

## **STRUCTURE AND ORGANISATION**

### **Abstract**

Whether a deposit insurance system will be effective in meeting its public-policy objectives will be determined, in part, by how the system is structured and organised. Structure and organisation encompasses a deposit insurance system's mandate, roles and responsibilities; its governance arrangements; and its human resources and other operational considerations. Mandates, roles and responsibilities vary widely among deposit insurance systems. It is critical that they be well-defined and consistent with the stated public-policy objectives of the scheme. In order to discharge its mandate effectively, a deposit insurer should have access to requisite information on its member institutions. The choice of the governing structure for the deposit insurance system usually is influenced by the mandate and the degree to which the deposit insurer is legally separate from the other safety-net participants or those having an interest in deposit protection and financial-sector stability. Governance systems can be enhanced through the use of sound strategic- and risk-management processes and good internal-control and audit systems. Arrangements should be made to ensure that the governing structure is accountable and transparent. Human resources and other operational issues are a critical elements of the structure and organisation of a successful deposit insurance system. Key issues are: attracting and retaining qualified employees, determining the appropriate mix between dedicated staffing and outsourcing, ensuring the confidentiality of information supplied to employees, and guaranteeing that employees receive legal protection against lawsuits for their action in the normal course of their activities.

## STRUCTURE AND ORGANISATION

The ability of a deposit insurance system to fulfil its public-policy objectives is greatly influenced by its structure and organisation. The development of an appropriate structure and organisation for a deposit insurance system requires an examination of a number of factors. These include the deposit insurance system's specific mandate, its roles and responsibilities; governance arrangements; human resources; and other operational considerations. This paper will identify the relevant structural and organisational issues for deposit insurance systems, and will examine the trade-offs associated with choosing a particular structure and organisation. This paper represents the work of the Subgroup on Structure and Organisation.<sup>1</sup>

### **Mandates, Roles and Responsibilities**

The mandate of an organisation encompasses the set of official instructions given to an organisation to perform its task(s). Organisational roles and responsibilities generally arise from the given mandate. A number of issues should be taken into account when setting out mandates, roles and responsibilities for a deposit insurance system. These include: the linkages between the deposit insurer's mandate and its public-policy objectives and country circumstances; the degree to which mandates are defined in law or by other means; the degree of coordination with other organisations that comprise the financial safety net; and the processes in place for reviewing mandates.

Mandates, roles and responsibilities vary widely among deposit insurance systems. They can focus on the relatively limited paybox responsibilities, such as the collection of premiums and the payment of claims to depositors, or they can be broader and focus on risk-minimisation responsibilities. Such responsibilities may include risk assessment and management, supervision, and intervention and failure resolution.<sup>2</sup>

Mandates also can be influenced by the degree to which a deposit insurance system is either privately or publicly sponsored, administered or financed. In purely private systems—those sponsored and administered by private-member associations with no government involvement or financial backing—mandates tend to reflect objectives consistent with their members' wishes.<sup>3</sup> There are, however, some privately administered deposit insurance systems that have legislative underpinnings and significant public elements. These systems legally may be required to pay depositors' claims, may be given access to government assistance, and may include the participation of bankers and government officials on their governing bodies. In such cases, their

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<sup>1</sup> The Subgroup is comprised of representatives from Philippines (coordinator), Canada, Germany, Jamaica, and The World Bank. This paper is designed for deposit insurance practitioners and other interested parties. It is primarily based on the judgment of the Working Group members and the experiences of various countries that have addressed structure and organisation issues for deposit insurance systems. The paper also incorporates use of the available literature on the subject.

<sup>2</sup> The issue of powers is discussed in another paper.

<sup>3</sup> A number of privately administered systems have restricted their stated objectives and mandates to providing deposit insurance solely for protecting small and unsophisticated depositors.

mandates, roles and responsibilities may reflect a wider range of concerns such as promoting confidence and financial-system stability.

On the other end of the spectrum are purely public systems, which entail government sponsorship, administration and financing. Their mandates tend to emphasise objectives consistent with broader public concerns. Nevertheless, many so-called publicly sponsored and administered systems may rely on private financing from their membership and may rely on private-sector advisers and the views of member financial institutions. In practice, virtually all deposit insurance systems have some private and public characteristics. This public/private-sector mix, and resultant mandates, roles and responsibilities are country-specific.

