Risk Assessment: Results of an International Survey of Deposit Insurers

*by Jane F. Coburn and John P. O'Keefe**

The success of the financial safety net that a country provides for its financial system is ultimately indistinguishable from the ability of government authorities to manage the risks to the safety net.[1] To do their job well, risk managers need information on the risk exposures of the financial institutions that are covered by the safety net, and they also need procedures for limiting their own risk exposure.

To learn more about how other countries address these and other important needs of a financial safety net, in January 2000 the Federal Deposit Insurance Corporation (FDIC) surveyed 73 foreign deposit insurance organizations in 64 locations (some locations have more than one deposit insurer). All the organizations had specific deposit insurance schemes. The survey consisted of 65 multiple-choice and essay questions not only on risk assessment but also on failure-resolution methods, asset liquidation and the role of the receiver, and funds availability. As of June 2000, 37 insurers in 34 locations had responded.[2]

This is the second in a three-part series on the results. The first part describes failure-resolution methods as well as asset-liquidation practices and the role of the receiver (as reported by the 37 participating deposit insurers).[3] This article discusses the risk-assessment practices of these same insurers, and a subsequent article will address funds availability (that is, the availability of resources to absorb unavoidable risk-related losses). The approach taken throughout the series is to provide context for survey responses by drawing on the academic literature and the experiences of the FDIC.

The majority of the 37 insurers that responded to the risk-assessment section of the survey are located in Europe. Ten of the 37 respondents—Austria, Belgium, Canada, France, Germany, Italy,

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[1] The financial safety net may be broadly defined as government support of private sector borrowers through explicit and implicit guarantees and other means (Walter and Weinberg (2002)). Defined in this way, the financial safety net extends to both financial and nonfinancial businesses. This article, however, defines the financial safety net more narrowly as the deposit insurance system for banks and thrift institutions.

[2] Austria, Germany, and Italy have multiple deposit insurers. Not every question was answered by every respondent, so for each question there may have been fewer than 37 responses.

[3] Bennett (2001).

Japan, the Netherlands, Spain, the United Kingdom—hold 62 percent of the world's banking assets and encompass 41 percent of the world's gross domestic product and 15.5 percent of the world's population. Comparable figures for the United States are 17.2 percent of the world's banking assets, 28.8 percent of the world's gross domestic product, and 4.6 percent of the world's population. Borrowing terms from the International Monetary Fund, we categorize the locations of the respondents as "advanced economies," "developing economies," or "economies in transition," but we combine the two categories of "developing economies" and "economies in transition" into one.[4]

In any business, potential creditors and equity shareholders cannot make sound investment decisions without accurate and timely information on the condition of, and risks to, the relevant business entities. This need for information creates incentives for the business entities to prepare and make public financial statements regularly. The availability and use of such information are necessary for markets to allocate financial resources efficiently; such allocation makes possible the market discipline that rewards good management and punishes bad management.

In banking, however, when countries extend a safety net to creditors of financial institutions, the information needs of some creditors are greatly reduced. More specifically, insured depositors, who make up the vast majority of the creditors of most insured banks and thrifts in the United States, have little incentive to monitor the risks of insured depositories (henceforth, "banks").[5] But this need for information is not eliminated. Rather, it is transferred to the deposit insurer, which stands in place of insured depositors among banks' creditors when banks fail.[6]

Regardless of how countries organize their financial system safety nets, therefore, it is clear that the government agencies responsible for managing the safety net need accurate and timely information on the condition of, and risks to, the financial institutions to which the safety net extends. That information can come from on-site inspections of banks and off-site analyses of the financial statements that banks make available to government authorities and the public.[7] In addition, the responsible agencies must be able to place the information on banks in its proper economic and political context. Thus, they require information about the markets (local, national, and international economic conditions) in which banks operate and about the legislative and other political developments affecting the environment in which banks compete. All the information about banks, their markets, and their competitive environment enables risk managers to take the next step in the process of assessing banks' financial health, which is to forecast bank failures. Finally, the responsible government agencies must also be concerned with limiting the deposit insurer's own risk exposure—for example, by terminating deposit insurance or by closing failed and failing banks. (As mentioned above, closing failed or failing banks is discussed in the first article in the series, and the availability of resources when losses are unavoidable is the subject of the next article.)

Accordingly, the risk-assessment section of the survey asked whether the deposit insurance organization has access to examination and accounting information about banks, how information about economic trends is used, whether legislative or other political developments are monitored, whether the health of insured depository institutions is assessed and whether bank failures are forecasted, and whether deposit insurance is

4 Table 1 lists the survey respondents in their respective categories.

5 Should a bank fail, insured depositors typically receive full compensation for their insured deposits from the FDIC within one to two business days. However, they still face the risk of having to re-deposit their funds in banks that offer lower interest rates or charge higher service costs or do both.

6 To the extent that the deposit insurer (or another government authority) has other "safety-net" duties aside from meeting insured depositors' claims, it might have additional needs for information. The additional duties that entail additional needs for information include selecting failure-resolution methods, acting as receiver and liquidator of failed banks, supervising banks for safety and soundness, pricing deposit insurance, and managing the insurance fund. Those and other additional duties are not discussed in this article.

Countering these demands for financial disclosure is banks' need to shield their proprietary information from competitors and to protect any proprietary information that they require their customers to disclose. In addition, the costs and burdens of providing information limit the extent to which it is feasible to disclose information to financial markets and government authorities.

7 Research on U.S. banks suggests that bank safety-and-soundness examinations (discussed below) provide some important auditing functions that private sector auditors do not seem to provide; see Dahl, Hanweck, and O'Keefe (1998).

