Fred Carns*

THE ROLE OF DEPOSIT INSURANCE SCHEMES IN THE FINANCIAL SAFETY NET

The recent evolution of deposit insurance (DI) in the United States, which involves primarily the reforms prescribed in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), and the global evolution of DI more generally in recent years, are, to a degree, parallel stories. Clearly, there is a trend toward expanded powers for DIs within the financial safety-net with increasing emphasis on effective DI operation as an essential component of the larger financial stability framework. The role of DIs is both expanding and deepening throughout the global architecture for maintaining financial stability.

For historical context, it is helpful to begin with a look at the growth in the sheer number of DI systems worldwide over the past seven decades. The first national system of DI was established in the USA, where the Federal Deposit Insurance Corporation (FDIC) began operations in 1934. The next system did not appear until 1961, when India established its DI system. During the subsequent 20 years, 15 DI systems were established. Since 1980, 118 systems have been created. The rise to prominence of explicit DI systems within the global stability framework has been a relatively recent phenomenon.

Experience has taught us that DI provides essential confidence, especially during times of crisis. With the development of Core Principles and a Methodology

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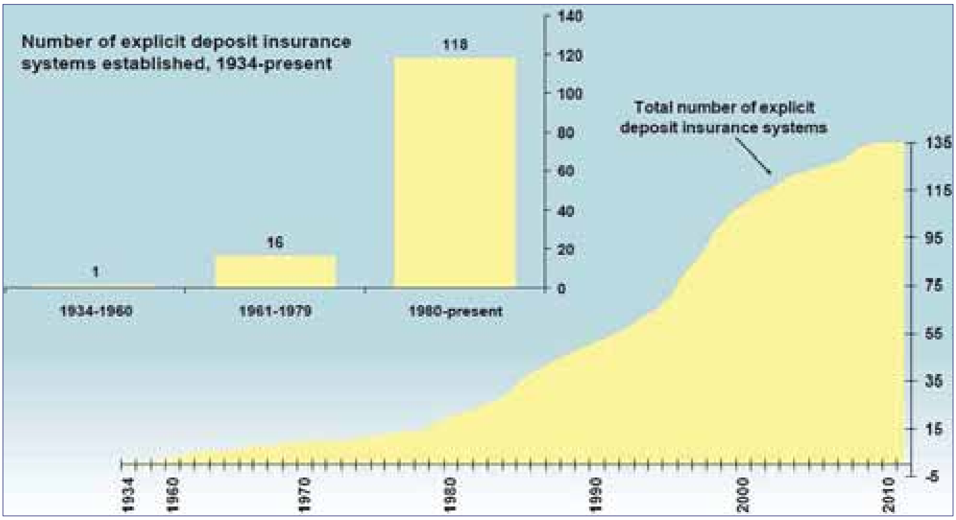
* Fred Carns is the Director, International Affairs, Federal Deposit Insurance Corporation.

for assessing compliance, there is a global focus on making DI systems function as effectively as possible[1]. The Financial Stability Board (FSB) has included the Core Principles among its 12 key standards and is currently using these to conduct a thematic review of DI systems among G20 countries. And the IMF and World Bank will use the Core Principles and Methodology for their Financial Sector Assessment Program.

Chart 1. The number of deposit insurance systems has increased significantly over time[2]



Source: Author's slide no 2 of the presentation at the Conference session.

Looking at recent experience in the USA, the DI system proved to be very effective in preventing bank runs during the crisis despite a substantial number of bank failures. Chart 2 shows that bank failures in the US rose from 0 in 2006 to 140 in 2009 and 157 in 2010 before moderating this year, and that 48 banks failed as of June 11, 2011. The updated number is 80 failures as of October 14, 2011. The upshot is that we have had a very large number of failures over the past 3 years in the US without experiencing any bank runs.

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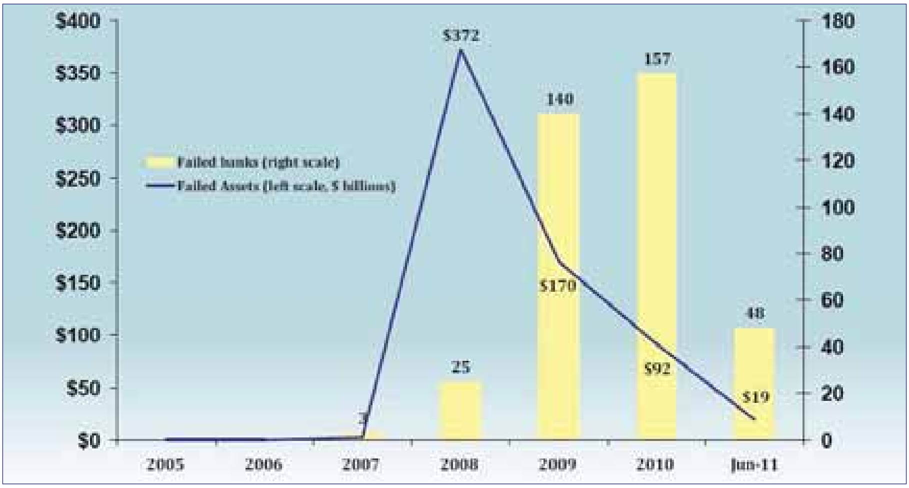
1 As of May 8, 2012, IADI shows 139 individual deposit insurance systems across 111 jurisdictions.

