
Session 5:

THE ROLE OF DEPOSIT INSURANCE SCHEMES IN THE FINANCIAL SAFETY NET

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1. THE OBJECTIVES OF THE DGS

There are two primary objectives of the DGS – to support consumer and market confidence, and to support financial stability. They are connected. The DGS is, of the safety net players, the one with the closest, most direct relationship and contact with individual consumers (i.e. depositors). The Ministry of Finance or regulator may not expect to deal with large numbers of individual consumers. Whatever form protection takes, whether “least cost”, “loss” or “risk minimiser”, or “paybox”, protection must support those two objectives, and the DGS must be equipped operationally to do so.

Recent events have also emphasised the need to promote awareness of the DGS, independently from the safety net, albeit collaboration with both regulators and the industry is required to raise awareness. Whether awareness is of a DGS brand or of the scope of protection is an open question – but the DGS needs to manage consumer awareness of the protection in order to support the objectives of confidence and financial stability.

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2. THE PRE-CONDITIONS

In addition to the 18 core principles themselves, the IADI Core Principles for Effective Deposit Insurance System helpfully set out the necessary pre-conditions for an effective deposit insurance system. These importantly refer to standards required for setting the scope and framework within which the deposit insurer can operate e.g. the legal framework, an established insolvency process with a corporate (albeit this may now be regarded as inadequate) or a special regime, and the requirement for established and effective regulation – such supervisor to be a “partner” of the DGS. It is worth noting that the costs of the DGS may be considered an element of the cost of regulation.

3. THE RELATIONSHIPS OF THE DGS

The obvious relationships are with the safety net players i.e. the Ministry of Finance, the Central Bank, the supervisor and (if different) the resolution authority.

To engage in such relationships, the DGS needs a clear mandate with established powers for execution of its role. It needs to be adequately resourced and funded to be able to fulfil that duty. The independence of a DGS from other safety net players provides reassurance to consumers and to the industry. Consumers can be satisfied the DGS will not be influenced by political or regulatory issues when deciding on intervention or payout; this independence also protects the industry as the levy payer and funder of the DGS. However, the DGS must be accountable to the authorities, whether the regulator and/or Ministry of Finance or other governmental bodies. In practice, this may be delivered by an independent board accountable by statute (or by agreement).

Between the multiplicity of safety net players, responsibilities should be understood and documented. Although maligned during the crisis, the Memorandum of Understanding remains a useful tool for such purpose.

The need for and benefit of close relationships with safety net players are evidenced in contingency planning, for example access to data required for payout (such as the single customer view). In the UK, the “SCV” data allows FSCS to provide “payout reports” to assist the resolution authority in its decision making (as payout may be preferred to more invasive resolution methods). Contingency planning, scenarios and simulations need to be developed in partnership with the regulatory authorities.

4. INVESTOR AND POLICYHOLDER PROTECTION SCHEMES

Increasingly, such schemes have prominence within the safety net, even if generally considered to address issues which are less systemic than deposit insurance. Within Europe, Directives require investor compensation and may mandate insurance guarantee schemes, albeit at present there is a varied approach across the Member States.

There are clearly shared interests between protection schemes relating to consumer protection and market confidence, and the role of consumer awareness to engender market confidence and financial stability. There are advantages to integration provided by combined resource and critical mass, and an arguably higher state of operational readiness. In any event, schemes need to share information, and consider working together both to plan for a crisis and failures, and also to deliver both protection itself and clear and consistent messages to consumers.

5. THE LAST RESORT

The DGS is neither the first nor the last resort – indeed the last resort is likely to be temporary public ownership (or nationalisation). Recovery comes before resolution or deposit payout, managed through supervisory responsibilities.

Whether the introduction of the DGS is before, with, or after resolution may depend between jurisdictions. In the UK, the liquidation and payout option is to be considered, and deployed or discarded, before more invasive resolution measures (such as transfer of deposits and assets or a bridge bank). In any event, FSCS may contribute to the costs of a transfer of deposits, insofar as the amount does not exceed the cost of payout in an insolvency.

Wherever the DGS ranks, the importance of contingency planning and collaboration between the authorities at an early stage cannot be underestimated. The DGS should be part of the regulatory and resolution process and not introduced as an afterthought.

6. IS THE ROLE OF THE DGS ENHANCED?

Following the crisis, governments are determined to protect the taxpayers from future costs. This elevated the importance of the role of the DGS during the crisis and since the crisis in reform measures. The DGS must provide consumer protection, support financial stability, but be funded by the industry. This is emphasised by the work around the IADI Core Principles.

Many DGS have gained additional powers, resources and responsibilities following the crisis and have improved operability – for example faster payout. In Europe, Member States are responding to the more rigorous requirements in the Deposit Guarantee Schemes Directive. The crisis has also led to closer relationships between the authorities as evidenced by MoUs. It is important the DGS has the opportunity to influence policy development, reflecting the benefit of practical experience.

The DGS has the contact with the consumer – it is the DGS which protects “the little guy”. In view of the increased importance of that role, and additional new powers and resources, there are the commensurately increased expectations of the DGS to deliver protection. The position has moved on markedly from 2007/2008 and the DGS needs to be ready to respond to the future challenges.