

# **LEGAL ASPECTS OF DEPOSITOR PROTECTION SCHEMES: COMPARATIVE PERSPECTIVE**

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## I. Introduction

The primary purpose of this paper is to provide an overview of the main legal issues regarding depositor protection schemes and to analyse those issues in a comparative context.

At the outset, depositor protection schemes, and specifically deposit insurance systems, do not exist in a vacuum, but rather are components of an overall financial safety net. At its heart, the purpose of a financial safety net in any given jurisdiction is to minimise systemic risk, while at the same time promoting financial stability and (hopefully) financial and hence economic development. Of key significance, all parts of the financial safety net are interrelated and must be designed to work together in an integrated manner. According to Mario Giovanoli, “the topics of prudential supervision, liquidation, the potential liability of financial authorities and deposit guarantee schemes are linked and form a vast cluster of interrelated topics which need to be addressed globally.”<sup>1</sup>

Further, it is generally agreed that law and legal infrastructure have a key role in building not only an effective financial safety net, but also in financial stability generally and moreover in financial and economic development.<sup>2</sup> In a recent paper, Asli Demirgüç-Kunt and Edward Cane analyse the relationship between deposit insurance and financial stability.<sup>3</sup> They conclude: “[c]ross-country empirical research on deposit insurance strongly supports the hypothesis that in institutionally weak environments, poorly designed deposit-insurance arrangements tend to increase the probability of future banking crises.”<sup>4</sup> Based on this conclusion they recommend that governments should address weaknesses in transparency, deterrence and accountability before adopting explicit deposit insurance schemes, with specific focus on banking regulation and supervision, protection of property rights, enforceability of contracts, and quality of accounting and disclosure.<sup>5</sup> Similarly, James Barth, Gerard Caprio, Jr and Ross Levine stress that “regulations and supervisory practices that force accurate information disclosure and limit the moral hazard incentives of poorly designed deposit insurance critically boost bank performance and stability.”<sup>6</sup>

This paper does not analyse the specific policy and design features of deposit insurance, as this has been done elsewhere.<sup>7</sup> Rather, the authors, to present an analogy, focus on structural issues, much as would a structural engineer when faced with implementation of an architect’s overall design.

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<sup>1</sup> M. Giovanoli, “Preface”, in M. Giovanoli & G. Heinrich (eds), *International Bank Insolvencies: A Central Bank Perspective* (London: Kluwer 1999), xv.

<sup>2</sup> See A. Demirgüç-Kunt & R. Levine (eds), *Financial Structure and Economic Growth: A Cross-Country Comparison of Banks, Markets, and Development* (MIT: Cambridge MA 2001).

<sup>3</sup> A. Demirgüç-Kunt & E. Cane, *Deposit Insurance around the Globe: Where does it work?* (Washington DC: World Bank July 2001).

<sup>4</sup> Demirgüç-Kunt & Cane, 24.

<sup>5</sup> *Id.*, 25.

<sup>6</sup> J. Barth, G. Caprio & R. Levine, “Bank Regulation and Supervision: What Works Best?” (Washington DC: World Bank Aug. 2001), 41.

<sup>7</sup> See FSF, *Guidance for Developing Effective Deposit Insurance Systems* (Basel: FSF Sep. 2001); Demirgüç-Kunt & Levine, *supra*; Demirgüç-Kunt & Cane, *supra*; and Barth, Caprio & Levine, *supra*.

## **II. Methodology**

This paper is based upon a series of reports on depositor protection schemes in seventeen jurisdictions,<sup>8</sup> prepared by members and associates of the Centre for Commercial Law Studies at Queen Mary, University of London.<sup>9</sup> Each report was in turn based upon a template designed to elicit key legal issues relating to the respective financial safety net structures and specifically depositor protection schemes and related issues.<sup>10</sup> In turn, the template is based upon international guidance available in the areas covered and upon recent research. Based upon the template and respective reports, the authors developed a summary of the key characteristics of each jurisdiction (section IV below). The information contained in the summaries is detailed at the beginning of section IV.

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<sup>8</sup> In Europe: Germany, Sweden, Turkey and the United Kingdom. In the Americas: Brazil, Colombia, Mexico and the United States. In Africa and the Middle East: Egypt, Nigeria and South Africa. In Asia: Japan, Korea, Malaysia, the People's Republic of China, Taiwan (China) and Thailand

<sup>9</sup> A full list of those involved is included at Annex A to this paper.

<sup>10</sup> The template form is included at Annex B to this paper.

### **III. Comparative Analysis of Depositor Protection Schemes**

In analysing depositor protection schemes, it is first necessary to place them in the appropriate context, namely as one aspect of an overall financial safety net designed to prevent systemic risk and maintain financial stability. In general terms, the financial safety net has developed out of specific regulatory objectives to form the traditional regulatory and supervisory process. In this process, the key authorities and their functions can be categorised as follows: (1) monetary policy authorities; (2) supervisory authorities; (3) lender of last resort; (4) deposit insurance authorities; (5) insolvency authorities; (6) criminal authorities; (7) the legislature and government (policy); (8) the judicial system (dispute resolution, contract enforcement and judicial review); and (9) international commitments (eg WTO/GATS).

#### **A. Background: Regulatory Objectives**

Historically, banking regulation developed as a response to crises resulting from the nature of banking business as a fractional reserve system based upon the management of credit and duration risks – a system that works wonderfully so long as depositors remain confident in the safety of their money with individual banks. The risk, of course, is that the collapse of one bank could lead contagious loss of confidence, resulting in bank runs, potentially causing the collapse, not only of individual banks, but of the banking system as whole (systemic risk) and the consequent collapse of economic activity generally.<sup>11</sup>

The response to this classic, but very real, problem was the development of the theory of the need for a “Lender of Last Resort” (LoLR) by Walter Bagehot in his seminal work, *Lombard Street*. The LoLR would provide liquidity support in order to allow banks to meet depositors’ demands and avoid closure, thereby supporting confidence and stemming potential systemic collapse.

The problem, of course, is the equally classic theory of “moral hazard”. Specifically, in this context, moral hazard has two components: first, potential incentives to management to take additional (perhaps excessive) risks due to the promise of a government bailout; and second, the consequent risk to public purse due to the potential expense.

The response to this problem has been the development of what may be termed the “traditional process of bank regulation and supervision”.

#### **B. Regulatory and Supervisory Process**

Under this formulation, the goal of the traditional regulatory and supervisory process is simple on its face: the prevention and resolution of financial institution crises. Unfortunately, while the goal is simple; its achievement is anything but. Nonetheless, it is worth reviewing the contents of the traditional formulation for preventing and resolving bank crises. At its most basic, the formulation involves two sets of processes: one *ex ante*, the other *ex post* crisis.

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<sup>11</sup> This section draws on R. Lastra, *Central Banking and Banking Regulation* (London: Financial Markets Group 1996).

The *ex ante* measures focus on two related goals: first, supporting sound management and internal controls (a well-managed bank is less likely to be the subject either of a crisis or of contagion); and second, regulation and supervision and supervision (bank management has short memories and needs to be given rules to follow and monitored to make sure that they in fact follow the rules). Key issues of course relate to the administrative process and rule/discretion-based approaches (eg prompt corrective action). Of course, once again, while both appear relatively simple on their face, only recently have we begun to arrive at agreed formulations of their content.<sup>12</sup>

The *ex post* measures focus on bolstering confidence, stemming contagion and resolving problem institutions. Immediate measures focus on suspension of convertibility (never popular), the provision of support through the LoLR mechanism (to deal with illiquidity) and various mechanisms for depositor protection, of which deposit insurance is the most significant (to address insolvency). In addition to the immediate measures, other *ex post* measures are required to deal with the insolvency of individual institutions. In respect to individual institution insolvencies, four key mechanisms exist: (1) organisation of a rescue package; (2) provision of open assistance; (3) merger or acquisition (public or private); and (4) liquidation and pay-off. Finally, in some cases, measures will be required to address systemic insolvency, but these are rarely (if ever) organised in advance of such an actuality.

### C. Crisis management – individual banks

In looking at the role of law, it is worth looking in greater depth at issues that arise in the traditional crisis management process. Typically, suspension of convertibility is not provided for *ex ante* (although it may be and has been, for example, in Sweden).