Table 1

Survey Respondents, Summary Statistics, 1999

Deposit Insurer	Population: Total Population (millions)	Population: Share of World Population (percent)	GDP: Total GDP (US$ millions)	GDP: Share of World GDP (percent)	Banking Industry: Number of Banks	Banking Industry: Banking Assets (US$ billions)	Banking Industry: Share of World Banking Assets (percent)
Advanced Economies							
Austria	8.18	0.14%	$ 208,949	0.69%	844	$ 608.3	1.32%
Belgium	10.15	0.17	245,706	0.81	84	938.1	2.03
Canada	30.49	0.52	612,049	2.03	112	584.6	1.27
France	59.10	1.01	1,410,262	4.67	328	3,506.3	7.59
Germany	82.09	1.40	2,081,202	6.89	2,517	6,877.7	14.89
Greece	10.63	0.18	123,934	0.41	28	82.1	0.18
Isle of Man[a]	0.08	0.00	985	0.00	49	n.a.	n.a.
Italy	57.34	0.98	1,149,958	3.81	363	2,263.2	4.90
Japan	126.51	2.15	4,395,083	14.55	177	7,620.0	16.50
Netherlands	15.81	0.27	384,766	1.27	80	1,328.5	2.88
Portugal	9.96	0.17	107,716	0.36	50	334.2	0.72
Spain	39.42	0.67	562,245	1.86	154	1,470.1	3.18
Sweden	8.86	0.15	226,338	0.75	40	260.1	0.56
Taiwan	22.00	0.37	362,000	1.20	49	n.a.	n.a.
United Kingdom	58.74	1.00	1,373,612	4.55	302	3,628.3	7.86
Subtotal	539.36	9.18%	$13,244,805	43.85%	5,177	>$29,501.5	>63.88%
Developing Economies and Economies in Transition							
Africa							
Nigeria	108.95	1.85	43,286	0.14	81	9.5	0.02
Tanzania	32.79	0.56	8,777	0.03	10	1.3	0.00
Uganda	21.62	0.37	6,349	0.02	21	0.9	0.00
Europe							
Czech Republic	10.28	0.17	56,379	0.19	36	84.5	0.18
Hungary	10.07	0.17	48,355	0.16	46	26.7	0.06
Latvia	2.43	0.04	6,664	0.02	25	3.2	0.01
Lithuania	3.66	0.06	10,454	0.03	11	2.7	0.01
Poland	38.65	0.66	154,146	0.51	87	76.2	0.17
Romania	22.46	0.38	33,750	0.11	18	8.0	0.02
Slovak Republic	5.40	0.09	19,307	0.06	25	15.6	0.03
Turkey	64.39	1.10	188,374	0.62	67	96.2	0.21
Middle East							
Bahrain	0.67	0.01	5,350	0.02	36	8.1	0.02
Oman	2.46	0.04	14,962	0.05	18	9.4	0.02
Western Hemisphere							
Brazil	163.95	2.79	760,345	2.52	208	286.5	0.62
El Salvador	6.15	0.10	12,229	0.04	18	7.6	0.02
Jamaica	2.56	0.04	6,134	0.02	16	4.1	0.01
Mexico	97.37	1.66	474,951	1.57	63	202.7	0.44
Peru	25.23	0.43	57,318	0.19	20	20.4	0.04
Trinidad and Tobago	1.29	0.02	6,998	0.02	17	3.7	0.01
Subtotal	620.38	10.54%	$ 1,914,128	6.34%	823	$ 867.3	1.88%
Total	1,159.74	19.72	15,158,933	50.18	6,000	>30,368.8	>65.77
United States	273.13	4.65	8,708,870	28.83	8,907	7,956.9	17.23
World	5,879.00	100.00%	$30,211,993	100.00%	n.a.	$46,177.5	100.00%

Note:

Population–1999 midyear estimates. *Source:* International Monetary Fund (June 2000), *International Financial Statistics.* Taiwan Province of China and Isle of Man statistics from CIA (1999), *World Factbook.*

GDP–1999. *Source:* World Bank, 2000, Development Indicators. Taiwan and Isle of Man statistics are 1998 estimates from CIA (1999), *World Factbook.*

Banking Industry–Number of banks. *Source:* Thomson Bank Directory (2000), Thomson Financial Publishing. Banking assets as of 1999: International Monetary Fund (June 2000), *International Financial Statistics* (bank assets are summations of lines 20 through 22 in the International Financial Statistics, converted to December 1999 U.S. dollars). World total does not include Afghanistan, Dem. Rep. of Congo, People's Dem. Rep. of Yemen, St. Pierre & Miquelon, and Vietnam. December 1999 data were not available for Djibouti, Greece, Guinea, Republic of Yemen, so data from second-quarter 1998 were used.

[a]British Crown Dependency.

revocable. Survey results for each of those topics are presented below, preceded in each case by a discussion of important issues and an outline of the FDIC's practice.

Information on Banks' Condition and Riskiness

In the United States, information on banks' condition and riskiness comes from two sources: on-site examinations and off-site analysis of banks' financial statements (accounting information).

Access to Examination Information

The purpose of examining banks in the United States is to assess an institution's overall financial condition, review management practices and policies, monitor adherence with banking laws and regulations, review internal control systems, identify risks, and uncover fraud or insider abuse. The FDIC's safety-and-soundness examinations consist of three-parts: pre-examination planning, on-site examination, and completion of the report of examination. Pre-examination planning takes place off-site at the field office, where the examiner-in-charge completes an analysis and review of the institution, contacts the institution for financial records, and develops an examination work plan. During this stage, the examiner-in-charge decides on areas that need special attention and on the work that will be done first; these decisions will make for an efficient and orderly examination. The examiner-in-charge also notifies the institution of the date when the examination team will be visiting the bank, typically within the next two weeks. This interval allows the institution enough time to respond to any pre-examination requests for information.

Once the examination team enters the institution, the examiners concentrate on the institution's asset quality, financial condition, and operations. The examination team also evaluates the institution's adherence to banking laws and regulations, the adequacy of the institution's internal controls and procedures, and the capability of management reporting systems to provide reliable and accurate data.

