



IADI Core Principles: Mapping Against the GDGB

Date of Paper : 21 July 2010

Version Number : V1.00

Table of Contents

Purpose	4
Background	4
IADI Core Principles for Effective Deposit Insurance Systems	4
IADI Principle 1 – Public policy objectives:	4
IADI Principle 2 – Mitigating moral hazard:	5
IADI Principle 3 – Mandate:	5
IADI Principle 4 – Powers:	5
IADI Principle 5 – Governance:	6
IADI Principle 6 – Relationships with other safety-net participants:	6
IADI Principle 7 – Cross-border issues:	6
IADI Principle 8 – Compulsory membership:	7
IADI Principle 9 – Coverage:	7
IADI Principle 10 – Transitioning from a blanket guarantee to a limited coverage deposit insurance system:	7
IADI Principle 11 – Funding:	8
IADI Principle 12 – Public awareness.....	8
IADI Principle 13 – Legal protection	8
IADI Principle 14 – Dealing with parties at fault in a bank failure:	9
IADI Principle 15 – Early Detection and timely intervention and resolution:	9
IADI Principle 16 – Effective resolution processes:	9
IADI Principle 17 – Reimbursing depositors:	10
IADI Principle 18 – Recoveries:	10

Published by:

Gibraltar Deposit Guarantee Board

C/O 943 Europort, Gibraltar

www.gdgb.gi



Purpose

This paper outlines the core principles as decided by the collaboration of the Basel Committee on Banking Supervision (BCBS) and the International Association of Deposit Insurers (IADI) in July 2008. These have been reviewed by both institutions resulting in an internationally agreed set of Core Principles for Effective Deposit Insurance Systems. These are detailed alongside the Gibraltar Deposit Guarantee Scheme' actions which establish these shared principles.

Background

The Deposit Guarantee Scheme Act, 1997 establishes 'The Gibraltar Deposit Guarantee Board.' This Board is charged administering the Deposit Guarantee Scheme. The Board is independent from the Financial Services Commission or Government of Gibraltar. The Board may employ persons to provide secretarial services for the day to day administration of the Scheme or for administering a bank failure.

Appointments to the Board are made by the Minister responsible for Financial Services. The Board also has a Secretary who has no voting rights. The Chairman has a casting vote amongst members present at any meeting. The quorum of the Board will be three members, one of whom must be the Chairman.

The Board is a body corporate and may be sued in its name. However, members of the Board have immunity from prosecution or suit in performing their functions unless they are shown to have been acting in bad faith.

The Board is required to have its accounts audited and these must be published within three months of the end of the audit taking place.

More information on the functioning and purpose of the scheme may be obtained from the Board's web-site at www.gdgb.gi

IADI Core Principles for Effective Deposit Insurance Systems

IADI Principle 1 – Public policy objectives:

The first step in adopting a deposit insurance system or reforming an existing system is to specify appropriate public policy objectives that it is expected to achieve. These objectives should be formally specified and well integrated into the design of the deposit insurance system. The principal objectives for deposit insurance systems are to contribute to the stability of the financial system and protect depositors.

The GDGB has been designed to secure Gibraltar deposits and offer reassurance to depositors of the security of their monies. By providing the public the assurance that compensation will be provided in the event of a bank being declared in default, depositors are aware of the level of protection and therefore perceive for the financial system to be sound.

IADI Principle 2 – Mitigating moral hazard:

Moral hazard should be mitigated by ensuring that the deposit insurance system contains appropriate design features and through other elements of the financial system safety net.

The scheme is activated by one of its participants being declared in default by the Commissioner of Banking which must take place within 5 days. The other participants of the scheme would be required to provide a pre-specified sum into the scheme in order to fund the compensation which would become payable to the eligible account holders in the defaulting bank. Verified claims must be paid within 20 working days of the Commissioner's declaration having taken place. The timescales in place (which are Directive led) provides the public at large with a known amount of time by when they might expect to receive their claim.

IADI Principle 3 – Mandate:

It is critical that the mandate selected for a deposit insurer be clear and formally specified and that there be consistency between the stated public policy objectives and the powers and responsibilities given to the deposit insurer.

The Deposit Guarantee Scheme Act, 1997 establishes 'The Gibraltar Deposit Guarantee Board.' This Board is charged with administering the Scheme. Powers to the Board are prescribed within the Deposit Guarantee Scheme Act.

IADI Principle 4 – Powers:

A deposit insurer should have all powers necessary to fulfil its mandate and these powers should be formally specified. All deposit insurers require the power to finance reimbursements, enter into contracts, set internal operating budgets and procedures, and access timely and accurate information to ensure that they can meet their obligations to depositors promptly.

The GDGB is backed by the Deposit Guarantee Scheme Act which gives the Board all the necessary powers for the administration of the scheme. These powers include, upon one of the participants being declared in default, that of levying from the remaining participants, one or more levies to meet the costs of the compensation payable under the Scheme.