Of greater concern is the LoLR process. Under the current formulation (based upon the ideas of Thornton and Bagehot in the 19<sup>th</sup> century), provision of LoLR support should follow the following rules<sup>13</sup>:

- (1) Support should only be provided to **temporarily illiquid but solvent** banks;
- (2) Support should be provided **freely but at penalty interest**;
- (3) Support should be provided to **anyone with good collateral** who meets (1) and (2);
- (4) The LoLR should make its **readiness to lend clear ex ante**;
- (5) Nonetheless, the decision to provide support should remain **discretionary**; and
- (6) This discretion should be based upon the test of the **existence of potential systemic risk**.

While LoLR is typically not thought of in terms of legal issues, in fact, the formulation is clearly based upon the presupposition of a functioning legal system supporting financial transactions, as well as upon an effective regulatory and supervisory process.<sup>14</sup>

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<sup>12</sup> See generally J. Norton, *Devising International Bank Supervisory Standards* (The Hague: Kluwer 1995) and the ever-growing body of work emanating from the Basel Committee on Banking Supervision, available at [www.bis.org](http://www.bis.org).

<sup>13</sup> See R. Lastra, “Lender of Last Resort: an International Perspective”, 48 *ICLQ* 339-60 (Apr. 1999).

<sup>14</sup> In fact, this is the basis of international efforts to support financial stability: see Group of Ten (G-10), “A Strategy for the Formulation, Adoption and Implementation of Sound Principles and Practices to Strengthen Financial Systems”, Report of the Group of Ten (G-10) Working Party on Financial Stability in Emerging

“Temporarily illiquid but solvent” requires two sets of preconditions: (1) supervisory information in order to determine the respective condition; and (2) a definition of insolvency, which is generally a public policy choice enshrined in insolvency legislation. “Freely but at penalty interest”, fortunately, is relatively self-sufficient, except that the LoLR must have the ability in fact to provide potentially unlimited support, which will often only be available through control over the monetary supply. “Anyone with good collateral” clearly requires both a legal judgement and a qualitative judgement. The legal judgement is based upon the ability to take collateral: different legal systems vary greatly on this point.<sup>15</sup> “Readiness to lend clear ex ante” requires a legal system that supports **lending** – very much determined by the respective system of private law. The remaining two criteria “simply” require an effective system of information-gathering on the part of the LoLR in order to make the respective determination – and if that system was perfect, of course, there would be no need for the support in the first place!

This brief discussion is simply intended to show how seemingly fundamental formulations in relation to bank crisis management are based on the underlying legal system. If the requisite elements are not in place, the system cannot meet its goals of preventing systemic risk, while at the same time controlling moral hazard. In the jurisdictions reviewed, there was a mixture of implicit and explicit structures for LoLR, though in most cases the LoLR is the central bank, but in some cases the deposit insurance authority (usually in conjunction with the central bank).

## **D. Deposit insurance**

Turning now to the next mechanism of immediate crisis resolution: the idea that some sort of depositor protection scheme can be put in place to support confidence in times of crisis. In recent years, increasing numbers of jurisdictions have been turning to these sorts of systems, especially deposit insurance.<sup>16</sup> In this section of the paper we elaborate on three interconnected legal and policy issues that are fundamental for the understanding – from a legal point of view – of deposit insurance, before turning to explicit and implicit systems, respectively. The first issue is the mandatory nature of deposit insurance, as opposed to the contingent nature of the lender of last resort role of the central bank. The second issue is the difference between explicit and implicit deposit insurance. The third issue is the status of preferred creditors that insured depositors have under an explicit deposit guarantee scheme.

### **1. Contingent versus mandatory**

Deposit insurance provides a guarantee on certain deposits that is non-contingent. Lender of last resort, on the other hand, is contingent. The injection of liquidity in times of crises is not mandatory, but discretionary, i.e., subject to the discretion of the central bank authority. Thus, explicit deposit insurance provides legal certainty regarding the coverage of insured

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Market Economies (Basel: Group of Ten, April 1997); Group of Twenty-two Systemically Significant Countries, *Reports on the International Financial Architecture* (Oct. 1998).

<sup>15</sup> See eg “Focus on secured transactions”, *Law in transition* (Autumn 2000); N. de la Pena, H. Fleisig & P. Wellons, “Secured Transactions Law Reform in Asia: Unleashing the Potential of Collateral”, *Law and Policy Reform at the Asian Development Bank 2000*, vol. 2 (Manila: ADB 2000); and J. Norton & M. Andenas (eds), *Emerging Financial Markets and Secured Transactions* (London: Kluwer 1998).

<sup>16</sup> See Demirgüç-Kunt & Cane, *supra*, and Barth, Caprio & Levine, *supra*.

depositors. There is always a degree of uncertainty (some economists refer to it as “constructive ambiguity”) regarding the provision of emergency liquidity assistance by the central bank.

It should also be pointed out that while explicit deposit insurance protects mainly the depositors, lender of last resort protects mainly the financial system (systemic considerations).

To minimise the risk of moral hazard, it is important to demarcate what each institutional arrangement can do and what it cannot do or should not do. Explicit deposit insurance can protect insured depositors, but it cannot – nor should – protect other depositors or creditors, nor shareholders, nor managers. Explicit deposit insurance cannot protect the banks, because it can only be activated once a bank is closed. Lender of last resort “can provide emergency liquidity – quick cash up front – over a short period of time, when no other sources of funding are readily available. What the central bank should not do is lend over an extended period of time nor commit funds without the explicit approval of the fiscal authority.”<sup>17</sup> Legislation in the USA (the Federal Deposit Insurance Corporation Improvement Act of 1991) suggests the LoLR loans to insolvent institutions should be made only to *viable* institutions and introduces penalties in the case of extended loans to insolvent institutions; in some cases, the new rules shift the financial burden from the FDIC to the Federal Reserve System when the latter chooses to lend via its Discount Window Lending to insolvent or critically undercapitalised institutions.<sup>18</sup> Thus, the legislation introduces an important element of accountability, which given the discretionary nature of the LoLR, is a salutary development.

As the starting point, any form of depositor protection can either be implicit or explicit. In addition, it is clearly possible for any jurisdiction to have no such system in place at all; while some suggest that no system is in fact an implicit government guarantee, it is possible (though certainly not politically easy) not to provide government support at all and on occasion governments have managed to stand aside. In most cases, however, no deposit insurance system does in fact imply an implicit government guarantee, at least for depositors of the largest financial institutions. While an implicit guarantee certainly raises many issues, these are typically political rather than legal. In the context of the jurisdictions reviewed, Egypt and the PRC both have in place implicit guarantees. South Africa at present could credibly be viewed as not having a system of depositor protection. Egypt appears to intend to retain its current system; both the PRC and South Africa appear to be considering implementing explicit, limited-coverage deposit insurance systems.

Explicit systems typically take one of two forms: (1) an explicit blanket guarantee of all deposits or (2) an explicit, limited-coverage system of deposit insurance. Each raises a variety of legal issues.

## **2. Explicit versus implicit deposit insurance**

Explicit deposit insurance, i.e., the creation of a deposit guarantee scheme by law, with rules with regard to the extent of the “insurance” or protection, the rules of the scheme and the type of deposits/depositors protected, can be an useful instrument of protective bank regulation.

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<sup>17</sup> See R. Lastra, “Lender of Last Resort: an International Perspective”, 48 *ICLQ* 339-60 (Apr. 1999), 344.

<sup>18</sup> *Id.* at 348-349.

Indeed, explicit deposit insurance has traditionally served two purposes: consumer protection and the prevention of bank runs. In this paper we argue that a third rationale of explicit deposit insurance is that it allows the public authorities to close banks more easily, as it becomes politically acceptable to liquidate insolvent institutions, in the knowledge that less unsophisticated depositors are protected.

Under an explicit deposit guarantee scheme, depositors are only paid once the bank is closed, liquidated. Thus, there can be no deposit insurance if the bank remains open. Therefore, explicit deposit insurance presupposes that a bank has failed and, hence, it is not compatible with the “too big to fail” doctrine.

