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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

PHILIPPINES

ASSESSMENT OF PHILIPPINES DEPOSIT INSURANCE CORPORATION

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Assessment of the Philippine Deposit Insurance Corporation

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Background

1. The global economic and financial sector crisis of 2008/09 became a stark reminder to countries around the world of the need for an effective process for maintaining the confidence of depositors and resolving troubled financial institutions with the least amount of adverse impact on the financial sector and the community served by the institutions. The role of deposit insurance was highlighted during this difficult time. Nations without a formal system found the need to reassure their citizens by announcing formal government guaranties. Nations with established systems were not immune from the public's concern and as a result many increased the allowable coverage. The Philippines, although somewhat immune from the global crisis, none the less felt the impact of the crisis and responded, as did other countries, by taking steps to address the possible impact of the crisis by bolstering depositor confidence.

2. The Philippines stands out among its Asian neighbors at being in the forefront of deposit insurance. Long before deposit insurance became popular at the peak of the Asian financial crisis of the late 1990's, the Philippines already had an established formal deposit insurance system. The Philippine Deposit Insurance Corporation (PDIC) is a government instrumentality.¹ It was established in June 1963 with the passage of Republic Act (RA) 3591. The role of PDIC at that time was to help build the banking sector by encouraging citizens to save and to deposit those savings in the formal banking system. It was to do this by assuring depositors of the safety of their deposits by providing a government sponsored insurance of up to a P 10,000 per depositor in the event of a bank failure. The underlying motivation was to promote a safe and sound banking system and to foster public confidence in it.

3. Over the course of the years between 1963 and 2009, the PDIC has been called upon to fulfill its role in the financial sector safety net when banks were found to be in trouble. In response to changes in banking as well as identified weaknesses in the original legislation, RA 3591 was amended in 1992 (RA 7400) following Presidential Decrees in 1978 and 1984. This amendment increased the insured deposit coverage to P100,000. per depositor and expanded the authority of the PDIC by allowing it to undertake independent examination of insured depository institutions. This new act also mandated the PDIC to be the receiver/liquidator of failed banks. In line with practices of other deposit insurance agencies, namely the Federal Deposit Insurance Corporation of the United States (FDIC), the PDIC's power to provide assistance to insured institutions which were in danger of failing was increased. PDIC's independent authority to examine banks was taken away in 2000 with the passage of the General Banking Act.

¹ The PDIC is attached to the Department of Finance and is governed by a five-member Board of directors comprised of: the Secretary of Finance (Ex-officio Chairman), PDIC President (Vice-Chairman), Governor of the Central bank (Ex-Officio) and two representatives of the private sector. The president of the PDIC, along with the two private sector representatives, is appointed by the President of the Philippines for six year terms.

4. PDIC's charter was again amended by RA 9302 (12 August 2004) when the coverage limit of deposit insurance was increased from P100,000 to P250,000. Importantly, this amendment also partially reinstated PDIC's authority to examine banks, albeit, subject to prior approval by the Monetary Board. The amendment also revoked PDIC's ability to terminate the insured status of Banks, thus somewhat minimizing its ability to control its risk and costs. In June 2009, in responses to the global financial sector crisis, PDIC's charter was again amended. Deposit insurance coverage was increased effective June 1, 2009 from P250,000 to P500,000. The amendment also clarified the types of deposits and transactions which would not be covered by the deposit insurance. The legislation also somewhat increased PDIC's ability to manage its risks by providing it with Special examination authority to examine banks with threatened or impending closure. PDIC was also given authority to examine deposit accounts in the event there is a finding of unsafe and unsound banking practice.

General Observations and Comments

5. Over the course of time since the original FSAP report of 2002, several measures have been taken to better position the PDIC to fulfill its mandate, but these measures still fall short of the full needs of PDIC to be truly effective in sustaining confidence and stability in the banking system. The Prompt Corrective Action (PCA) process of the BSP is very time consuming and allows the rehabilitation plan to be designed by the bank itself. Although established to be a 90 day process, it is often extended to upwards of 180 days. During the PCA process, PDIC has little involvement with the bank.

6. The initial period of the receivership is little more than a continuation of the PCA albeit under the PDIC. It is yet another period to permit the owners to restructure and strengthen the failing bank. Under Section 30 of the New Central Bank Act, the PDIC should make a determination on the viability of rehabilitating the bank within ninety days of a bank having been placed in receivership. Thus the defining moment is not the appointment of a receiver for liquidation, as this is just another step in a series of delays leading to the ultimate resolution of a troubled/failed financial institution. Although based upon the applicable acts, PDIC is a "risk minimizing" deposit insurer, its ability to actually manage its risk remains limited in some respects. PDIC does not have any authority to participate in the decision process of who will be a member of its fund as it has no ability to weigh in on bank applications. It is not clear that the deposit insurer is consulted when the Monetary Board (MB) makes a decision concerning PCA and receivership, both of which are likely to impact PDIC.

Assessment

<p>This assessment is loosely based upon draft standards for effective deposit insurance. The assessment is not a detailed item by item review, but rather a review based upon general principles for deposit insurance. The ratings provided within the review are indicative and not meant to be binding upon the standard setters who are expected to soon adopt a common set of standards based upon their current draft.</p>

7. Currently there is no internationally adopted standard by which to assess deposit insurance as there is for banking, capital markets, accounting, corporate governance or insurance.

A great deal of work however has been undertaken to lead to such standards. The Bank for International Settlements (BIS) through The Basel Committee on Banking Supervision in coordination with the International Association of Deposit Insurers (IADI)² joined forces following the onset of the latest financial crisis (2008) to develop a set of standards for assessing the effectiveness of deposit insurance systems around the world. In June 2009, the joint group released its early findings in the form of a report entitled “Core Principles for Effective Deposit Insurance Systems”.³ In addition to the suggested Principles, the report suggests certain pre-conditions to an effective deposit insurance system. The preconditions, although important in the context of deposit insurance, are generally accepted as important to any sound banking system; they include: the need for an on-going assessment of the general economy as well as the banking sector, a sound governance structure of all participating entities in the country’s financial system safety net, strong and effective regulation and supervision of the sector and a well developed legal framework and accounting and disclosure regime.

