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Deposit Insurance: Role, Limitations and Challenges

by Gilberto M. Llanto, Ph.D.

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The passage of Republic Act (RA) 9302 on July 27, 2004, amending Republic Act 3591 - An Act Establishing the Philippine Deposit Insurance Corporation - was a landmark piece of legislation for the deposit insurance system in the country. RA 9302 increased the maximum deposit insurance coverage from P100,000 per depositor, which was set in 1992, to P250,000 per depositor, thereby providing greater protection to 26 million depositors nationwide. With the new charter in place, the Philippine Deposit Insurance Corporation (PDIC) has a significantly expanded authority to carry out its role as deposit insurer, receiver and liquidator of closed banks and, in coordination with Bangko Sentral ng Pilipinas (BSP), as regulator of member banks.

The new charter likewise reinstated PDIC's authority to examine banks subject to prior approval by the Monetary Board. This will enable PDIC to minimize risks to the Deposit Insurance Fund. The new law also introduced stiffer penalties for unsafe and unsound banking practices of up to 12 years in prison and a maximum of P2 million in fines or both.

The new law has enhanced the role of deposit insurance in protecting small depositors and maintaining the stability of the financial system. The focus of this paper is to briefly examine the role of deposit insurance in the financial system, conditions for the effectiveness of a deposit insurance system in fulfilling its goals, and its limitations. The paper then sketches key challenges facing PDIC in the immediate future.

The Role of Deposit Insurance

The financial landscape is continuously changing and evolving with deregulation, liberalization, and new technologies driving financial innovations. New financial products and services emerge in response to the growing demand for more efficient means to conduct financial transactions. For their part, financial regulators keep a sharp eye on any phenomenon, product, service or process that may create undue financial stress and instability that in turn may lead to severe loss of confidence in the financial system. The great fear of regulators is the advent of systemic financial crises that wreak havoc not only on the financial landscape but also on the real sector. Financial crises are disruptive and costly as shown in the experience of the 1997 Asian financial crisis. To maintain the stability of the financial system and thereby avert financial crises, regulators establish a financial safety net.[1] Regulatory intervention attempts to maintain financial stability and at the same time, induce greater efficiency of financial markets.

Financial intermediation in a continuously changing financial landscape is a complex and tricky business. Depository institutions finance illiquid assets (for example, plants and equipment, consumer durables) with the use of liquid liabilities (savings) with a promise to pay a positive return to liability holders in the future. They also create assets whose maturity (long term) may differ significantly from the maturity (short term) of their liabilities. Depositors would be naturally concerned about the solvency of those risk-taking depository institutions. A loss of confidence in the institution can easily result in flight to safety and frenzied withdrawals of deposits. Panics arising from the loss of confidence of depositors do not only destroy depository institutions but also lead to a drastic weakening of the financial system if not abated. The continuing challenge to those institutions is to maintain a high level of depositor confidence by keeping adequate capital and quality assets.

[1] This is discussed below.

The inefficient transformation of liquid into illiquid assets and the mismatch of maturities may create instability in the financial sector. In response, governments have established a financial safety net to ensure the stability and integrity of the financial system.[2] The financial safety net seeks to maintain the stability of the financial system by protecting the critical intermediation function of banks and their role in the national payment system.[3]

A vital element of the financial safety net is deposit insurance. The most important role of deposit insurance is to protect depositors from market imperfections by guaranteeing the liquidity of deposits, thus, lending stability to the financial system. To some extent, depending on the coverage, deposit insurance assures depositors that their hard-earned savings would be safe, intact and demandable (subject to claims processing) notwithstanding the performance of their depository institution. In the extreme case of full (100%) deposit insurance coverage, liability holders would not lose sleep over some faulty investment decisions of their depository institutions (banks), that is, excessive risk taking because they are sure to be indemnified in case of bank closure.

Thus, as an important element of the financial safety net, deposit insurance assures depositors that they will have immediate access to their insured deposits even if their bank fails, thereby reducing the incentive to make a 'run' on the bank.[4] This prevents panic from spreading throughout the financial system which will adversely affect both healthy and troubled banks if not immediately contained.