The European Shadow Financial Regulatory Committee in its Statement No. 5 of 18 October 1999<sup>19</sup> took the view that explicit deposit insurance can and should play a key role primarily in facilitating the liquidation of insolvent banks without the need for implicit deposit protection. The ESFRC argued that the practice of bailing out insolvent institutions (implicit protection) creates expectations of official support beyond deposit insurance limits, thereby distorting market incentives and undermining financial discipline (the so-called moral hazard problem). It is the strongly held view of the ESFRC that deposit insurance should be designed and operated in a way that allows, and indeed requires, national authorities to liquidate insolvent banks, thereby exposing uninsured depositors and other creditors to default risk. Such an approach ensures that high-risk institutions pay a market penalty in terms of higher funding costs. In this way excessive risk-taking can be discouraged.

Implicit deposit insurance, as opposed to explicit deposit insurance, is a “blanket guarantee” for all sorts of depositors (insured and uninsured), other creditors, shareholders and even managers. Implicit deposit insurance often presupposes that the bank remains in business (either because it is “too big to fail” or because it is politically difficult to close the bank) thus creating pervasive moral hazard incentives. While explicit deposit insurance is applied *ex post* (following the closure of a bank), implicit deposit insurance is often applied while a bank is still in operation.

Explicit deposit insurance inflicts only very limited damage upon taxpayers, and, depending on the funding of the scheme, there may no damage at all. However, implicit deposit insurance has the potential of shifting the burden onto taxpayers, since rescue packages tend to be financed by the government. The use of rescue packages results not only in moral hazard considerations but may also affect competition, especially if a too big to fail doctrine is applied.

### **3. Explicit blanket guarantee of deposits**

An explicit blanket guarantee can take either a formal legal form (Japan, Mexico, Taiwan, Turkey) or simply be a government pronouncement or policy (Korea 1997-2000, Malaysia, Sweden 1992-1996, Thailand). Either will likely be sufficiently clear and robust for purposes of confidence; the difficulty arises if the government decides to eliminate the guarantee and move to an explicit, limited-coverage system of deposit insurance. A number of countries appear to be facing this sort of transition in the near future: Japan, Mexico, Taiwan, Thailand, Turkey. Korea and Sweden appear to have made successful transitions from blanket

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<sup>19</sup> Statement No. 5 (Oct. 1999) of the European Shadow Financial Regulatory Committee, of which Dr Lastra is a member. The statements of the ESFRC can be found on the websites of the Centre for European Policy Studies (CEPS) [www.ceps.be](http://www.ceps.be) and the American Enterprise Institute [www.aei.org](http://www.aei.org).



guarantees to limited, explicit systems. Malaysia does not appear to intend to abandon its current guarantee.

#### **4. Explicit, limited-coverage deposit insurance system**

Explicit deposit insurance is a guarantee limited to one type of “preferred creditors”, i.e., insured depositors. Under explicit deposit insurance uninsured depositors, other creditors, shareholders and managers are not protected. Therefore, explicit deposit insurance is more compatible with market discipline, as uninsured depositors and other creditors have an interest in monitoring the solvency of the bank while still in operation.

Explicit deposit insurance, by limiting the protection of “insured depositor” exposes uninsured depositors, general creditors, subordinated debtholders, shareholders and management to increased risk exposure, thereby encouraging them to monitor and limit the riskiness of the bank.<sup>20</sup> These incentives are very important, particularly in the case of shareholders, whose limited liability renders them more prone to lend on a high risk/high return basis, while restricting their own exposure through high leverage.<sup>21</sup> In the absence of open bank assistance, management will also be inclined to run the institution in a prudent manner, or risk being removed from office.

In its statement of October 1999, the ESFRC recommended that uninsured deposits and other liabilities should be “credibly uninsured”, meaning that holders of such claims have no expectation of official support in the event of a bank insolvency. Explicit deposit insurance must be set at a level that enables national authorities to accept the political consequences of bank liquidations.

In September 2001, the Financial Stability Forum endorsed the report of its Working Group on Deposit Insurance, chaired by Jean Pierre Sabourin as international guidance for jurisdictions considering the adoption of an explicit, limited-coverage deposit insurance system.<sup>22</sup> According to the Chairman of the FSF, Andrew Crockett, the report is built on three general findings<sup>23</sup>: (1) explicit and limited deposit insurance is preferable to implicit coverage if it clarifies obligations to depositors and creditors and limits the scope for discretionary decisions that may result in arbitrary actions; (2) deposit insurance systems must be properly designed, well implemented and understood by the public to be credible and to avoid moral hazard; and (3) to be effective, the deposit insurance system needs to be part of a well-designed financial safety net, supported by strong prudential regulation and supervision, effective laws that are enforced, and sound accounting and disclosure regimes.

According to the FSF report, the principal objectives of a deposit insurance system are<sup>24</sup>: (1) to contribute to the stability of a country’s financial system; and (2) to protect less financially sophisticated depositors from the loss of their deposits when banks fail.

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<sup>20</sup> See R. Lastra, *Central Banking and Banking Regulation* (London: Financial Markets Group 1996), 130.

<sup>21</sup> See generally R. Dale, “Deposit Insurance, Policy Clash over EC and US Reforms,” in F.C. Schadrack and L. Korobow (eds), *The Basic Elements of Bank Supervision* (New York: Federal Reserve Bank of New York 1993).

<sup>22</sup> FSF, *Guidance for Developing Effective Deposit Insurance Schemes* (Basel: FSF Sept. 2001), pref.

<sup>23</sup> FSF, pref.

<sup>24</sup> FSF, 3.

The Working Group developed 20 “key points of guidance” for countries considering the adoption or reform of an **explicit, limited-coverage deposit insurance system**.<sup>25</sup> The key points are grouped under 4 main headings<sup>26</sup>:

- **Contextual issues for deposit insurance systems**, specifically: (1) Contextual Background; and (2) Moral Hazard.
- **Processes for adopting and maintaining a deposit insurance system**, specifically: (3) Public Policy Objectives; (4) Situational Analysis; (5) Transition: Blanket Guarantee to Deposit Insurance; and (6) Self-assessment Methodology
- **Structure and design features**, specifically: (7) Mandate and Powers; (8) Structure; (9) Governance; (10) Human Resources and Statutory Indemnification; (11) Interrelationships among Safety-net Participants; (12) Membership; (13) Coverage; (14) Funding; (15) Public Awareness; and (16) Cross-border Issues.
- **Resolutions, reimbursements, claims and recoveries**, specifically: (17) Failure Resolution; (18) Reimbursing Depositors; (19) Claims and Recoveries; and (20) Depositor Ranking, Collateralisation and Rights of Set-off

In almost every case, each of these points of guidance raises certain legal issues.

### 1. Contextual Background

According to the report, “[t]he distribution of powers and responsibilities between the financial safety-net participants is a matter of public-policy choice and individual country circumstances.”<sup>27</sup> One of the key determinants of the contextual background is the effectiveness and content of the legal system.

### 2. Moral Hazard

“Good corporate governance and sound risk management of individual banks, effective market discipline, and frameworks for strong prudential regulation, supervision and laws, can mitigate moral hazard and these elements are most effective when used in concert.”<sup>28</sup> Corporate governance, market discipline and financial regulation are all based upon legal infrastructure. Further, as noted above, weaknesses in the legal system can undermine the effectiveness of any deposit insurance scheme and should be addressed first.

According to the report, certain deposit insurance system features that may also mitigate moral hazard include: limits on amounts insured; exclusion of certain categories of depositors from coverage; certain forms of coinsurance; differential or risk-adjusted premium assessment systems; early closure of troubled banks; and willingness and ability to take legal action for improper conduct.<sup>29</sup> Closure of banks and availability of legal action both emanate from the structure and content of the legal system.

### 3. Public Policy Objectives

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<sup>25</sup> FSF, 41.

<sup>26</sup> See FSF, 41-51. See generally, FSF, Working Group on Deposit Insurance, Guidance for Developing Effective Deposit Insurance Systems: Background Documents (Basel: FSF Sep. 2001).

<sup>27</sup> FSF, 7.

<sup>28</sup> FSF, 41; see 8-9.

<sup>29</sup> FSF, 9, 42.

“The first step in designing a deposit insurance system is to identify the public-policy objectives that it is expected to achieve and these objectives must be well understood.”<sup>30</sup> Once public policy objectives are set, it is then necessary to design the overall system; it is at this point at which an analysis of the legal system in existence vis-à-vis the desired design features becomes necessary.