In 2001, the FDIC employed 1,500 safety-and-soundness examiners to examine 2,640 banks on a schedule mandated by the Federal Deposit Insurance Act: healthy, small institutions (those with a composite examination rating of 1 or 2 and less than $250 million in assets) must be examined every 18 months, and all larger institutions, as well as those small institutions whose composite examination rating is 3, 4, or 5, must be examined every 12 months.[8] The FDIC conducts examinations of all the banks for which it is the primary regulator, that is, FDIC-insured state-chartered banks that are not members of the Federal Reserve System. In most cases involving well-managed institutions, however, the FDIC alternates examinations with the respective state authorities and has entered into agreements with the state banking departments governing the manner in which examination responsibilities are shared.

For institutions of which the FDIC is the primary regulator, therefore, the FDIC determines first-hand if they are in the "problem" category. For institutions whose primary regulator is another agency—that is, for national banks, state-chartered banks that are members of the Federal Reserve System, and savings associations—the FDIC relies on the examinations conducted by other regulators to determine a bank's overall condition and the risks posed to the deposit insurance fund.[9] The FDIC is in close contact with the other regulatory agencies and is constantly aware

[8] All federal and state bank examiners use a rating system that focuses on six *components* of the on-site examination findings: capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk. Each of those components is rated. At the end of the examination, the overall condition of the institution is evaluated and a *composite* rating from 1 to 5 is determined. An institution performing well above average receives a composite rating of 1 (the best rating), and an institution in severe financial difficulties with a strong probability of failure within 12 months receives a composite rating of 5 (the worst rating).

[9] Garcia ((2001), 51) states that a deposit insurance agency "should be able to request the [relevant] supervisor to undertake a special examination of any insured financial institution that [the deposit insurance agency] feels may be in financial difficulties. Whether [the deposit insurance agency] staff should be able to participate in onsite inspections would vary from country to country."

of their examination activities. Through its case manager program, the FDIC monitors non-FDIC-supervised banks, and the case managers are responsible for sharing information with other regulators. Thus, whether by direct examination or by monitoring and sharing information, the FDIC compiles information, including examination reports, on all insured banks. Interagency agreements and statements of policy encourage the process of sharing information. In 1997, the FDIC issued a policy statement that outlines a program for sharing examination findings and establishes guidelines for resolving differences in examination findings between federal regulators.

In addition, the FDIC has special backup examination authority for the institutions of which it is not the primary regulator, and in early 2002 the federal banking regulators agreed to a process for determining when the FDIC would use its backup examination authority. Its backup activities generally take the form of participation in the examinations conducted by the primary federal regulator or the state authority, or attendance at meetings where the findings of an examination are discussed. The FDIC's participation in such activities usually involves assessing the potential risk the particular institution may pose to the deposit insurance fund.

The report of examination—the third part of the examination process—factually presents the bank's condition, identifies problems, provides management with suggestions and recommendations, and discloses the examination ratings. The report of examination, in other words, documents the results of the examination and the basis on which the composite rating was determined. This report is a confidential document shared only with the institution's senior management and board of directors, and its contents can be disclosed only with the FDIC's authorization.

Of the 37 deposit insurers that responded to the survey, 19 answered "Yes" to the following question: *On a regular basis, do you collect or have access to the report of examination from individual insured depository institutions?* (See Table 2.) Of the 19 replying yes, 10 were in advanced economies and 9 were in developing economies and economies in transition. Only 2 of the 19 receive less than the full report of examination.

Access to Accounting Information

Demirgiic-Kunt and Kane, offering advice to countries that are considering adopting deposit insurance systems, write that ". . . upgrading accounting and disclosure rules so that accurate information reaches the markets in a timely fashion [exempliflies] the kinds of institution reforms that improve incentive structures and limit excess risk-taking."[10] To the extent that bank creditors are not covered by deposit insurance and therefore seek to exert market discipline, accurate disclosure of financial information can serve to control excessive risk taking by banks. Besides uninsured bank creditors, the deposit insurer that stands in the place of insured creditors also relies on accurate financial disclosure to manage the insurance system and limit risks to that system.

U.S. banks are required to file reports of income and condition with their primary federal bank regulator on a quarterly basis. These reports contain detailed balance-sheet and income-statement information, as well as a great deal of supporting financial information. The financial reports are available to the public 75 days after the end of each quarter.[11] Net income, equity capital, and problem loans are readily ascertainable from these required quarterly reports, as are numerous financial statistics for individual banks and aggregate values. The FDIC publishes a summary of the quarterly financial results for FDIC-insured commercial banks and savings institutions in its *Quarterly Banking Profile*, each issue of which includes aggregate data on condition and income and on performance and condition ratios. The FDIC makes extensive use of these data in pre-examination planning, off-site monitoring programs, assessments of an institution's capital adequacy and financial strength, and economic research.

10 Demirgüç-Kunt and Kane (2001), 25.
11 Some reported information is made available only to bank regulators and is not publicly disclosed.