8. It is based upon these recommended voluntary core principles that this assessment was undertaken.⁴ A draft methodology for assessing the principles is currently being reviewed by participating member countries. Since this is an *informal* assessment, the approach is a broad based one looking at the context of what the principles are meant to address. It is not based upon the methodology and its detailed criteria for each principle. When completed, this assessment can serve to complement the PDIC’s self assessment which will be based upon the methodology which is drafted as a detailed checklist of each criterion. Having assessments using the two approaches will provide PDIC with the big picture compliance overview and a detailed criterion by criterion review thus giving it a comprehensive assessment of its role and operations. The assessment looks at the draft 18 Core Principles which are broadly categorized into ten groups: Setting objectives (principles 1 to 2); Mandates and powers (principles 3 to 4); Governance (principle 5); Relationships with other safety-net participants and cross-border issues (principles 6 to 7); Membership and coverage (principles 8 to 10); Funding (principle 11); Public awareness (principle 12); Selected legal issues (principles 13 to 14); Failure resolution (principles 15 to 16); and Reimbursing depositors and recoveries (principles 17 to 18).⁵ The findings are intended to provide the authorities with an independent top down assessment of the current deposit insurance regime’s compliance against the growing body of suggested standards.⁶

Setting Objectives

• **Principle 1 – Public policy objectives:** The first step in adopting a deposit insurance system or reforming an existing system is to specify appropriate public policy objectives that it is expected

² The PDIC is an active member of IADI and one of its founding members.

³ The Principles are adaptable to a broad range of country circumstances and structures. They are not to be considered exhaustive, in that country circumstances may mandate alternative approaches and they are voluntary.

⁴ The PDIC is conducting a self assessment based upon the same principles and detailed criteria, using the newly issued draft methodology.

⁵ Basel Committee on Banking Supervision and International Association of Deposit Insurers, Core Principles for Effective Deposit Insurance Systems, June 2009

⁶ For purposes of this assessment a rating has been applied based upon the assessor’s top down assessment. Since it is not based upon a criterion by criterion assessment, the ratings could differ from any formal assessment conducted after the core principles and their methodology are adopted. The rating of compliance is a) fully compliant, b) partially compliant, c) partially non-compliant and d) non-compliant. The difference between partially compliant and partially non-compliant is reflective of the assessor’s view of the direction of compliance.

to achieve. These objectives should be formally specified and well integrated into the design of the deposit insurance system. The principal objectives for deposit insurance systems are to contribute to the stability of the financial system and protect depositors.

Background and Finding⁷

9. Section 1 of R.A. 3591, as amended (June 2009) provides that the Corporation as a basic policy shall promote and safeguard the interests of the depositing public by way of providing permanent and continuing insurance coverage on all insured deposits. Further: Section 1 of RA 9576 provides that the policy of the State in this area is to strengthen the mandatory deposit insurance coverage system to generate, preserve, maintain faith and confidence in the country's banking system, and protect it from illegal schemes and machinations. The policy and objectives are integrated into the overall deposit insurance regime. The policy and objectives are clearly stated, but it is not apparent that PDIC has all of the power necessary to fully implement all of them. The deposit insurance system has been designed and implemented to cover the bulk of small deposits with recognition that larger deposits will not be covered. Thus, it has protected at a minimum depositors generally not in a position to understand or to be able to gather information concerning the true condition of their bank. PDIC contributes significantly to the stability of the banking system and is recognized by depositors as a source of protection in the event their bank fails. The public policy objective of the PDIC is broader than merely providing limited deposit coverage. It is in the remaining areas, such as protecting it from illegal schemes and helping to preserve faith in the systems, which have not been fully addressed. PDIC appears to do what it can with what it has been given, but legislative support for its ability to fully implement the policy objectives has not been provided. The current public policy is a good one and meets the standard, but it needs further legislative support to ensure full implementation. It is for this reason that it would be judged to be only partially compliant with the draft standards.

• **Principle 2 – Mitigating moral hazard:** Moral hazard should be mitigated by ensuring that the deposit insurance system contains appropriate design features and through other elements of the financial system safety net.

Background and Finding

10. Much has been written concerning the moral hazard risk that deposit insurance can entail. The issue of moral hazard in relation to deposit insurance is generally of concern in three key areas, officers and directors of insured institutions, depositors and the insured institutions themselves. As to the first two, supervisory laws and regulations coupled PDIC's ability to reject deposit coverage as discussed below show efforts to control the associated moral hazard. As to the third, the insured institutions themselves, supervisory powers are the primary control over the moral hazard. In some countries, a risk-based deposit insurance system has been instituted to cause those who take the greatest risk to pay a higher premium. This system can serve to contain moral hazard associated with an institution's increased risk taking at the cost of healthier institutions belonging to the insurance fund. The PDIC acts to eliminate possible moral hazard generally and specifically when it discovers particular events such as were recently discovered following the failure of Legacy Banking Group. By law it has been provided certain

⁷ See Principle 4 for an assessment of the power to fulfill the policy objectives.

powers which permit it to contain some potential moral hazard, such as the recently approved power to exclude deposit insurance coverage over certain types of deposits and transactions related to actions undertaken in fraud or violation of established banking laws and regulations. It also has the authority to file suit against those deemed responsible for causing a bank to fail as one of the measures to prevent future abuse. This authority has been cautiously used, but with limited success due to delays in litigation. The delays often result in mooted the value of the litigation in that any assets upon which recovery might have been made, are long since gone. PDIC has also filed criminal cases, but again with limited success. They have filed over 60 cases, only two of which have resulted in convictions to date, and even those are subject to appeals. The low success rate is the result of many factors, including missing bank records which would support their arguments and a judiciary that needs increased awareness of banking related issues. The Philippine Judicial Academy has partnered with PDIC in conducting seminars for judges to address this concern. On the issue of risk taking by insured institutions, the Philippines has discussed but has not yet adopted a risk based premium system.

11. Its claim process has been strengthened in light of concern by staff over the effectiveness of its filters to prevent abuse of the deposit insurance and is currently being restructured. The design of the overall framework of the system leading to a demand on deposit insurance is not adequate to eliminate moral hazard in that today it is possible for depositors to take advantage of PDIC's lack of readily available deposit data. The regulatory system for banks provides a great deal of forbearance which if not better controlled increases moral hazard and ultimately the cost to the deposit insurer. Some of the weaknesses mentioned in the context of mandate and power can cause an increase in moral hazard. The delay in effectively addressing troubled banks permits them to make decisions and to take on added risk to remain open. In addition, the current legal structure for bank resolution is limited which could result in depositors, creditors and stockholders assuming certain banks are immune from closure because banks that are insolvent are not closed promptly. PDIC continues to seek legislative changes to address some of these weaknesses and to strengthen its ability to prevent moral hazard. Recent changes have helped, but more are sought. The weaknesses identified are indicative of the degree of non-compliance with the suggested principle. If a formal review were to be conducted it is likely a rating of partially non-compliant might be given.

