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Foro de Seguro de Depósitos de las Américas

Americas Deposit Insurance Forum

IADI International Association of Deposit Insurers

IPAB Instituto para la Protección al Ahorro Bancario

Session 1:

Funding for deposit insurance and resolution

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Target fund size and Investment policy

Complying with DICP-9: AMF's Approach

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Background: IADI standards and guidance

- **DICP-9 essential criterion 5** states that after establishing an *ex ante* deposit insurance fund:
  - (a) the **target fund size is determined on the basis of clear, consistent and transparent criteria**, which are subject to periodic review; and
  - (b) a **reasonable time frame is set** to achieve the target fund size.
- **DICP-9 essential criterion 6** requires a **defined investment policy** that aims at ensuring:
  - (a) the **preservation** of fund capital and maintenance of **liquidity**; and
  - (b) that **adequate risk management** policies and procedures are in place.
- **IADI guidance paper** entitled *Enhanced Guidance for Effective Deposit Insurance Systems*:
  - ➢ appropriate target fund level **should be consistent with their mandate** (EG no. 2).

Background: relationship between three core variables

Target determined using:
- Quantitative criteria
- Qualitative criteria (e.g. mandate, local/market specificities)

MODEL

Fund size

Time frame

Sources of funds :
- Premiums
- Investment income
- Other sources

DIF target: the "simple ABCD" story

- When DIs meet, they would usually compare:

  A: their assets in % of the covered deposits (e.g. 75 bps)

  B: their target fund size (e.g. 100 bps)

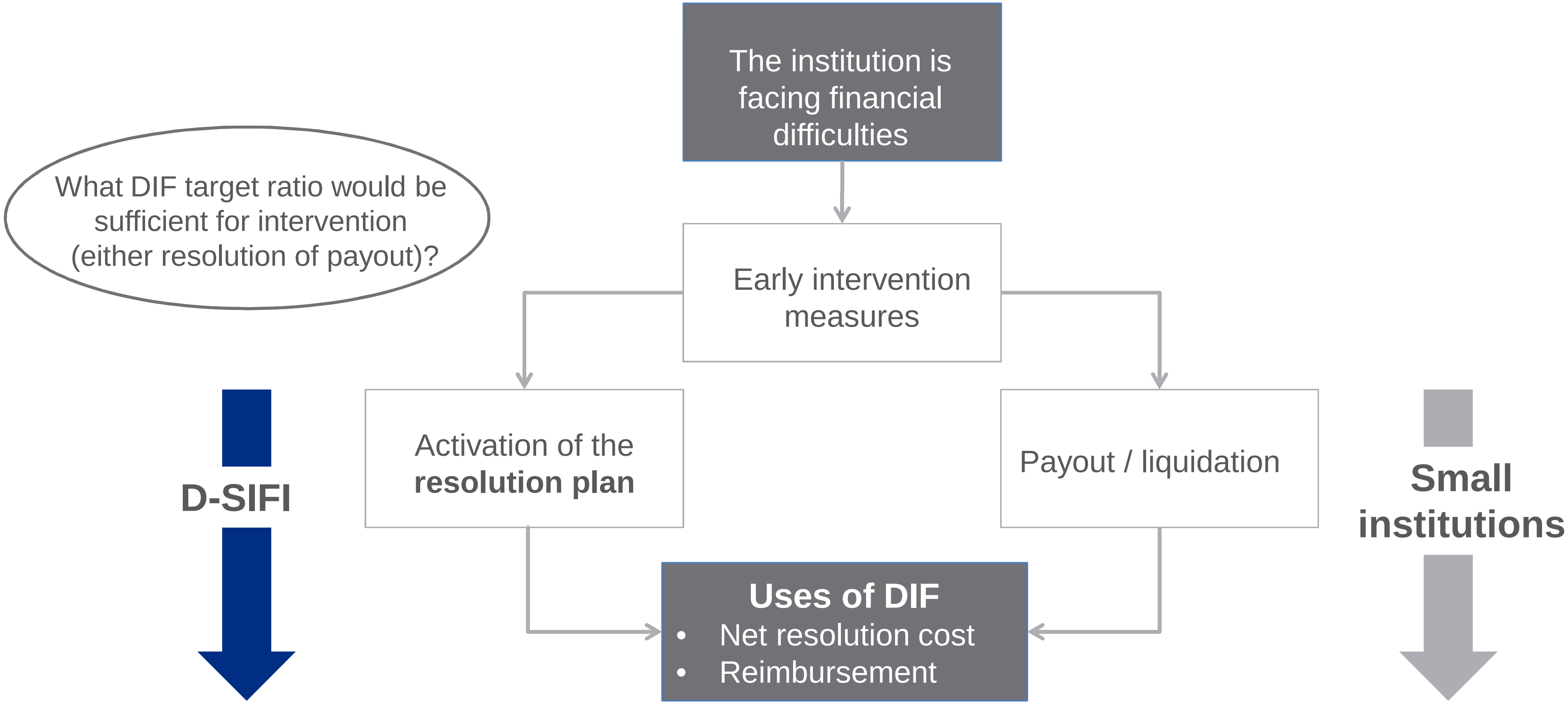
  C: their time frame (e.g. 10 years)