Table 2
Report of Examination

Deposit Insurer	On a regular basis, do you collect or have access to the report of examination from individual insured depository institutions? Yes	No	Do you receive less than the full report of examination? Yes	No
Advanced Economies				
Austria (AAR)	X			X
Austria (AABB)	X			X
Belguim		X		X
Canada	X			X
France		X		
Germany (EdB)	X			X
Germany (E)	X			X
Greece		X		
Isle of Man[a]	X			X
Italy (IDPF)		X	X	
Italy (DPFCB)		X	X	
Japan		X		X
Netherlands	X			X
Portugal	X			
Spain		X		X
Sweden		X		X
Taiwan	X			X
United Kingdom	X			
Subtotal	10	8	2	12
Developing Economies and Economies in Transition				
Africa				
Nigeria	X			
Tanzania	X			X
Uganda	X		X	
Europe				
Czech Republic		X		X
Hungary		X		X
Latvia		X		X
Lithuania		X		X
Poland		X	X	
Romania		X		X
Slovak Republic		X	X	
Turkey		X		
Middle East				
Bahrain		X		X
Oman	X			X
Western Hempishere				
Brazil	X		X	
El Salvador	X			X
Jamaica	X			X
Mexico	X			X
Peru	X			X
Trinidad and Tobago		X		
Subtotal	9	10	4	12
Total	19	18	6	24

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.
[a] British Crown Dependency.
AAR = Association of Austrian Raiffesenbanks
AABB = Association of Austrian Banks and Bankers
EdB = Entschadigungseinrichtung deutscher Banken
E = Einlagensicherungs
IDPF = Interbank Deposit Protection Fund
DPFCB = Deposit Protection Fund for Co-operative Banks

The data are also publicly available at the FDIC's Web site through two products: *Institution Directory* and *Statistics on Depository Institutions*. The *Institution Directory* provides a comprehensive financial profile of each FDIC-insured bank, and the *Statistics on Depository Institutions* provide detailed financial reports that enable the user to analyze the banking industry. The user can create reports containing customized peer groups of FDIC-insured banks and bank holding companies. Demographic data are available, along with an institution's most-recent quarterly financial statement and performance ratios.

Most insurers that responded to the survey regularly receive balance-sheet and income data from banks. Of the 37 respondents to the following survey question, 27 replied "Yes": *On a regular basis, do you collect or have access to regularly reported balance-sheet and income data from individual insured depository institutions?* (See Table 3.) Of those replying yes, 13 were in advanced economies and 14 were in developing economies and economies in transition.

Effective March 31, 1997, generally accepted accounting principles (GAAP) were adopted as the reporting basis for the balance sheet, income statement, and supporting schedules for U.S. banks. According to Garcia, "Internationally accepted accounting and auditing standards will facilitate realistic loan valuations and empower market discipline."[12] Of the 26 respondents to the following survey question, 21 answered "Yes": *Do these data [balance sheet, etc.] meet internationally accepted accounting standards?* (See Table 4.) Of the 21 that answered yes to the question, 10 operate in advanced economies and 11 in developing economies and economies in transition.[13]

The survey also queried deposit insurers about their ability to determine net income, equity capital, and troubled loans. The FDIC is able to determine these values for all FDIC-insured banks on a quarterly basis, and most foreign deposit insurers are able to determine them as well. Of the 26 respondents to the following survey question, 23 answered "Yes": *Do these data allow you to accurately determine the insured depository institution's net income?* (See Table 5.) Of the 23 that answered yes, 10 operate in advanced economies and 13 in developing economies and economies in transition. Of the 26 respondents to the following survey question, 24 answered "Yes": *Do these data allow you to calculate an accurate level of the insured depository institution's equity capital or surplus?* (See Table 6.) Of the 24 that answered yes, 10 operate in advanced economies and 14 in developing economies and economies in transition. Of the 25 respondents to the following survey question, 18 answered "Yes": *Do these data include the amount of the insured depository institution's troubled or past-due loans?* (See Table 7.) Of the 18 that answered yes, 8 operate in advanced economies and 10 in developing economies and economies in transition.

Information on the Economic and Political Contexts

Obtaining accurate and timely information on banks is the first step for risk assessment. The second step is understanding that information in the economic and political contexts of bank operations. The goal, of course, is to use that information in a systematic way that permits one to assess the health of insured depository institutions.

Analysis of Local, National, and International Economic Trends

The nonfinancial and financial segments of the economy are interdependent. On the one hand, consumers and businesses—the nonfinancial segments—rely on financial intermediaries and direct credit markets to finance expenditures; financial intermediaries support the payments system; and a significant increase in the cost of credit or in the non-price rationing of credit can adversely affect the financial condition of consumers and business-

[12] Garcia (2001), 19.

[13] Significant differences exist between U.S. generally accepted accounting standards and internationally accepted accounting standards. The U.S. Securities and Exchange Commission requires financial statements that were prepared in accordance with international accounting standards to be reconciled with the U.S. GAAP.

Table 3

Accounting Information

Deposit Insurer	On a regular basis, do you collect or have access to regularly reported balance-sheet and income data? If yes, how frequently are these data reported? Yes	No	Frequency
Advanced Economies			
Austria (AAR)	X		Four per year
Austria (AABB)	X		Monthly or quarterly plus annual report
Belguim	X		Annually
Canada	X		Varies
France		X	
Germany (EdB)	X		
Germany (E)	X		
Greece		X	
Isle of Man[a]	X		Quarterly Banking Returns
Italy (IDPF)	X		Semiannually for banks in Order; quarterly for banks in "watch"
Italy (DPFCB)	X		Semiannually for Cooperative Banks; quarterly for banks in "watch"
Japan		X	
Netherlands	X		Monthly balance-sheet data; yearly income data
Portugal	X		Average amount of monthly credit balances is reported annually
Spain		X	
Sweden		X	
Taiwan	X		Quarterly
United Kingdom	X		Annual Report and Accounts
Subtotal	13	5	
Developing Economies and Economies in Transition			
Africa			
Nigeria	X		Varies
Tanzania	X		Monthly
Uganda	X		Monthly balance sheets, quarterly statements, annual final accounts
Europe			
Czech Republic		X	
Hungary	X		Quarterly
Latvia		X	
Lithuania	X		Quarterly
Poland	X		Monthly, quarterly
Romania		X	
Slovak Republic		X	
Turkey	X		Quarterly
Middle East			
Bahrain		X	
Oman	X		Quarterly
Western Hempishere			
Brazil	X		Monthly
El Salvador	X		Monthly
Jamaica	X		Monthly balance-sheet data; quarterly income data
Mexico	X		Quarterly
Peru	X		Monthly
Trinidad and Tobago	X		Published Annual Reports
Subtotal	14	5	
Total	27	10	

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

[a] British Crown Dependency.