### **Linkages to public-policy objectives**

The public-policy objectives of the deposit insurance system and its mandate should be consistent in order to enhance the effectiveness of the system. Serious problems can result when they diverge. The issue of consistency is relevant across all deposit insurance systems.

### **Specification of mandates, roles and responsibilities**

The degree to which mandates, roles and responsibilities are well-defined is another important consideration. The advantage of a well-defined system is that there is less ambiguity, because the rules are clear to all parties, including depositors, insured institutions, and safety-net participants. This can reinforce stability and confidence in the deposit insurance system. By making transparent information on the roles and responsibilities of the deposit insurer, and the terms and conditions of deposit insurance, incentives for greater accountability and good governance are provided.<sup>4</sup> The specification of the accountability regime, terms and conditions of insurance—such as membership, coverage, and the reimbursement process—and on the coordination and information-sharing arrangements between the deposit insurer and other safety-net participants should be well-defined.

Formal specification can be accomplished either through law or regulation, a policy statement or agreement, or by private contract. Although some private systems may not be defined in legislation, they can be defined alternatively in private contracts. Even in cases where the deposit insurer is not a separate legal entity—for example, a department of a central bank—there are benefits to having well-defined mandates and responsibilities, including improved coordination with the activities of other departments within the organisation.

### **Coordination with other safety-net participants**

In order to discharge its mandates effectively and meet its objectives, a deposit insurer should have access to requisite information on its member institutions. The need for adequate and timely information among members of the safety net is particularly critical because few deposit

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<sup>4</sup> There can be disadvantages associated with having too many characteristics of a system defined in law or private contracts. In some countries, operational features, such as staffing levels and budgets, are established by statute, which may diminish the flexibility of the deposit insurance system to respond to changing conditions.

insurers have broad supervisory authority. At a minimum, access to basic information about member institutions, including information on current financial condition and the existence of problems, needs to be assured. Although informal arrangements can work well in some circumstances, it is often necessary that information sharing be mandated either through legislation or by private agreements, or both, given the sensitivity of member-specific information and the challenge of maintaining open communication channels. These should set out what is to be shared and by whom, as well as the type, level of detail, and frequency of the information to be exchanged. In all cases, the confidentiality of the information should be assured. There also should be goodwill among the heads of the agencies, indicating that they are firmly committed to information exchange.

Coordination of the activities of the safety-net participants is important for ensuring an effective deposit insurance system and for avoiding inefficiencies and conflicts between safety-net participants. The need for cooperation among safety-net participants should be taken into account when determining the mandate, roles and responsibilities of the deposit insurer. This is particularly crucial in situations when the deposit insurer is accorded a broad mandate, such as the role to intervene in member institutions' affairs or act as receiver or liquidator. Experience has shown that clarity and coordination can contribute not only to the effectiveness of a deposit insurance system but also to the effectiveness of the entire financial safety net.<sup>5</sup>

### **Process for the periodic review of mandates**

It is important to ensure that a process exists for the periodic review of the mandate, roles and responsibilities of a deposit insurance system. Rapidly changing conditions in the overall economy, and the financial sector in particular, make it necessary to undertake a situational analysis.<sup>6</sup> The review process can include a regular assessment and report to stakeholders of the system's effectiveness in meeting its mandate, including any recommended changes.

### **Governance Arrangements**

Other important considerations relate to the structure and organisation of a deposit insurance system. These include: the structure of the governance system; the composition of the governing body and its duties and responsibilities; internal-control processes; and transparency and accountability regimes.

### **Structure of governance**

The choice of the governing structure for the deposit insurance system usually is influenced by the mandate and the degree to which the deposit insurer is legally separate from the other safety-net participants. One option is to assign responsibilities for the insurance function to an existing entity. This option has been adopted in many cases where the insurance function is primarily public. Many countries have chosen to locate their deposit insurance function as a department

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<sup>5</sup> For a more detailed discussion of how coordination can be accomplished please refer to the paper on interrelationships.

<sup>6</sup> See the paper on situational analysis.

within a central bank or supervisory authority. This approach can be more cost-effective from an administrative point of view than the creation of a separate entity. It also allows the deposit insurer to tap into staff resources and skills from the existing entity. This type of arrangement also may facilitate information sharing and coordination.

