objective : to facilitate unsound FIs to return normal operations or acquired by other FIs**
- **Methods:**
 - **Dispatching officers for on-site guidance**
 - **Attending board meetings**
 - **Sending written guidance letter**



Superintendence

- ***Banking Act § 44-2*** and related regulations
- **Objectives** : to act as superintendent at unsound FIs involved major fraud, bank runs and capital inadequacy
- **Method** : On-site superintendence



Early Banking Resolution - Conservatorship

Banking Act

PCA mechanism

Standard for market withdrawal:
Capital adequacy (BIS) ratio

If BIS ratio $< 2\%$,
the bank to be put under
conservatorship within 90 days

Banking Act

Bank should also be
taken over

In case a bank:

- Is unable to pay its liabilities and could harm depositors' interests; or
- Has losses exceeding $1/3$ of capital and bank cannot make improvement within the stipulated timeframe

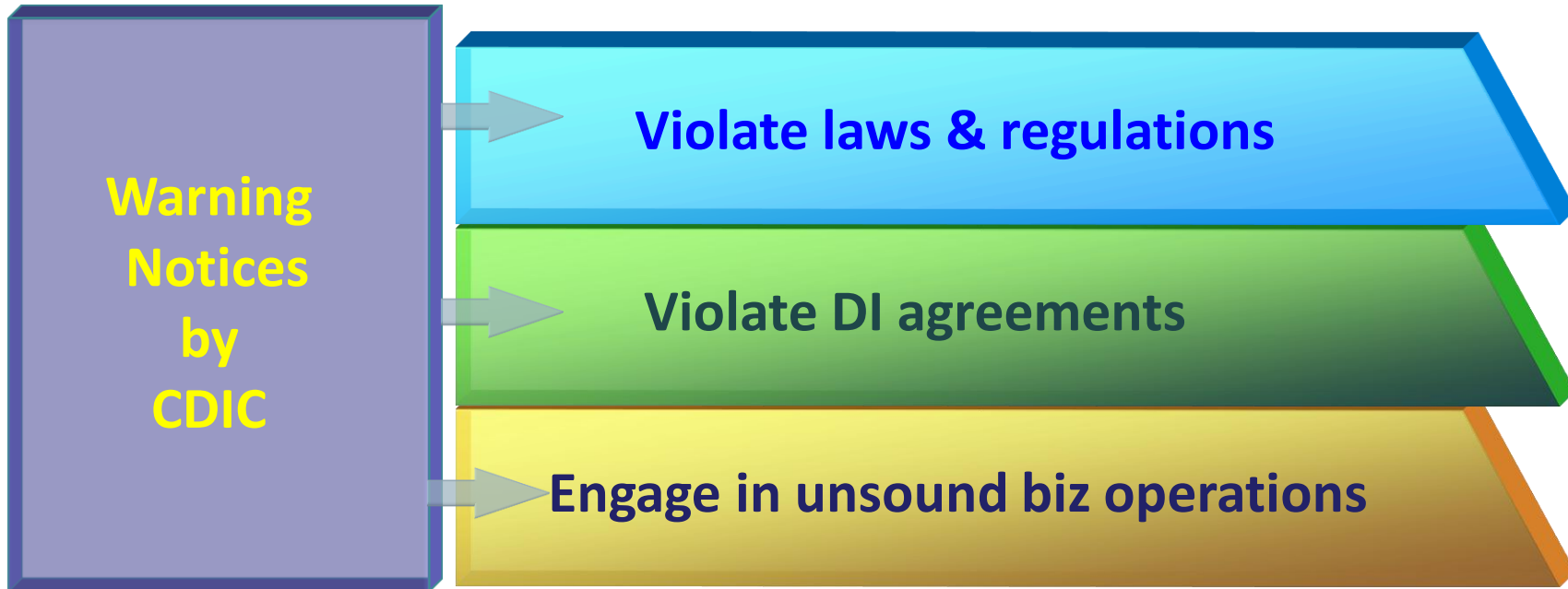


Special Inspection Authority

- **Inspecting conditions of terminating status of unsound FIs**
- **Inspecting assets and liabilities of failing FIs**
- **Conducting civil liabilities investigations of employees of failed FIs**
- **Inspecting the accuracy of the assessment and content of electronic data files required by CDIC**