Well-functioning deposit insurance lends stability to the financial system and helps reduce the possibility of a banking crisis. Deposit insurance builds confidence in the banking system and prevents an emergency liquidation of assets and a bank run. For other financial institutions, the presence of the insurer is seen as a mechanism to prevent a panic by assuring depositors

[2] A detailed analysis is in Santomero A. M. 1997. "Deposit Insurance: Do We Need It and Why?" The Wharton School, Pennsylvania, unpublished paper.
[3] Helfer, R.T. 1999. "What Deposit Insurance Can and Cannot Do." *Finance and Development,* March.
[4] Helfer (1999).

in other institutions (that is, those that are not members of the deposit insurance) of the integrity of the financial system as a whole.[5]

The downside of deposit insurance, especially full (100%) coverage is moral hazard on the part of financial risk-takers. A basic problem in financial transactions such as deposit-taking is asymmetry of information. Depository institutions have more and better information about their risk-taking behavior than liability holders or even the regulators. Depository institutions may want to control information because of self-interest. As a result, their opportunistic behavior may induce them to be less forthcoming about the value of their portfolios. In some cases, they may be compelled to hide information regarding the deterioration of the value of their portfolios. There is, therefore, a natural tension between holders of bank liabilities (depositors) and the financial institution issuing those liabilities and creating illiquid assets. Confidence in the depository institution, discussed earlier, presents itself as a challenge to keep depositors loyal to the institution and at the same time, keep speculators at bay. Here is where the adequacy of banking regulation and supervision assumes a very critical role to ensure the integrity of inter-temporal financial transactions characterized by information asymmetry.

To illustrate, borrowers get their loans in the present time with a promise to repay in the future. Depositors by the same token, also expect to realize positive future returns to their deposits. The inter-temporal nature of these types of transaction and the information asymmetry in financial markets create certain risks on the part of the lending institution in the first case, and on the part of depositors in the second. Borrowers and deposit-taking institutions have more information about themselves and the true state of their projects. The role of the supervisor is to make sure that there is adequate information disclosure and transparency in these transactions.

[5] Santomero. 1997. Experience in the United States in the 1930s showed that financial safety nets have been generally successful in eliminating the contagious transmission of shocks from one depository institution to the rest of the system.

The country's financial system has experienced several hiccups and upheavals in the past and PDIC has played a significant stabilizing role in the financial system by providing an immediate response to depositor demand for access to their deposits. During the period 1970-1998, 339 banks were closed, of which six were commercial banks, 44 thrift banks and 289 rural banks. Cumulative deposit liabilities of the 339 closed banks reached P5,657 million.[6]

A more recent experience is shown in **Table 1** which provides data on the amount of insured deposits in the period 1999-2005 and the corresponding payment ratios. PDIC has paid 92.85 percent of insured deposits for said period, certainly quite an achievement considering the inadequate record-keeping of deposits. The major reason for delays in the payment of insured

Table 1. Insured Deposits and Payment Ratios, 1999-2005 (Amounts in Million Pesos)

	Number of Closed Banks	Insured Deposits	Insured Deposits Paid	Ratios%
1999	33	3,485.52	3,314.39	95.09
2000	24	3,360.50	3,119.78	92.84
2001	18	750.14	664.92	88.64
2002	13	744.96	682.18	91.57
2003	10	383.03	353.78	92.36
2004	4	206.97	188.67	91.16
2005*	7	532.22	463.16	87.02
TOTAL	**109**	**9,463.34**	**8,786.88**	**92.85**

Source: PDIC website and data from the PDIC Data Center
Note: 2003 - 1 under receivership
2004 - 2 under receivership
2005 - all under receivership
** Data for closed banks, as of May 2005*
**Data for insured deposits and payments, as of April 2005*

[6] Leung, E. 1998. "Bank Deposit Insurance System in the Philippines." http://www.pdic.gov.ph

deposits is the poor quality of deposit records upon takeover by PDIC of the closed bank. It is thus very difficult to establish the insured amounts payable to depositors. The new law, as mentioned before, will enable PDIC in coordination with BSP to impose guidelines and standards for deposit record-keeping, thus hastening the payment of insurance claims.[7]

At this point, it should be mentioned that notwithstanding problems arising from the poor quality of record-keeping, PDIC's continuing efforts at expeditious settlement of claims has paid off in terms of a shorter period of time for payouts. The average number of days to start payouts from date of closure has improved from 289 calendar days in 1993 to 41 calendar days in 2002, and single digit levels beginning 2003. Prompt payment of insured deposit claims is necessary to maintain credibility and confidence in the deposit insurance system. It helps eliminate possible contagion effects of closure.[8]