The timescales by which a bank is declared in default and pay out is to occur is stipulated by legislation which is derived from EU Directives. The Board also collects information from scheme participants on potential compensation on a quarterly basis.

IADI Principle 5 – Governance:

The deposit insurer should be operationally independent, transparent, accountable and insulated from undue political and industry influence.

The GDGB is independent from the Financial Services Commission or Government of Gibraltar. The Board may employ persons to provide secretarial services for the day to day administration of the Scheme or for administering a bank failure.

Appointments to the Board are made by the Minister responsible for Financial Services.

IADI Principle 6 – Relationships with other safety-net participants:

A framework should be in place for the close coordination and information sharing, on a routine basis as well as in relation to particular banks, among the deposit insurer and other financial system safety-net participants. Such information should be accurate and timely (subject to confidentiality when required). Information-sharing and coordination arrangements should be formalised.

GDGB participants must submit surveys of potential compensations on a quarterly basis. These surveys are reviewed by the secretary of the scheme who prepares a table documenting the cross liability of each participant should another scheme participant be in default. Each participant is provided with a copy of this document which would stipulate the exposure that each bank has in the event of a failure of any of the other banks. The names of banks are not stipulated within the report for confidentiality reasons.

IADI Principle 7 – Cross-border issues:

Provided confidentiality is ensured, all relevant information should be exchanged between deposit insurers in different jurisdictions and possibly between deposit insurers and other foreign safety-net participants when appropriate. In circumstances where more than one deposit insurer will be responsible for coverage, it is important to determine which deposit insurer or insurers will be responsible for the reimbursement process. The deposit insurance already provided by the home country system should be recognised in the determination of levies and premiums.

In circumstances where the sharing of information is required and provided that confidentiality is ensured, the GDGB would be in a position to exchange relevant information with other jurisdictions under Section 4(3A) of the Act.

It is a condition of a bank's licence that the bank is a member of the Scheme. A branch of an EEA bank can also 'top up' into the Scheme where this offers more advantageous compensation than that of its home State.

Similarly, branches of Gibraltar banks operating in other EEA States (none at present) can 'top-up' into that State's scheme. These branches may withdraw from the Scheme by giving six months notice but will still be liable to pay any contributions should another bank fail between the date of the notice and the expiry of the six months.

IADI Principle 8 – Compulsory membership:

Membership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (e.g. retail and small business depositors) to avoid adverse selection.

It is a condition of a bank's licence that the bank is a member of the Scheme. A branch of an EEA bank can also 'top up' into the Scheme where this offers more advantageous compensation than that of its home State.

Branches of non-EEA State banks are also required to participate in the Scheme where its home country does not offer equivalent protection.

IADI Principle 9 – Coverage:

Policymakers should define clearly in law, prudential regulations or by-laws what an insurable deposit is. The level of coverage should be limited but credible and be capable of being quickly determined. It should cover adequately the large majority of depositors to meet the public policy objectives of the system and be internally consistent with other deposit insurance system design features.

The GDGB has all of the requirements stated above in The Deposit Guarantee Scheme Act, 1997. Under this Act an eligible deposit is defined under Section 2(2) and Schedule 1 defines deposits which are not qualifying. The Deposit Guarantee Scheme (Amendment) Act 2009 increased the total level of compensation for qualifying deposits to Euro 50,000 and decreased the amount of days that may elapse prior to payment to 20 working days of the occurrence of the event which gives rise to the Commissioner of Banking declaring an institution in default (under Section 10 of the Act.)

IADI Principle 10 – Transitioning from a blanket guarantee to a limited coverage deposit insurance system:

When a country decides to transition from a blanket guarantee to a limited coverage deposit insurance system, or to change a given blanket guarantee, the transition should be as rapid as a country's circumstances permit. Blanket guarantees can have a number of adverse effects if retained too long, notably moral hazard. Policymakers should pay particular attention to public attitudes and expectations during the transition period.

The GDGB has a limited coverage approach but any changes would be reliant on Gibraltar legislation being amended. Any Directive led changes are transposed into local law were necessary.

IADI Principle 11 – Funding:

A deposit insurance system should have available all funding mechanisms necessary to ensure the prompt reimbursement of depositors' claims including a means of obtaining supplementary back-up funding for liquidity purposes when required. Primary responsibility for paying the cost of deposit insurance should be borne by banks since they and their clients directly benefit from having an effective deposit insurance system.

For deposit insurance systems (whether ex-ante, ex-post or hybrid) utilising risk adjusted differential premium systems, the criteria used in the risk-adjusted differential premium system should be transparent to all participants. As well, all necessary resources should be in place to administer the risk-adjusted differential premium system appropriately.

The Gibraltar scheme is an ex-post scheme whereby scheme participants would need to contribute to the pay-outs of a failure in a participant bank. GDGB participants must submit surveys of potential compensations on a quarterly basis. These surveys are reviewed by the secretary of the scheme who prepares a table documenting the cross liability of each participant should another scheme participant be in default. Each participant is provided with a copy of this document and therefore are aware of the potential compensation to be paid out.