Mandates and Powers

• **Principle 3 – Mandate:** It is critical that the mandate selected for a deposit insurer be clear and formally specified and that there be consistency between the stated public policy objectives and the powers and responsibilities given to the deposit insurer.

Background and Finding⁸

12. The mandate of the PDIC is that of a Risk Minimizer. In addition to the stated policy of intent with regards to the deposit insurance, RA 9576 (1 June 2009) also provides that the government must extend all means and mechanisms necessary for the PDIC to effectively fulfill its vital task of promoting and safeguarding the interests of the depositing public by way of

⁸ The mandate itself is clear and appropriate; see Principle 4 for an assessment of the power to fully implement the stated mandate which indicates weakness in the powers provided and a lower assessment rating.

providing permanent and continuing insurance coverage on all insured deposits, and in helping develop a sound and stable banking system at all times. The mandate itself is very clear and should provide sufficient comfort to ensure the full ability of PDIC to carry out the mandate. As seen in the assessment of Principle 4 however, this currently not the case. Simply considering the mandate itself, one could possibly consider it to be fully compliant with the concept behind the draft principle.

• **Principle 4 – Powers:** A deposit insurer should have all powers necessary to fulfill its mandate and these powers should be formally specified. All deposit insurers require the power to finance reimbursements, enter into contracts, set internal operating budgets and procedures, and access timely and accurate information to ensure that they can meet their obligations to depositors promptly.

Background and Finding:

13. The PDIC is a risk minimizing deposit insurer⁹, but its ability to adequately control its risks is somewhat limited by not providing it with full measures which might be necessary for a risk minimizer. PDIC has for the most part effectively used all of the powers and tools which it has, but what has been provided to them is not as comprehensive as its mandate might suggest. A risk minimizer should be involved in the granting of deposit insurance. In the Philippines, deposit insurance becomes mandatory upon the granting of a license to conduct banking services, and yet PDIC is not necessarily engaged or consulted in the granting of a banking license. The MOU with BSP provides at section 3 for information sharing at the licensing stage, but this actually provides for the sharing of information after the Monetary Board has approved in principle the granting of the license. Thus, the sharing of data is purely for informational purposes which is not sufficient for PDIC to be able to measure and manage its risks as a risk minimizer. Subsequent to the granting of a license, however, BSP requires a certificate of “good standing” from the PDIC for any bank wishing to expand its branch network, accept government deposits, or engage in derivative transactions, which does help the PDIC. It was recently provided the authority to exclude deposit insurance for certain types of deposits and transactions, which may not only limit moral hazard, but reduce the cost of resolution. Currently, however, there are areas which could increase the cost to the PDIC in the resolution of troubled financial institutions. Prompt Corrective Action (PCA) is not well defined, Rather than setting the stage for a real liquidation of a bank should it fail to meet its PCA plan of action and be placed under receivership, it becomes just a preliminary step in the rehabilitation process. Once an institution is handed over to PDIC for receivership, it is once again being given a period of time to “rehabilitate”. Experience at PDIC suggests that this delay rarely results in a successful rehabilitation of the problem institution. This extends the time for the near inevitable failure and liquidation and as a result, potentially increases the cost ultimately to be borne by the deposit insurer. Due to limitations in its ability to review deposits on an expanded basis (beyond situations when there are findings of unsafe and unsound banking practices) it is not adequately

⁹ A deposit insurer which is mandated to be a risk-minimizer is one which is able to be proactive in risk identification, assessment, and management. The insurer obtains timely and accurate information which it uses to assess the financial condition of an insured institution, and of the financial industry as a whole. It is also able to address problem institutions in a timely manner, thus reducing cost and effectively the longer term risk to the deposit insurance fund.

prepared to negotiate a transfer of deposits in a manner to maximize its recoveries and to minimize the disruption to bank customers in case of liquidation. This limitation also prevents it from being able to act more decisively and timely in paying depositors their insured deposits. In addition, it is not clear that its ability to review deposits at institutions is sufficiently broad to allow it to properly police the fees paid by institutions for deposit insurance. The weakness identified prevents PDIC from being able to fully care out the policy and mandate provided to it. This contradiction leaves the PDIC as currently partially non-compliant. The authorities are aware of this deficiency and issues surrounding it are currently being discussed in the context of possible legislative changes.

Governance:

- **Principle 5 – Governance:** The deposit insurer should be operationally independent, transparent, accountable and insulated from undue political and industry influence.

Background and Finding¹⁰

14. Although the PDIC is attached to the Department of Finance (DOF), it is operationally independent and manages its own affairs and decisions without interference from the DOF. The corporate structure and general governance of PDIC is set out in its charter starting at Section 2 which defines the authority and functions of the Board of Directors and qualifications for Board members. Legislatively, the independent or private sector Board Members are to have staggered terms. They are appointed by the President of The Philippines and due to timing of their appointments and other factors, this often results in their having staggered terms. This helps to ensure stability in the Board. Section 3 addresses the office of the president and the respective role and responsibilities of the office. The PDIC Charter at Sections 8 and 9 provides for the powers and duties of the corporate entity.

15. The PDIC is accountable in a number of ways to a variety of stakeholders, but most importantly to depositors throughout the country and more specifically to depositors whose banks have failed. Due to legislative constraints on its ability to readily access deposit information in advance of a receivership or liquidation, PDIC is not able to promptly service the depositors. Further, at this time the disclosure of information concerning transactions and financial assistance is limited. This appears to result from PDIC being seen solely as the party responsible for liquidating banks and paying depositors, rather than one which also provides support to open banks. As a result there is concern that if its open bank transactions and assistance were made public, that it could have an adverse impact on the operations of a bank. Management and staff are discussing how to overcome the stigma and how to increase public awareness of PDIC's role. Secondly, there is a fear of law suits.

16. The PDIC is subject to annual external audits by the Government's auditors. In addition, it has its own internal auditors. Audit results are provided in its annual report. PDIC has been issued an unqualified opinion for the past three years. SECTION 20 (a) of the Charter provides

¹⁰ In a culture of constant political interference, PDIC has done a commendable job to insulate its decision making process. Governance could possibly be enhanced through increased contact with and reporting to stakeholders

that the Corporation shall annually make a report of its operations to the Congress as soon as practicable after the 1st day of January in each year.