Warning of Terminating Membership



Required unsound FIs to make rectifications
within a stipulated timeframe

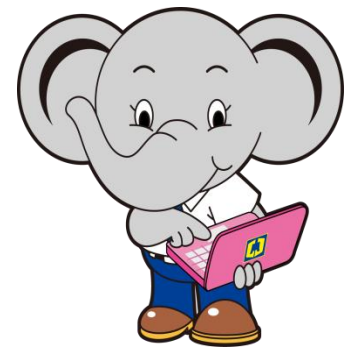


DIS Membership Termination

- Failure to take corrective actions within stipulated timeframe
- Failure to make improvements through recapitalization
- Failure to strengthen financial conditions and business operations with a certain timeframe
- FIs are defined as unviable to make any improvements prior to the deadline set by the competent authorities or CDIC
- Occurrence of major fraud or illegal activities with the potential to increase cost of payouts



Conclusion



Conclusion

- **Early prevention is better than cure**
 - **Establishing financial early warning system**
 - **Conducting off-site monitoring**
 - **Conducting on-site inspection**



Conclusion (cont.)

- Providing guidance in advance is better than payout
 - Collaborating closely with supervisory agencies
 - Controlling insurance risk by taking timely actions
 - Promoting risk management concepts of FIs and stakeholders



Conclusion (cont.)

- Keeping the EWS Model updated by including relevant factors to adapt to the changing financial environment as different economic cycles may have major influences on the EWS model
- The EWS model must be reviewed and revised periodically based on financial supervision needs
- CDIC's EWS Model is being revised





Thank You !

www.cdic.gov.tw

Effective Resolutions

J.P Sabourin

CEO, Malaysia Deposit
Insurance Corporation



Agenda

A. Introduction

- What defines effective resolutions?
- Essential elements for effective resolutions

B. MDIC's legislative framework for Effective Resolutions

C. Future Initiatives

D. Conclusion

What defines effective resolutions?

Effective resolutions should meet stated objectives



Essential elements for effective resolutions

- 1 Mandate, roles and responsibilities of each safety-net participant is clearly defined and formally specified.
- 2 National legal framework ensures the effective and timely functioning of failure resolution framework.
- 3 Mandate and powers allow for the effective resolution of banks of all sizes.
- 4 Effective resolution tools are designed to help preserve critical bank functions.
- 5 Least cost resolution for financial system is set out in the mandate.
- 6 Resolution criteria clearly set out that shareholders take the first losses.
- 7 Transact only with parties who have capacity and capability.
- 8 Options implemented must result in permanent solution – don't pay twice!

Agenda

A. Introduction

- What defines Effective Resolutions?
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D. Conclusion

Four cornerstones in building a robust and comprehensive legislative framework for effective resolution

1

Having well defined mandate in legislation

3

Clear triggers on when powers are to be exercised by the resolution authority

Malaysia Deposit Insurance Corporation Act 2011 ("MDIC Act")

2

Extensive and clearly defined resolution powers

4

Immunities and protection available to employees and agents of the resolution authority

