



Eastern Caribbean Central Bank

**ESTABLISHMENT OF A DEPOSIT INSURANCE SYSTEM FOR  
THE EASTERN CARIBBEAN CURRENCY UNION**

*June 2020*

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# ESTABLISHMENT OF A DEPOSIT INSURANCE SYSTEM FOR THE EASTERN CARIBBEAN CURRENCY UNION (JUNE 2020)

## 1.0 INTRODUCTION

The paper outlines the main goals and objectives for the establishment of a deposit insurance system (DIS) in the Eastern Caribbean Currency Union (ECCU), inclusive of a Deposit Insurance Corporation (DIC), Deposit Insurance Legislation and Deposit Insurance Fund (DIF). The paper also outlines initial recommendations on core design features of the DIS.

## 2.0 KEY MESSAGES

A DIS is a vital component of a comprehensive financial safety net system that is geared towards ensuring the financial intermediation process is not severely disrupted by negative events, such as bank failures. The ECCU financial landscape is dominated by banks, which hold the majority of the region's financial assets and are at the centre of the intermediation process. The rationale for establishing a DIS is motivated by the following considerations:

1. **Enhance financial safety net through strengthening of “trust”:** All financial systems function more efficiently when there is high level of trust by all participants. The implementation of a DIS in the ECCU will play a crucial role in improving and solidifying trust in the financial system by offering a mechanism for depositors' compensation and crisis resolution when there are severe shocks (systemic or idiosyncratic).
2. **Support financial stability:** It supports the financial stability objective in the following areas: First, it reduces the probability of a run on illiquid but solvent banks and also reduces the risk of contagion associated with such events. Second, it enhances consumer confidence and protection by reducing the risk of depositors losing money whether in a large or small bank, foreign or domestic, in the case of insolvency. Third, an explicit DIF will mitigate and reduce risks such as moral hazard which is prevalent in the current system based on an implicit unlimited guarantee.
3. **Improve business conditions for indigenous banks:** It will reduce the negative perception, which suggests that indigenous banks are not as sound as foreign banks.
4. **Reduce fiscal cost and uncertainty about pay-out:** Historical evidence for the ECCU has shown that resolving bank failures is very expensive. The existence of a DIF

will transfer the cost of insolvency to the banking sector, provide certainty about member governments' obligations and reduce their discretionary pay-out, as it will limit the scope and coverage of the reimbursements to depositors.

5. **Align the ECCU financial system with International best practices.**
6. **Improve the resolution process:** A DIS ensures the orderly and speedy compensation of depositors and provides a platform for better pre-crisis and resolution planning.

#### **A. Policy Goals/Objective**

The main objective of a DIS for the ECCU is to protect small, less sophisticated depositors including SMEs, in the event of a financial institution failure. This is necessary to promote sound financial stability and to strengthen consumer confidence and protection. It will also add a critical element to the financial safety net regime of the region and promote more certainty and transparency in the resolution process.

#### **B. Summary of Proposed Core Design Features**

In accordance with the International Association of Deposit Insurers Core Principles (the Core Principles), used as the standard benchmark for establishing effective deposit insurance systems globally, the following are some broad proposals for designing a DIS for the ECCU:

- a. **Public Policy Rationale:** The ECCU member countries should establish a DIS with the primary objective of protecting small less sophisticated depositors in cases where banks become insolvent and fail. The establishment of such an institutional arrangement will enhance consumer protection and strengthen financial system stability, particularly as a consequence of the likely increased confidence of small depositors in the protection of their deposits in the case of the existence of a properly funded and managed DIC. Careful consideration must be given to the design of the DIS so as to ensure that the competitiveness of indigenous banks is not adversely affected and other negative features such as “moral hazard” are effectively restricted, so that there are no unintended consequences for financial stability. The design should also take into account the cost of operation vis-a-vis the functions to be performed and implications for the financial sustainability of the arrangement.
- b. **Mandate and Powers:** The DIC should operate with a “**Pay Box Plus**” mandate, where it would be primarily responsible for the reimbursement of covered deposits in the event of a

bank failure. Under this mandate, the DIC is, by law, authorised to use resources from the DIF to facilitate a resolution transaction such as a purchase and assumption (P&A) transaction, which is less disruptive to a financial system than liquidation and direct reimbursement of deposits.

- c. **Governance Structure:** The following structures are proposed for consideration:
- i. *Set up the DIC as a separate legal entity with each ECCU member country having equal stakes, with its own legislative framework and governance arrangements. It could be housed at the ECCB to exploit operational and administrative economies of scale;*
  - ii. *Set up the DIC as a department/unit in the ECCB, with its mandates and powers grounded in a legislative act. This would minimise operational cost, leverage administrative and operational efficiency of systems already in place at the ECCB and eliminate prospective challenges associated with sharing of information with a third party, as would be the case if the DIC were to be established as a separate legal entity; or*
  - iii. *Establish the DIC as an independent legal entity (solely-owned by the ECCB), with its mandate and powers captured in a legislative act, and official arrangement with the ECCB for the ECCB to assist the DIC in matters such as information technology (IT), human resource, accounting and investment of funds.*
- d. **Membership:** Membership in the Fund should be mandatory and automatic for all deposit taking financial institutions licensed under the Banking Act. Licensees that are considered by the ECCB to be problematic should be resolved prior to the operationalisation of the deposit insurance system or be required to have a credible plan to address any deficiencies within a prescribed period. Entry of newly licensed deposit taking financial institutions to the DIF's membership should be based on the DIC's licensed financial institution membership criteria. In addition, in the interest of financial system stability, once operational, the DIC should collaborate with relevant financial safety-net partners on developing credit union membership criteria for the inclusion of credit unions or other deposit taking institutions in the DIF's membership.
- e. **Qualifying Deposits and Coverage:** Qualifying deposits would include all the deposits held by member institutions, by natural and legal persons. The list of excluded deposits should include: interbank deposits/balances; deposits of government and statutory corporations; deposits of NBFIs (licensed nonbank financial institutions, credit unions, insurance companies, credit institutions); deposits of persons who have been deemed to have contributed to or

benefited from the circumstances given rise to the failure of the financial institution; and deposits of persons suspected of money laundering or terrorist financing.

Based on a preliminary assessment of the data, all qualifying deposits should be covered up to **EC\$50,000.00**, including principal and accrued interest, per depositor (individual and SMEs) and per institution. The level and scope of coverage should be applied equally to all member institutions.