The country's law on the secrecy of bank deposits has prevented PDIC from implementing a more effective monitoring of bank behavior and getting timely information on member institutions. It is ironic that the deposit insurer can examine deposit records only upon take over of the closed bank. Thus, the concerned bank's opportunistic behavior which takes advantage of information asymmetry may have put depositors' funds at great peril because the regulator is not sufficiently empowered to undertake a more effective monitoring of the institution. Based on past experience, PDIC "usually finds the records of closed banks in poor condition, incomplete and not updated, thus requiring lengthy verification of records resulting to delayed processing and settlement of claims."[9]

The information lag means that PDIC can only verify and establish validity of the insured deposits long after the institution finds itself in dire straits. Policymakers should examine this issue in order to fortify PDIC's power to take prompt corrective action

[7] Gamboa, A. 2004. "Determining Insured Deposits Under R.A. 9302." *PDIC Forum*, Vol. 2, No. 2, December.
[8] PDIC. 2003. "Deposit Insurance: Fulfilling Its Role in the Financial System Safety Net." *PDIC Forum*, Vol. 1 No. 1, December.
[9] Ibid.

when findings point to imminent bank failure and other associated problems. Timely corrective action may even allow the troubled institution to avoid closure while at the same time enabling PDIC to steer clear of the greater costs associated with insurance claims payments and liquidation of failed banks.

Having appreciated the role of deposit insurance and both its positive (confidence building, actual reimbursement of insured deposits immediately after bank closure) and negative (moral hazard, opportunistic behavior by depository institutions) impacts, we turn to a discussion of conditions for effectiveness of deposit insurance. How do we ensure that deposit insurance is well functioning? What factors contribute to its efficacy?

Conditions for effectiveness

The effectiveness of deposit insurance depends on several factors. The paper shall dwell only on a few important factors. *First*, a basic requirement is the presence of adequate bank regulation and supervision. The BSP acts as the primary regulatory authority and it has developed its capacity for regulation and supervision over the years. With respect to regulatory approach, it has shifted to risk-based supervision to maintain an efficient watch of the banking system. The BSP adheres to international standards on bank regulation and supervision as endorsed by international bodies such as the Basel-based Bank for International Settlements. The new Charter vests on PDIC the authority to examine banks with prior approval by the Monetary Board to allow prompt corrective or remedial action. In coordination with BSP, PDIC will also institute standardized record-keeping procedures on deposits in order to ensure prompt settlement of depositor claims.

Second, a cooperative framework with other regulators such as BSP, the Securities and Exchange Commission and the Office of the Insurance Commission will ensure comprehensive monitoring and supervision of both financial institutions and firms in the real sector. Such a cooperative framework, which provides timely information exchange and coordination of corrective action, is extremely necessary in view of a rapidly changing financial services industry. The virtue of a cooperative

framework presents itself in the light of "convergence" of products and services, in short, "financial services integration" or "financial convergence" that one witnesses in the changing financial landscape.

The traditional institutional framework for the regulation of financial institutions tasks specific regulatory agencies to regulate particular financial products or services. The central bank regulates the banking industry while the securities and exchange commission oversees securities and the insurance commission takes regulatory responsibility over insurance. However, advances in information and communications technology and financial innovations brought about by deregulated and more competitive financial markets motivate financial convergence. There are different forms of integration: universal banking, financial conglomerates and *bancassurance*. Financial convergence seems to require something more than the traditional regulatory approach. Thus, the debate is whether to have separate regulators for the three traditional financial services: banking, securities and insurance or to have a unified financial sector regulatory agency.

Recent developments in more advanced countries indicate a growing interest in the integration of financial supervision. For instance, the United Kingdom has established the Financial Services Authority (FSA) upon the passage of a law consolidating the existing financial supervisory authorities. South Korea adopted the single regulator supervisory model of the U.K and has created the Financial Supervisory Commission (FSC). Designing the regulatory architecture is not an easy task. The institutional capacity and resources of a country have to be taken into account when installing the regulatory framework.

In the final analysis, what may be required is a high degree of coordination, cooperation and harmonization which is very difficult to achieve because of significant differences in the three major financial industries' regulatory frameworks.[10]

[10] Milo. M. 2004. "Integration of Financial Supervision: The Global Experience." *PDIC Forum*, Vol. 2, No. 1, June.