There are several drawbacks to not having a separate deposit insurance entity. The primary disadvantage is that the existing entity—whether it is a central bank, supervisory or other authority—may have difficulty separating its other responsibilities and interests from those of the deposit insurance function. It may be difficult to ensure that the interests of the deposit insurer are given appropriate weight in the decision-making process. In addition, it may give rise to conflicts because the objectives of the deposit insurer may conflict with those of the existing entity.

Alternatively, the deposit insurance function can be set up as a separate legal entity. In this case, a governance choice is to vest a board of directors or managing board with the responsibility to direct the affairs of the organisation and to be held responsible for the sound functioning of the deposit insurance system. Board systems appear to be the predominant choice in cases where the deposit insurer has separate legal status from other safety-net participants or, in the case of private schemes, industry members. Board systems also may be utilised when the deposit insurer is designated as an autonomous subsidiary of a central bank, industry association or other organisation. In public systems, the board can be made responsible directly to the legislature or to the supervisory authority. In private arrangements, the board can be made responsible to its member institutions through an industry association.

There are advantages associated with a separate legal status and a board structure. In particular, the deposit insurer may be more focused and effective in carrying out its often unique mandate, roles and responsibilities. Opportunities for conflicts are reduced compared to a departmental model. However, a board structure usually requires stronger accountability and transparency regimes as well as greater administrative resources than other alternatives. Legally separate deposit insurance systems also may face greater challenges in terms of information sharing and coordination with other safety-net participants.

### **Composition and duties of the governing body**

The governing body of a deposit insurance organisation usually includes individuals who have decision-making authority. In addition, the input and views of other safety-net participants or relevant stakeholders are often taken into account. In order to improve effectiveness and to ensure the integrity of the deposit insurer, members of the governing body should understand the organisation's activities and the environment in which it operates. The members should be subject to some form of a "fit-and-proper" test, be free from serious conflicts of interest, and be as independent as possible from undue political or industry influence. It should be noted, however, that some of the best-qualified candidates for appointments to a governing body are the same people who may have conflicts of interests—individuals such as regulators or those affiliated with member institutions. Different systems make different judgments about who should be permitted to serve in a governing capacity and how conflicts should be managed. In

general, the narrower the mandate of the deposit insurance system, the less likely is the potential for conflicts of interest.

For deposit insurance systems that are predominately administered privately through a board arrangement, the board composition may include active member institutions. Deposit insurance systems that are jointly administered may include members affiliated with financial institutions as well as government officials on their board. However, care needs to be taken to ensure that such arrangements do not lead to conflicts of interest that can be detrimental to the deposit insurance system. A number of public systems reserve positions for independent private members—those not currently active in the affairs of member institutions—in order to obtain additional expertise and advice. Some public schemes allow for members who are actively affiliated with member institutions. However, most systems discourage this practice because the interests of such members may conflict with the interests of other stakeholders and the confidentiality of information could be compromised.

Governance systems often can be enhanced through the use of special advisory bodies or committees. Such committees can include industry representatives, particularly in systems that may exclude their direct participation in the governing body. These committees also may include industry representatives who can provide their expertise and views on certain matters, such as real estate. Once again, however, the use of outside experts should not compromise the confidentiality of information or permit conflicts of interest to arise.

The delineation of the duties and responsibilities of the governing body is a critical aspect of good corporate governance. It is important for members of the governing body—such as members of the board, management and employees—to understand and to meet their responsibilities. It also is important to evaluate regularly the board's effectiveness in fulfilling its responsibilities.

In many countries, the governing body is given authority for the selection and oversight of senior management, and the responsibility to review management, operations and the performance of the organisation. This can be extended to require that the governing body ensure that effective strategic- and risk-management processes are in place.<sup>7</sup> The governing body's authority also may include the ability to remove any officer or employee of the organisation for cause, and to deal with confidentiality, ethical business conduct, and conflict-of-interest issues. Other approaches may provide the board with the authority, under statute, to prepare and issue rules and regulations necessary for the sound functioning of the organisation. Some systems with a focus on risk minimisation may provide extra authority, through statute, to make regulations affecting the affairs of member institutions.