- f. **Funding Mechanism:** The DIF would be funded using a partial ex-ante funding approach with the member banks paying an annual premium, collected on a semi-annual basis. The target size of the fund should be between 5.0 per cent and 10.0 per cent of the total value of insured deposits with the DIC having the power to obtain funds, if required, on an ex-post basis. In case of a shortfall, emergency funding could be provided by the ECCB or through extraordinary contributions by ECCU member countries. Initially, the deposit insurance premiums are expected to be computed on a flat-rate basis with subsequent consideration given to the use of risk-based rates. Based on information gleaned from regional deposit insurance systems and consultations held with various entities, the following key parameters are being recommended: (i) *a premium rate of 0.5 per cent*; (ii) *total insured deposits as a base to calculate the premium contributions*; (iii) *a range of 5.0 to 10 per cent of total insured deposits, based upon the assessed risk of failures, as the optimal target size for the fund* and; (iv) *the risk based premium rates, which may be used in the future.*
- g. **Public Awareness:** The DIC should have legal powers to promote public awareness about deposit insurance on an on-going basis and work with member institutions to develop programs to ensure consistent messaging.
- h. **Legal Powers (Recoveries):** By legislation, the DIC will be subrogated to the insured depositors' claims provided the full pay out is made to insured depositors.

### 3.0 BACKGROUND

One of the principal goals of financial sector regulations is to support and strengthen trust and confidence of consumers in the financial sector. The ability to best deliver on those important goals is improved when there is a comprehensive financial safety net system in place. A deposit insurance system (DIS) that explicitly offers some type of protection to depositors, in cases where

an institution becomes insolvent and fail, is one of the critical elements of a sound financial safety net system.

The global financial crisis, through its deleterious impact on the economies and segments of the financial sector of the ECCU, has highlighted some of the challenges and shortcomings of the region's financial safety net system. In a systematic, strategic policy response to the challenges that confronted the respective economies and financial systems following the crisis, the Monetary Council in 2009 endorsed "***The ECCU Eight Point Stabilization and Growth Programme***". The idea of providing depositor insurance protection was discussed as part of a package of initiatives and policies under *Pillar 6* of the plan entitled "*Financial Safety Net Programmes*". There has been limited progress since 2009 in actually implementing this particular initiative. However, ECCB policymakers, Board and the Monetary Council signaled their intention to prioritise and continue to pursue the establishment of a DIS for the ECCU, by including it in the **ECCB Strategic Plan 2017-2021** as a key initiative under **Goal 2; "Ensure a Strong, Diversified and Resilient Financial Sector."** This new thrust recognises that the establishment of such an institution should be seen as a statutory obligation pursuant to Article 42(1) (a) of the ECCB Agreement which states "*The Bank may, with the approval of the Council, administer or participate in corporation or schemes established for the purpose of insuring bank deposits.*"

The ECCB is of the view that deposit insurance protection is a critical missing element of the region's financial safety net system. The development and implementation of a well-functioning DIS will significantly enhance financial stability through two main channels. First, it deters a run on illiquid but solvent financial institutions, which gives such institutions time to address their funding issues, without facing the threat of further exacerbation of the problem due to a call on deposits. And second, guaranteeing payments up to a certain amount to depositors of failed institutions strengthens consumer confidence and the protection features of the financial system.

Moreover, the establishment of a DIS will bring the ECCU in line with international best practices with respect to having a comprehensive financial safety net and improve business conditions for indigenous banks, by neutralising the negative perception that they are not as sound as foreign banks.

The purpose of this paper is to outline the relevant policy and design issues as well as to make recommendations for the establishment of a deposit insurance system for the ECCU.

#### **4.0 CRITICAL ELEMENTS OF THE DEPOSIT INSURANCE FUND**

The Core Principles are used worldwide as a benchmark for establishing and reforming deposit insurance systems, as they provide the requisite guidance for identifying critical policy issues. In accordance with the Core Principles, the following policy issues will be discussed and recommendations made on key features for establishing an appropriate deposit insurance, in the context of the ECCU's economic, financial and political landscape.

##### **4.1 Public Policy Objectives**

***The principal public policy objectives for establishing a deposit insurance system should be formally specified and publicly disclosed.*** An essential step in establishing a DIS is to ensure the formal specification and public disclosure of the public policy objectives. The Monetary Council's decision for the implementation of various financial safety net programmes, including the establishment of a DIS, was based on the need to protect small, vulnerable depositors; promote sound financial stability of the financial system; and to strengthen consumer confidence and protection.

Trinidad and Tobago (1986), Jamaica (1998), The Bahamas (1999) and Barbados (2006) have established DICs. With the exception of Trinidad and Tobago, protecting depositors and contributing to financial stability are the public policy objectives of these territories, as stated within their respective legislation. The deposit insurance legislation of Trinidad and Tobago cited the protection of depositors as the primary purpose for the establishment of a DIC in that country.

Noteworthy is that the CARICOM Policy on Deposit Insurance (the CARICOM Policy), which was presented to The Council for Finance and Planning in June 2018, has the following objectives:

- i. Contribute to the development and growth of fair, efficient and sound financial markets within the Caribbean Community;
- ii. Provide eligible depositors within the Caribbean Community with a minimum level of protection;

- iii. Strengthen the crisis management and financial stability frameworks in member states through greater co-ordination with financial safety-net partners; and
- iv. Promote more effective cross-border supervision of financial institutions in order to reduce contagion risk from financial crises within the CARICOM.

### **Recommendation**

**The ECCU member countries should establish a deposit insurance system, including a DIC and an explicit privately funded DIF, with the public policy objectives of protecting small less sophisticated depositors, including SMEs, and enhancing the financial safety net. The resources of the DIF should be used exclusively to: i) reimburse insured deposits; and ii) contribute to the resolution, via a purchase and assumption transaction, of a member financial institution, to the extent that this would avoid a pay-out event and in an amount not to exceed the cost to the DIF in the event of a pay-out.**

### **4.2 Mandate and Powers**

***The mandate and powers of the deposit insurer should support the public policy objectives and clearly be defined in legislation.*** The mandate and powers of the DIC must be formally and clearly specified in legislation, and consistent with the public policy objectives. The mandate of a deposit insurer could be classified into the following four categories:

- i. **A “pay box” mandate** - the deposit insurer is generally responsible for the collection of insurance premiums, management of the Fund, and payment of claims to depositors. The intervention powers are that of the primary regulator;
- ii. **A “pay box plus” mandate** - the deposit insurer has the same responsibilities as under a “pay box” mandate, with additional responsibilities of risk monitoring. Under this mandate, the DIC is, by law, authorised to use resources from the DIF to facilitate a resolution transaction such as a P&A or deposit transfer, either of which is less disruptive to a system than liquidation and direct reimbursement of deposits. The pay box plus system is utilised in Jamaica, where the Jamaica Deposit Insurance Corporation Ltd is authorised to make enquiries and recommendations to the Ministry of Finance regarding distressed institutions and arrange for restructuring of failed institutions in its capacity as receiver/liquidator;

- iii. A “loss minimizer” mandate - the deposit insurer actively engages in a selection from a range of least–cost resolution strategies; and
- iv. A “risk minimizer” mandate - the deposit insurer has comprehensive risk minimization functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases prudential oversight responsibilities.