PDIC has a memorandum of agreement with BSP to share financial and non-financial data of banks, examination reports, and other relevant information. The merits of a coordinated framework for supervision is well appreciated by the country's financial regulators. The BSP, PDIC, SEC and the Insurance Commission have agreed to form the Financial Sector Forum to facilitate information exchange and coordination of regulatory activities and policies. This effort will help close regulatory gaps.

Third, to protect its insurance fund, the insurer should also have supervisory authority over its members. Thus, the role of deposit insurance in bringing systemic stability and strengthening of the financial sector is carried out when it effectively enforces prudential regulation and supervision on its members. The mandate and powers of the insurer also determines the extent to which it can deal with a troubled bank. Moreover, deposit insurers can only be effective if they are operationally independent and part of a system that is supported by strong prudential regulation and supervision and sound accounting and disclosure regimes.[11] Without a sound system of supervision that includes capital standards as well as mechanisms for enlisting help from the market in imposing discipline on system participants, deposit insurance will be ineffective and will only increase the costs and pains of resolving a financial crisis.[12]

Fourth, under the new Charter, PDIC can implement a risk-minimization strategy which seems superior to the least-cost solution strategy that has been traditionally prescribed in other deposit insurance systems. There is a big difference between a least-cost and a risk-minimizing strategy. The least-cost approach refers to finding the least-cost solution after a bank is in trouble. A least-cost deposit insurer is usually only called upon to act after the supervisor has exhausted its arsenal of powers to resuscitate or rehabilitate the bank. As receiver and liquidator of failed banks, PDIC has followed this traditional approach in

[11] Sabourin, J.P. 2004. "The Deposit Insurer's Role in Maintaining Financial Stability." Presented at the *Chicago Federal Reserve Conference on Systemic Financial Crises: Resolving Large Bank Insolvencies,* September 30.
[12] Helfer, R.T. 1999. "What Deposit Insurance Can and Cannot Do." *Finance and Development,* March.

the past, due to the absence of examination powers that would have allowed it to intervene in a more timely manner.

Under a risk-minimization strategy on the other hand, a deposit insurer assesses and monitors the different risks taken by the depository institution in order to minimize its exposure to loss on an ongoing basis, and to be prepared to act prior to a bank getting into trouble.[13] With the implementation of the new Charter which restored PDIC's examination powers and thus, the ability to intervene early on in close coordination with the BSP, and vested in it authority to investigate frauds, irregularities and anomalies committed by banks, increase fines and penalties for unsafe and unsound banking practices, the Corporation's ability to minimize risk exposure had been strengthened. A risk-minimizing strategy would require a strong collaborative relationship with the Bangko Sentral (BSP), free exchange of information, and a number of checks and balances between the supervisor and deposit insurer. The new Charter provides for a cooperative arrangement between PDIC and BSP to work closely in this respect which would allow for better monitoring and assessment of banks

Fifth, deposit insurance and government guarantees give rise to moral hazard and adverse selection problems. An incentive problem is bound to occur as the tendency for a financial institution to get into riskier projects may increase. The financial institution may be emboldened to finance more risky or illiquid assets because of the government guarantee. It may also happen that relatively weaker and inefficient institutions would be more interested in applying for insurance membership if only to benefit from the explicit guarantee of the insurer (the adverse selection problem). Thus, the deposit insurer has to develop the capacity to monitor member institutions. It should design a deposit insurance scheme that induces financial institutions to adhere to prudential practices.

Moral hazard and incentive problems may be eliminated with efficient pricing of insurance premiums while mandatory

[13] See Sabourin, J.P. 2004. "The Deposit Insurer's Role in Maintaining Financial Stability." Presented at the *Chicago Federal Reserve Conference on Systemic Financial Crises: Resolving Large Bank Insolvencies*, September 30.

membership of banks to the deposit insurance would remove adverse selection. However, in reality, a risk-differentiated pricing is difficult to estimate for each class of asset. A practical mechanism to mitigate moral hazard problems is by providing partial cover or capping a maximum limit on the amount insured. By providing only partial coverage, depositors would have to exercise prudence in choosing a bank. In turn, banks would have to prove to the public that they have a solid and stable financial position in order to attract depositors. A mandate on transparency and adequate information disclosure will force the bank to generate a positive image and instill confidence on the part of depositors.