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<sup>7</sup> Effective strategic management usually incorporates an understanding of the environment in which an organisation operates, the establishment of organisational objectives, the development of implementation plans to achieve objectives, and the capability to report and assess progress toward meeting objectives. Effective risk management typically involves having the capability to identify and assess risks inherent in an organisation's current and anticipated operations, initiate policies to deal with these risks appropriately, and regularly review and evaluate risk-management policies.

## **Internal-control processes**

Internal-control processes—by which deficiencies are identified and corrected—are important governance considerations. Sound internal-control and audit processes play a crucial role in ensuring the integrity and efficiency of operations, and they can enhance corporate standards of accountability. Internal audit programs typically involve regular compliance and accountability reviews and the monitoring of performance according to set standards and policies.<sup>8</sup> Some systems go so far as to include public-service delivery and operational quality reviews. It can be particularly helpful if the internal-control processes of the deposit insurer correspond to the general requirements for audit purposes set for financial institutions or comparable government institutions.

## **Accountability, transparency and disclosure**

Appropriate accountability, transparency and disclosure regimes for the deposit insurer and other safety-net participants are important structure and organisation issues. It is important that the deposit insurer, regardless of its structure, be held accountable for its decisions and actions. In circumstances where deposit insurance is provided through a legally separate entity, accountability can be bolstered by ensuring that the board of directors and senior management are responsible and accountable to their primary stakeholder. In many public systems utilising an independent board structure, the organisation is made accountable in law to the public, often *via* the legislature or an appropriate ministry of the government. Input from member institutions and other interested parties can be channeled through the use of special advisory bodies or committees. Achieving the right balance between accountability and independence will depend, to a large extent, on country-specific factors.

In predominantly private systems, the deposit insurance organisation often is held directly accountable to its member institutions or industry association. Where a private system is mandated by law, the deposit insurer often is made accountable to both its members and the public *via* the legislature, or to a department or ministry of the government.

Setting up an appropriate transparency and disclosure regime also can provide benefits to a deposit insurance system. Transparency refers to the process by which information on the system and its actions is made available and readily understood by the public. Ensuring that the system is transparent and disclosing information on a timely, consistent and accurate basis can enhance accountability, sound management and the functioning of the system. Typically, this involves making transparent the deposit insurer's mandate, roles and responsibilities. In addition, information should be disclosed about a deposit insurer's activities, decision-making processes, financial position (for example, disclosure of audited financial statements that adhere to generally accepted accounting principles), funding arrangements, costs associated with failure resolutions

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<sup>8</sup> High-risk areas such as cash, securities, premises and assets of closed banks can be covered in separate verification processes.

and other relevant information for the provision of deposit insurance.<sup>9</sup> A number of deposit insurance systems require a full consultative process with relevant stakeholders whenever changes are proposed to the policy or legislative framework affecting the system. This can be done as a matter of law or as a matter of administrative process. The consultative process, including the time frame, are often a function of the complexity and degree of controversy surrounding any changes.

It is important to recognise the need for confidentiality and the judicious release of information as appropriate. The extent and frequency of information disclosed by deposit insurers varies considerably among systems. Some systems regularly disclose detailed reports on their activities, financial position, performance, funding positions, and even information on the costs associated with individual failures and problem institutions. Other systems release only a limited amount of information to the public. This reflects legitimate concerns that the disclosure of too much information (particularly information on the costs associated with failures and anything related to the financial position of individual member institutions) could negatively affect public confidence and the stability of the financial system.<sup>10</sup> Ultimately, an appropriate balance should be struck between the desire to promote accountability and sound management through disclosure, and the need to ensure confidence and financial-system stability.

## **Human Resources and Operational Considerations**

Human resources are a critical element of the structure and organisation of a successful deposit insurance system. Issues of interest are: ensuring the availability of human resources to meet the operational objectives of the system; compensation, incentives, training and other measures to attract and retain skilled staff; and confidentiality and legal-liability issues relating to employees.

A number of approaches have been used to ensure the availability of qualified persons to meet the operational objectives of deposit insurance schemes. Some deposit insurers rely primarily on a body of dedicated staff, others emphasise the use of outsourcing, while still others utilise a combination thereof. Country-specific factors, such as the mandate and structure of the deposit insurance system, as well as the availability of skilled resources, influence staffing decisions.