Of the five CARICOM Member States with established deposit insurance systems, the DICs in Trinidad and Tobago, Barbados, Bahamas and Guyana were established by the central banks and remain largely dependent on the central bank for technical, financial and other resources. Based on this fact, the CARICOM Policy advocates for the expansion of the legal and regulatory frameworks of the respective territories to provide the DICs with resolution powers and an enhanced role as a financial safety-net partner.

In the ECCU’s case, the ECCB already performs most of the financial safety net functions. It is the lender of last resort, the primary supervisory and regulatory authority and has a range of crisis management tools along with resolution powers. In light of this reality and given the relatively high costs associated with the establishment and operation of an independent deposit insurance system, due consideration should be given to ensuring the establishment of a financially sustainable institution which could effectively deliver on its mandates.

In choosing the mandate and power, the cost and benefits of each type should be carefully examined and assessed, taking into account the specialness and peculiarities of our arrangement. The following are some key aims which we should strive to achieve:

1. Ensure that the competitiveness of indigenous banks is not adversely affected and other negative features such as “moral hazard” are effectively restricted, so that there are no unintended consequences for financial stability.
2. Minimise administrative and operational costs of the DIC for example by avoiding duplication of roles and functions already performed by the ECCB.
3. Facilitating the sharing of information that will allow the DIC to effectively manage the risks to the DIF.
4. Minimise compliance cost for the banks, cost to consumers and general cost of doing business.

5. Ensure utilisation of the resources is done in a transparent manner and the resources are used for the purposes prescribed without undue influence from the industry and political actors.

A major objective of the DIC will be the proper management and investment of the funds it collects, including the premiums paid by member institutions. Whereas the board of the DIC will be ultimately responsible for ensuring this objective, in accordance with 2 above, the DIC should contract the services of the ECCB to invest collected funds. The DIC resources should be managed and invested consistent with international best practices, prioritizing safety and liquidity over return on investment, and ensuring adequate risk management and internal control safeguards. The DIC resources shall not be used to provide support to open financial institutions either through liquidity support, equity investment or placements of its resources in member institutions. **Appendix I** outlines an example of the impact on the DIC in the case of a purchase and assumption transaction versus a liquidation process.

### **Recommendation**

- i. **The DIC should operate with an “pay box plus” mandate, where it would be primarily responsible for the reimbursement of insured deposits of failed member institutions and may contribute funds towards the ECCB’s resolution of a member institution, specifically via a purchase and assumption (P&A) transaction with a financially sound purchaser.**

**Any contribution made by the DIC toward resolving a failed member institution should not exceed the maximum cost to the DIC if it were to pay out the insured depositors of the failed member institution.**

- ii. **The DIC should be accorded with the following specific powers, which should be embedded in the deposit insurance legislation:**
  1. Set operating budgets, policies, systems and practices;
  2. Assess, levy and collect initial contributions and annual deposit insurance premiums from member institutions;
  3. Create and maintain an ex-ante deposit insurance fund (DIF) from such initial contributions and annual premiums;

4. Discretion to comingle funds collected from member institutions not licensed under the Banking Act, 2015, with funds collected from member institutions licensed under the Banking Act, 2015. In such a case, the funds will be required to be accounted for on a separate basis.
5. Collect funds on an ex-post basis;
6. Invest the funds collected, based on an approved investment strategy;
7. Obtain directly from member institutions, relevant information (type, number and value of insured deposits) to ensure fulfilment of its mandate;
8. Receive from and share with financial safety-net participants, within and outside the ECCU, relevant information;
9. Enter into agreement with the ECCB for the secondment of staff and provision of services;
10. Authorise the ECCB and or any other financial safety-net participant to act on its behalf;
11. Utilise resources of the DIF to pay deposits in respect of a failed or failing institution, or to assist with a purchase and assumption transaction with a financially stable financial institution;
12. Appoint auditors;
13. Enter into contracts; and
14. Carry out such activities as may be necessary to ensure fulfilment of its mandate.

Regarding (7) above, the DIC should be authorised to:

- (i) require any relevant information from a member institution or any director, manager, officer, auditor, employee or agent of that member institution, towards achieving the objectives and functions of the DIC;
- (ii) in collaboration with ECCB supervision staff, conduct on site assessments of member institutions to confirm the accuracy of data submitted by member institutions;
- (iii) require member financial institutions to maintain their depositors' records in a format prescribed by the DIC to facilitate an efficient reimbursement of insured depositors when required; and

- (iv) request, not more than once a year, that member institutions engage in a pay-out simulation exercise.

### **4.3 Governance Structure**

***The deposit insurer should be operationally independent, well governed, transparent, accountable and insulated from external interference.*** According to the Core Principles, there is a need to ensure that the deposit insurer is operationally independent and insulated from political interference in order to better protect the assets of the DIF. However, consideration must also be given to establishing a cost effective arrangement that would be financially sustainable.

The five established Deposit Insurance Corporations (DICs) in the CARICOM region are state-owned separate legal institutions and each DIC has a significant collaborative/consultative relationship with its central bank. Each of the DICs has a Board of Directors.

The Core Principles requirement for independence, does not in this instance, necessarily preclude the DIC from placing reliance on the ECCB or any other financial safety-net participant to carry out certain functions on its behalf. Given that the ECCB is the primary supervisory and regulatory authority with statutory resolution powers, reliance of the DIC on the ECCB should prove beneficial for the ECCU Region as long as the DIC has the ability to protect its DIF from misuse.

If the proposed DIC is set up as a separate legal entity, it could still be housed within the ECCB Headquarters. This would position the ECCB to perform an important role in the initial stages of the DIC's operation, particularly through knowledge transfer and assistance with back-office services such as IT, human resource, accounting and investment of funds. Such an arrangement should prove to be cost-effective for the ECCU. The DIC's independence would be enhanced through the existence of a Board of Directors, composed of officials from the ECCB and another financial safety-net participant, and from private sector representatives with the requisite skills set. The DIC Board of Directors would however be accountable to the Monetary Council, through the provision of periodic reports and audited financial statements. The development of internal policies and procedures would be done based on comprehensive strategic planning and an appropriate risk management framework.