IADI Principle 12 – Public awareness

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

The GDGB has a website (www.gdgb.gi) which is kept up to date with any amendments to legislation. All participants in the Scheme must make available to their depositors information about the scheme(s) to which they belong as well as a summary of the provisions of the scheme(s) including the amount and scope of their coverage. Actual or intending depositors may ask banks for details about the conditions for compensation and the procedures for claiming it and the bank must provide this. All this information must be provided in English when given in Gibraltar or in the official languages of the Member State in which the branch is operating.

Advertisements for deposits may make factual references to the existence and participation of the bank in these schemes. If a licensed bank is not a participant, it must also state this fact.

IADI Principle 13 – Legal protection

The deposit insurer and individuals working for the deposit insurer should be protected against lawsuits for their decisions and actions taken in "good

faith" while discharging their mandates. However, individuals must be required to follow appropriate conflict-of-interest rules and codes of conduct to ensure they remain accountable. Legal protection should be defined in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified.

Section 6(2) of the Act states that "The members of the Board, their alternates, the Secretary and outside persons appointed under section 5(8) shall have immunity from prosecution or suit for all their actions or omissions while carrying out their functions for the Board unless any action or omission is shown to have been in bad faith."

IADI Principle 14 – Dealing with parties at fault in a bank failure:

A deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in a bank failure.

Dependant on the cause of the bank failure, there are provisions under Section 82 of the Financial Services (Banking) Act for the Financial Services Commission to seek redress.

IADI 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.

This falls under the remit of the Financial Services Commission through the Financial Services (Banking) Act and Financial Services (Capital Adequacy of Credit Institutions) Regulations, 2007. Supervisory quarterly returns will reflect the own funds requirements that a bank should have in place and would highlight if a bank is reducing its buffer to the regulatory minimum. If the bank is falling close to its minimum own funds requirements, the FSC would then take action towards remediation of the position.

IADI Principle 16 – Effective resolution processes:

Effective failure-resolution processes should: facilitate the ability of the deposit insurer to meet its obligations including reimbursement of depositors promptly and accurately and on an equitable basis; minimise resolution costs and disruption of markets; maximise recoveries on assets; and, reinforce discipline through legal actions in cases of negligence or other wrongdoings. In addition, the deposit insurer or other relevant financial system safety-net participant should have the authority to establish a flexible mechanism to help preserve critical banking functions

by facilitating the acquisition by an appropriate body of the assets and the assumption of the liabilities of a failed bank (e.g. providing depositors with continuous access to their funds and maintaining clearing and settlement activities).

The Deposit Guarantee Scheme Act 1997, Sections 11 and 12, detail the length of time that can elapse prior to payments being made and the level of applicable compensation. The GDGB originally set up an IT system to deal with pay outs however this is now of date. Further information is being sought from other jurisdictions to ascertain how they deal with payouts so that a more appropriate system and procedure can be put in place.

IADI Principle 17 – Reimbursing depositors:

The deposit insurance system should give depositors prompt access to their insured funds. Therefore, the deposit insurer should be notified or informed sufficiently in advance of the conditions under which a reimbursement may be required and be provided with access to depositor information in advance. Depositors should have a legal right to reimbursement up to the coverage limit and should know when and under what conditions the deposit insurer will start the payment process, the time frame over which payments will take place, whether any advance or interim payments will be made as well as the applicable coverage limits.

The Deposit Guarantee Scheme Act 1997 includes all the relevant information that the depositor should be aware of. This legislation can be accessed through the Financial Services Commission website www.fsc.gi or the GBGB website www.gdgb.gi. Additionally, the GDGB website also includes the relevant information in a manner more easily accessible by the general public. The Deposit Guarantee Scheme Act 1997, Sections 11 and 12, detail the length of time that can elapse prior to payments being made and the level of applicable compensation.

All participants in the Scheme must make available to their depositors information about the scheme(s) to which they belong as well as a summary of the provisions of the scheme(s) including the amount and scope of their coverage. Actual or intending depositors may ask banks for details about the conditions for compensation and the procedures for claiming it and the bank must provide this. All this information must be provided in English when given in Gibraltar or in the official languages of the Member State in which the branch is operating.

IADI Principle 18 – Recoveries:

The deposit insurer should share in the proceeds of recoveries from the estate of the failed bank. The management of the assets of the failed bank and the recovery process (by the deposit insurer or other party carrying out this role) should be guided by commercial considerations and their economic merits.

This is dealt with under Section 18 of the Deposit Guarantee Scheme Act 1997 which explains the Board's right to subrogation. Section 18 of the



Act allows the Board to substitute the claimant as a creditor of the defaulting bank; this section of the Act states: "(3) Any amount received by the Board under this section shall be paid into the fund established in respect of the default in question. The Board shall pay the claimant any amount which it receives in respect of his deposit and which exceeds–

(a) the amount of compensation paid or payable in respect of the particular qualifying deposit; and

(b) any costs incurred by the Board specifically in relation to that deposit."