Having a fully dedicated staff allows for a high level of control over the functions of the deposit insurer and its ability to maintain tight control over service standards and quality. These functions include: executive decision-making; the management of operational policies, systems and practices; the strategic- and risk-management processes; and contingency planning. However, having a large proportion of dedicated staff can lead to higher fixed costs and may reduce the flexibility of the insurer to respond to changes in staffing requirements. It should be

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<sup>9</sup> Risk-minimisation deposit insurance systems with roles in examinations, interventions and failure resolution also may benefit from the disclosure of how these activities are set out and coordinated with those of the other safety-net participants.

<sup>10</sup> This form of disclosure can result in a reduction in asset values and losses to the deposit insurance system. In addition, the detailed disclosure of funding arrangements, particularly in cases where a deposit insurer is unclear on how it will fund the resolution of large member institutions in difficulty, also can erode confidence in the system or lead to conclusions by the public, rightly or wrongly, of the existence of a "too-big-to-fail" policy.



noted that the latter concern can be addressed to some degree by cross-training employees in multiple skills.

Alternatively, the deposit insurer can assign certain tasks to outside service providers through outsourcing. Outsourcing can include borrowing staff as needed from another safety-net participant or maintaining contracts with private-sector firms to undertake certain activities. It also is possible to outsource specific tasks while maintaining ultimate responsibility and control through the use of dedicated staff. Some countries have used this approach in the case of estate administration. External service providers can be required to file detailed business plans with the insurer before commencement of their activities.

Advantages of outsourcing include flexibility to allocate staff, the ability to reduce staffing costs during idle periods, and the ability to take advantage of the efficiencies and specific expertise that service providers may offer.<sup>11</sup> Outsourcing also can create arm's-length arrangements that may benefit a deposit insurer, such as in the case of outsourcing asset-disposition duties. In some systems, the deposit insurer is the major creditor and it may be perceived that there is conflict of interest if the insurer undertakes these roles directly, particularly if the deposit insurer is a priority creditor. Outsourcing these functions also may free the deposit insurer from any rigidities in government rules, such as those regarding restrictions on negotiated sales.

Major disadvantages of outsourcing include increased difficulty in controlling events as well as difficulties in ensuring consistent quality across the organisation. Given the difficulty in predicting the incidence of troubled banks and failures, service providers may not be able to respond quickly or adequately to an increased demand for their services.<sup>12</sup> Experience suggests that the net savings associated with outsourcing may not be lower than from maintaining a dedicated staff.

Because of the trade-offs associated with staffing issues, many deposit insurance systems rely on dedicated staff and outsourcing. For example, some systems assign dedicated staff to core-management functions within their organisations, while non-core functions are assigned to outside providers. Nevertheless, care must be taken to ensure that quality standards are met.

The ability to attract and retain qualified employees and establish competitive compensation is another key human-resource challenge for deposit insurance systems. Many schemes, both public and private, have limited financial resources and often have difficulty providing competitive compensation relative to the financial-services industry—and in some cases, even relative to other safety-net participants. Furthermore, some systems may face constraints in securing adequate resources to train and develop employee skills.

A variety of approaches have been undertaken to address human-resource issues. Some have focused on efforts to ensure that salary ranges are competitive with defined markets. Another

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<sup>11</sup> Given the financial constraints many deposit insurance systems face in attracting and retaining highly skilled staff and experts, contracting out may provide a cost-effective alternative to access the skills of such individuals.

<sup>12</sup> In some situations the unavailability of experts can hinder attempts to outsource and lead to functions being carried out in-house.

approach has been to offer opportunities for career progression through succession planning and training and development. For example, training and development can be undertaken in-house in situations where the dedicated staff of the organisation is large or if outside courses are unavailable. In other instances the deposit insurer may share training and development programs resources with other safety-net participants or industry associations. There also has been a growing recognition among deposit insurers of the benefits to be gained from international training, assistance, and collaboration. Although such assistance and collaboration can enable deposit insurers to share their knowledge, the ability to secure necessary funding for such activities may be beyond the capabilities of some deposit insurance systems. Additional assistance may be required from stakeholders such as governments and international organisations.

