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IMF Report supports PDIC Charter amendments

The International Monetary Fund (IMF) expressed its support to the strengthening of the capabilities of the Philippine Deposit Insurance Corporation (PDIC) as a co-regulator of the banking system through the amendments of its Charter. The **IMF Staff Report for the 2008 Article IV Consultation** released on December 22, 2008 called on a number of measures to enhance the institutional and financial capabilities of the state deposit insurer to support the doubling of the maximum deposit insurance coverage (MDIC) from P250,000 to P500,000.

The Senate had earlier approved Senate Bill 2964 to amend the PDIC Charter while the House of Representatives passed on second reading recently its own version. Upon approval by the House of the PDIC bill on third and final reading, both chambers of Congress will convene as a bicameral conference committee to reconcile the two bills and endorse for joint resolution a final PDIC bill.

The joint bill is seen to boost the state deposit insurer's capacity to protect the depositors of the Philippine banking system through the increased MDIC and the adoption of corollary measures that will reinforce the institutional and financial capabilities of the PDIC.

The IMF team, led by IH Lee, released its financial strengthening recommendations that included enhancements in the deposit insurance system in **IMF Public Information Notice (PIN) No. 09/21** dated February 17, 2009. The PIN summarized the results of the IMF consultations with key Philippine economic officers and private sector representatives that included Finance Secretary Margarito Teves, Bangko Sentral ng Pilipinas Governor Amando Tetangco, Jr., Budget Management Secretary Rolando Andaya, and National Economic Development Authority Secretary General Ralph Recto.

The consultations, held in Manila on November 5 to 14, 2008, focused on near-term financial sector and macroeconomic policies to safeguard domestic and external stability in the face of adverse global financial spillovers.

The IMF recommendations to enhance PDIC include the doubling of the MDIC, the creation of a bridge bank as a bank resolution method, and the recapitalization of PDIC. The IMF also noted that PDIC must be given the flexibility to temporarily raise the MDIC amidst a turbulent financial sector. IMF likewise recommended enhanced legal protection for PDIC staff.

"We are pleased that the IMF recommendations are in consonance with the PDIC Charter Amendments which will soon be taken up in a bicameral conference committee of the Senate and House of Representatives," PDIC President Jose C. Nograles said. "This gives a strong signal that we are in the right track with our aim to strengthen PDIC which, in turn, will help promote stability and confidence in the banking system," Nograles added.

House Bill 5911, which also seeks to increase the MDIC to P500,000 per depositor, was approved on second reading by the House of Representatives on February 24. The bill also includes financial strengthening measures to support the MDIC increase such as capital build-up and tax privileges and exemption. The Senate approved its version of the measure, Senate Bill 2964, last January 19, 2009 that called for the doubling of the MDIC as well as institutional and strengthening measures to enhance PDIC's oversight and regulatory functions and to mitigate the moral hazard of increased deposit insurance.

Increase in MDIC

The IMF directors have expressed support for the proposed doubling of the MDIC from P250,000 to P500,000. PDIC has proposed the same increase in the MDIC since late 2008 as a pre-emptive, proportionate response amidst the global financial meltdown. Raising the MDIC level is seen to help maintain confidence in the stability of the Philippine banking system. PDIC earlier reported that the P500,000 MDIC level covers 97.2% of total deposit accounts in the banking system.

The IMF likewise stressed that PDIC should be given flexibility to raise the MDIC when necessary. Nograles said that the flexibility clause is also contained in the Senate version that provides PDIC the authority to extend and further adjust the MDIC level whenever there are conditions threatening the monetary and financial stability of the country as determined by the BSP and the Department of Finance.

Capital strengthening

Along with the flexibility to increase the MDIC, IMF said PDIC should be recapitalized to support the higher insurance liabilities under the higher ceiling. Government contribution to the PDIC Deposit Insurance Fund (DIF) in the amount of P3 billion has not been increased since 1992.

For its part, the PDIC, in its proposed Charter amendments, is seeking financial strengthening measures that include exemption from taxes, sovereign guarantee on bonds, debentures and other debt issuances, and authority to adjust assessment rate to banks. Nograles said that these measures will allow PDIC to shore up its insurance reserves while at the same time, accessing the financial markets. PDIC's flexibility to adjust assessment rate will enable the Corporation to align with risks to the DIF which is the source of funds for payouts of deposit insurance claims.

Bridge Bank

The IMF has likewise given the creation of a bridge bank facility the green light. A bridge bank, known for its "close on a Friday, open on a Monday" concept, is a temporary bank established and operated by the closed bank's receiver to acquire the closed bank's assets and assume its liabilities. PDIC is the statutory receiver of closed banks in the country. IMF supported bridge banking as a viable bank resolution toolkit and encouraged authorities to reconsider a more flexible application of the purchase-and-assumption tool than direct payout.

President Nograles said the PDIC is seeking authority to run a bridge bank in its proposals in Congress to protect depositors of a failed bank by ensuring that there will be no disruption in banking services hence, maintain depositor confidence in the system.

The bridge bank will have the "good assets" and insured deposits of a failed institution. The "bad assets" and uninsured deposits will remain with the receiver for liquidation. A bridge bank preserves the franchise value of a failed institution prior to its sale to a new investor, its purchase and assumption or merger and consolidation.

President Nograles said a bridge bank will provide allowance in terms of time for a better and well-planned final resolution of a failed bank. "This resolution method will be less costly to the deposit insurer because it will not require outright payout to depositors and liquidation of the remaining assets of the failed bank", he said

The bridge bank concept originated from the United States with the enactment of the Competitive Equality of Banks Act of 1987. The Federal Deposit Insurance Corporation (FDIC) was the first to establish a bridge bank in 1987. In July 2008, following the collapse of IndyMac Bank, one of the largest thrift banks in the United States, FDIC created a bridge bank, IndyMac Federal Bank.

Bridge banking is an international best practice which was likewise adopted by deposit insurance systems in Japan, Taiwan and Korea. It is one of the 21 Core Principles for Effective Deposit Insurance Systems published by the International Association of Deposit Insurers (IADI). The Core Principles are designed to enhance the effectiveness of deposit insurance systems and are based on IADI research and guidance papers and practical experience of members, associates and observers. The IADI is an international organization of 52 deposit insurers established to contribute to the stability of financial systems worldwide. The PDIC is a founding member of the organization and President Nograles is a member of its policy making Executive Council.

The PDIC President expressed optimism that that the amendment of the PDIC Charter will further contribute to the stability of the financial system. The PIN is part of the IMF's initiatives to promote transparency of IMF's views and analysis of economic developments and policies. PINs are issued with the consent of the countries concerned.

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