AAR = Association of Austrian Raiffesenbanks
AABB = Association of Austrian Banks and Bankers
EdB = Entschadigungseinrichtung deutscher Banken
E = Einlagensicherungs
IDPF = Interbank Deposit Protection Fund
DPFCB = Deposit Protection Fund for Co-operative Banks

Table 4

Accounting Standards

Deposit Insurer	Do these data [balance sheet, etc.] meet internationally accepted accounting standards? Yes	No
Advanced Economies		
Austria (AAR)	X	
Austria (AABB)	X	
Belguim		X
Canada	X	
France		
Germany (EdB)	X	
Germany (E)	X	
Greece		
Isle of Man[a]	X	
Italy (IDPF)	X	
Italy (DPFCB)	X	
Japan		
Netherlands	X	
Portugal		X
Spain		
Sweden		
Taiwan	X	
United Kingdom		
Subtotal	10	2
Developing Economies and Economies in Transition		
Africa		
Nigeria	X	
Tanzania	X	
Uganda	X	
Europe		
Czech Republic		
Hungary	X	
Latvia		
Lithuania	X	
Poland	X	
Romania		
Slovak Republic		
Turkey		X
Middle East		
Bahrain		
Oman	X	
Western Hempishere		
Brazil	X	
El Salvador		X
Jamaica	X	
Mexico		X
Peru	X	
Trinidad and Tobago	X	
Subtotal	11	3
Total	21	5

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

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IDPF = Interbank Deposit Protection Fund
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Table 5

Net Income

Deposit Insurer	Do these data allow you to accurately determine the insured depository institution's net income? Yes	No
Advanced Economies		
Austria (AAR)	X	
Austria (AABB)		X
Belguim	X	
Canada	X	
France		
Germany (EdB)	X	
Germany (E)	X	
Greece		
Isle of Man[a]	X	
Italy (IDPF)	X	
Italy (DPFCB)	X	
Japan		
Netherlands	X	
Portugal		X
Spain		
Sweden		
Taiwan	X	
United Kingdom		
Subtotal	10	2
Developing Economies and Economies in Transition		
Africa		
Nigeria	X	
Tanzania	X	
Uganda	X	
Europe		
Czech Republic		
Hungary	X	
Latvia		
Lithuania	X	
Poland	X	
Romania		
Slovak Republic		
Turkey	X	
Middle East		
Bahrain		
Oman	X	
Western Hempishere		
Brazil	X	
El Salvador	X	
Jamaica		X
Mexico	X	
Peru	X	
Trinidad and Tobago	X	
Subtotal	13	1
Total	23	3

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

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Table 6

Equity Capital or Surplus

Deposit Insurer	Do these data allow you to calculate an accurate level of the insured depository institution's equity capital or surplus? Yes	No
Advanced Economies		
Austria (AAR)	X	
Austria (AABB)	X	
Belguim		X
Canada	X	
France		
Germany (EdB)	X	
Germany (E)	X	
Greece		
Isle of Man[a]	X	
Italy (IDPF)	X	
Italy (DPFCB)	X	
Japan		
Netherlands	X	
Portugal		X
Spain		
Sweden		
Taiwan	X	
United Kingdom		
Subtotal	10	2
Developing Economies and Economies in Transition		
Africa		
Nigeria	X	
Tanzania	X	
Uganda	X	
Europe		
Czech Republic		
Hungary	X	
Latvia		
Lithuania	X	
Poland	X	
Romania		
Slovak Republic		
Turkey	X	
Middle East		
Bahrain		
Oman	X	
Western Hempishere		
Brazil	X	
El Salvador	X	
Jamaica	X	
Mexico	X	
Peru	X	
Trinidad and Tobago	X	
Subtotal	14	0
Total	24	2

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

[a] British Crown Dependency.

AAR = Association of Austrian Raiffeisenbanks

AABB = Association of Austrian Banks and Bankers

EdB = Entschadigungseinrichtung deutscher Banken

E = Einlagensicherungs

IDPF = Interbank Deposit Protection Fund

DPFCB = Deposit Protection Fund for Co-operative Banks

Table 7

Troubled or Past-Due Loans

Deposit Insurer	Do these data include the amount of the insured depository institution's troubled or past-due loans? Yes	No
Advanced Economies		
Austria (AAR)	X	
Austria (AABB)	X	
Belguim		X
Canada	X	
France		
Germany (EdB)		X
Germany (E)		X
Greece		
Isle of Man[a]	X	
Italy (IDPF)	X	
Italy (DPFCB)	X	
Japan		
Netherlands	X	
Portugal		X
Spain		
Sweden		
Taiwan	X	
United Kingdom		
Subtotal	8	4
Developing Economies and Economies in Transition		
Africa		
Nigeria	X	
Tanzania	X	
Uganda	X	
Europe		
Czech Republic		
Hungary		X
Latvia		
Lithuania	X	
Poland	X	
Romania		
Slovak Republic		
Turkey	X	
Middle East		
Bahrain		
Oman		
Western Hempishere		
Brazil		X
El Salvador	X	
Jamaica		X
Mexico	X	
Peru	X	
Trinidad and Tobago	X	
Subtotal	10	3
Total	18	7

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

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es, as can a serious disruption of the payments system. On the other hand, national and regional economic recessions and declines in sectors of the economy (for example, agriculture, real estate, or other commodity or service markets) can negatively affect the financial segment by impairing borrowers' ability to repay loans, thus causing lenders' financial condition to deteriorate. Similar concerns apply to international markets, given the importance of foreign trade and finance to sectors of the domestic economy. For these reasons, deposit insurers might have an interest in monitoring local, national, and international economic trends. Moreover, deposit insurers might be interested in how those trends could affect banks.