The DIC board should be required to hold ordinary meetings at least once per calendar quarter and should provide for the safe custody of the corporation's Common Seal, which should be affixed to instruments pursuant to a resolution. All documents made by the DIC other than those required by law, should be made under seal and all decisions of the DIC may be signified under the hand of the Chairman, Deputy Chairman or the Secretary.

The DIC board should also be required to review the size of the DIF, at least once per year, regarding actual and potential liabilities, and should be allowed to adjust the minimum target size of the DIF, with the approval of the Monetary Council, accordingly. Additionally, the DIC board, where it determines that the DIF has reached the maximum target level and all outstanding debts to the ECCB and ECCU member governments have been fully repaid, should have the option to introduce a moratorium on premiums and refund any excess amounts to members.

While a stand-alone independent entity is recommended by the Core Principles, consideration should also be given to setting it up as a department or unit in the ECCB. This would minimise operational cost, leverage administrative and operational efficiency of systems already in place at the ECCB and eliminate prospective challenges associated with sharing of information with a third party; if it were a separate legal entity. As part of the ECCB, the principles of accountability and transparency in administration and operations would not be compromised since the ECCB is subject to maintaining rigorous internal and international standards in carrying out its functions. This arrangement should prove to be the least costly and auger well for financial sustainability of the arrangement.

**The following structure is recommended:**

**Establish the DIC as an independent legal entity, solely owned by the ECCB, with its mandates and powers captured in a legislative act, and official arrangements with the ECCB for the ECCB to assist the DIC in matters such as IT, human resource, accounting and investment of funds. The following are some key features:**

- i. The DIC should be wholly owned by the ECCB and should have an initial authorized capital of ECD 1,500,000 (*to be decided on*) which should be fully

subscribed and paid up by the ECCB. The DIC board should have the authority to increase the authorised capital as it determines.

- ii. The DIC should be directed by a five-member board of directors, chaired by the Governor of the ECCB, two members from financial safety-net partners, and two members from the private sector, preferably from the accounting, audit, banking, legal or insurance industry. At least one member of the DIC board should have deposit insurance expertise. Active bankers or recently retired bankers should not be members of the Board. Board members from the private sector should be appointed by the ECCB for an initial period of up to three years. Such appointments should be non-coincidental and at least one year apart to ensure continuity.
- iii. The DIC board should appoint a general manager to be responsible for the day to day management of the DIC. Other management positions should be filled as determined by the DIC board.
- iv. The DIC should be ultimately accountable to the Monetary Council through the provision of periodic reports and audited financial statements. The DIC board should be required to inform the Monetary Council about matters regarding increasing the level of insurance coverage; increasing the minimum target size of the DIF; introducing moratoriums on premiums; refunding excess amounts to member financial institution; and recommending to the Minister to make regulations to give effect to the legislation.
- v. The DIC should be housed within the ECCB with the necessary legal/contractual arrangements for the ECCB and any other financial safety-net partner to carry out certain back office functions on its behalf.

#### **4.4 Relationship with other Financial Safety Net Entities**

***There should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, between the deposit insurer and other financial safety-net participants.*** A financial safety-net participant can be defined as any entity that has a legal responsibility to contribute to the stability of a financial system. There are a number of financial safety-net participants within the ECCU financial system, including the ECCB, ECSRC and the various single regulatory units.

The DIC, as a financial safety-net partner, should have defined relationships with its various counterparts in order to obtain and share relevant information to carry out its mandate. On approval from its board, the DIC should be able enter into agreements/arrangements for cooperation, coordination and the exchange of information with other financial safety net partners, provided that the DIC is satisfied with the counterpart's capacity to protect the confidentiality of the information.

Regarding its relationship with the ECCB, the DIC should ensure an official arrangement with the ECCB to have the ECCB provide the DIC with information relevant to the DIC's purpose. The information should include but not be limited to:

- i) examination and other relevant reports for member institutions that may pose a risk to the DIF;
- ii) supervisory enforcement actions taken against member institutions;
- iii) prompt notification whenever it appears likely that a member institution will be placed in receivership or liquidation; and
- iv) periodic reports of recoveries on assets from the receiver or liquidator of a failed member institution.

### **Recommendation**

- i. The DIC legislation should allow for the DIC's exchange of information and coordination of activities with other financial safety-net participants.**
- ii. The DIC should execute an MMOU with financial safety-net partners.**

### **4.5 Membership**

***Membership in a deposit insurance fund should be compulsory for all financial institutions licensed under the Banking Act, 2015.*** According to the Core Principles, the conditions, process and timeframe for attaining membership need to be explicitly stated and transparent. In the event that licensees are not able to meet the membership criteria, a phased approach may be undertaken where licensed financial institutions have to present a credible plan to address any deficiencies in order to attain full membership.

The credit union sector is a significant sector of the ECCU financial system and there are credit unions that could be considered systemically important from a regional and or member country perspective. It is therefore important that measures be implemented to facilitate eventual membership of credit unions in the DIF. The strength of the individual credit unions and of the regulatory/supervisory framework for resolving credit unions, should be carefully assessed in considering credit union membership. A separate deposit insurance fund for credit unions should also be considered.

### **Recommendation**

- i. Membership in the DIF should be mandatory and automatic for all financial institutions licensed under the Banking Act.**
- ii. Licensees that are considered by the ECCB to be problematic should be resolved prior to the operationalisation of the DIC or required to have a credible plan to address any deficiencies within a prescribed timeframe.**
- iii. Entry of newly licensed financial institutions to the DIF's membership should be based on the DIC's licensed financial institution membership criteria.**
- iv. Membership of members that are licensed financial institutions shall cease upon:**
  - a. Surrender, cancellation or revocation of its licence by the ECCB;**
  - b. The transfer of all its deposit liabilities to another deposit taking institution;**
  - c. The appointment of a liquidator pursuant to a resolution for its voluntary winding up;**
  - d. The merger or amalgamation with any other member institution.**
- v. In the interest of financial system stability, once operational, the DIC should collaborate with the ECCB and other relevant financial safety-net partners on developing credit union membership criteria to treat with the inclusion of credit unions in the DIC's membership.**

### **4.6 Qualifying Deposits and Coverage**

***Coverage should be limited, credible and cover the large majority of depositors but leave a substantial amount of deposits exposed to market discipline.*** One of the objectives of including a deposit insurance system as a financial safety-net component is to protect depositors. In most instances, protection of the most vulnerable depositors is the focus.