#### 4. Situational Analysis

The FSF report suggests, when adopting or reforming a deposit insurance system, policymakers should conduct a “situational analysis” of, inter alia: (1) economic factors, state and structure of the banking system and public attitudes and expectations; and (2) state of legal, prudential regulatory, supervisory, accounting and disclosure regimes.<sup>31</sup> Specific legal considerations include: effectiveness of enforcement; efficiency of the legal system; creditors’ rights; support for early intervention and prompt corrective action; ability to close banks promptly; systems for clear and orderly liquidation, including resolution of creditors’ claims.<sup>32</sup> Unfortunately, at present, little internationally agreed guidance exists in respect to most of these areas; further, much divergence exists between different systems and jurisdictions.

#### 5. Transition: Blanket Guarantee to Deposit Insurance

According to the report, three special issues should be considered: confidence; capacity to fund; and speed.<sup>33</sup> As noted above, in a number of jurisdictions analysed, the transition process is structured ex ante through legislation, but in others it is not.

#### 6. Self-assessment Methodology

The SAM, as recommended in the report, includes the following steps<sup>34</sup>: (1) setting public policy objectives; (2) situational analysis; (3) validation; (4) development of strategic action plan; (5) implementation and acceptance; and (6) ongoing evaluation and validation.

As noted above, the role of law and legal infrastructure arises in the context of implementation and acceptance – the translation of the design into an existing structure.

#### 7. Mandate and Powers

While the report finds no single mandate is suitable, it nonetheless recommends it be specified, along with all necessary powers, in law, in a formal policy statement, an agreement or by private contract in order to clarify the role of deposit insurance within the financial safety net.<sup>35</sup> In the jurisdictions reviewed, it is typical to have a law or provisions in the banking or central bank law addressing mandate and powers.

#### 8. Structure

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<sup>30</sup> FSF, 11, 42

<sup>31</sup> FSF, 12-14, 42-43.

<sup>32</sup> FSF, 13.

<sup>33</sup> FSF 14-15, 43.

<sup>34</sup> FSF, 16 Fig. 1.

<sup>35</sup> FSF, 17, 44

According to the report, primary decision is whether to establish a new entity or assign to an existing entity; regardless, responsibility and accountability of each safety-net function must be established.<sup>36</sup> Elements of structure, responsibility and accountability are typically included within the legal instrument establishing the system.

#### 9. Governance

The form should reflect the mandate and structure, with transparency and clear oversight and accountability.<sup>37</sup> Transparency, oversight and accountability should be included in the structuring legislation.

#### 10. Human Resources and Statutory Indemnification

Employees should receive legal protection against lawsuits for actions taken in good faith.<sup>38</sup> At present, there appears to be a split in this regard, with approximately half of jurisdictions having such protection in place. Clearly, however, if such protection is to exist, it must be consistent with the overall system of administrative law.

#### 11. Interrelationships among Safety-net Participants

Clarity of mandates, accountability and information gateways are essential for effectiveness.<sup>39</sup> As noted throughout, overall design is very important. Unfortunately, financial safety nets are not always clearly designed, especially when issues outside the clear remit of the central bank or banking supervisor are involved (such as insolvency and creditors' rights).

#### 12. Membership

Generally, members should be subject to strong regulation and supervision; membership should be mandatory; and entry should be transparent.<sup>40</sup>

#### 13. Coverage

Coverage should be defined clearly in law or by private contract.<sup>41</sup>

#### 14. Funding

The system of funding should be clear and set *ex ante*.<sup>42</sup>

#### 15. Public Awareness

No significant legal issues arise in this context.

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<sup>36</sup> FSF, 18, 44.

<sup>37</sup> FSF, 18, 44-45.

<sup>38</sup> FSF, 19, 45.

<sup>39</sup> FSF, 19-20, 45-46.

<sup>40</sup> FSF, 21-23, 45.

<sup>41</sup> FSF, 23-24, 46-47.

<sup>42</sup> See FSF 26-28, 47-48.

## 16. Cross-border Issues

The legal issues here are very complex and beyond the scope of the present paper.<sup>43</sup>

## 17. Failure Resolution

The report lists a number of steps necessary to liquidate a bank's business and affairs, including<sup>44</sup>: (1) resolution or disposition of the failed bank; (2) reimbursement of insured depositors; (3) liquidation of the bank's assets; (4) settlement of claims; and (5) disposition of litigation.

According to the report, an effective failure resolution process should<sup>45</sup>: (1) meet the deposit insurer's obligations; (2) ensure that depositors are reimbursed promptly and accurately; (3) minimise resolution costs and disruption of markets; (4) maximise recoveries on assets; (5) settle bona fide claims on a timely and equitable basis; and (6) reinforce discipline through legal actions in cases of wrongdoing.

The report lists three basic failure resolution options (in addition to possible solutions prior to failure): liquidation and reimbursement of depositors' claims; purchase-and-assumption transactions (sales); and open-bank financial assistance – the choice of which is heavily influenced by bankruptcy/insolvency and other laws.<sup>46</sup> Consequently, review of bankruptcy/insolvency systems available for financial institutions is important.<sup>47</sup>

## 18. Reimbursing Depositors

Reimbursement focuses on legal issues, including conditions, eligibility, procedures, and payments – all of which are strongly influenced by the underlying legal system and rules.<sup>48</sup>

## 19. Claims and Recoveries

According to the report, the powers provided to the entity responsible for the claims-and-recoveries function should be guided by applicable laws and should include<sup>49</sup>: (1) contract rights and privileges; (2) the ability to allow or disallow claims; (3) the capability to enforce or repudiate certain contractual obligations; and (4) the ability to challenge fraudulent transfers and transactions. Each of these, as well as the availability of methods for dispositions of assets<sup>50</sup>, are largely determined by the underlying legal system

## 20. Depositor Ranking, Collateralisation and Rights of Set-off

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<sup>43</sup> See FSF, 30, 49. For discussion, see generally M. Giovanoli & G. Heinrich (eds), *International Bank Insolvencies: A Central Bank Perspective* (London: Kluwer 1999).

<sup>44</sup> FSF, 31.

<sup>45</sup> FSF, 31, 49.

<sup>46</sup> FSF, 31-34, 49-50.

<sup>47</sup> Id.

<sup>48</sup> FSF, 34-36, 50.

<sup>49</sup> FSF, 36, 50.

<sup>50</sup> These include: asset-by-asset sales; auctions or sealed bids; asset pools; securitisation; asset-management companies; and equity partnerships. FSF, 36-38, 50-51.

Priority, collateralisation and set-off are all legal creations and hence must be reviewed closely in individual systems.<sup>51</sup>

### **E. Insolvency – individual bank**

As noted above, beyond immediate measures to deal with banking crises, some system needs to be in place to deal with situations of insolvency. Clearly, however, no system is necessary in jurisdictions which do not intend to allow any banks to become insolvent. (Historically, this has been the case in Japan and the PRC, but appears to be changing in both cases.)

Generally speaking, the goals of bank insolvency are threefold: (1) fair treatment of all creditors; (2) maximisation of the value of the estate; and (3) reduction of systemic risk – with all three goals potentially in conflict.<sup>52</sup> Typically, however, the various functions concerned are often embedded in different institutions.<sup>53</sup> The key authorities and their functions can be categorised as follows: (1) insolvency authorities; (2) supervisory authorities; (3) lender of last resort; (4) monetary policy authorities; (5) deposit insurance authorities; and (6) criminal authorities.<sup>54</sup> Most of these have been reviewed above; criminal issues are beyond the present scope.

As noted above, the availability of the traditional methods very much depends upon the individual legal system. The organisation of a rescue package typically will not require specific authorisation. On the other hand, the ability to provide open assistance may be clearly constrained by law. The availability of merger or acquisition, whether public or private, likewise varies, with some jurisdictions having specific legislation addressing financial institution mergers/acquisitions, while in others (especially common law jurisdictions) such issues are primarily dealt with through the relevant company law. In most cases, however, issues will arise under banking law/regulation concerning licenses/authorisation. Finally, the availability of liquidation and pay-off varies greatly, with some jurisdictions having completely separate stand-alone systems for bank insolvencies (US), while in others, bank insolvencies are largely dealt with through the general system of corporate insolvency, although typically modified in some way by banking law/regulation (UK). The greater concern is typically in the latter sorts of jurisdictions where insolvency law and systems may not be overly effective.<sup>55</sup> Significantly, an ineffective system of insolvency may also be a barrier to effective out-of-court workouts.