  D: the premium rate allowing to get from **A** to **B** over **C**

Specificities of the Québec jurisdiction

- AMF has jurisdiction over **one D-SIFI** which represents **98.9% of insured deposits.**
- **Scarce historical data** on resolution or deposit payout.
  - Last interventions made over 20 years ago, in small to medium-sized institutions.
  - The market is currently more concentrated than 20 years ago.
- The AMF is an **integrated regulator** with a **risk minimizer** mandate.
  - Prudential supervision, resolution and deposit insurance.
- Hence, **we cannot limit ourselves to the "simple ABCD" story**.

AMF's two-tier approach



AMF's "ABCDE" story

- At any point in time :

A: The current capital level of the D-SIFI

B: probable impacts of severe crisis, using stress tests

C: the minimal post-resolution capital required to be credible / viable

D: the potential targets for the fund

E: the resolution trigger that maximises the probability of **(A – B) ≥ (C – D)**

→ **We use the resulting resolution trigger to appreciate the adequacy of the fund.**

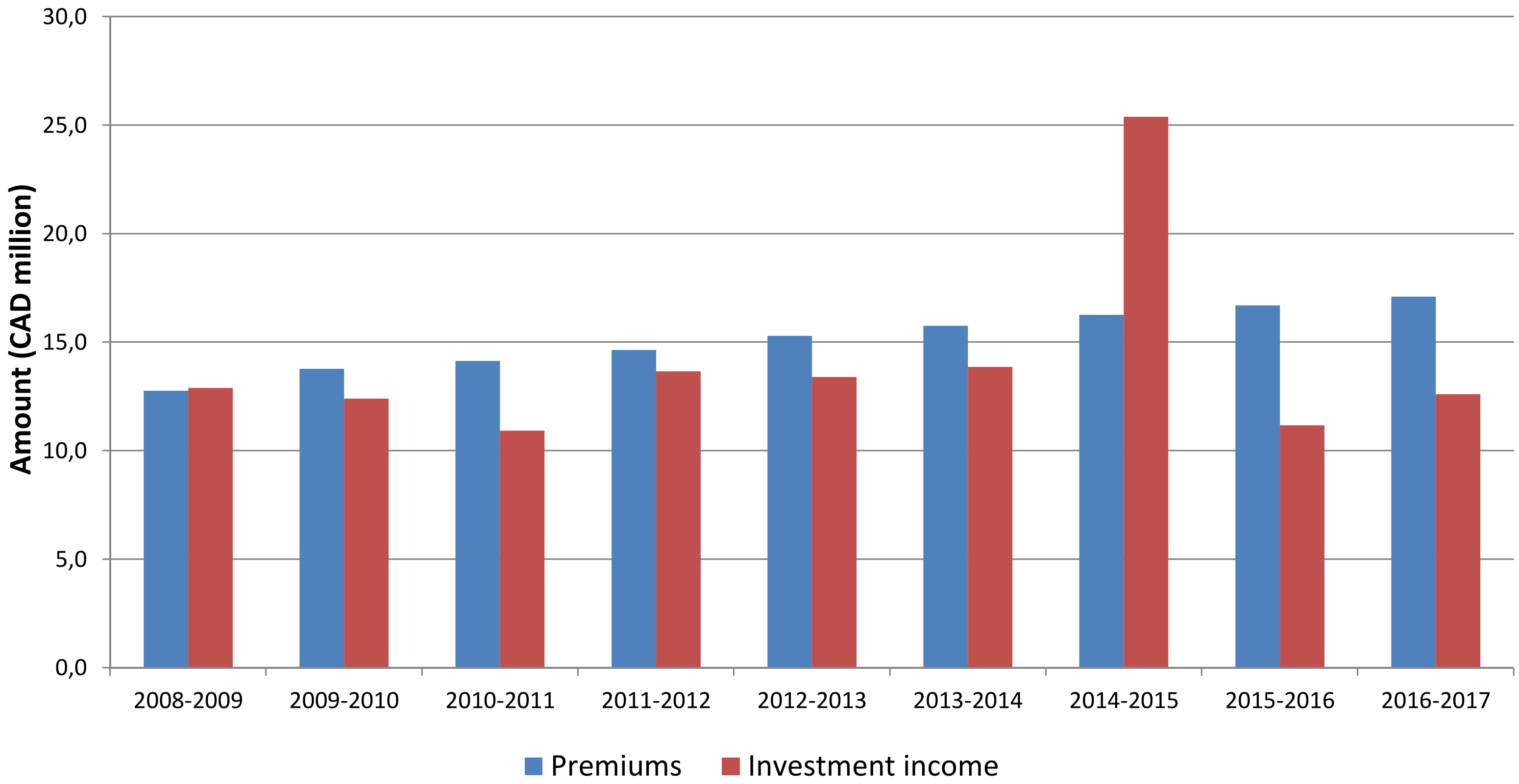
Further thoughts on the fund size:

- In our model, a higher fund target generates stronger resilience to crisis and/or potentially lower resolution triggers (i.e. the model has the right incentives).
- One practical challenge we face is to generate stress tests severe enough (yet credible) to bring the observed capital ratio (**A**) below the minimally viable level required after a crisis (**C**).
- Also, given our risk minimizer mandate, we can implement (confidential) prudential requirements **(A*)** and early intervention measures, so that **A** remains **≥ A*** on a going-concern basis.
  - ➢ We can use **A*** in addition to adjusting premium levels (or time frame) while we are building up the fund size.

Further thoughts on the revenues:

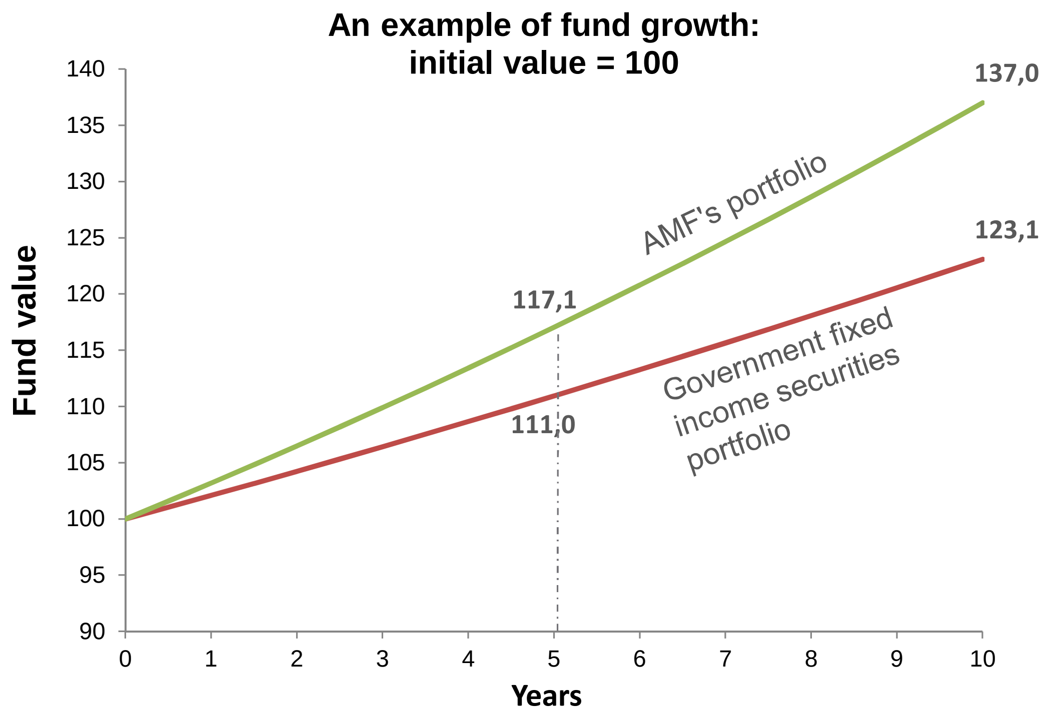
- In some jurisdictions, governments have put in place large public investment funds managers (e.g. public pension and insurance schemes).
  - In Québec: the Caisse de dépôt et placement (www.lacaisse.com)
- The AMF has put in place a detailed governance framework and determined an acceptable risk level for its investment policy :
  - ➢ Current asset allocation: 85% fixed income, 15% securities, 0% non-liquid assets
  - ➢ Expected returns: 3.2% annually over 10 years, 3.3% annual volatility
  - ➢ Liquidity agreement in place that allows access to >95% of the DIF value within 24 hours (the remaining in less than 1 month).

AMF's experience since 2008-2009: investment returns almost similar to premiums



Looking forward in a low interest rate environment

Portfolio	Government fixed income securities portfolio	AMF's portfolio
Expected return (annualised-10 year)	2.1 %	3.2 %
Risk (volatility) (annualised-10 year)	3.2 %	3.3 %



Source: Caisse de dépôt et placement forecast
Gov. Securities Portofolio: 90% Gov. bond and 10% Gov. T-bill

Key messages

- The overarching policy objective is to avoid rescuing institutions using taxpayers' money.
- Comparing DI fund sizes in % of insured deposits could reveal only one small part of the story.
- The adequacy of DIs' fund targets, time frames, and premiums depends on their mandate and the specificities of their market / jurisdiction.
- Under the right circumstances, some adjustments to the investment policy may deliver a lot on the revenue side.
- We suspect that some of the ideas we shared could also apply (with adaptations) to other DIs with risk/loss minimizers mandates and/or a highly concentrated banking sector.
  - ➢ Don't hesitate to contact us to compare notes, share your own ideas and discuss findings!

Some potential questions for the participants

- Do you use a "multi-tier" resolution/liquidation approach, based for example on the size of the failing institution? How do you decide which institution fall into which category? Does it affect your fund size(s) target(s)?
- Under which conditions would you consider having a public sector investment manager help your DIF reach its objectives? If none is available in your jurisdiction, would you consider using private sector investment managers? Build internal trading capacity? None of the above?
- Would you like IADI to further explore the issue of DIF investment policy, for example by enhancing the CPRC annual survey on topics like asset allocation, historical and expected returns / risks, asset management function?

Thank you! Gracias!

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