The CARICOM Policy on Deposit Insurance indicates that approximately 90.0 per cent or more of depositors are fully protected where insurance is in place, which is in line with international standards.

**Table I** below provides two coverage scenarios for the DIS and the corresponding coverage percentage. Based on the requirements of a minimum of ninety (90.0) per cent coverage of total number of depositors and the classical rule of 2 to 3 times per capita, a coverage level ranging from **EC\$50,000.00 to EC\$100,000.00** per depositor, per institution will meet those benchmarks in the case of the ECCU. Given the ranking of the ECCU in the table below, the recommendation is for a coverage level of EC\$50,000.

<b>Table I: Comparison of Coverage Levels of DIS within CARICOM (as at 31 December 2016)</b>						
<b>DEPOSIT INSURERS</b>	<b>COVERAGE LEVEL IN LOCAL CURRENCY (\$)</b>	<b>COVERAGE LEVEL (US\$)</b>	<b>NO. OF MEMBER INSTITUTIONS</b>	<b>COVERAGE AS A PERCENTAGE OF DEPOSITORS /DEPOSIT ACCOUNTS (%)</b>	<b>IN PERCENT OF GDP PER CAPITA (%)</b>	
Bahamas Deposit Insurance Corporation (DIC- BS)	50,000	50,000	12	96	174	
Barbados Deposit Insurance Corporation (BDIC)	25,000	12,500	12	86.5	78	
Jamaica Deposit Insurance Corporation (JDIC)	600,000	4,671	11	96	96	
Deposit Insurance Corporation Trinidad and Tobago (DICTT)	125,000	18,815	24	94.8	117	
ECCU Deposit Insurance Corporation (scenario 1)	50,000	18,519	34	93.6	168*	
ECCU Deposit Insurance Corporation (scenario 2)	100,000	37,037	4	96.4	336*	
<b>Source:</b> <i>CARICOM Report on Deposit Insurance Corporations. The ECCU information was sourced from the ECCB and based on 2018 data. *Calculations are based on the aggregate value of the ECCU territories' absolute GDP and total deposits.</i>						

In the discussion about the coverage level for the DIF, due consideration must be given to the implications of **Section 153(2)(c)** of the Banking Act, which requires payments to any depositor of up to two hundred thousand dollars (EC\$200,000) in the event of a liquidation. This section of the Act is meant to identify the category that a depositor falls into as well as the hierarchy of claims in the case of a liquidation, and not to provide a guaranteed sum to be paid out to

depositors during liquidation. So in the case of a liquidation, the process of compensation of depositors who remain in the failed bank, even after reimbursement by the DIC up to the threshold, will be guided by the provisions of Section 153 in meeting the demand for claims. Therefore, an amendment to Section 153 of the Banking Act is not necessary since it does not conflict with the DIC mandate.

The CARICOM Policy on Deposit Insurance defines a deposit as a credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and which a credit institution is required to repay under the legal and contractual conditions applicable, including a fixed-term deposit and a savings deposit, but excluding a credit balance where –

- i. Its existence can only be proven by a defined financial instrument unless it is a savings product which is evidenced by a certificate of deposit made out to a named person and which exists in a Member State;
- ii. Its principal is not repayable at par; and
- iii. Its principal is only repayable at par under a particular guarantee or agreement provided by the credit institution or a third party.

The CARICOM Policy also states that deposit insurance will apply to natural and legal persons and will cover local currency deposits and widely used foreign currency deposits. The following deposits qualify for deposit insurance coverage -

1. savings and checking accounts;
2. time deposits and certificates of deposits;
3. managers' checks;
4. money orders and drafts;
5. travellers' cheques issued by the policyholder;
6. prepaid letters of credit;
7. credit balances of deposit instruments in transit;
8. interest accrued and/or payable on all insurable deposits;
9. any other deposit liabilities so designated by the DIC; and
10. Foreign currency accounts.

The list of excluded deposits will be standardised and will include, at minimum, interbank deposits/balances, unfunded letters of credit, deposits of government and statutory corporations, subordinated debt, preference shares, deposits of persons who have been deemed to have contributed to or benefited from the circumstances given rise to the failure of the financial institution and suspected of money laundering or terrorist financing.

**Appendix 2** provides scenarios to describe the aggregation of depositors for the purpose of determining the coverage amount.

### **Recommendation**

- i. The coverage limit should apply to all deposits, per depositor (individual and SMEs) and per institution and the level and scope of coverage should be applied equally to all member institutions. This means per depositor at every member institution that deposits are held.**
- ii. The coverage limit should be \$50,000.**
- iii. Current and savings accounts, term deposits, joint accounts and trust accounts, and foreign currency denominated accounts, and other accounts as approved by the DIC board should be covered.**

**The list of excluded deposits should include: interbank deposits/balances; deposits of government and statutory corporations; deposits of NBFIs (licensed nonbank financial institutions, credit unions, insurance companies, credit institutions); deposits of persons who have been deemed to have contributed to or benefited from the circumstances given rise to the failure of the financial institution; and deposits of persons suspected of money laundering or terrorist financing.**

### **4.7 Funding**

***The deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims.*** In countries with explicit deposit insurance protection, the financial institutions are primarily responsible for funding it. The most common method is to levy premiums, whether **ex-ante** or **ex-post**. An alternative

method involves the use of the cash reserves ratio and the setting aside of reserves for the covered deposits. Critical for assessing how the deposit insurance will be funded is determining the targeted fund size, which is a ratio of the deposit insurance fund to estimated insured deposits. This is influenced by factors such as the composition, size and liability structure of the insured banks, the associated failure probabilities and loss rates. The discussion of the related issues and simulation of scenarios for the purpose of determining how long it will take to reach the target level, is beyond the scope of this paper. However, the Core Principles recommend that the fund reach its target size within approximately ten years. Based on information gleaned from other regional deposit insurance systems the following key parameters are being recommended: (i) a premium rate of 0.5 per cent; (ii) total insured deposits as a base to calculate the premium contributions; (iii) 5.0 per cent of total insured deposits as the optimal target size for the fund and; (iv) the risk based premium rates, which may be used in the future.