In 1995, the FDIC took steps to more actively address market trends and emerging risks before they become problems for banks.[14] From the unique perspective of the deposit insurer, the FDIC began to analyze more closely the risks to the deposit insurance fund and translated this analysis into guidance for examiners and bankers. Developing a dynamic approach that combined traditional examination methods and new initiatives, the FDIC sought to (1) identify major problems, national or regional, that might threaten the viability of the bank insurance fund, and (2) mitigate the adverse effects that future events might have on the financial health of banks.

The FDIC continues to assess local, national, and international economic trends to determine their implications for banks and for the deposit insurance fund. The FDIC identifies and monitors existing and emerging risks and translates this information into specific and useful guidance for its examination workforce. The FDIC's analysts work closely with examiners, providing comprehensive regional economic data and analyses to help them assess emerging risk exposures for individual banks and groups of banks.

The FDIC also employs subject-matter experts who collect and analyze data and monitor economic and financial risks. These subject-matter experts study many areas, including the global economy and country exposures, the domestic economy, industry sectors, capital markets, underwriting standards, and commercial real estate. This information is published in numerous reports and surveys that are available to bankers, the public, and government oversight groups.

The majority of the deposit insurers surveyed do not regularly assess local, national, and international economic trends. Of the 37 respondents to the following question, 14 answered "Yes": *Do you regularly assess local, national, and international economic trends to determine their implications for insured depository institutions?* (See Table 8.) Of the 14 that answered yes, 6 operate in advanced economies and 8 in developing economies and economies in transition.

Analysis of Legislative and Other Political Developments

The legal and political environment in which banks operate can influence their financial condition indirectly and directly. In the United States, changes in federal and state laws in areas that have a direct influence on consumers and businesses can affect banks indirectly. For example, a change in federal tax law on real estate investments in 1986 was one factor that contributed to the decline in real estate markets in the late 1980s, and this decline in turn contributed to the subsequent failures of banks with large loan concentrations in commercial real estate development.[15] Alternatively, regulation of banking activities is often used as a direct means of promoting the health and stability of the banking industry. For example, regulatory capital requirements are defined in terms of minimum capitalization standards for safe and sound banks, and banks that are not safe and sound have higher capital requirements.

The FDIC's Office of Legislative Affairs interacts with Congress and publishes a weekly report

[14] FDIC (1995), 31.

[15] FDIC (1997), 1:140–41.

Table 8
Economic Trends

Deposit Insurer	Do you regularly assess local, national, and international economic trends to determine their implications for insured depository institutions? Yes	No
Advanced Economies		
Austria (AAR)		X
Austria (AABB)		X
Belguim		X
Canada	X	
France		X
Germany (EdB)		X
Germany (E)	X	
Greece		X
Isle of Man[a]	X	
Italy (IDPF)		X
Italy (DPFCB)	X	
Japan		X
Netherlands	X	
Portugal	X	
Spain		X
Sweden		X
Taiwan		X
United Kingdom		X
Subtotal	6	12
Developing Economies and Economies in Transition		
Africa		
Nigeria		X
Tanzania	X	
Uganda	X	
Europe		
Czech Republic		X
Hungary	X	
Latvia		X
Lithuania		X
Poland	X	
Romania		X
Slovak Republic		X
Turkey		X
Middle East		
Bahrain		X
Oman	X	
Western Hempishere		
Brazil		X
El Salvador		X
Jamaica	X	
Mexico	X	
Peru		X
Trinidad and Tobago	X	
Subtotal	8	11
Total	14	23

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

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describing current congressional activities affecting banks. The FDIC's Chairman frequently testifies about topics of concern to Congress, especially topics important for congressional oversight of the FDIC.

The responses to the survey of deposit insurers indicate that a majority of respondents monitor legislative or other political developments. Of the 37 deposit insurers that responded to the following survey question, 33 answered "Yes": *Do you routinely monitor legislative or other political developments that may have implications for insured depository institutions?* (See Table 9.) Of the 33 that answered yes, 15 operate in advanced economies and 18 in developing economies and economies in transition.

Use of Information to Forecast Potential Failures

As mentioned above, risk management assumes that the goal of collecting and analyzing information is to assess the health of insured depository institutions.[16] A subset of assessing health is forecasting potential failures, for it is inevitable that some banks will fail. Between 1980 and 1994 the United States saw the failure of more than 1,600 FDIC-insured banks, holding $206 billion in assets and constituting 9 percent of the assets of all U.S. insured depository institutions.[17] In 1988 the FDIC suffered its first operating-income loss; the losses continued through 1991, totaling $25.3 billion for the four-year period.[18]

The FDIC is, however, responsible (but not solely) for minimizing the financial cost of bank failures, and one way to do this is to identify financially troubled banks and intervene before failure occurs. Thus, using examination and financial data and off-site monitoring programs and systems

[16] Many of the survey respondents are able to assess the health of insured depository institutions. Of the 35 respondents to the following survey question, 20 answered "Yes": *Do you use the data available to you to regularly assess the health of insured depository institutions?* (See Table 10.) Eleven of the "Yes" respondents operate in advanced economies and 9 in developing economies and economies in transition.

[17] FDIC (1997), 15.

[18] FDIC (2000a), 109.