17. The organizational structure of the PDIC is based upon the functions it must fulfill. In addition to the various work groups, there is the Audit Committee and the Risk Management Committee, both of which report to the Board. The PDIC requires that its workforce be of high integrity and like all government entities, PDIC is covered by RA 6713 (Code of Conduct and Ethical Standards for Public Officials and Employees). In addition to the governmental standard code, PDIC's Board of Directors, under resolution No. 2003-05-077 (May 30, 2003), approved its own code of ethics. This code expands upon the government code by providing for an increased emphasis on conflicts of interest, making clear the prohibition on misuse of information and prohibits the solicitation of gifts as well as the acceptance of almost all gifts. The staff of the PDIC is exempt from the Government Salary Standardization law, which should help to ensure recruitment and retention of high quality staff. The PDIC competes with private banks and BSP for staff, both of whom generally have higher salaries. Although this exemption exists, salaries may not exceed the salary of the president of the PDIC which is set by the President. The salary of the president of the PDIC was last increased in 2000. The current governance structure, both as spelled out in law and as allowed to function allows the PDIC to perform its task in relative freedom from interference; for this reason, subject to any future changes, PDIC could anticipate a rating of fully compliant on the issue of governance should an assessment be conducted.

Relationships with other safety-net participants and cross-border issues

• **Principle 6 – Relationships with other safety-net participants:** A framework should be in place for the close coordination and information sharing, on a routine basis as well as in relation to particular banks, among the deposit insurer and other financial system safety-net participants. Such information should be accurate and timely (subject to confidentiality when required). Information-sharing and coordination arrangements should be formalized.

Background and Finding

18. PDIC is legally independent of other participants in the national safety net, but its role is not equal to others which may have an impact on its ability to access data as needed. Its Board of Directors is composed of other participants in the safety net (BSP and DOF) which brings some cross dialogue. It should be noted that PDIC is not a member of the Monetary Board and is not routinely consulted on matters with implications to the safety-net and thus it does not actively participate in critical discussions concerning the viability of depository institutions despite it having primary responsibility for the cost of the failure of the institutions, through its responsibility to insured depositors. This can result in undue delay in bank resolution and payments to insured depositors.

19. Its information gathering is also somewhat constrained, but legislative changes have given it greater authority, but subject to prior approval of the Monetary Board. There does exist however a Memorandum of Agreement (“MOA”) between the BSP and the PDIC which covers information sharing. In form it covers a great deal and looks to be compliant, but in actuality the parties could do more to enhance its implementation. It generally provides an overall framework

for the exchange of information and data in order for both organizations to fulfill their respective mandates.

20. The roles and responsibilities of the safety net participants are fairly well defined. If questions arise on mandates or roles, they are discussed at the Financial Sector Forum (FSF) for resolution or clarification. The PDIC is a member of the FSF along with the BSP, SEC, and Insurance Commission. This is a voluntary interagency body established to provide a framework for coordinating supervision and regulation of the financial sector. The members of the FSF have entered into a MOA for the exchange of relevant reports, data and market information. The FSF is an informal participant in the safety net as it has no formal role, but it successfully brings the players together. There are bi-monthly meetings of the most senior officials and monthly meetings of various committees, sub-committees and technical working groups.

21. While during routine times it is not clear that the members of the safety net are sufficiently coordinating and communicating their activities, the 2008 failure of the Legacy Bank group demonstrates how it works and works fairly well when it is important. This is an area of some difficulty for many countries. The need and appreciation for easy access to data available to participants in the safety net is well understood as a matter of principle, but full implementation is often lacking. This is the case in the Philippines, and as a result it might only be deemed as partially compliant with regards to the structure and reality of the relationships between and among the participants in the safety net.

• **Principle 7 – Cross-border issues:** Provided confidentiality is ensured, all relevant information should be exchanged between deposit insurers in different jurisdictions and possibly between deposit insurers and other foreign safety-net participants when appropriate. In circumstances where more than one deposit insurer will be responsible for coverage, it is important to determine which deposit insurer or insurers will be responsible for the reimbursement process. The deposit insurance already provided by the home country system should be recognized in the determination of levies and premiums.

Background and Finding¹¹

22. All of the basic tenets of the principle are in place, but yet to be fully tested. Philippine banks do not have a major presence outside of the country. Domestic Foreign banks do not play a major role in the economy, making up less than 11% of total banking assets and only 3% of total insured deposits as of 30 June 2009. The most recent global crisis revealed to some extent the level of coordination among deposit insurers. While there is a general agreement on the need to share data and information on the condition of cross border banks, it was found that each regulator/supervisor/deposit insurer is somewhat reluctant to do so, given concerns for the sensitivity of the market. Data is provided based upon each entities interpretation of “need to know”, and generally after the fact. For branches of foreign banks, the condition of the home office is not always shared on a timely basis as was the experience in the global turmoil of 2008. More could be done by the headquarters of local foreign branches to keep local supervisors and deposit insurers better informed. Regular meetings of Central Bank Governors, bank supervisors

¹¹ The principle has less to do with individual deposit insurers than it does to the system as a whole on a global basis.

and deposit insurers at various forums helps on an informal basis to keep the dialogue open, but in time of crisis may not be sufficient. The draft principle states the ideal but reality for most countries today would likely result in findings of only partially compliant, as would be the case for the Philippines. Concern by authorities around the world over confidentiality causes delays in the sharing of information. In countries with a large number of foreign banks, or strategically important ones, this is an important issue. At the moment for the Philippines this is not a significant matter.

Membership and Coverage

• **Principle 8 – Compulsory membership:** Membership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (eg. retail and small business depositors) to avoid adverse selection.

Background and Finding

23. The Philippines, at Section 4, RA No. 3591, as amended to Section 5 of RA 9302 August 2004, has provided for mandatory participation in the deposit insurance regime of all entities which have been authorized to perform banking functions in the Philippines. The determination of banking functions and the authorization/approval of institutions to do so is up to the BSP. Today, members can include all commercial banks, savings banks, mortgage banks, rural banks, development banks, cooperative banks, savings and loan associations and branches and agencies in the Philippines of foreign banks and all other corporations authorized to perform banking functions in the Philippines. As of the end of June 2009, there were 804¹² active members in the deposit insurance program. The granting of deposit insurance is automatic with the granting of a license by the BSP to conduct banking services. The mandatory and almost automatic membership provides a clear understanding to the public on institutions which are covered. Care must be given however, as to those institutions not covered and the role they play in intermediation. Non-member institutions of a significant size relative to their geographic location should be looked at from time to time to ensure they are not promising some form of guaranty on deposits or otherwise insinuating PDIC coverage. Should membership in the institutions grow to a size larger than originally intended by the corporate structure of the institution, consideration should be given by the bank supervisory agency as to what impact if any the failure might have on banking in the community. Care should be given to avoid any implied guaranty of the government should there be a failure. Further, it would not be advisable for PDIC to be involved in the liquidation of non-member institutions as this could blur the lines of coverage in the eyes of the public, putting pressure on the PDIC and the Government to ex-post extend deposit coverage. In order to further reduce moral hazard and to protect the insurance fund, it would be of value for the BSP to assess the rules and regulations under which each type of insured depository institution is permitted to operate to ensure consistency in their application. The public in the Philippines are provided a clear guidance as to which institutions are insured by the PDIC. The mandatory nature of the insurance allows the public to better select an institution with whom they wish to conduct business. The Philippines fully complies with the concept of providing protection to small depositors in their dealings with deposit taking financial institutions.