Setting out the reasons for mandate in legislation

Preamble to the Malaysia Deposit Insurance Corporation Act 2011

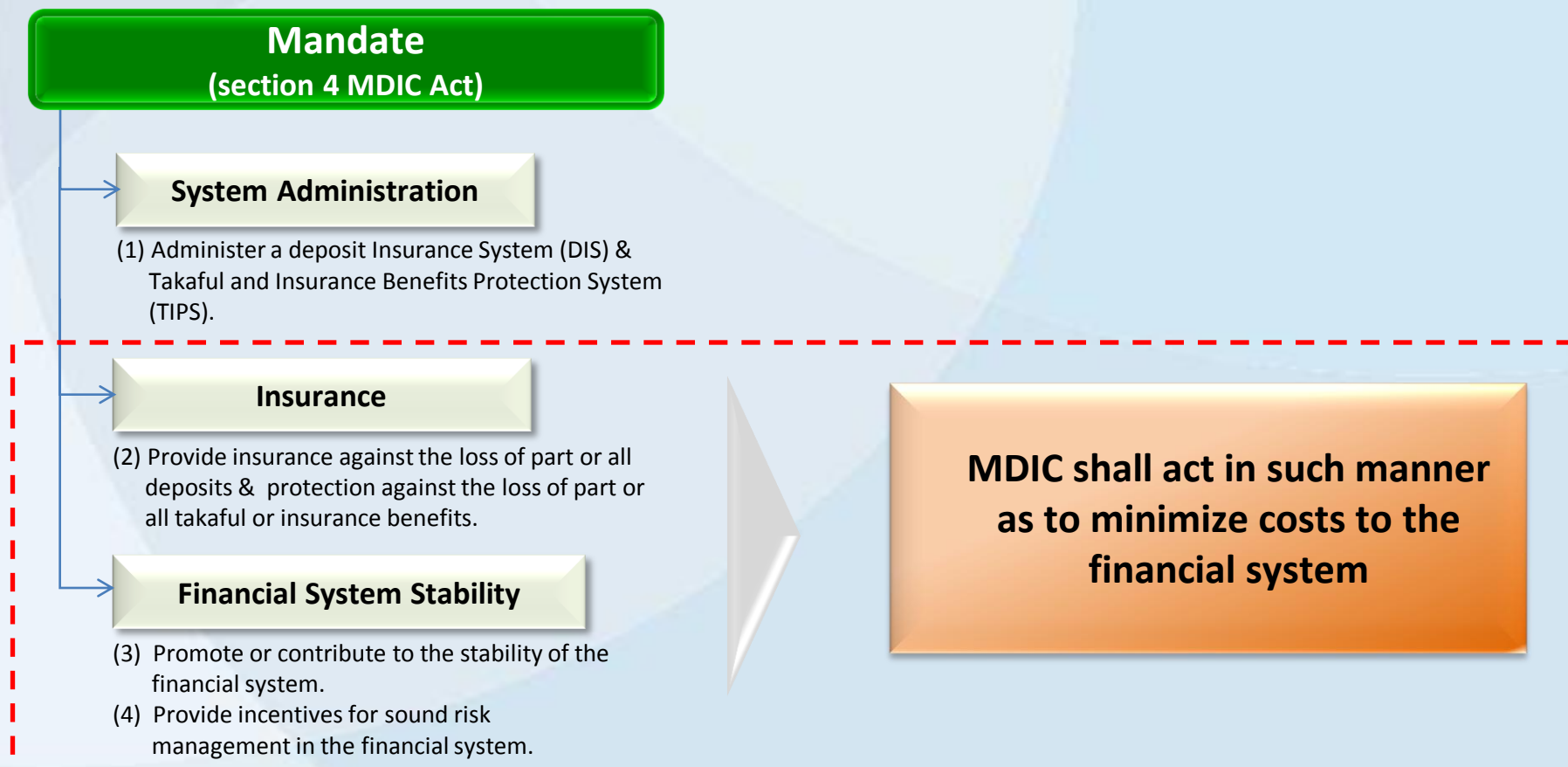
Where as the stability of the financial system is a key determinant of the economic growth and prosperity of Malaysia:

And Whereas the deposit insurance system and the takaful and insurance benefits protection system are important components of the financial safety net since they promote and contribute to the stability of the financial system:

And Whereas the purpose of the deposit insurance system and the takaful and insurance benefits protection system is to protect depositors from the loss of part or all of their deposits and takaful beneficiaries and insured persons from the loss of part or all of their takaful or insurance benefits in the event of the failure of a member institution and the Malaysia Deposit Insurance Corporation is to carry out its mandated functions with speed and efficiency and promote sound risk management in the financial system and promote and enhance financial consumer protection:

And Whereas special provisions are required in the public interest to empower the Corporation to implement promptly the resolution actions set out in this Act at minimum cost to the financial system.