Table 9

Legislative and Other Political Developments

Deposit Insurer	Do you routinely monitor legislative or other political developments that may have implications for insured depository insitutions? Yes	No
Advanced Economies		
Austria (AAR)	X	
Austria (AABB)	X	
Belguim	X	
Canada	X	
France	X	
Germany (EdB)		X
Germany (E)	X	
Greece	X	
Isle of Man[a]	X	
Italy (IDPF)		X
Italy (DPFCB)	X	
Japan	X	
Netherlands	X	
Portugal	X	
Spain		X
Sweden	X	
Taiwan	X	
United Kingdom	X	
Subtotal	15	3
Developing Economies and Economies in Transition		
Africa		
Nigeria	X	
Tanzania	X	
Uganda	X	
Europe		
Czech Republic	X	
Hungary	X	
Latvia	X	
Lithuania	X	
Poland	X	
Romania	X	
Slovak Republic	X	
Turkey	X	
Middle East		
Bahrain	X	
Oman	X	
Western Hempishere		
Brazil	X	
El Salvador	X	
Jamaica	X	
Mexico	X	
Peru	X	
Trinidad and Tobago		X
Subtotal	18	1
Total	33	4

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

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Table 10

Assessment of Health of Institutions

Deposit Insurer	Do you use the data available to you to regularly assess the health of insured depository institutions? Yes	No
Advanced Economies		
Austria (AAR)	X	
Austria (AABB)	X	
Belguim		X
Canada	X	
France		X
Germany (EdB)		X
Germany (E)	X	
Greece		X
Isle of Man[a]	X	
Italy (IDPF)	X	
Italy (DPFCB)	X	
Japan		X
Netherlands	X	
Portugal	X	
Spain		X
Sweden	X	
Taiwan	X	
United Kingdom		X
Subtotal	11	7
Developing Economies and Economies in Transition		
Africa		
Nigeria	X	
Tanzania	X	
Uganda	X	
Europe		
Czech Republic		
Hungary	X	
Latvia		X
Lithuania		X
Poland	X	
Romania	X	
Slovak Republic		X
Turkey		X
Middle East		
Bahrain		
Oman	X	
Western Hempishere		
Brazil		X
El Salvador	X	
Jamaica	X	
Mexico		X
Peru		X
Trinidad and Tobago		X
Subtotal	9	8
Total	20	15

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

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to identify problem institutions, the FDIC's Financial Risk Committee meets quarterly to project the cost of bank failures that may occur in the next year. (Although the committee meets quarterly, failure projections are prepared more often than quarterly, and off-site monitoring is conducted continually.) The committee's primary function is to set a loss reserve for anticipated failures of FDIC-insured banks. The committee also identifies areas of risk to the industry, assesses the level of risk among banks, and meets with other federal banking regulators to discuss risk exposures, compare trends, and review adverse events to determine their implications for various approaches to risk.

If a country funds deposit insurance before failure losses are incurred, the insurer needs to forecast insurance losses and provide at a minimum for expected losses.[19] If the insurer has duties related to providing insurance—resolving failed banks, liquidating assets, and managing receiverships—failure forecasts might assist in planning for these other duties as well. If the insurer has duties not related to providing insurance—conducting monetary policy or fiscal policy or both—failure forecasts might be useful to the extent that failures would disrupt financial markets and the economy.[20]

Of the 37 respondents to the following survey question, 12 answered "Yes": *Do you have a committee or group that meets regularly whose mission is to forecast potential insured depository institution failures?* (See Table 11.) Of the 12 that answered yes, 6 operate in advanced economies and 6 oper-

Table 11

Forecasting Failures

Deposit Insurer	Do you have a committee or group that meets regularly whose mission is to forecast potential insured depository institution failures? Yes	No
Advanced Economies		
Austria (AAR)	X	
Austria (AABB)	X	
Belguim		X
Canada		X
France		X
Germany (EdB)		X
Germany (E)	X	
Greece		X
Isle of Man[a]	X	
Italy (IDPF)		X
Italy (DPFCB)	X	
Japan		X
Netherlands		X
Portugal		X
Spain		X
Sweden		X
Taiwan	X	
United Kingdom		X
Subtotal	6	12
Developing Economies and Economies in Transition		
Africa		
Nigeria		X
Tanzania	X	
Uganda		X
Europe		
Czech Republic		X
Hungary		X
Latvia	X	
Lithuania		X
Poland		X
Romania		X
Slovak Republic		X
Turkey		X
Middle East		
Bahrain	X	
Oman	X	
Western Hempishere		
Brazil		X
El Salvador		X
Jamaica		X
Mexico	X	
Peru	X	
Trinidad and Tobago		X
Subtotal	6	13
Total	12	25

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

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[19] If deposit insurance is funded after failure losses are incurred, the insurer might still need to predict bank failures. If insurance losses are fully funded by the government, forecasts might be needed for government budget planning; and if insurance losses are fully funded by banks, banks might also need forecasts for budgetary reasons.

[20] The Federal Deposit Insurance Act has provisions to ensure that failure resolutions do not seriously disrupt financial markets and the economy. If written recommendations from the FDIC Board of Directors, the Board of Governors of the Federal Reserve System, and the secretary of the U.S. Department of the Treasury (in consultation with the president) indicate that the use of regular statutory (least-cost) failure-resolution procedures might have serious adverse effects on economic conditions or financial stability, a less-disruptive procedure must be used even if it increases the costs of resolution.

ate in developing economies and economies in transition.

Procedures to Limit the Insurer's Risk Exposure: Terminating Deposit Insurance

Once potential failures are forecast, the question becomes whether the government authorities charged with managing the financial safety net can take active measures to limit the risks to which these failures will expose them. The primary means of preventing failures is to use bank regulation and supervision to promote safe and sound banking practices, but when those measures fail to rein in unsafe or unsound practices, more severe action is needed. Although such actions can take many forms, Garcia recommends "[giving] the supervisor a system of prompt remedial actions."[21]

The most serious remedial action available to the FDIC is to terminate deposit insurance. Because deposit insurance is so important to a bank's ability to attract deposits, termination of deposit insurance can effectively lead to a bank's closing. A proposal to terminate deposit insurance can be used as a remedial measure—a final attempt to encourage a bank's management to improve its financial condition and alter its banking practices, especially if bank management has previously not cooperated with supervisory officials. If the bank is unable to improve its financial condition, however, terminating deposit insurance can reduce failure-resolution costs.