### **F. Systemic insolvency**

As noted, measures to address systemic insolvency are typically only developed in the context of an actual situation. Unfortunately, not only can weakness in the overall design of the financial safety net potentially lead to such problems, weaknesses in supporting legal

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<sup>51</sup> FSF, 38-40, 51.

<sup>52</sup> “Bank insolvencies entail systemic risks which are absent in the bankruptcy of most commercial concerns.” E. Patrikis, “Role and Functions of Authorities: Supervision, Insolvency Prevention and Liquidation”, in Giovanoli & Heinrich, 283.

<sup>53</sup> Patrikis, 284.

<sup>54</sup> Cf. Patrikis, 284-85.

<sup>55</sup> This problem is well-recognised and is the subject of a joint project between the World Bank and UNCITRAL to establish “Principles of Insolvency”.

infrastructure can also make resolution more difficult. This is a subject worthy of development of international guidance.

#### IV. Jurisdiction Summaries

This section summarises the results of the individual Jurisdiction Reports (listed in Annex A; Annex B contains the form questionnaire for the Jurisdiction Reports). This summary presents a brief overview of the key information regarding each jurisdiction. The following information is included in each summary:

Legal system

Common law/Civil law/Mixed

Financial structure<sup>56</sup>

Financially developed/underdeveloped

Bank-based/Market-based

Permissible financial institution activities<sup>57</sup>

Restrictiveness rating (1-4)

WTO/GATS/FSA<sup>58</sup>

Regulatory structure/authority(ies)

Institutional/Sectoral/Functional/Amalgamated<sup>59</sup>

Authorities (accountability)

LoLR

Depositor protection scheme (if any and if so, what kind)<sup>60</sup>

Explicit/Implicit/None

Coinsurance/Coverage

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<sup>56</sup> Demirgüç-Kunt & Levine classify financial structure into four categories, based on extensive economic analysis: (1) financially developed, bank-based; (2) financially developed, market-based; (3) financially underdeveloped bank-based; and (4) financially underdeveloped market-based. A. Demirgüç-Kunt & R. Levine, "Bank-Based and Market-Based Financial Systems: Cross-Country Comparisons", in A. Demirgüç-Kunt & R. Levine (eds), *Financial Structure and Economic Growth: A Cross-Country Comparison of Banks, Markets, and Development* (MIT: Cambridge MA 2001), ch. 3, esp. Table 3.12, 121.

<sup>57</sup> Additional data drawn from the World Bank's Bank Regulation and Supervision database. Barth et al. classify restrictiveness on a scale from 1-4, with 1 completely unrestricted and 4 as completely restricted. Barth, Caprio & Levine. J. Barth, G. Caprio, R. Levine, "The Regulation and Supervision of Banks around the World: A New Database" (Washington DC: World Bank May 2001). Database available at [www.worldbank.org/research/interest/prr\\_stuff/bank\\_regulation\\_database.htm](http://www.worldbank.org/research/interest/prr_stuff/bank_regulation_database.htm). See "Bank Regulation and Supervision: What Works Best?" (Washington DC: World Bank Aug. 2001) and J. Barth, L. Dopico, D. Nolle & J. Wilcox, "An International Comparison and Assessment of the Structure of Bank Supervision", in J. Lin & D. Arner (eds), *Reforming Financial Regulatory Structure* (forthcoming 2002), ch. 3.

<sup>58</sup> Details available at the website of the WTO: [www.wto.org/english/tratop\\_e/finance\\_e/finance\\_commitments\\_e.htm](http://www.wto.org/english/tratop_e/finance_e/finance_commitments_e.htm).

<sup>59</sup> See J. Lin, D. Arner & M. Bushehri, "Financial Liberalisation and Restructuring: The International Context", in J. Lin & D. Arner, *supra*, ch. 1 & generally Part II: Options in Regulatory Structure.

<sup>60</sup> Additional data from the World Bank databases Bank Regulation and Supervision, *supra*, and Deposit Insurance around the world, available at [www.worldbank.org/research/interest/confes/upcoming/deposit\\_insurance/data.htm](http://www.worldbank.org/research/interest/confes/upcoming/deposit_insurance/data.htm). See A. Demirgüç-Kunt & R. Levine, "Deposit Insurance Around the Globe: Where does it work?" (Washington DC: World Bank July 2001); A. Demirgüç-Kunt & T. Sobaci, *Deposit Insurance Around the World: A Data Base* (Washington DC: World Bank May 2000).



Funded/Unfunded/Funding mechanism  
Source of funding: Private/Joint/Official  
Administration: Private/Joint/Official  
Compulsory/Voluntary

Bank insolvency structure (if any and whether separate law/entity)<sup>61</sup>

Deposit Insurance Intervention (if DI)  
Bank insolvency regime

Proposed changes (if any)

Activities  
Regulatory structure  
Depositor protection  
Bank insolvency

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<sup>61</sup> Additional data drawn from the World Bank's Banking Regulation and Supervision database, *supra*; and M. Giovanoli & G. Heinrich (eds), *International Bank Insolvencies: A Central Bank Perspective* (London: Kluwer 1999).

## Europe:

### Germany

#### Legal system

Civil law: German CC + EU overlay

#### Financial structure

Financially developed

Bank-based

#### Permissible financial institution activities

1.3

#### WTO/GATS/FSA – EU

#### Regulatory structure/authority(ies)

Sectoral (Amalgamation in process), under ambit of MoF

Banking and investment firms: Banking Supervisory Office (Bundesaufsichtsamt) with Deutsche Bundesbank (accountable to MoF)

Securities: Securities Supervisory Authority and Exchange Supervision Bodies in *Länder*

Insurance: Federal Insurance Supervisory Office

Monetary policy: ECB

#### LoLR

Institutionalised (*Liquiditäts-Konsortialbank*): *Bundesbank* and members of various banking associations shareholders

Depositor protection scheme: explicit, privately funded multi-tier deposit protection system

Explicit: 1966/1969/1998 (Deposit Security Fund, Savings Bank Security Fund, Credit Cooperation Security Scheme, German Bank Association Deposit Protection Fund Law)

Coinsurance: private: 30% of capital; official coinsurance 90% to eur20,000

Funded: Percentage of deposits

Private

Private

Compulsory

#### Bank insolvency structure

Intervention: Bundesaufsichtsamt

General insolvency system: Insolvency Act 1999, qualified by Banking Act 1961 (amended)

No auto PCA

#### Proposed changes (if any)

**Amalgamated regulatory structure**

## Sweden

### Legal system

Civil law: Swedish CC + EU overlay

### Financial structure

Financially developed  
Market-based

### Permissible financial institution activities

2.3

### WTO/GATS/FSA – EU

### Regulatory structure/authority(ies)

Amalgamated  
Supervision/Regulation – all financial institutions/markets: Financial Supervisory Authority (Finansinspektionen) (accountable to Government)  
Monetary policy: Riksbank

### LoLR

Explicit: Riksbank

### Depositor protection scheme (if any and if so, what kind)

Explicit 1993/1996 (Deposit Guarantee Scheme)  
Blanket guarantee 1992-1996  
SEK250,000 (Eur28,663)  
Funded: Insured deposits, Risk-based  
Joint  
Official  
Compulsory

### Bank insolvency structure (if any and whether separate law/entity)

Intervention: Finansinspektionen  
Unitary regime: Companies Act (DGS takes over claims)  
No Auto PCA

### Proposed changes (if any)

## **Turkey**

### Legal system

Civil law: French CC

### Financial structure

Financially underdeveloped  
Market-based

### Permissible financial institution activities

3.0

### WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Sectoral

Banks: pre-2000 – Central Bank and Treasury

2000 – Banking Regulation and Auditing Institution (accountable: MoF)

### LoLR

Central Bank

### Depositor protection scheme: Savings Deposit Insurance Fund (Banks Act 1999)

Explicit: 1983 (Turkish Deposit Insurance Fund)/1999

Blanket guarantee 1994 – present (1983-1994: L 150m)

Funded: Insured savings deposits, Risk-based

Official

Joint

Compulsory

### Bank insolvency structure (if any and whether separate law/entity)

Intervention: Minister of Finance

Special provisions in general system: Enforcement and Bankruptcy Act and Banks Act 1999