Limitations of financial safety nets and key challenges

It is erroneous to think of deposit insurance by itself as a sufficient instrument to ensure the stability of the financial system and to protect depositors. Deposit insurance extends protection to depositors and the promotion of depositor confidence somehow contributes to the stability of the financial system. But there are limitations to deposit insurance's effectiveness. One has to remember it is only one of several elements of a financial safety net which may consist of several instruments, depending on the particular country, the level of sophistication of its regulatory framework and level of financial development. Different countries would have different financial safety nets. For instance, typically, in addition to deposit insurance, a central bank's short-term lending, overdraft credit and lender-of-last-resort function assure bank liquidity and the integrity of the national payment system.

Adequate bank regulation and supervision form the cornerstone of any financial safety net because without them, financial institutions would have excess appetite for risky behavior. Without adequate regulation and supervision, "reckless banks" would be shielded from the "losses they might otherwise suffer when they gamble with their assets in hopes of high returns."[14]

[14] Helfer (1999).

The irony is that the financial safety net which is expected to ensure the stability of the financial system and to protect depositors (in the specific case of deposit insurance), raises "the specter" of moral hazard which "encourages risky behavior by leading financial risk-takers to believe that they will reap the benefits of the risky investments they make while being protected from the losses."[15] Thus, a word of caution from experts: in designing and operating a safety net, countries need to balance two competing goals- assuring stability in the financial system when liquidity and solvency problems arise, while at the same time minimizing moral hazard.[16]

BOX 1. SALIENT FEATURES OF FDICIA

- Reduction in Federal Reserve's discretion in discount window lending by permitting lending only to problem banks likely to survive liquidity problems;
- Resolving bank failures by using the method that presented the 'least cost' method to the deposit insurance fund;
- Establishment of risk-based deposit insurance premiums for banks;
- Requiring all federal bank and thrift regulators to use "prompt corrective action" in terms of closer supervision and more capital in banks that did not meet graduated capital thresh-olds;
- Reducing the latitude of the FDIC and the Federal Reserve for applying the "too big to fail" doctrine.

Source: Helfer (1999).

The challenge therefore is to find ways to limit moral hazard. To address this critical issue, the U.S. Congress enacted the Federal Deposit Insurance Corporation Improvement Act (FDICIA) which took effect in 1991. The salient features of FDICIA are shown in **Box 1**. FDICIA basically tried to provide the incentives for limiting moral hazard which induce banks to be more judicious about risk taking.

[15] Helfer (1999).
[16] Helfer (1999).

In the Philippines, the BSP exercises "prompt corrective action" by having closer supervision of troubled banks and by requiring banks to meet international (Basel 1 and in 2007, Basel 2) capital standards, among others. Philippine banks are exerting their best efforts to comply with the new capital adequacy requirements which will be the first line of defense in the face of volatile markets. The growing competition in the financial markets also entails capital intensification.

On the other hand, the recent increase in deposit insurance cover under the new Charter does not impose a corresponding increase in assessment rates despite a greater risk to the Deposit Insurance Fund (DIF). The remedy under the amended law is the enhancement of PDIC's capability to minimize risks to the DIF by reinstating its authority to examine banks subject to prior approval by the Monetary Board. Nevertheless, the increase in deposit insurance coverage should also lead to a re-examination of the assessment rates charged by PDIC in the light of the need to improve the long-run sustainability of the DIF.

Philippine policymakers can draw some lessons from the experience of their U.S. counterparts in devising ways to limit moral hazard. The system of deposit insurance in the country should start moving towards a risk-based pricing of insurance premiums. As previously mentioned, appropriate pricing of premiums is an efficient way to avoid incentive and moral hazard problems.

The reinstatement of PDIC's authority to examine banks, which was aimed to protect the DIF, is somewhat hindered by the need to get prior approval of BSP's Monetary Board before PDIC can examine a bank. While this is required by law and is necessary to avoid duplication, it may slow down the ability of PDIC to take prompt corrective action in the case of troubled banks.

It is essential to consider the equally important, if not more important, role played by the marketplace in disciplining

risky behavior. This is done by allowing insolvent banks to fail and imposing higher costs for short-term liquidity support from central banks. Large insolvent financial institutions have often played the "too big to fail" strategy to forestall closure and take over by a designated receiver. Thus, regulators have to constantly develop their capacity to determine whether problem banks are merely facing temporary liquidity problems or have become insolvent beyond redemption. Timely action by the regulator builds confidence in the financial system. Since managers and owners of financial institutions are in a better position to appreciate and manage the risks they take, the incentive must be there to elicit more responsible behavior from them by allowing the marketplace to pose a credible and operable threat of loss of equity and investments, jobs and even reputation for bad behavior.