¹² As of 30 September 2009, the number of banks totaled 797.

• **Principle 9 – Coverage:** Policymakers should define clearly in law, prudential regulations or by-laws what an insurable deposit is. The level of coverage should be limited but credible and be capable of being quickly determined. It should cover adequately the large majority of depositors to meet the public policy objectives of the system and be internally consistent with other deposit insurance system design features.

Background and Finding

24. The term “insured deposit” is defined by legislation Section 4(g) of R.A. 9576 (which further amended RA 3591). Deposits are defined to mean the amount due to any *bona fide* depositor for legitimate deposits in an insured bank net of any obligation of the depositor to the insured bank as of date of closure, but not to exceed Five hundred thousand pesos (P500,000.00). The coverage is based upon individual depositors and thus, the amount due is determined by adding together all deposits in the bank maintained in the same right and capacity for his/her benefit either in his/her own name or in the name of others. The amendments of 2009 also clarified which types of deposits would not be covered, thus giving PDIC greater control over accounts set up for fraudulent purposes (among others).

25. The deposit insurance coverage limit is to be reviewed, two (2) years from the date it was changed by legislation. Thereafter it is to be reviewed on a five year cycle. PDIC has followed a methodology in determining the appropriate coverage limit based upon several factors such as: inflation adjustments from the date of the last coverage change and the extent of coverage change per capita GDP which it tries to maintain at two times GDP. In addition, a review is undertaken to determine the percentage of insured deposit accounts compared to total deposit accounts and consideration is given to insure that a majority of small deposit accounts are covered. The methodology used is based upon systems used in other countries, but also reflects the specific needs of the country.

Deposit Insurance Coverage

Date	Coverage Amount	Coverage Basis
1963	P10,000	Section 4 of R.A. 3591 (June 1963)
1978	P15,000	Presidential Decree No. 1451
1984	P40,000	Presidential Decree No. 1897
1992	P100,000	Section 4 of R.A. 7400 (1992)
2004	P250,000	Section 4 of R.A. 9302 (12 August 2004)
2009	P500,000	Section 4 of R.A. 9576 (1 June 2009)

26. As of the latest change to the coverage amount in June 2009, 97% of all deposit accounts are now fully covered by deposit insurance, while approximately 31% of the total monetary volume of deposits is covered. Generally a country strives to ensure that approximately 80% of all deposit accounts are covered. The percentage of covered accounts is a bit higher, but the percentage of total monetary coverage justifies this and will be reviewed in two years. The authorities have fully applied the principle in that The Philippines has provided a clear statement in the law on the amount of deposit insurance coverage and has published the number to bring about a fuller awareness in the public.

Principle 10 – Transitioning from a blanket guarantee to a limited coverage deposit insurance system: When a country decides to transition from a blanket guarantee to a limited coverage deposit insurance system, or to change a given blanket guarantee, the transition should be as rapid as a country’s circumstances permit. Blanket guarantees can have a number of adverse effects if retained too long, notably moral hazard. Policymakers should pay particular attention to public attitudes and expectations during the transition period.

Background and Finding

27. The Philippines has had an established deposit regime for a number of years. The coverage amounts have changed over time, and more recently in response to the global financial crisis (2009), but no blanket coverage regime has been instituted since the establishment of the PDIC in 1963. The Government and PDIC are to be congratulated for not overreacting during the recent global crisis and shifting to a blanket guarantee. Having already established a limited coverage system, they appropriately looked at the risk of failures and the appropriate coverage limits and acted accordingly. Although circumstances around the world were different at the time of the recent events, perhaps lessons can be learned from the experience of the Philippines in this regard.

• **Principle 11 – Funding:** A deposit insurance system should have available all funding mechanisms necessary to ensure the prompt reimbursement of depositors’ claims including a means of obtaining supplementary back-up funding for liquidity purposes when required. Primary responsibility for paying the cost of deposit insurance should be borne by banks since they and their clients directly benefit from having an effective deposit insurance system. For deposit insurance systems (whether ex-ante, ex-post or hybrid) utilizing risk adjusted differential premium systems, the criteria used in the risk-adjusted differential premium system should be transparent to all participants. As well, all necessary resources should be in place to administer the risk-adjusted differential premium system appropriately.

Background and Finding

28. The PDIC is a traditional ex-ante funded deposit insurance regime. The authority for setting premium assessment rates is found at Section 6(a), RA No. 3591, as amended 2004. Section 6 provides that the assessment rate is to be set by the Board of Directors, but cannot exceed one-fifth of one per cent per year. This maximum assessment rate has been applied for several years. The premium assessments are straight line for all deposit taking institutions and are not risk based. The basis for the assessment is the amount of the liability of each bank for deposits as defined under subsection (f) of section 4 R.A. 9302 12 August 2004. In support of the assessment process, each bank is required to file with the PDIC a certified statement showing assessment base.

29. Providers of banking services automatically become members of the PDIC upon the granting of a license from the BSP. The members are assessed premiums for the deposit insurance coverage. These assessments are the basis for the operation of the PDIC and for its reserves. PDIC does not have the flexibility to raise premiums beyond the currently established maximum limits and does not have the ability to make special assessments. Some jurisdictions

have established the premium formula based upon the risks posed by each member of the system, but PDIC does not have this ability. As a result of its funding/premium system and its lack of ability to change it, or to make special assessments in the event of a sudden need, it is unclear if it can adequately respond to difficult situations in a timely manner without jeopardizing its fund although there is a sovereign guarantee on PDIC's borrowings as discussed below.