MDIC's mandate is clearly codified in the MDIC Act



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MDIC has specific powers to deliver on its IFR mandate

Powers exercisable prior to non-viability notification

Loss Mitigation Powers

A range of intervention powers that can be exercised prior to the non-viability trigger for the purpose of reducing or averting a risk to the financial system or a threatened loss to MDIC.

Special Examination Powers

Powers that allow for detailed assessment and Investigation (due diligence) to be undertaken early when a member institution (“MI”) shows signs of distress. These powers are fundamental to determine and implement IFR action.

Powers exercisable post non-viability notification

Failure Resolution Powers

Wide toolkit to resolve non-viable MIs in a manner that minimises costs to the financial system before they become hopelessly insolvent.

Powers exercisable prior to non-viability notification

Loss Mitigation Powers

MDIC may acquire shares of a member institution.

MDIC may :

- (a) provide loans or advances with or without security, or guarantee with or without security any loan or advance provided to a member institution.
- (b) make a deposit with a deposit taking member.
- (c) impose a premium surcharge on the member institution.

MDIC may acquire assets from a member institution.

MDIC may guarantee or assume all or part of the liability of a deposit taking member in respect of a deposit.

MDIC may make a loan, whether with or without security, to a corporation other than a member institution:

- for the purpose of or in connection with the implementation of any resolution actions; or
- for purpose of reducing or averting a risk to the financial system or a threatened loss to the Corporation.



Failed Bank comprises of:

Assets

Liabilities

Business Undertakings

Special Examination Powers

MDIC may conduct a special examination of a member institution where MDIC has reason to believe that a due diligence or other examination should be made for the purposes of:

Exercise its intervention and failure resolution powers

Preparedness to reimburse insured depositors (“payout”)

Powers exercisable post non-viability notification

Failure Resolution Powers

- (a) MDIC may acquire shares of a member institution from its existing shareholders.
- (b) MDIC may reduce share capital and cancel shares of member institutions under assumption of control (subject to conditions and with Court approval).

MDIC may subscribe to shares issued by the member institution (i.e. new money).

MDIC may:

- (a) Require a member institution:
 - To take any steps/action as MDIC considers necessary
 - Cease soliciting, taking or repaying deposits
 - Restructure the whole or part of its business.
- (b) Terminate membership of member institution.
- (c) Present a petition to the High Court for the winding up of the member institution.

MDIC may:

- (a) Assume control of the whole or part of the assets, liabilities, business and affairs of the member institution.
- (b) Apply to the High Court to appoint a receiver, manager or receiver and manager to manage the whole or part of the assets, liabilities, business and affairs of the member institution.
- (c) Transfer such assets, liabilities, business and affairs of the member institution to a Bridge Institution.



Existing Shareholders



Failed Bank comprises of:

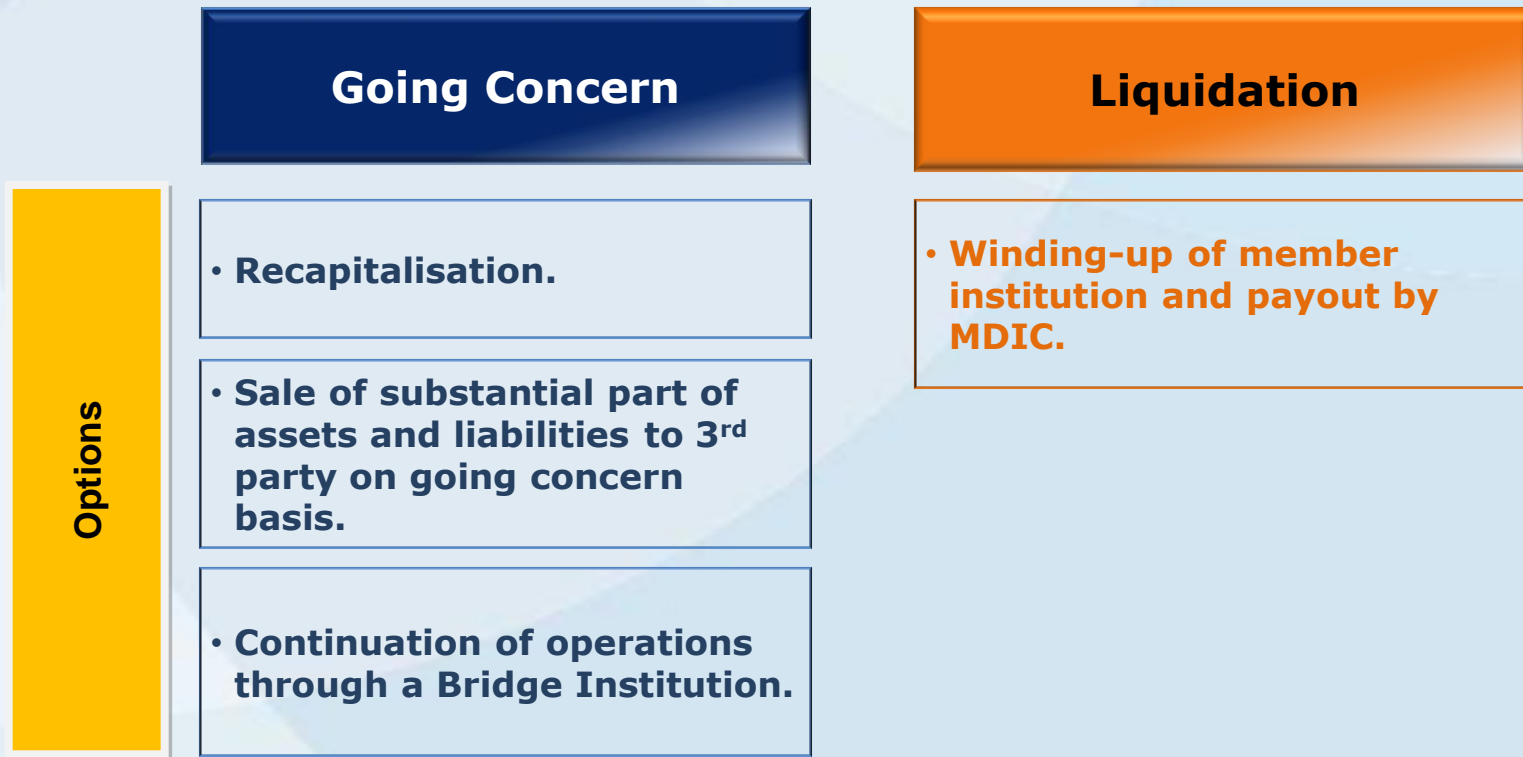
Assets

Liabilities

Business Undertakings

Failure Resolution Powers

Based on the failure resolution powers, MDIC is able to execute a host of going concern and liquidation options.



Failure Resolution Powers

Recapitalisation

- Recapitalisation of a failed member institution can take many forms, such as:
 - Injection of fresh capital
 - Disposal of assets
 - Writing down of liabilities
 - Converting debt to equity
- It is important for a resolution authority to ensure that shareholders of failed institutions absorb losses first before a failed institution is recapitalised.
- A recapitalisation would also necessitate a restructuring of the operations to ensure that the business is sustainable in the long run.