No Auto PCA

### Proposed changes (if any)

## **United Kingdom**

### Legal system

England: Common law + EU overlay

Scotland: Mixed: Roman law + common law overlay + EU overlay

### Financial structure

Financially developed

Market-based

### Permissible financial institution activities

1.3

### WTO/GATS/FSA – EU

### Regulatory structure/authority(ies)

Amalgamated

Prudential/Conduct – Financial Services Authority (FSMA 2000) (accountable: Treasury)

MP/Stability – Bank of England (accountable: Parliament)

### LoLR

Explicit: Bank of England (BoE Act 1998)

### Depositor protection scheme: Deposit Protection Fund, Banking Act 1979, 1987, FSMA 2000

Explicit: 1982/1995/2000

Coinsurance: Larger of 90% coinsurance to gbp20,000 (eur22,222)

Unfunded: Insured deposits, Demand assessment

Private

Private

Compulsory

### Bank insolvency structure (if any and whether separate law/entity)

Intervention: FSA

FSMA modifies general system: Insolvency Act 1986

No auto PCA

### Proposed changes (if any)

## **Americas:**

### **Brazil**

#### Legal system

Civil law: French CC

#### Financial structure

Financially underdeveloped

Market-based

#### Permissible financial institution activities

2.5

#### WTO/GATS/FSA – Yes

#### Regulatory structure/authority(ies)

Sectoral

Stability/Policy: National Monetary Council

Monetary policy: Central Bank

Banking: Central Bank (accountable to MoF)

Securities – Brazilian Securities and Exchange Commission (CVM)

Insurance – Private Insurance Superintendency/Secretariat for the Supervision of Pension Funds.

#### LoLR

Explicit: National Monetary Council (Act 1965) with Central Bank (practice)

#### Depositor protection scheme: Credit Guarantee Fund (Fundo Garanidor de Credito, FGC)

Explicit: 1995

R20,000 (US\$17,000)

Funded: Percentage of insured deposits

Private

Private

Compulsory

#### Bank insolvency structure (if any and whether separate law/entity)

Intervention: Central Bank

Law 6,024/74, Decree Law 2,321/87, and Law 9,447/97; general bankruptcy law

7,661/45 applies otherwise

Auto PCA

#### Proposed changes (if any)

## **Colombia**

### Legal system

Civil law: French CC

### Financial structure

Financially underdeveloped

Bank-based

### Permissible financial institution activities

N/r

### WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Sectoral

Regulation: Vice-ministry of Finance

Banking: Banking Superintendency

Monetary policy: Central Bank

### LoLR

Central Bank

### Depositor protection scheme: Financial Institution Guarantee Fund – Banking Law 1985

Explicit: 1985/1993 (Financial System Organic Statute 1993)/1999

Coinsurance: Coinsurance to Co\$ 20m (US\$8600)/75% per deposit

Funded: Percentage of insured deposits

Private

Official

Compulsory

### Bank insolvency structure

FSOS 1993, Law regarding the liquidation of Financial Institutions 1999

### Proposed changes (if any)

## **Mexico**

### Legal system

Civil law: French CC

### Financial structure

Financially underdeveloped  
Market-based

### Permissible financial institution activities

3.0

### WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Amalgamated – all part of government  
Prudential/Conduct – National Banking and Securities Commission (accountable: MoF)  
Stability/monetary policy: Banco de Mexico (accountable: MoF)

### LoLR

Explicit: Institute for the Protection of Bank Savings

### Depositor protection scheme: Institute for the Protection of Bank Savings, Law for the Protection of Bank Savings 1999

Explicit: 1986/1990/1999

Gradually reduced to US\$ 130,000

1999-2002 – unlimited amount but limited obligations on the monetary

2003-2004 – 10m UDI/5m UDI

2005 on – 400,000 UDI (US\$ 130,000)

Funded: Percentage of all obligations

Joint

Official

Compulsory

### Bank insolvency structure (if any and whether separate law/entity)

Intervention: CNBV/IPBS

Law for the Protection of Bank Savings in conjunction with General Law of Corporations and the Law of Bankruptcy and Suspension of Payments

Auto PCA

### Proposed changes (if any)

Gradual elimination of blanket guarantee



## United States

### Legal system

Common law: Federal/state/UCC

### Financial structure

Financially developed  
Market-based

### Permissible financial institution activities

3

### WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Sectoral/Institutional  
Financial holding companies: Federal Reserve  
National banks – Office of the Comptroller of the Currency (Accountable: Treasury)  
State banks – state regulators  
Insurance – state regulators  
Securities – Securities and Exchanges Commission and state regulators

### LoLR

Federal Reserve

### Depositor protection scheme: Federal Deposit Insurance Corporation, FDICIA, FIRREA, Federal Reserve Act

Explicit: 1934/1991  
US\$100,000  
Funded: Domestic deposits, Risk-based  
Joint  
Official  
Compulsory

### Bank insolvency structure

Intervention: FDIC  
Independent: 12 USC 1821  
Auto PCA

### Proposed changes (if any)

**New banking holding company structure**

## **Africa/Middle East**

### **Egypt**

#### Legal system

Civil law: French CC

#### Financial structure

Financially underdeveloped

Bank-based

#### Permissible financial institution activities

3.3

#### WTO/GATS/FSA – Yes

#### Regulatory structure/authority(ies)

Sectoral (banking/securities/insurance)

Banks: Central Bank (accountable: no)

Monetary policy/stability: Central Bank

#### LoLR

Central Bank (implicit)

#### Depositor protection scheme

Implicit: blanket guarantee (custom and policy)

All authorized banks

#### Bank insolvency structure (if any and whether separate law/entity)

Banking legislation

Auto PCA

#### Proposed changes (if any)

Explicit system established in legislation in 1992 (Law no. 37 1992) but never implemented.

## **Nigeria**

### Legal system

Common law

### Financial structure

N/r (probably: Financially underdeveloped  
Market-based)

### Permissible financial institution activities

2.3

### WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Sectoral/Institutional

Coordination/harmonization: Financial Services Regulation Co-ordinating Committee (FSRCC)

Entire system: Central Bank and MoF

Banks: Central Bank (accountable: MoF)

Community banks: National Board for Community Banks

Securities: Securities and Exchange Commission (SEC)

Insurance: National Insurance Supervisory Board

Development banks: various

### LoLR

Central Bank

### Depositor protection scheme (if any and if so, what kind)

Explicit: 1988/1998 (Nigerian Deposit Insurance Corporation, NDIC Decree No. 22 1988)

N50,000 (US\$500)

Funded: Percentage of deposits

Joint

Official

Compulsory

### Bank insolvency structure (if any and whether separate law/entity)

Intervention: Central Bank upon approval of President

NDIC Decree No. 22 of 1988; Banks and Financial Institutions Decree No. 25 of 1991 (as amended); Insolvency Act

Auto PCA

### Proposed changes (if any)

## South Africa

### Legal system

Mixed: Roman-Dutch CC + common law overlay

### Financial structure

Financially developed

Market-based

### Permissible financial institution activities

2.0

### WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Sectoral (banking/non-banking)

Banking: Reserve Bank (accountable: MoF)

Non-banking: Financial Services Board (“FSB”) – Financial Services Board Act 1990.