30. The PDIC has studied other deposit insurers around the world and has established its formula for determining the required size of its reserves. It must constantly update its required reserve calculation based upon demands, current and projected as well as average historic recoveries on assets of failed institutions. It has thus far done a good job at this and has not encountered any difficulty even as it has routinely responded with insured deposit payments. The recent doubling of deposit insurance coverage from P 250,000 to P 500,000 could impact its reserve requirements. While the Government has responded to this change by agreeing to cover the second P 250,000 of deposit payouts for a three year period and to provide certain tax waivers, it is not clear that at the end of the three year period that PDIC will have reached its desired reserve estimates. This is an area which should be monitored on an on-going basis as the rating could go to partially compliant if funding is not adequate at the end of the three year period. The 2009 amendments to the Charter provided PDIC a sovereign guarantee on PDIC's borrowings (not to exceed twice the amount of the fund on the day of issuance). This should help PDIC in the event of extraordinary funding needs while the fund grows to cover expected coverage needs.

31. Premiums are invested in obligations of the Republic of the Philippines, or in obligations guaranteed as to principal and interest by the Republic. The investment policy is mandated by legislation at Section 17, RA No. 3591, as amended. Reports on fund management are regularly provided to senior management and the Board of Directors of the PDIC.

32. Adequate funding is one of the key elements of a deposit insurance system and is critical to instilling confidence in the public that the deposit insurer is able to actually meet the demands placed upon it. By law and practice, the Philippines has managed to maintain adequate funding. The PDIC regularly assesses its funding and projected funding needs. The recent significant increase in the insured coverage limit will need to be carefully managed over the transition period to ensure the continued ability to remain fully compliant with this important feature of deposit insurance.

Public Awareness

• **Principle 12 – Public awareness:** In order for a deposit insurance system to be effective it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.

Background and Finding

33. PDIC has an on-going awareness campaign addressing the information needs of various stakeholders. The campaign employs a multimedia approach to reach as many stakeholders as possible.

34. When a bank closes, PDIC deploys staff of the Depositors Assistance Bureau (DAB) to undertake networking and links with officials of local government units and other institutions as well as conducts information dissemination on the bank's closure. DAB staff conducts a Depositor Forum following every bank closure to explain the claims procedures, distributes claim forms and assists depositors in filing their deposit insurance claims.

35. The PDIC has a "Financial Literacy" project in partnership with the Department of Education and Commission on Higher Education that helps to explain the role of the PDIC and deposit insurance to students enrolled in secondary schools and business schools. It is in this program that PDIC also hopes to build for itself a broader image than one associated purely with failed banks.

36. PDIC also has a Resource Center to assist the academic and research community on their information needs for deposit insurance materials and references on financial stability issues. To continue bridging communication between PDIC and students, the Corporation also conducts school visitations to give briefings on PDIC and deposit insurance. The PDIC also hosts study visits for students.

37. To provide continuing linkage with member-banks, PDIC holds periodic dialogues and consultations with bank groups to discuss impending PDIC regulations and industry updates.

38. To actively advocate responsible banking, PDIC spearheaded a collaborative effort among bank groups and the Bangko Sentral ng Pilipinas to establish its "Be a Wise Saver" program. The program is aimed at providing information on safe and responsible banking to depositors and the general public.

39. PDIC continues its public awareness campaigns through institutional advertisements, speaking engagements and postings of information materials in the corporate website.

40. The efforts of the authorities to ensure public awareness of the role of PDIC as well as deposit insurance are to be commended. These efforts should have a positive impact on potential small depositors and could help to promote access. It is good to see that the program to ensure this awareness is not a static one, but one which can remain flexible to the ever changing needs of the population.

Selected Legal Issues

• **Principle 13 – Legal protection:** The deposit insurer and individuals working for the deposit insurer should be protected against lawsuits for their decisions and actions taken in "good faith" while discharging their mandates. However, individuals must be required to follow appropriate conflict-of-interest rules and codes of conduct to ensure they remain accountable. Legal protection should be defined in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified.

Background and Finding¹³

41. In order to undertake all of the tasks necessary for a deposit insurer, the staff must be well trained and enabled to undertake their tasks. Importantly, they must be able to make informed decisions and to recommend and take actions within the profile of their jobs without fear of litigation. Section 9 (h) of PDIC's Charter attempts to address this by providing that PDIC's directors, officers, employees and agents are held free and harmless to the fullest extent permitted by law from any liability, and they shall be indemnified for any and all liabilities, losses, claims, demands, damages, deficiencies, costs and expenses of whatsoever kind and nature that may arise in connection with the performance of their functions. Unfortunately, the litigation can still be filed against them individually and must be defended, and as such is viewed by staff as falling short of providing adequate protection to prevent the chilling effect of the fear of litigation. This is a clear problem for PDIC and others (BSP/SEC) and has had an impact in the fulfillment of its mandate.¹⁴

42. The issue of providing sufficient protection to supervisors and deposit insurers to instill in them the ability to do their jobs to the fullest is critical to the financial system as a whole. It is important that these individual are not inhibited from taking or recommending action designed to protect the system. When this does not exist, there is an increased risk of delay in bringing corrective action or in alerting senior level staff of concerns while further detailed investigations are pursued. The delays caused by the reluctance can easily result in further deterioration. The Philippines is not immune in this regard. On paper it appears to provide satisfactory protection to encourage timely action, but in reality it is not applied in a way that renders the desired result. In this respect it is only partially compliant. The result of the partial compliance is seen in many areas, from timely action, to the ability to maximize recoveries on behalf of depositors and the insurance fund.

• **Principle 14 – Dealing with parties at fault in a bank failure:** A deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in a bank failure.

Background and Finding

43. The PDIC Charter at Section 21(d) provides that The Corporation may require an insured bank to provide protection and indemnity against burglary, defalcation, losses arising from discharge of duties by, or particular acts of defaults of its directors, officers, or employees, and other similar insurable losses. It also provides that the Board of Directors in consultation with the Bangko Sentral, shall determine the bonding requirement as it refers to directors, officers and employers of the insured bank as well as the form and amount of the bond. Whenever any insured bank refuses to comply with the bonding requirement, the Corporation may contract for such protection and add the cost thereof to the bank's deposit insurance.

¹³ The PDIC looks to be fully compliant in this regard, but does not meet the standard set as "ideal" where qualified immunity should be available, removing the threat of litigation within defined terms when the litigation arises as a result of the performance of their duties.

¹⁴ See Governance section at Principle 5 for a discussion on the conduct rules for staff.

44. Section 21(g) provides that the Board of Directors is authorized to impose administrative fines for any act or omission enumerated in the preceding subsection, and for violation of any order, instruction, rule or regulation issued by the Corporation, against a bank and/or any of its directors, officers or agents responsible for such act, omission, or violation, in amounts as it may be determined to be appropriate, but in no case to exceed three times the amount of the damages or costs caused by the transaction for each day that the violation subsists, taking into consideration the attendant circumstances, such as the nature and gravity of the violation or irregularity and the size of the bank. (Amended on 12 August, 2004 by RA).