Failure Resolution Powers

Recapitalisation

MDIC Act provides the following powers to allow MDIC to recapitalise and to restructure a failed financial institution:

- Acquire assets from a member institution (section 25(2)(a)(i))
- Reduce share capital and to cancel paid-up capital of a member institution (section 102)
- Subscribe to shares issued by the member institution (section 99(1)(b))
- Require the member institution to restructure the business (section 99(1)(a))
- Assume control and restructure the business (section 99(1)(c))

MDIC is also evaluating the need for including bail-in powers which would provide powers to convert debt into equity under certain specific circumstances.

Failure Resolution Powers

Sale of substantial part of assets and liabilities to 3rd party on going concern basis.

2 possible scenarios

Management of failed Institution is co-operative

Sale can be effected by Management and MDIC can provide guarantees or enter into loss share agreements with the acquirer.
(Section 25(2)(e))

Management of failed Institution is NOT co-operative

MDIC or an Appointed Person can assume control of the member to effect the transaction
(Section 99(1) (c))

Failure Resolution Powers

Sale of substantial part of assets and liabilities to 3rd party on going concern basis.

Where MDIC or an Appointed Person assumes control to effect the transaction:

- He can dispose of its assets or businesses or any part thereof, or appoint any person to do so on behalf of MDIC (section 99(1)(c))
- There is no requirement to notify or obtain the approval of shareholders or creditors in general meeting or otherwise, or any governmental, regulatory or other authority, unless under certain specified circumstances (section 99(3)(a))
- Any request for a review of the transaction must be through the Assessor Committee (section 104(2))
- Assessor Committee will only review reasonableness of transacted price and does not have powers to unwind the transaction (First Schedule)

Failure Resolution Powers

Continuation of operations through a Bridge Institution

MDIC Act provides for the following to facilitate a prompt setting up of a bridge institution:

- Once designated by the Minister, a bridge institution shall be deemed to have been issued a licence or registration to carry on business as a licenced bank /Islamic bank and shall not be required to pay any fee in relation to such licence or registration **(section 120 (1) & (2))**
- There is a statutory stay of proceedings during the period of 90 days following the designation of a bridge institution **(section 125)**
- MDIC may transfer asset or liability or cause a transfer back to the member institution of any asset or liability as MDIC may determine by means of one or more transfer instruments or in accordance with general law **(section 99(5))**

Failure Resolution Powers

Winding-up of member institution and payout by MDIC.

- Winding-up of the member institution is a significant event and may result in a loss of confidence by depositors if not managed well.
- Regular bankruptcy regimes are typically designed to deal with corporate failures and are not suited for financial institutions. For instance, regular bankruptcy regimes often adopt a public process and is often lengthy.
- In the case of a financial institution, a public process may result in a loss of confidence by the depositors which may result in a bank-run.
- It is therefore, essential, that a resolution authority has appropriate mechanisms to effect the closure of the financial institution immediately upon the filing of the winding-up petition.
- As the liquidator is a key player in the resolution, it is important that the objectives of the liquidator is aligned to that of the resolution agency

Failure Resolution Powers

Winding-up of member institution and payout by MDIC.

MDIC Act provides for the following to allow MDIC to carry out the liquidation effectively:

- Objective of the liquidator is provided in the MDIC Act (**section 131**)
- Subject to an order of the Court, a liquidator, shall carry out his functions under the direction and supervision of MDIC (**section 133**)

There is a need to consider the benefits of harmonizing the insolvency legislations into a single regime for financial intuitions to ensure effective liquidation process.

Four cornerstones in building a robust and comprehensive legislative framework for effective resolution