Deposit insurance can be terminated in two ways: involuntarily (the FDIC initiates it) and voluntarily (the bank initiates it). The standard for involuntary termination of deposit insurance is high and involves either unsafe and unsound banking conditions or practices or violations of laws or regulations (for example, crimes of money laundering, engaging in monetary transactions in property derived from specific unlawful activities, and structuring transactions to evade reporting requirements). Involuntary termination of deposit insurance does not occur if (1) the financial institution will be closed within the next 90 days, (2) open-bank assistance is possible, or (3) the financial institution is actively seeking new capital.

Initially, the FDIC will notify the bank's primary regulator (and send a copy to the bank) of the facts and circumstances underlying the proposed termination and the specific corrective actions needed, and will state that corrections must occur in the next 30 days. If the bank does not correct the problems, the FDIC issues a notice of intent to terminate insured status. The notice gives the reasons for terminating insurance and lists a hearing date, which is usually within 120 days of the notice, although the applicable statute allows for a hearing date within 30 days of the notice.

If the bank contests the notice, an administrative law judge will hear the case (hearings are open to the public) and will decide whether the FDIC may proceed to terminate insurance. However, this decision is a recommendation, not a final ruling. The administrative law judge is not involved in the case after this hearing.

When terminating deposit insurance, the FDIC may issue a temporary order suspending insurance, usually within 10 days of the vote of the FDIC Board of Directors to terminate insurance. Temporary suspension of insurance addresses certain emergency situations that cannot wait for a formal hearing date, and an expedited hearing takes place as soon as possible. In these situations the FDIC must have evidence of either abnormal risk of loss or damage to the insurance fund. The temporary suspension order reduces the risk that the insurance fund will suffer losses while the procedures for a permanent order are being followed.

Banks have a right to judicial review of enforcement actions in the court of appeals. Unless the court of appeals or the FDIC Board of Directors changes the enforcement action, the FDIC will pursue its termination of deposit insurance. The FDIC will notify depositors that their deposits will

[21] Garcia (2001), 11.

remain insured for a certain period between six months and two years (the FDIC Board usually selects two years).

When a bank is notified that its deposit insurance will be terminated, the bank may ask to enter into two agreements with the FDIC—a settlement agreement and a procedure agreement. The settlement agreement states that if changes do not occur within a short, fixed period, the bank agrees to the termination order and waives its legal right to challenge the action. The procedure agreement clearly defines the changes referred to in the settlement agreement and the way in which depositors will be notified if insurance is terminated.

The FDIC is the only U.S. bank regulator with the authority to terminate federal deposit insurance. It uses this authority sparingly and, with respect to unsafe and unsound banking conditions or practices, only when a bank is unable to correct its financial problems. Garcia states that "the supervisor or the [deposit insurance agency] will have strong powers to deal in a strict manner with nonviable banks, terminate the interests of shareholders, and impose 'haircuts' on uninsured depositors and unsecured creditors."[22] The FDIC's authority to terminate deposit insurance is quite different from the authority of the deposit insurers that responded to the survey. Few deposit insurers outside the United States have the authority to revoke deposit insurance in cases in which an insured depository institution is operating in an unsafe and unsound manner. Of the 36 deposit insurers that responded to the following survey question, 11 answered "Yes": *Does the deposit insurer have the authority to revoke deposit insurance in cases where an insured depository institution is operating in an unsafe and unsound manner?* (See Table 12.) Of the 11 that answered yes, 7 operate in advanced economies and 4 in developing economies and economies in transition; only 2 of the respondents—both in advanced economies—had ever used this authority.

[22] Garcia (2001), 53. "Haircuts" is generally defined as full or partial losses on uninsured deposits when a bank fails.

Summary

The results of the survey indicate both similarities and differences between foreign deposit insurers and the FDIC. The similarities begin with access to information: one-half of the foreign deposit insurers that responded to the survey have access to reports of examination, and three-quarters regularly receive reported balance-sheet and income data. These financial data meet internationally accepted accounting standards; and most of the respondents are able to determine net income, equity capital, and troubled loans. Overwhelmingly the respondents follow legislative and other political developments. As a result, more than 50 percent of the respondents are able to assess the financial health of banks.

The differences mainly involve how information is used in risk assessment. Most deposit insurers that responded to the survey do not forecast potential bank failures nor do they follow economic trends. In addition, most respondents do not have the authority to terminate deposit insurance.

Table 12

Termination of Deposit Insurance

Deposit Insurer	Does the deposit insurer have the authority to revoke deposit insurance in cases where an insured depository institution is operating in an unsafe or unsound manner? Yes	No	If yes, has this authority ever been used? Yes	No
Advanced Economies				
Austria (AAR)		X		
Austria (AABB)		X		
Belguim		X		
Canada	X		X	
France		X		
Germany (EdB)		X		
Germany (E)	X			X
Greece	X			X
Isle of Man[a]	X			
Italy (IDPF)	X		X	
Italy (DPFCB)	X			X
Japan		X		
Netherlands		X		
Portugal		X		
Spain		X		
Sweden		X		
Taiwan	X			
United Kingdom		X		X
Subtotal	7	11	2	4
Developing Economies and Economies in Transition				
Africa				
Nigeria	X			X
Tanzania	X			X
Uganda		X		
Europe				
Czech Republic		X		
Hungary				
Latvia		X		
Lithuania	X			X
Poland		X		
Romania		X		
Slovak Republic		X		
Turkey		X		
Middle East				
Bahrain		X		
Oman	X			X
Western Hempishere				
Brazil		X		
El Salvador		X		
Jamaica		X		
Mexico		X		
Peru		X		
Trinidad and Tobago		X		
Subtotal	4	14	0	4
Total	11	25	2	8

Note: Classification of economies into "Advanced," "Developing," or "Economies in Transition" is from International Monetary Fund (2000). Deposit insurers without an "X" in either the Yes or No column did not answer the question on the survey or did not provide an answer that was easily categorized as yes or no.

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