However, in an attempt to provide some initial insights on important issues involved in augmenting the fund to its targeted level over a reasonable time period, some rudimentary assumptions are made to calibrate a basic saving goal financial model. The results in **Table 2** are based on the following underlying assumptions:

- i. The calculation of total covered deposits, based on our preliminary criteria, was estimated at \$5.6b for the ECCU.
- ii. The number of banks currently eligible for coverage was estimated at thirty-four (34).
- iii. The target fund size ratio of 5 per cent is informed by what obtains for some of the deposit insurance systems in other member countries in the CARICOM region.
- iv. The rate of return on investment of 2.5 per cent on the funds was considered in this example, given it is an important variable in calculating the time for achieving the targeted goal.
- v. The annual premium is calculated as 0.5 per cent of total insured deposits and is informed by the experiences of some other countries in the CARICOM region.

<b>Variables</b>	<b>Frequency</b>	<b>%/EC\$</b>
<i>Premium</i>	Annual	0.05
<i>Initial Contribution from insured members</i>	One-time payment of .05 per cent of total insured deposits	28,000,000
<i>Equity Injection</i>		1,500,000
<i>Target Size of Fund (5% of cumulative insured deposits up to 50,000)</i>		282,077,000
<b>Number of periods to achieve Fund Target</b>	Years	10

The implication of the results in Table 2 for policymakers in the ECCU is that attention must be placed on some key variables if we are to achieve the targeted fund size in a reasonable time. Safeguarding the early credibility of the fund by ensuring that the target is achieved over a reasonable timeframe means that policymakers would have to carefully consider issues related to the optimal size of the fund, investment policies, sources of initial capital and the appropriate rate for the premiums.

The ECCB should provide an equity contribution to the DIC to defray the start-up costs of the corporation. If the DIC is a stand-alone separate legal entity, it should be authorised via legislation to borrow moneys for the purposes of fulfilling its mandate as per Jamaica and Barbados' deposit insurance legislation.

In the event that the DIF is insufficient for reimbursement of insured deposits, or its assets are below the minimum target size, the DIC should have access to emergency funding via:

- i) extraordinary premiums;
- ii) loans from the ECCB and or the ECCU; and
- iii) other sources that may be available.

The DIC board should determine the rate for extraordinary premiums and should ensure that the absolute amount of an extraordinary premium should not exceed one per cent of the average amount of insured deposits held by each member institution over the preceding assessment period. The DIC should also be allowed to introduce differential premiums, which may be based on the composite supervisory rating of member institutions. The DIC should never disclose to

the public, the differential premium charged to each member institution. The regular premium should not be reduced because of the introduction of differential premiums.

The DIC in Barbados is exempt from the payment of corporation tax, stamp duty or any other impost, whereas in the Bahamas, the DIC is exempted from the provisions of the Insurance Act and the Stamp Act. The DIC legislation in Trinidad and Tobago allows insured institutions to deduct contributions, levies and premia to the DIF in computing their chargeability to tax, and in Jamaica, the DIC is exempted from tax, stamp duty etc.

### **Recommendation**

- i. The Fund should be built via the accumulation of funds on an ex-ante basis as well as on having the power to obtain funds if needs be on an ex-post basis.**
- ii. The proposed DIC member institutions should be required to make an initial contribution and thereafter, pay annual deposit insurance premiums, collected semi-annually. The ECCB should be the sole contributor of equity in the case of a stand-alone legal structure.**
- iii. The annual premiums should initially be computed on a flat-rate basis and paid semi-annually with subsequent consideration given to the use of risk-based rates.**
- iv. The legislation should include the availability of emergency funding from the ECCB, Member Governments and other available sources. The application of differential premiums should also be available to the DIC.**
- v. The DIF's income should be tax-exempted towards enhancing the DIF's capacity to enhance its capital.**

### **4.8 Public Awareness**

***In order to protect depositors and contribute to financial stability, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.*** The DIC will require legal authority to promote public awareness about deposit insurance on an ongoing basis. Information on the membership, terms, conditions and limitations of the DIF should be provided to depositors continuously through the DIC's website

and other forms of communication. The DIC could also provide member institutions with formatted language for member institutions' communication with depositors about the DIF.

The DIC should establish a communication strategy to ensure the rollout of a public awareness program in advance of the launch of the DIF. Information about the scope, insurance coverage, member institutions, timeframe and procedure for reimbursement should be the focus of the communication program. Once established and operational, the DIC should engage in marketing to keep the public informed about its operations.

### **Recommendation**

- i. The DIC should have legal authority to promote public awareness about deposit insurance on an ongoing basis.**
- ii. The DIC should develop a public awareness strategy to ensure adequate communication to the public about the DIC, well in advance of its establishment.**

### **4.9 Legal Protection**

*The deposit insurer and individuals working both currently and formerly for the deposit insurer in the discharge of its mandate must have legal protection from liability arising from actions, claims, lawsuits etc. for decisions taken in good faith in the normal course of their duties.* The deposit insurance legislation in Jamaica, Barbados and The Bahamas offers protection of the DIC, its directors, staff, agents etc. in respect of anything done or omitted in good faith and without negligence in the performance of functions of the DIC. The DIC and its directors, employees, and agents should be protected from lawsuits and related legal fees, which result from discharging the DIC's mandate in good faith.

### **Recommendation**

- i. The deposit insurance legislation should provide the necessary protection for the DIC and its directors, staff and agents.**
- ii. The DIC directors, staff and agents should be guided by conflict of interest rules.**

#### **4.10 Failure Resolution**

***An effective failure resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability.*** The ECCB is the primary regulator/supervisor of the ECCU financial system and has resolution powers for treating with institutions licensed under the Banking Act. Given that it is recommended that the initial insured members be licensees of the Banking Act, the ECCB should continue to perform the bank resolution role. If the DIC is established as separate legal entity, it should have a collaborative role in the bank resolution process, particularly through the financing of certain resolution tools for safeguarding and facilitating payment of insured deposits. In the case of a failing member institution, the ECCB, as regulator and resolution authority, may allow the institution to fail and thereby place it into receivership for liquidation to take place. In such a case, the DIC would be required to make payments to depositors of the member institution in accordance with the deposit insurance legislation. Alternatively, the ECCB may decide to transfer some or all of the assets and liabilities of the member institution to a viable financial institution or a bridge bank as a means of resolution. In this instance, the ECCB would have discussions with the DIC towards its participation in the process. The DIC would have the option to contribute funds for the resolution of the member financial institution, provided that the contribution of the DIC would not exceed the total disbursement amount to be paid by the DIC had the member institution been placed in liquidation.