Most deposit insurance systems need to rely on confidential information collected from institutions and other safety-net participants to fulfil their mandates. Thus, measures to ensure that this information remains confidential are important considerations for employees. A number of countries have introduced provisions regarding secrecy and confidentiality regarding all documents, information and records pertaining to matters dealt with by the deposit insurance entity.

In terms of legal-liability issues, situations exist in some countries where employees of deposit insurers and other safety-net participants are held personally liable for actions taken on behalf of their organisations. Although this arrangement may have been instituted in an effort to improve accountability, a number of countries noted that it has resulted in serious impediments to employee and organisational performance. The lack of legal protection can reduce incentives for employees to be vigilant in the carrying out of their mandates—particularly in cases where mandates emphasise promptness in detection, intervention and closure of troubled institutions. The Working Group recognised the importance of statutory indemnification and recommended that staff should receive legal protection against lawsuits for their official action in the normal course of deposit insurance activities or supervision.<sup>13</sup>

### **Information technology and other issues**

Information systems and the use of technology are other important operational areas for deposit insurance systems. Although specific needs may vary depending on the type of deposit insurance system in place and its mandate, access to timely, accurate and consistent information can be extremely beneficial.

Information management systems that process information quickly and accurately can help a deposit insurer detect and deal with problems. In some cases, this information can be generated from systems within the deposit insurer, although in other cases, it may be necessary to retrieve information from other safety-net participants.

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<sup>13</sup> Financial Stability Forum Working Group on Deposit Insurance, *A Consultative Process and Background Paper*, June 2000.

## Conclusions

- Mandates, roles and responsibilities can vary widely among deposit insurance systems. It is critical that the mandates, roles and responsibilities are consistent with the stated public-policy objectives of the deposit insurance system.
- Formal specification of the mandates, roles and responsibilities—either in law, a formal policy statement or agreement, or by private contract—and the establishment of relationships and linkages with other safety-net participants enhance the effectiveness of a deposit insurance system. The mandates, roles and responsibilities of the deposit insurance system should be clear to all parties concerned. This will reinforce stability and confidence in the financial system. It also will contribute to greater accountability and sound governance of the deposit insurance system.
- In order to discharge its mandate effectively, a deposit insurer should have access to requisite information on its member institutions. The need for adequate and timely information is particularly critical because few existing deposit insurers have broad supervisory authority.
- The coordination of the activities of the safety-net participants is important for ensuring an effective deposit insurance system and for avoiding inefficiencies and conflicts between safety-net participants.
- A variety of forms of governance can be utilised by a deposit insurance system. The choice of the governing structure usually is influenced by the mandate and the degree to which the deposit insurer is legally separate from the other safety-net participants.
- The composition of the governing body of a deposit insurance organisation should include individuals who understand the organisation's activities and the environment in which it operates. These individuals should have decision-making authority. In addition, the input and views of the safety-net participants and/or relevant stakeholders often are taken into account by the governing body. The members should be subject to some form of a "fit-and-proper" test, be free from serious conflicts of interest, and be as independent as possible from undue political or industry influence.
- Governance systems can be enhanced through the use of sound strategic- and risk-management processes and good internal-control and audit systems. Arrangements should be made to ensure that the governing structure is accountable and transparent.
- Human resources are a critical element of the structure and organisation of a successful deposit insurance system. The ability to attract and retain qualified employees and establish competitive compensation are key challenges for most deposit insurers.
- A number of approaches have been used to ensure the availability of qualified persons to meet the operational objectives of deposit insurance schemes. Some deposit insurers rely primarily on a body of dedicated staff, others emphasise the use of outsourcing, while still

others utilise a combination thereof. Country-specific factors, such as the mandate and structure of the deposit insurance system, as well as the availability of skilled resources, influence staffing decisions.

- Most deposit insurance systems need to rely on confidential information collected from institutions and other safety-net participants to fulfil their mandates. Thus, measures to ensure that this information is made available to the deposit insurance system and remains confidential are important.
- The lack of legal protection for employees can reduce incentives for deposit insurers to be vigilant in carrying out their mandates—particularly in cases where mandates emphasise early detection, intervention and closure of troubled institutions. The importance of statutory indemnification should be recognised and employees should receive legal protection against lawsuits for their action in the normal course of deposit insurance activities or supervision.
- The ability to have in place information management systems to access and process information quickly and accurately is vital for a deposit insurer to detect and deal effectively with problems.