45. As discussed above at principle 2, PDIC does have authority to pursue those at fault in a bank failure and those that may have committed fraud in dealing with the failed institution. Having the authority or ability to pursue the responsible parties has not however been as successful as might be desired or expected under this principle. Today, the system is only partially able to comply with the principle. On paper, for the most part, it appears to be able to do so, but in reality is only able to do so in a limited manner. PDIC's experience with filing criminal actions has been poor.¹⁵ It has been hampered in a number of ways. The system provides for a number of delays, the judiciary has not been adequately prepared to handle such cases in a timely manner, records of banks have been destroyed or go missing, many of which are required to pursue the claims against responsible parties. The result has been loss of opportunity to increase recoveries for the receivership.

Failure Resolution

• **Principle 15 – Early detection and timely intervention and resolution:** The deposit insurer should be part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks. The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well defined criteria by safety-net participants with the operational independence and power to act.

Background and Finding

46. Although PDIC does not have the ability to routinely examine insured banks, it has been provided authority to either conduct a joint examination with the BSP or an independent examination upon approval of the MB. In addition, it can conduct a “special” examination of banks with threatened or impending closure. PDIC can also examine deposit accounts in the event a bank is found to be engaged in unsafe and unsound practices. It can obtain access to exam reports of banks, but only after the report has become final, which can take a considerable amount of time thus, diminishing somewhat the report's value. In addition, it is permitted to gather certain data from its insured members on a regular basis. This is provided for at section 9

¹⁵ Section 21(f) of the PDIC charter enumerates criminal acts as well as the corresponding penalties of prison mayor or a fine of not less than P50, 000.00 but not more than P2million, The Revised Penal Code provides a further basis to PDIC for referring criminal actions.

of RA No. 3591, as amended. This includes reports of the banks' condition. Pursuant to this authority, PDIC has issued regulations which require banks to provide specific information on deposit record keeping on a regular basis and requires a bank's president or compliance officer to sign a notarized certification as to the banks' keeping and maintaining of a true and accurate record or statement of its deposit transactions. The various sources of information gathering, through MOAs, participation in the FSF, its special examination power all assist the PDIC to anticipate possible bank problems, but not always on a timely basis.

47. Addressing failing institutions can involve a number of different possible solutions. The decision making process sets the stage for actions and potential recoveries. The primary and most important step in the process is effective supervision. Enforcement actions cease and desist orders and prompt corrective actions are all critical in the progressive handling of problem institutions. The decision making process as an institution gets closer to PCA is critical in commencing the preparations for a possible failure. The decision making process, especially the PCA is under the authority of the Monetary Board to which the PDIC has been excluded, both formally and as an ex-officio member. PDIC should participate in these Monetary Board discussions, especially as an institution gets closer and closer to being in danger of failing. This is not the case today, resulting in the views and concerns of the PDIC which ultimately must bear the cost of the failure not being given adequate consideration. Further, as previously noted, PDIC should have access to deposit information on a continuous basis or at a minimum for troubled institutions and all relevant data of a bank prior to the declaration of receivership or liquidation in order to better facilitate timely interventions and resolution.

48. Timely resolution of troubled financial institutions is important to the overall credibility of the system. It also demonstrates to both bankers and the public the ability of the authorities to manage difficulties with the least amount of disruption. At the moment this is not possible in the Philippines due to constraints in the system and as such, if a formal review were to be conducted, it is likely that a finding of partially non-compliant on this principle would be issued.

• **Principle 16 – Effective resolution processes:** Effective failure-resolution processes should: facilitate the ability of the deposit insurer to meet its obligations including reimbursement of depositors promptly and accurately and on an equitable basis; minimize resolution costs and disruption of markets; maximize recoveries on assets; and, reinforce discipline through legal actions in cases of negligence or other wrongdoings. In addition, the deposit insurer or other relevant financial system safety-net participant should have the authority to establish a flexible mechanism to help preserve critical banking functions by facilitating the acquisition by an appropriate body of the assets and the assumption of the liabilities of a failed bank (e.g. providing depositors with continuous access to their funds and maintaining clearing and settlement activities).

Background and Finding

49. PDIC is the legally mandated “receiver” of banks placed under receivership. Once appointed receiver, PDIC will conduct an inventory of assets, but cannot commence other aspects of its role until a determination has been made on whether the institution can be rehabilitated. The combination of bank secrecy (deposit secrecy), the right of owners to submit a rehabilitation plan post-receivership (90-day opportunity), and the opportunity for owners to

judicially challenge actions can significantly delay effective resolution. The ability of owners to submit rehabilitation plans may unnecessarily delay the liquidation of an institution, even when it should be clear from the condition of the bank or ongoing actions of the owners that the delay will merely provide further opportunity for asset deterioration resulting in less recovery for depositors and other creditors.

50. Due to the bank secrecy laws, neither the PDIC nor the BSP has the ability to market the bank prior to the actual appointment of the receiver. The current system essentially eliminates the possibility for the PDIC to review the records of a failing institution and to market all or part of it to a third party at or near the time of the appointment of a receiver. This is a weakness that potentially impacts many. The group that appears to benefit most by the current structure is the current owners/shareholders. When an institution can be marketed as it heads to receivership, rather than after the appointment, there are several potential benefits which may not otherwise be realized. Depositors frequently do not have to be paid off if deposits can be transferred as part of the transaction which provides them continuity of access to their funds. Equally important is the disruption a closing (without the sale to a third party) can cause to the financial health of a community. Borrowers may lose their lines of credit or other borrowing facilities which can be the breaking point for small businesses resulting in their having financial difficulties. Worse yet, a depositor small business borrower may lose access to funds needed in its operation which were in its deposit account when the institution was placed into receivership, and loses its borrowing ability until it reestablishes a relationship with a new lender. The occurrence of delay in depositor payments coupled with losses of lines of credit also has the potential of adversely impacting credit culture by suggesting that it may be best to withhold loan payments from troubled institutions so as to protect oneself in the event of the declaration of a bank holiday or the appointment of a receiver.