Monetary policy/stability: SARB

Coordination/Policy: MoF and Policy Board for Financial Services – Policy Board for Financial Services and Regulation Act 1993

### LoLR

Explicit: SARB – SARB Act

### Depositor protection scheme

None

### Bank insolvency structure (if any and whether separate law/entity)

Insolvency Act; Banks Act, Companies Act

No auto PCA

### Proposed changes (if any)

Explicit deposit insurance system

Amalgamated regulatory structure

## Asia

### Japan

#### Legal system

Civil law: German CC + US overlay (financial law)

#### Financial structure

Financially developed

Bank-based

#### Permissible financial institution activities

3.3

#### WTO/GATS/FSA – Yes

#### Regulatory structure/authority(ies)

Amalgamated

All financial sectors: Financial Supervisory Authority (accountable: Cabinet, Diet, public)

Monetary policy/stability: Bank of Japan (also involved in bank supervision)

#### LoLR

Explicit: Bank of Japan – Bank of Japan Law 1998

Depositor protection scheme: Deposit Insurance Corporation – Law Concerning Emergency Measures for the Revitalization of the Functions of the Financial System (Financial Revitalization Law), Financial Function Early Strengthening Law (Early Strengthening Law), Establishing Law of the Financial Revitalization Commission (FRC Law)

Explicit: 1971/1996/1998

Y10m (US\$71,000) to 1997, but in full until Apr 2002

Funded: Percentage of insured deposits

Joint

Joint

Compulsory

#### Bank insolvency structure (if any and whether separate law/entity)

Intervention: FRC and FRA

Financial Function Early Strengthening Law 1998, Deposit Insurance Law

Auto PCA

#### Proposed changes (if any)

Elimination of blanket guarantee

## **Korea**

### Legal system

Civil law: German CC

### Financial structure

Financially developed  
Market-based

### Permissible financial institution activities

2.3

### WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Amalgamated  
Financial Supervisory Commission (FSC)/Financial Supervisory Service (FSS)  
(accountable: Government)

### LoLR

Bank of Korea

### Depositor protection scheme: Korea Deposit Insurance Corporation, Depositor Protection Act 1995

Explicit: 1996/1997/2000  
W50m (US\$38,500), in full until 2000  
Funded: Percentage of deposits  
Joint  
Official  
Compulsory

### Bank insolvency structure (if any and whether separate law/entity)

Intervention: KDIC  
General Banking Act, DPA, Act Concerning the Structural Improvement of the  
Financial Industry  
Auto PCA

### Proposed changes (if any)

**Recent amalgamated regulator and removal of blanket guarantee**

## Malaysia

### Legal system

Common law

### Financial structure

Financially developed

Market-based

### Permissible financial institution activities

2.5

WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Sectoral

Banks: Bank Negara Malaysia (accountable: MoF)

Securities:

Insurance:

### LoLR

Explicit: Bank Negara Malaysia – Banking and Financial Institutions Act 1989 (BAFIA); Central Bank of Malaysia Act 1959 (CBA)

### Depositor protection scheme (if any and if so, what kind)

Explicit: 1998 (before: implicit)

Blanket guarantee

### Bank insolvency structure (if any and whether separate law/entity)

Banking and Financial Institutions Act 1989 (BAFIA)

Central Bank of Malaysia Act 1959 (CBA)

Companies Act 1963

Auto PCA

### Proposed changes (if any)

## People's Republic of China

### Legal system

Socialist/Civil law: German CC

### Financial structure

N/a (probably: financially underdeveloped  
bank-based)

### Permissible financial institution activities

3.5

### WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Sectoral/Institutional (banking/insurance/securities)

Banking: People's Bank of China (Accountable: State Council)

Insurance: China Insurance Regulatory Commission

Securities: China Securities Regulatory Commission

Financial Asset Management: shared – PBOC, MoF, CSRC

### LoLR

Implicit: PBOC

### Depositor protection scheme

Implicit guarantee

### Bank insolvency structure

Bankruptcy Law (applied only to state-owned enterprises), Company Law,  
Commercial Banking Law, Regulations on Financial Institution Closure

### Proposed changes

In discussion: **Deposit Insurance Law**



## Taiwan (China)

### Legal system

Civil law: German CC + US overlay (financial law)

### Financial structure

N/r (probably: Financially developed  
Market-based)

### Permissible financial institution activities

3.0

WTO/GATS/FSA – Yes

### Regulatory structure/authority(ies)

Amalgamated (in final stages)

### LoLR

Explicit: Central Bank of China

Depositor protection scheme: Central Deposit Insurance Corporation, Deposit Insurance Act 1985, Financial Restructure Fund 2001 (to 2004)

Explicit: 1985/2001

CDIC: NT\$ 1,000,000 (US\$30,000); FRF - unlimited

Funded: Risk-based, Insured deposits

Joint

Official

Compulsory (since 1999)

Bank insolvency structure (if any and whether separate law/entity)

Company Law; Insolvency Law,

Auto PCA

Proposed changes (if any)

Potential blanket guarantee under FRF until 2004

Amalgamated regulatory structure

Financial holding companies law

## **Thailand**

### Legal system

Civil law: French CC

### Financial structure

Financially developed

Market based

### Permissible financial institution activities

2.3

### WTO/GATS/FSA –Yes

### Regulatory structure/authority(ies)

Sectoral (banking/securities/insurance)

Banks: Bank of Thailand and MoF (accountable: MoF)

Securities: Securities and Exchange Commission (SEC).

Insurance:

### LoLR

Explicit: Bank of Thailand – Financial Institution Development Fund (FIDF) 1985

### Depositor protection scheme

Explicit: 1997

Blanket guarantee

### Bank insolvency structure

Intervention:

Separate regime: Commercial Banking Act

No auto PCA

### Proposed changes (if any)

Draft Deposit Insurance Act

Draft Banking Act

**Annex A:**  
**Jurisdiction Reports (17)**

**Europe:**

Germany – Jens Binder  
Sweden – Erica Johansson  
UK/EU – George Walker

**Americas:**

Brazil – Jorge Guira  
Colombia – Mauricio Bacquero  
Mexico – Thomas Slover  
US – Joseph Norton

**Africa/Middle East:**

Egypt – Hani Sarie-Eldin and Rami El-Borai  
Nigeria – Iwa Akinrinsola  
South Africa – Angela Itzikowitz and Sorelle Gross

**Asia:**

Japan – Mamiko Yokoi-Arai  
Korea – Byung Tae Kim  
Malaysia – Zalina Zahudi  
People’s Republic of China – Zhongfei Zhou  
Taiwan (China) – Hung Lieh Liang  
Thailand – Torsak [Buranaruangroj](#)

## **Annex B**

### **Jurisdiction Report Template**

#### **Recommended approach:**

1. Review the Financial Stability Forum Guidance (*see appendix 1*, below) for background and overview of issues for consideration. I would also recommend looking at M. Giovanoli & G. Heinrich (eds), *International Bank Insolvencies: A Central Bank Perspective* (London: Kluwer 1999), which may have a relevant chapter on the jurisdiction.
2. Review the World Bank Deposit Insurance Database (*see appendix 2*, below) and include relevant information in the outline of the Country Report. Information included in the WB Deposit Insurance Database is in **bold/underline**. If the information in the database is not correct, identify any problems and dates of change(s) (if applicable).
3. Review the World Bank Database on Bank Regulation and Supervision (*see appendix 3*, below) and include relevant information in the outline of the Country Report. Information included in the WB Bank Regulation and Supervision Database is in ***bold/italic***. If the information in the database is not correct, identify any problems and dates of change(s) (if applicable).
4. Based on knowledge and research, address remaining issues in the Country Report, citing sources, where applicable. For present purposes, we only need 2-4 page, single-spaced summary outline reports. Subsequently, we may ask you to expand to 6-10 pages of text. (This expanded textual version will make it easier to subsequently to externally publish: DA intends to include the full report in a book on comparative financial regulatory structures, which will be published by Sweet & Maxwell Asia in 2002.)
5. If you have any problems, questions etc, please contact Prof. Norton([profjnorton@yahoo.com](mailto:profjnorton@yahoo.com)) or Douglas Arner at [d.arner@qmul.ac.uk](mailto:d.arner@qmul.ac.uk). Also, please let us know if you think of additional information that should be included.
6. Please submit drafts to JN and DA via email on or before **10 Jan. 2002, as we have to have our pare to WB by the 15<sup>th</sup>.** We need the reports by this date in order to have sufficient time to complete the main part of the paper prior to the seminar.

Thanks very much in advance!

## Standard outline:

### Country Reports (8-10 pp.)

[Jurisdictions included: Brazil, China, Colombia, Egypt, Germany, Japan, South Korea, Malaysia, Mexico, Nigeria, South Africa, Sweden, Taiwan, Turkey, Thailand, UK and US.]

#### A. Summary

[In all likelihood, this should come last. The summary should include a brief overview of the information included in the main report, namely: financial structure/permissible financial institution activities, regulatory structure/authority(ies), depositor protection scheme (if any and if so, what kind), and bank insolvency structure (if any and whether separate law/entity). This section should also note whether there are any proposed changes and, if so, what sort.]

#### B. The Financial Sector and the Financial Safety Net

##### 1. Financial sector overview

[This section should comprise a general description of the organisation of the financial system in the jurisdiction, for example: (1) bank-centred (eg. Germany); (2) capital markets-centred (eg. US); (3) family-dominated (eg. Hong Kong, Italy); (4) government-dominated (eg. People's Republic of China); or (5) (bank-government-centred (eg. Japan). If the historical conditions are changing, please note relevant factors (eg. Germany – EU single market programme).]