1

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3

Clear triggers on when powers are to be exercised by the resolution authority

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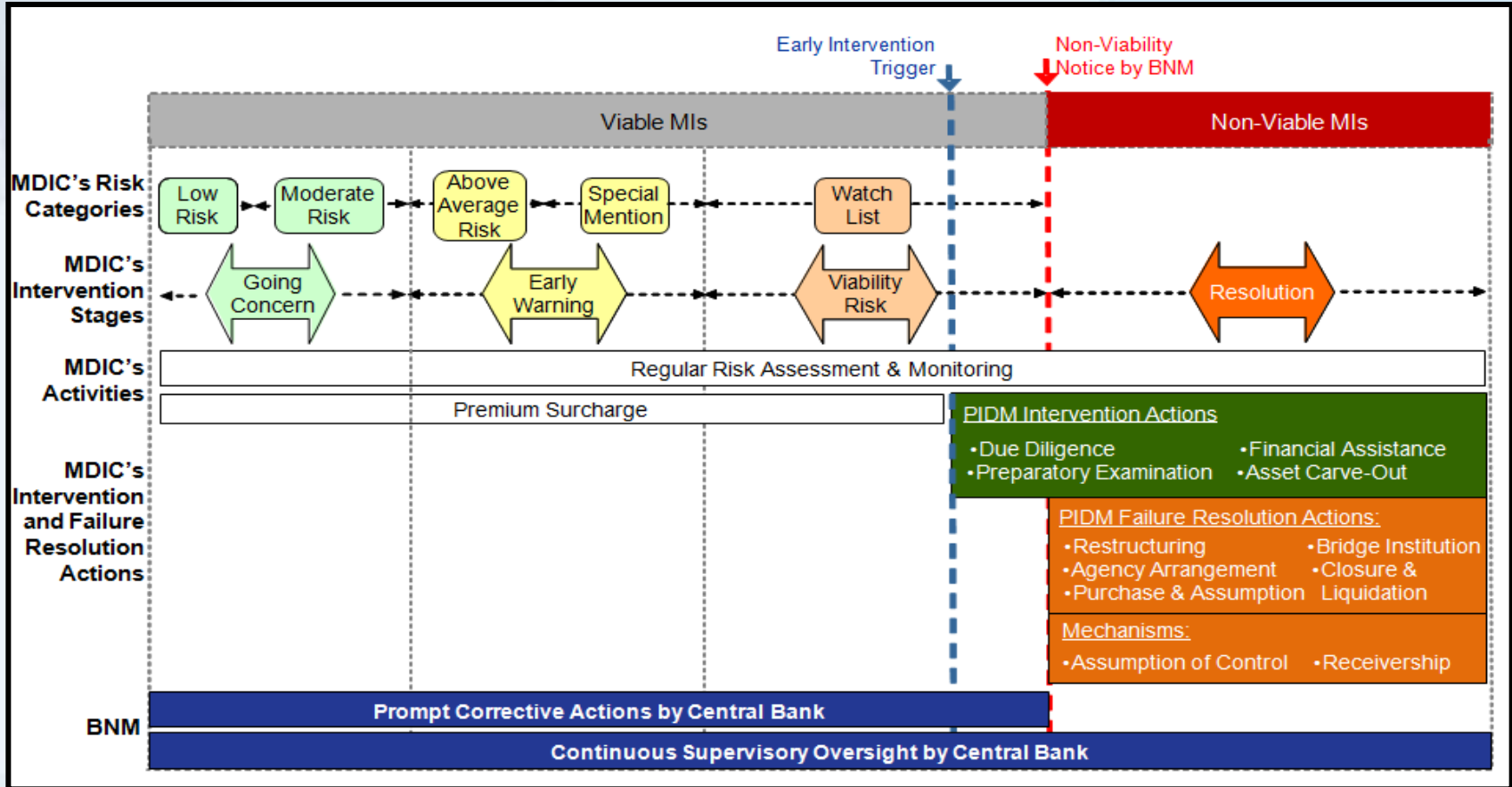
2

Extensive and clearly defined resolution powers

4

Immunities and protection available to employees and agents of the resolution authority

MDIC's intervention stages and triggers



Clear legislative triggers on when resolution powers will be exercised by MDIC

Notification of non-viability

Section 98 of the MDIC Act provides:

- (1) Bank Negara Malaysia may notify the Corporation in writing where Bank Negara Malaysia is of the opinion that a member institution has ceased to be viable or is likely to cease to be viable.
- (2) A notification under subsection (1) shall be final and binding