2 Core Principles for Effective Deposit Insurance Systems were developed by the International Association of Deposit Insurers and the Basel Committee on Banking Supervision in 2009.

Chart 2. Despite bank failures in the recent crisis, there have been no bank runs in the U.S.[3]



Source: Author's slide no 4 of the presentation at the Conference session.

Chart 3. Dodd-Frank reform has expanded the role of deposit insurance in the U.S.

Source: Author's slide no 5 of the presentation at the Conference session.

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3 As of year-end 2011, the number of bank failures in the U.S. was 92, comprising $32.9 billion in assets.

As part of the financial reforms enacted with the Dodd-Frank Act in the wake of the crisis, the role of the FDIC was expanded significantly. The new responsibilities include: resolution authorities for both banking institutions and non-bank financial institutions that are determined to be systemically important financial instutions (SIFIs); new authority shared with the Federal Reserve Board (FRB), to determine the content of resolution plans, or so-called “living wills”, submitted by SIFIs and impose restrictions on institutions that fail to submit adequate resolution plans; strengthened authority for back-up examinations and information-sharing; more discretion for the FDIC to determine the optimal size of the insurance fund; permanently higher coverage limits; and several technical changes designed to enhance the effectiveness of DI operations.

The Dodd-Frank Act established the Financial Stability Oversight Council (FSOC) charged with monitoring macro-stability, viewing the “big picture”, and with identifying the universe of nonbank-SIFIs that should be subject to enhanced prudential supervision by the FRB. The FDIC is a member of the FSOC along with the other federal financial regulatory agencies and there is also a seat on the Council for an independent member with insurance industry expertise. The FSOC is chaired by the Secretary of the Treasury. A number of standing committees have been established by the FSOC to help carry out its functions, and the FDIC serves on those committees that align with its expanded responsibilities.

Chart 4. The FDIC has taken several actions in line with its expanded powers

Source: Author’s slide no 7 of the presentation at the Conference session.

The FDIC has taken several actions post-crisis that reflect its expanded powers. It has created a new internal organization for monitoring risk and resolving the failures of SIFIs, and for addressing the international aspects of cross-border monitoring and failure resolution.

The FDIC also established a Systemic Resolution Advisory Council of outside experts to provide advice on a broad range of issues relating to SIFI resolution.

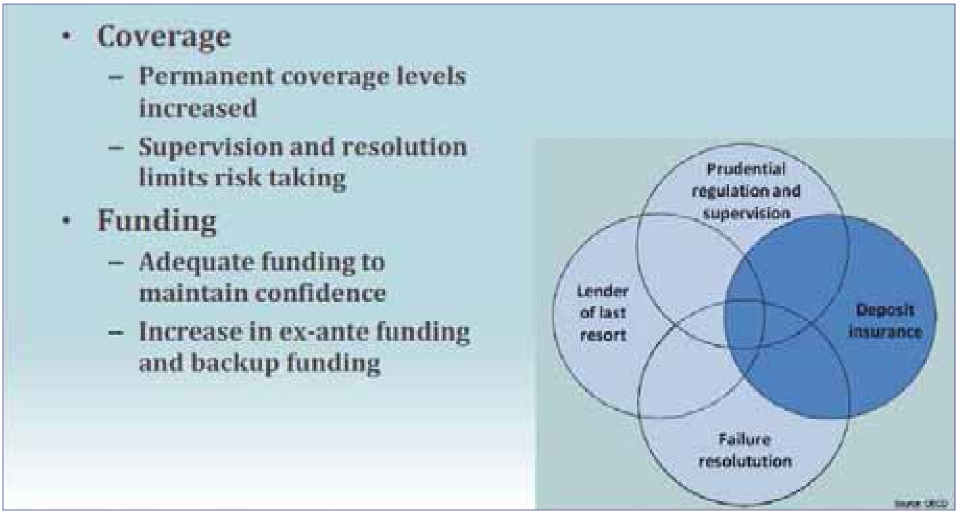
Chart 4 indicates the actions taken by the FDIC pursuant to its new authorities, and these are in various stages of completion. One update to Chart 4 is that the very important rule on resolution plans (or "Living Wills") is no longer a proposed rule, but is now final. All banking organizations larger than $50 Billion in assets and all other designated SIFIs will now be required to submit resolution plans that meet the criteria specified by the FDIC and FRB.