##### 2. Financial regulatory and supervisory structure

[Overview of current structure of financial regulation and supervision, including recent/proposed changes. This should include:

- Regulation and supervision of major sectors/activities (banking, insurance, securities, monetary policy/financial stability) and major legislation/coverage: **12. Supervision (12.1)**
- Permissible activities of financial institutions and major legislation/coverage: **2. Ownership (2.3); 4. Activities (4.1-4.4)**
- Interaction between various structures/institutions]

##### 3. Lender of Last Resort (LoLR)

[Who and any rules?]

##### 4. Depositor protection/Deposit insurance

[Any and if so who/what form? **Type: Implicit/Explicit/None;**

**Date enacted/revised and relevant legislation/regulation(s); 8. Depositor (Savings) Protection Schemes (8.1)**

**5. Insolvency – individual banks**

[Separate regime for banks or unitary corporate insolvency structure?

Date enacted/revised and relevant legislation/regulation(s): **11. Discipline/Problem institutions/Exit (11.5)**]

**6. Systemic insolvency**

[Any measures currently in place or used in the past.]

**C. Depositor Protection: Structure and Design Features**

[If none, discuss whether any proposals and their content.]

[If implicit, discuss the political background.]

[If explicit or proposed, discuss in the context of the (proposed) legal framework:]

**1. Mandates, powers and structure**

a. Mandate and powers

b. Structure

**Administration: official/joint/private**

c. Governance

**2. Interrelationship between financial safety-net participants**

[Regulation/supervision/LoLR/depositor protection/bank insolvency/non-bank financial institutions]

**3. Membership and coverage**

a. Membership

**Membership: compulsory/voluntary**; types of institutions]

b. Coverage

[Coverage limits (US\$/Eur/Local currency); Foreign currencies; Inter-bank deposits; per person/per account: 8. Depositor (Savings) Protection Schemes (8.1.3, 8.1.4); non-bank financial institutions]

[Has explicit blanket coverage existed in the past? If so, how was the the transition made to limited coverage? If explicit blanket coverage currently exists, are there plans to more to explicit limited coverage? If so, how and when?]

#### **4. Funding**

[Coinsurance; Permanent fund; Premium or asset base; Annual premiums; Risk-adjusted premiums; Source of funding; 8. Depositor (Savings) Protection Schemes (8.1.1)]

#### **5. Cross-border coverage**

[If addressed]

### **D. Resolving Distressed Financial Institutions**

[General: the relationship between deposit insurance, if any, resolution of distressed financial institutions, and bank insolvency regime]

#### **1. Mergers & acquisitions**

[Describe the jurisdiction's legal structure for addressing bank mergers and acquisitions, including by foreign financial institutions, noting especially barriers that prevent such transactions, by either/both local (eg. competition regulation) and foreign (eg. restrictions on foreign ownership of financial institutions).]

#### **2. Resolving troubled banks**

[Who takes the decision to intervene troubled banks/financial institutions? 8. Depositor (Savings) Protection Schemes (8.1.5, 8.1.6); 11. Discipline/Problem Institutions/Exit (11.7)]

What criteria are used and are they mandatory, eg. prompt corrective action, automatic closure? 8. Depositor (Savings) Protection Schemes (8.1.7); 11. Discipline/Problem Institutions/Exit (11.8)

What powers does the agency have with respect to reorganisation/restructuring? 11. Discipline/Problem Institutions/Exit (11.9)

Can the relevant agency(ies) declare a financial institution insolvent? 8. Depositor (Savings) Protection Schemes (11.6)

### **3. Financial institution insolvencies**

[Which laws address financial institution insolvencies? *11. Discipline/Problem Institutions/Exit (11.5)*

Does the jurisdiction have a system of consensual work-outs?]

### **4. Reimbursing depositors**

[When and how are depositors reimbursed in a financial institution insolvency/intervention?]

### **5. Claims and recoveries**

[Can the deposit insurance agency/fund/regulator take legal action against bank directors or other bank officials in the event of failure/intervention? *8. Depositor (Savings) Protection Schemes (8.6)*

Does the regulator/agency/fund have priority in claims in insolvency?]

### **6. Depositor ranking, collateralisation and rights of set-off**

[Can financial institutions exercise set-off against depositor claims (including collateral)? What priority do depositors have in insolvency, eg. if no scheme or for claims which exceed coverage?]

### **E. Analysis and conclusions**



## **Annex B**

### **Appendix 1**

Financial Stability Forum (FSF), *Guidance for Developing Effective Deposit Insurance Systems* (Sept. 2001) ([www.fsforum.org/Reports/DepositInsuranceFinal.html](http://www.fsforum.org/Reports/DepositInsuranceFinal.html))

Supporting research available at [www.cdic.ca/international](http://www.cdic.ca/international)

Including presentations by representatives of the following relevant jurisdictions (available at [www.cdic.ca/international/meetingdocs.cfm?Id=97&conf=conf](http://www.cdic.ca/international/meetingdocs.cfm?Id=97&conf=conf)):

EU  
Japan  
Mexico  
Thailand  
UK  
US

The FSF Guidance paper contains the following “Key Points of Guidance” (20):

1. Contextual Background
2. Moral Hazard
3. Public Policy Objectives
4. Situational Analysis
5. Transition: Blanket Guarantee to Deposit Insurance
6. Self-assessment Methodology
7. Mandate and Powers
8. Structure
9. Governance
10. Human Resources and Statutory Indemnification
11. Interrelationships among Safety-net Participants
12. Membership
13. Coverage
14. Funding
15. Public Awareness
16. Cross-border Issues
17. Failure Resolution
18. Reimbursing Depositors
19. Claims and Recoveries
20. Depositor Ranking, Collateralisation and Rights of Set-off

## **Annex B: Appendix 2**

### **World Bank Deposit Insurance Systems Database**

([www.worldbank.org/research/interest/conf/upcoming/deposit\\_insurance/data.htm](http://www.worldbank.org/research/interest/conf/upcoming/deposit_insurance/data.htm))

The World Bank deposit insurance database contains the following information (headings to be included in individual country reports are in **bold/underline**):

#### **Type (explicit/implicit)**

Date enacted/revised

#### **Foreign currencies (yes/no)**

#### **Inter-bank deposits (yes/no)**

#### **Coverage limits (US\$ or ECU/US\$/Local currency)**

Coverage ratio

#### **Coinsurance (yes/no)**

#### **Permanent fund (funded/unfunded)**

Premium or assessment base

Annual premiums

#### **Risk-adjusted premiums (yes/no)**

#### **Source of funding (private/joint/public)**

#### **Administration (official/joint/private)**

#### **Membership (compulsory/voluntary)**

In addition, short summaries of countries with deposit insurance systems as of spring 1999 are included in A. Demirguc-Kunt & T. Sobaci, Deposit Insurance Around the World: A Data Base (WB May 2000) (available on the Deposit Insurance Database website), of which the most relevant for present purposes are:

Colombia  
Germany  
Japan  
Mexico  
Sweden  
Taipei  
UK  
US

## Annex B: Appendix 3

### World Bank Database on Bank Regulation and Supervision

([www.worldbank.org/research/projects/bank\\_regulation.htm](http://www.worldbank.org/research/projects/bank_regulation.htm))

The WB bank regulation and supervision database contains information under the following general headings (general headings containing information to be included in individual country reports are in ***bold/italic***, with relevant sections listed in brackets):

1. Entry into banking
2. ***Ownership (2.5)***
3. Capital
4. ***Activities (4.1, 4.2, 4.3, 4.4)***
5. External audit requirements
6. Internal management/Organisational requirements
7. Liquidity and diversification requirements
8. ***Depositor (savings) protection schemes (8.1, 8.6)***
9. Provisioning requirements
10. Accounting/information disclosure requirements
11. ***Discipline/problem institutions/exit (11.5, 11.6, 11.7, 11.8, 11.9)***
12. ***Supervision (12.1, 12.14)***

Data are included for the following countries relevant for present purposes:

Australia  
Germany  
Japan  
Malaysia  
Mexico  
South Africa  
Sweden  
Thailand  
UK  
US