Although clear legislative trigger exists, Strategic Alliance Agreement provides for principle-based criteria for early intervention and non-viability determination

Early Intervention Triggers

1. Occurrence of an emergency event such as runs on Member, fraud, gross mismanagement and severe financial losses or exposure experienced by the Member;
2. The Member's capital is close to breaching the minimum regulatory level and the Member has not taken any effective measures or the measures taken have failed to strengthen the capital level within an appropriate time frame;
3. Rising trend in deposit withdrawal within a specific time frame;
4. Loss of confidence by the regulators in the management of the Member;
5. Breach of regulatory requirements that may lead to an adverse effect on the Member's business and financial soundness;
6. Concern over the Member's ability to meet some of its maturing obligations and the Member's access to funding is limited; or
7. Failure or potential failure of the Member's parent company, important associate and affiliate companies or significant shareholder.

Non-Viability Criteria

1. The Member is not following sound business and financial practices and further regulatory directives would not reasonably improve the Member's prospects to restore or preserve its business and financial soundness;
2. Shareholders are unlikely to restore the Member's capital to its regulatory level within an appropriate time frame and failure to do so would jeopardise the interest of depositors;
3. The Member is dependent, to an excessive extent, on loans, advances, guarantees or other financial assistance to sustain its operations; or
4. The Member has lost the confidence of depositors and the public.

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Immunities and protection to employees and agents of MDIC

Section 207 (1) provides:

No action, suit, prosecution or proceeding whatsoever shall lie or be brought, instituted or maintained in any court, tribunal or before any other authority against-

- (a) The Government of Malaysia or a State Government
- (b) The Minister
- (c) MDIC
- (d) Bank Negara Malaysia
- (e) Any director, officer or employee of any such Government, MDIC or Bank Negara Malaysia, either personally or in their official capacity
- (f) Any appointed person, any receiver, liquidator pursuant to the MDIC Act, the Assessor Committee or any of its members
- (g) Any director, officer, employee of a bridge institution or any wholly owned subsidiary of MDIC
- (h) Any person lawfully acting on behalf of any such Government, MDIC, Bank Negara Malaysia or any such director, officer or employee, either personally or in his capacity as a person acting as such,

for or on account of, or in respect of, any act done or statement made or omitted to be done or made, or purporting to be done or made or omitted to be done or made, in pursuance or in execution of, the MDIC Act, or any order in writing, direction, instruction, notice or other thing whatsoever issued under the MDIC Act:

Provided that such act or statement was done or made, or was omitted to be done or made, in good faith.

Agenda

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D. Conclusion

Future initiatives

MDIC periodically undertakes initiatives to test the robustness of its legislative provisions through best practice benchmarking exercise as well as failure resolution simulations exercises.

Some of the potential legislative reform initiatives include:

- Single insolvency regime for financial institutions
- Powers for MDIC to be the appointed liquidator
- Powers to effect resolution for systematically important financial institutions and financial groups

Agenda

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In conclusion...

I will leave you with this note on resolution powers.

- It is key to have a wide resolution toolkit which is flexible and able to be applied across different resolution scenarios
- When designing a legal framework for resolution of financial institutions, be clear of the resolutions you would need to effect in line with your mandate
- Ensure that relevant legal protection and immunities are provided to the resolution authority, its personnel and agents in executing its resolution functions.

Thank You

Appendix

Relevant Resolution Related Provisions in MDIC Act



Part I

PRELIMINARY

Section

1. Short title and commencement
2. Interpretation

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MALAYSIA DEPOSIT INSURANCE CORPORATION

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10. Establishment of subsidiaries

Chapter 2

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Chapter 3

Chief Executive Officer

Chapter 4

Officers and employees

Chapter 5

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Relevant Resolution Related Provisions in MDIC Act



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Chapter 3

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Transfer of Assets and Liabilities

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Entitlement to Preserve, Dispose of or Acquire Property