#### **Recommendation**

**The ECCB should continue to take the lead in bank resolution and should have discussions with the DIC whenever the resolution process involves a purchase and assumption transaction.**

#### **4.11 Depositor Reimbursement/Compensation**

***The DIC should reimburse depositors' insured funds promptly, in order to contribute to financial stability.***

## **Recommendation**

- 1. Depositors should have a legal right of reimbursement up to the coverage limit and have knowledge of the DIC's reimbursement procedures, which should clearly outline the steps involved.**
- 2. The reimbursement/compensation process should commence upon the ECCB's invocation of Section 140 of the Banking Act, 2015. Repayment of depositors should begin no later than 7 working days. Reliance should be placed on the deposit account records of the member institution for evidence of existence, validity, nature and ownership of insured deposits.**
- 3. Upon reimbursement of an insured depositor, the DIC should (a) be discharged from any liabilities to such insured depositor to the extent of the value of the reimbursement, and (b) subrogate in full to the insured depositor's claim against the failed institution, and its credit should have the same ranking as the original covered deposit.**
- 4. The DIC should pay insured deposits via a paying agent (PA) or through an assuming financial institution in the case of a purchase and assumption agreement.**
- 5. Deposits not claimed after 180 working days should be deposited by the DIC into the ECCB and should be presumed abandoned on the expiration of the 15-year period. A depositor should be able to claim unclaimed deposits from the ECCB prior to the expiration of the 15-year period.**
- 6. The DIC should not be required to pay interest on insured deposits past the date of the insured event.**
- 7. The reimbursement process should be subject to an independent audit and the results should be reported to the DIC and ECCB.**
- 8. Upon the occurrence of an insured event, the DIC should adequately publish a notice to inform the public of compensation procedures.**
- 9. The DIC should issue guidelines on the compensation process.**
- 10. In the event that a depositor has obligations with the failed member institution, the following guidelines should be applied:
  - a) The existence of performing loans will not affect the DIC's pay-out obligations;****

- b) If a depositor owes the member institution an amount for a matured or past-due loan and the depositor has a deposit that is not pledged as collateral, then the deposit will be used to set-off against the loan; and**
- c) If a depositor owes the member institution an amount for a loan and the loan is not matured or past-due, then, at the sole option of the depositor, the amount owed may be set-off against the deposit.**

#### **4.12 Recoveries**

*The deposit insurer should have, by law, the right to recover its claims in accordance with the statutory creditor hierarchy.*

#### **Recommendation**

The deposit insurance legislation should allow the DIC to be subrogated to the insured depositors' claims after the DIC would have reimbursed the insured depositors. The DIC may recover: a) any compensation paid to, or for the benefit of, an insured depositor out of the DIF which is in excess of what ought to have been paid to the insured depositor under the deposit insurance legislation; b) any compensation which is wrongly paid to any person, in such manner in within such period as the DIC may specify to that person; c) without prejudice to any other available remedy, any amount paid in excess or wrongly paid to any person should be recoverable by the DIC as a debt due by that person; and d) any unauthorised amounts paid by the paying agent.

## Appendix I

### Comparison of P&A and Liquidation Payoff (Example)

#### Failed Bank - Original Balance Sheet

Assets		Liabilities	
Cash and bank deposits	154	Deposits	800
Investments	185	Borrowings	70
Loans	710	Other liabilities	110
Fixed Assets	25	Subordinated debt	10
Investment in subsidiaries	5	Capital	110
Other Assets	21		
<b>Total:</b>	<b>1,100</b>		<b>1,100</b>

#### Failed Bank - Original Balance Sheet - Adjusted for Loss

Assets		Liabilities	
Cash and bank deposits	154	Deposits	800
Investments	185	Borrowings	70
Loans 1/	410	Other liabilities	110
Fixed Assets	25	Subordinated debt	10
Investment in subsidiaries	5	Capital 2/	-190
Other Assets	21		
<b>Total:</b>	<b>800</b>		<b>800</b>

1/ Loss of 300 in Loans

2/ Charged loss results in insolvency

### Comparison of Insured Deposit Effect under Liquidation and P&A Scenarios

#### Insured Deposit Repayment in a Liquidation Payoff

Assets		Liabilities	
Cash from DIS	570	Insured Deposits	550
		Other liabilities 1/	20
<b>Total:</b>	<b>570</b>		<b>570</b>

1/ Accrued interest on insured deposits

#### Insured Deposit Repayment via an Assuming Bank in a P&A

Assets		Liabilities	
Cash and bank deposits	154	Insured Deposits	550
"Good" Investments	85	Borrowings	
"Good" loans	200	Other liabilities 2/	20
Other Assets 1/	5		
<b>Sub-total</b>	<b>444</b>		<b>570</b>
Cash from DIS	126		
<b>Total:</b>	<b>570</b>		<b>570</b>

1/ Accrued interest on "Good" loans

2/ Accrued interest on insured deposits

## Appendix 2

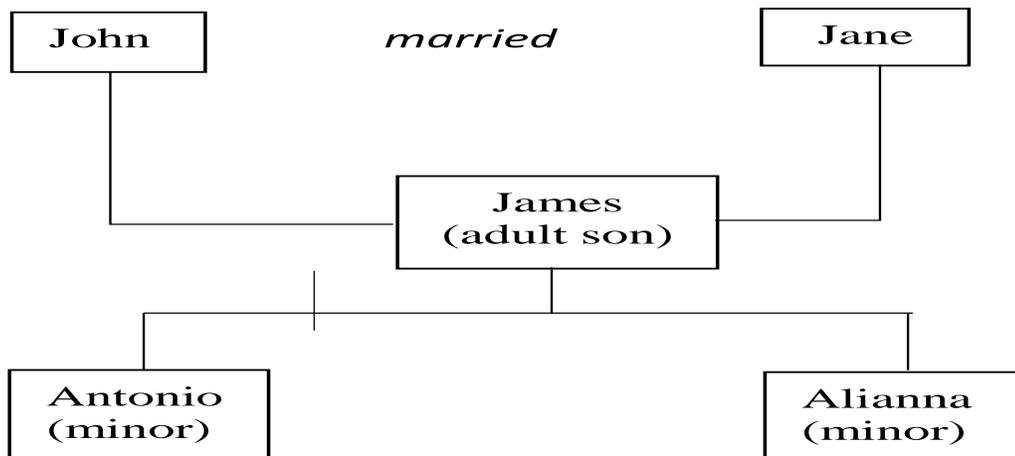
Scenarios to describe the aggregation of depositors for determining the coverage amount.