Chart 5. The global evolution of deposit insurance, in some ways, parallels that of the FDIC

Source: Author's slide no 8 of the presentation at the Conference session.

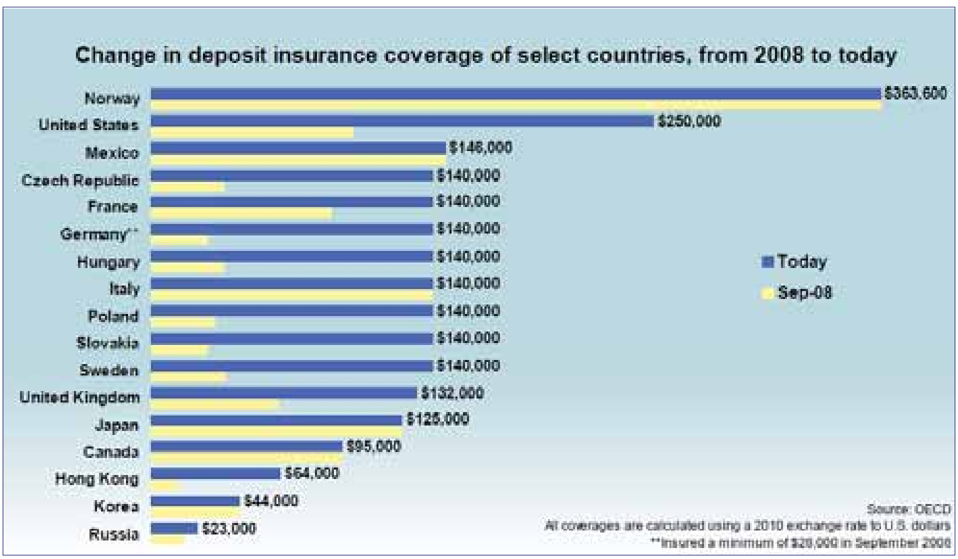
It is worth pointing out that what is happening globally with DI resembles, in varying degrees, what was just described for DI in the US. We all appear to be learning the same types of lessons together. As we look at the trends in DI systems worldwide, we see increased depositor protection combined with stronger supervision, more integration and closer coordination of safety-net functions, attention to crisis management in safety-net design, and expanding resolution authority to address the problems of the too-big-to-fail financial institutions and cross-border operations.

Chart 6. Deposit insurance is more embedded in the financial stability framework



Source: Author's slide no 9 of the presentation at the Conference session.

Chart 7. Deposit insurance coverage has generally increased as a result of the crisis



Source: Author's slide no 10 of the presentation at the Conference session.

DI is now recognized around the world as more than simple depositor protection. A well-functioning DI program is considered essential for maintaining confidence in, and promoting the stability of, the larger financial system. Correspondingly, we see a strong focus on establishing adequate coverage levels and securing adequate funding of DI systems *ex-ante*.

Chart 7 documents the point that coverage levels in many countries have been permanently increased as a result of the financial crisis. Across the world, coverage levels on average are higher today by a good margin than they were at the beginning of the financial crisis.

Chart 8. Deposit insurance continues to spread globally

Source: Author's slide no 11 of the presentation at the Conference session.

Chart 9. The role and features of deposit insurance system are evolving

Source: Author's slide no 12 of the presentation at the Conference session.

With the Core Principles in place to guide DI design, advances in capacity for rapid data collection and faster payout, and with harmonization of processes across borders, we can expect to see the continued advancement of DI around the globe and continued enhancements to established DI systems and their supporting structures.

While the institutional details may differ, countries around the world will continue, out of necessity, to develop and enhance the functions relating to effective DI systems, including resolution processes for SIFIs, means for cross-border harmonization, and coordinated systems of macroprudential supervision. The essential interconnectedness of these functions for maintaining financial stability compels policymakers to adopt decision-making structures that include all of the key safety-net participants, DIs in particular. Indeed, that is what we observe around the world and expect to continue as we move forward. As a result, this is a time of great opportunity for DIs, and we can seize that opportunity by continuing to work through the International Association of Deposit Insurers (IADI) to ensure that DI systems achieve their full potential for contributing to global financial stability.