51. PDIC is not able to be compliant on this principle due to constraints under the current law and as a result would likely be judged to be at least partially non-compliant if a formal assessment were conducted today. There is no real value added in having the receivership appointment prior to the real authority to liquidate, since the receivership requires an additional time period to assess the possible rehabilitation of the institution. The additional time for this assessment by the PDIC is not warranted in that it is doubtful its review for a possible rehabilitation will add to the safety and soundness of the system since any rehabilitation of the institution that could be done, should have been done by the institution itself voluntarily or under orders of the supervisor at an earlier time. It is also not clear why the legislation has not been clarified to terminate the rights of bank owners at the point of receivership, thus eliminating their ability to further delay the process through the submission of their own plan for rehabilitation. The continued presumption that the owners will now suddenly be able to come up with a viable plan when they did not do so previously delays an effective resolution and increases the cost to the deposit insurer. Prompt corrective action and progressive discipline is much more effective than waiting for the appointment of the receiver. Finally, the lack of a clear, effective and prompt legal or judicial process to address a failing deposit taking institution may be a contributing factor to the delays being experienced today in PDIC's being able to fully fulfill its mandate in a timely manner. Consideration should be given to permitting the creation of a Bridge Bank which could function once a bank is discovered to be having sufficient difficulties to warrant closure, but due to time and other constraints a smooth transaction involving a third party purchaser is not possible. This would permit a subsequent transaction which could better address the particular situation of the institution. In addition, a Purchase and Assumption (commonly referred to as P&A) to be all but fully negotiated prior to the appointment of a receiver is

necessary to permit a smooth transfer which would have a positive impact on depositors and others in the business community.

Reimbursing Depositors and Recoveries

• **Principle 17 – Reimbursing depositors:** The deposit insurance system should give depositors prompt access to their insured funds. Therefore, the deposit insurer should be notified or informed sufficiently in advance of the conditions under which a reimbursement may be required and be provided with access to depositor information in advance. Depositors should have a legal right to reimbursement up to the coverage limit and should know when and under what conditions the deposit insurer will start the payment process, the time frame over which payments will take place, whether any advance or interim payments will be made as well as the applicable coverage limits.

Background and Finding

52. PDIC commences payout when a bank is placed under receivership. Due to the inability to access depositor information at an earlier stage, and to better secure the records of the failed institution, PDIC is not able to pay depositors their insured coverage as quickly as depositors might expect. The claims process is currently under review. It had worked in an acceptable manner with small institutions, but with the failure of the Legacy Group and the circumstances surrounding its closure, weaknesses were discovered in the process to adequately determine ownership of accounts and the loan performance information of depositors for purpose of netting. On average from 2001 to 2008, the claims process commenced 21 days following determination of the bank's failure. Until recently most depositors were able to receive payments approximately 2 months following a bank failure. The recent larger and simultaneous failures will result in a longer period. The timeframe is understandable given the many constraints imposed upon PDIC, but nonetheless, is not viewed as acceptable in terms of building confidence and providing depositors timely access to their insured deposits.

53. PDIC was recently (2009) given the authority to examine deposits of banks in the event of a finding of unsafe and unsound banking practices. It is not clear why the authority is limited to situations where there have been findings of unsafe and unsound practices. This is a step forward, but remains too limited to fully enable PDIC to manage its risks and to prepare for a smooth transaction in the event an institution must be liquidated. In addition to this authority, PDIC has established mandatory standards for banks deposit record keeping. Regretfully, the value of the standards has been limited thus far as PDIC often finds that by the time it is allowed to enter an institution, the records are no longer available, or are riddled with gaps.

54. Section 16 of the PDIC Charter defines its role in the payment of insured deposits, including the need for public notice to depositors. Section 15 provides protection to the PDIC following the payment of insured depositors by providing for the subrogation of the depositors' claims to the PDIC.

55. PDIC's ability to provide depositors with prompt access to their insured funds is limited by its lack of timely and accurate information concerning deposits. The prompt payment of a depositor's insured claim is one of the most critical aspects of deposit insurance and goes to its

very core and ability to maintain confidence in the banking system and in the ability of the deposit insurer to fulfill its mandate. PDIC is hampered a little by its own processes (which are now under review), but more importantly by laws or the interpretation of laws limit its ability to more readily access deposit information. While PDIC appears to do the best it can under existing circumstances, at this time it would be rated as only partially compliant, or partially non-compliant on this important aspect of deposit insurance.

• **Principle 18 – Recoveries:** The deposit insurer should share in the proceeds of recoveries from the estate of the failed bank. The management of the assets of the failed bank and the recovery process (by the deposit insurer or other party carrying out this role) should be guided by commercial considerations and their economic merits.

Background and Finding

56. Section 15 of the PDIC Charter provides protection to the PDIC following the payment of insured depositors by providing for the subrogation of the depositors' claims to the PDIC. It further provides that all payments by the Corporation of insured deposits in closed banks are given the equivalent status as public funds and must be considered a preferred credit similar to taxes due to the National Government in the order of preference under Article 2244 of the new Civil Code. The relevant provisions for the preference of credits in bank liquidations are found in Articles 2241 to 2245 of the Civil Code (all credits are covered here) and Article 101 of the Labor Code. This priority helps PDIC to replenish and protect the fund. The protection is limited, however, in that PDIC is merely one of several preferred creditors. The right of subrogation has limited priority, although much better than the right of the uninsured depositor.

57. The PDIC is compliant for this principle, but the reality of recovery on assets diminishes the potential benefit. The experience of PDIC shows that asset recoveries are limited, most probably due to delays in the system which results in diminished values and/or assets actually vanishing.

58. **Conclusion:** For an organization like the PDIC there are a number of important areas for which it must be concerned: i) the adequacy of its reserves, ii) how the insurance reserve is funded, iii) what banks are permitted insurance coverage, iv) knowing what accounts are covered, v) understanding the on-going condition of insured institutions, vi) timely determination and action on problem insured institutions, vii) timely payment to insured depositors and viii) the liquidation of assets and recovery for depositors and by subrogation itself, and creditors. It must not only be able to respond to each of the items, but must also be able to address them and when necessary act to correct them. As seen in the assessment, PDIC today is not able to adequately address or manage all of the important areas with sufficient authority to enable it to be as strong a deposit insurer as it might be or for it to better protect the insured depositing public and to more strongly assist in maintaining the confidence, safety and soundness of the banking sector. The PDIC has done a good job of managing the key areas of importance and of managing its risks within the constraints under which it operates. Since 2002 the legislation concerning deposit insurance has been amended twice, once in 2004 and again, more recently in 2009. These amendments have helped to strengthen PDIC's ability to fulfill its mandate, but fall short of enabling it to fully meet its mandate or to adequately manage its risks. This assessment points out areas of legislative weakness which could be enhanced.