Green Acres Bank is a licensed commercial bank and a member of the DIC.

Table: Depositors of Green Acres Bank

Name of Depositor	ID Number	Tax Information Number (TIN)
John	5678	1
James	1234	2
Jane	9101	3
Antonio	NA	NA
Alianna	NA	NA
Paul	3250	4
AB Company (owned by Paul)	NA	5
Sam	0001	6
Pam	0002	7

John and Jane's Family Tree



**Scenarios of Calculation of Insurable Amounts per Depositor (Coverage: \$100,000)**

**Scenario I**

Jane has a savings and a checking account in her name. Her husband, John, has a savings and checking account in his name. Jane and John also have a joint time deposit account with equal rights (i.e. both parties are authorised to execute transactions using the joint account without the consent or signature of the other party). The balances in these accounts are given below:

	<b>Savings A/C</b>	<b>Checking A/C</b>	<b>Time Deposit</b>	<b>Total</b>
Jane ID# 1234 TIN# 2	25,000	25,000	-	50,000
John ID# 5678 TIN# 1	30,000	30,000	-	60,000
Jane and John ID#s 1234 and 5678 TIN#s 2 and 1	-	-	35,000	35,000

	<b>Insured</b>	<b>Uninsured</b>
Jane	50,000 + 17,500 → 67,500	-
John	60,000 + 17,500 → 77,500	-

Notes: The joint account's reimbursable amount is split equally between the account holders

See below, for the results when applying the same information with the exception of different balances.

	<b>Savings A/C</b>	<b>Checking A/C</b>	<b>Time Deposit</b>	<b>Total</b>
Jane ID# 1234 TIN# 2	25,000	25,000	-	50,000
John ID# 5678 TIN# 1	30,000	30,000	-	60,000
Jane and John ID#s 1234 and 5678 TIN#s 2 and 1	-	-	300,000	300,000

	<b>Insured</b>	<b>Uninsured</b>
Jane	50,000 + 150,000 → 100,000	-
John	60,000 + 150,000 → 100,000	-

Notes: The joint account's reimbursable amount is split equally between the account holders

## Scenario 2

James has his own account with Green Acres Bank, but has also opened a savings account at the same bank for his son, Antonio.

	<b>Savings A/C</b>	<b>Checking A/C</b>	<b>Time Deposit</b>	<b>Total</b>
James ID# 9101 TIN# 3	100,000	-	-	100,000
John for Antonio	30,000	-	-	30,000

	<b>Insured</b>	<b>Uninsured</b>
James	100,000	-
Antonio	30,000	-
Notes: Antonio is a minor. Therefore, the amount in the account opened for him by his father, James, is added to other individual accounts held by Antonio (no other accounts held in this case)		

## Scenario 3

John has opened a time deposit for his grandson, Antonio. Antonio's father, James, has opened a savings account for Antonio.

	<b>Savings A/C</b>	<b>Checking A/C</b>	<b>Time Deposit</b>	<b>Total</b>
John for Antonio ID# 5678 TIN# 1	-	-	100,000	100,000
James for Antonio ID# 9101 TIN# 3	30,000	-	-	30,000

	<b>Insured</b>	<b>Uninsured</b>
James	-	-
John	-	-
Antonio	100,000	30,000
Notes: Antonio is a minor. Therefore, the amount in the account opened for him by his father, James, is added to other individual accounts held by Antonio (the John for Antonio account in this case)		

## Scenario 4

Sam and Pam are a married couple. Sam has opened a trust account at Green Acres Bank where Pam is listed as a beneficiary. Sam also has a checking account at the bank and Pam has an individual savings account.

	<b>Savings A/C</b>	<b>Checking A/C</b>	<b>Time Deposit</b>	<b>Total</b>
Sam's Trust A/C ID# 0001 Tin# 6	-	-	250,000	250,000
Sam ID# 0001 Tin# 6	-	25,000	-	25,000
Pam ID# 0002 Tin# 7	10,000	-	-	10,000

	<b>Insured</b>	<b>Uninsured</b>
Sam's Trust A/C	100,000	150,000
Sam	25,000	-
Pam	10,000	-

Notes: The funds held in the trust account for Pam are not combined with Pam or Sam's individual accounts. The trust account is insured separately.

**Scenario 5**

Paul owns a company, AB Company Ltd. As a limited liability company, AB Company has its own TIN registration. Paul has individual accounts (a time deposit and a savings account) with Green Acres Bank. Paul has opened an account to process proceeds from the business in his own name and a third account was opened for the company itself.

	<b>Savings A/C</b>	<b>Checking A/C</b>	<b>Time Deposit</b>	<b>Total</b>
AB Company Tin# 5	-	150,000	-	150,000
Paul as AB Company ID# 3250 Tin# 4	25,000	50,000	-	75,000
Paul ID# 3250 Tin# 4	25,000	-	50,000	75,000

	<b>Insured</b>	<b>Uninsured</b>
Paul	100,000	50,000
AB Company Ltd	100,000	50,000

Notes: AB Company Ltd, as a separate legal entity, is insured separately from its owner, Paul. The account opened for *Paul as AB Company Ltd* is considered to be an individual account of Paul's since the TIN used to open the account is Paul's individual TIN.

## Scenario 6

*In this scenario we look at several excluded deposits under the Act.*

- 1) Bent Bank is another bank which has a time deposit with Green Acres Bank.
- 2) The Fisherman's Co-operative is a Cooperative Society registered under the Co-operative Societies Act.
- 3) The Fisherman's Co-op Credit Union is a credit union registered under the Co-operative Societies Act.
- 4) Dark Night Power Company is the state-owned utility company.
- 5) Life-long Premiums Ltd is an insurance company.
- 6) The Bank of Tomorrow has invested its employees' Pension Plan in a time deposit with Green Acres Bank.

	<b>Savings A/C</b>	<b>Checking A/C</b>	<b>Time Deposit</b>	<b>Total</b>	<b>Insured</b>	<b>Uninsured/ Excluded</b>
Bent Bank	-	-	300,000	300,000	-	300,000
F/man's Co-op	50,000	25,000	-	75,000	75,000	-
F/man's Co-op C/Union	150,000	-	-	150,000	-	150,000
Dark Night P.C.	-	400,000	-	400,000	100,000	300,000
Life-long Premiums	-	100,000	200,000	300,000	-	300,000
Ministry of Finance	25,000	-	-	25,000	-	25,000
Bank of Tmr Emp Pension	-	-	250,000	250,000	-	250,000

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