In this regard, to instill discipline, the new PDIC Charter assigned greater accountability to bank owners and officers by imposing stiffer penalties for unsafe and unsound practices. At the same time, it also promotes greater discipline on depositors by revising the procedures in insurance claims and deterring depositors from getting around the maximum deposit insurance coverage by splitting deposits. While the new Charter promotes discipline in the deposit insurance system by providing incentives to sound and prudent banking practices, PDIC and BSP have to coordinate in addressing the "too big to fail" syndrome and determining temporary liquidity problems from deep-seated structural problems in distressed banks that will require a different set of action from regulators.

The recent APEC Policy Dialogue on Deposit Insurance, held in Kuala Lumpur in February 2004, recommended that policymakers introduce trigger mechanisms for prompt corrective action when dealing with troubled institutions as these measures reduce costs to depositors and the deposit insurer, contribute to financial system stability and help reduce the likelihood of an isolated bank failure turning into a financial crisis.[17] Trigger mechanisms are also in line with the risk minimization strategy of capturing the problem at the initial

[17] Asia-Pacific Economic Cooperation. 2004. *APEC Policy Dialogue on Deposit Insurance: Key Policy Conclusions Paper*, June 25, 2004.

Table 2: Trigger Mechanisms for Early Intervention

	PCA Thresholds	Key Mandatory Actions
Well-capitalized	Total Capital ≥ 10 % AND Tier 1 Capital ≥ 6 % AND Leverage Ratio ≥ 5 %	None – deposit insurance benefits
Adequately capitalized	Total Capital ≥ 8 % AND Tier 1 Capital ≥ 4 % AND Leverage Ratio ≥ 4 % In some cases ≥ 3 %	No significant limits except capital distributions that lead to undercapitalization
Undercapitalized	Total < 8 % OR Tier 1 < 4 % OR Leverage < 4 % or 3%	Must file a capital plan, must get approval of supervisor. Restrictions on dividends and management fees Restrictions on growth
Significantly undercapitalized	Total < 6 % OR Tier 1 < 3 % OR Leverage < 3%	Same as undercapitalized Restrictions on executive compensation
Critically undercapitalized	Ratio of tangible equity to total assets ≤ 2%	Further restrictions on payments Subject to closure

Source: C. M. Cumming, 2004.

stages. The trigger mechanisms could act as the early-warning devices of assessors.

Table 2 provides for mechanisms that would promote rapid supervisory action leading to a reduction in resolution costs. The trigger mechanisms outlined in Table 2 are based on the U.S. Prompt Corrective Action (PCA) under the 1991 FDICIA. Regulatory intervention begins at the level of the bank's capitalization. FDICIA puts great emphasis in getting banks to hold more capital to reduce moral hazard problems. The PCA provisions under FDICIA were aimed to substantially reduce bank risk taking by giving privileges to well-capitalized institutions and subjecting institutions with falling capital ratios to strict regulations. Reducing the risk taking of banks is also an effective

way to constrain the "too big to fail" strategy of troubled banks. FDICIA also requires a mandatory review of any bank failure that imposes costs on the insurer, thus eliminating regulatory forbearance and political influence.

PCA highlights the importance of strong communication networks and information sharing among banks and the safety net authorities. It also emphasized the importance of good corporate governance in banks through the responsible behavior of management as key to resolving bank problems. Early interventions also involve decisive actions on the part of supervisors which call attention towards the need to indemnify supervisors in their discharge of mandated duties.[18]

One important PDIC proposal is the grant of legal immunity to officers and key persons in the Corporation with respect to the official discharge of their functions. It is necessary to provide adequate legal protection to deposit insurers for actions taken in good faith and in pursuit of the PDIC's mandate. Although this was not included in the recently enacted RA 9302, legal immunity for actions performed in the line of duty warrants proper inquiry with a view to have it as an amendment to law in the future. Outlining mechanisms for taking intervening steps as well as the corresponding mandatory actions, similar to the PCA strategy would justify endorsement of legal immunity and act as safeguards against abuse.

Finally, deposit insurance alone cannot increase financial stability. The effectiveness of PDIC is inherently rooted in the soundness of the financial system in place. As a financial safety net and a regulator, the Corporation is in an ideal position to work closely with other financial regulators to make the financial system more stable and stronger. Although bank failures cannot be completely eradicated, a stable financial system will not easily be shaken when a single financial institution encounters problems. In a setting where bank consolidations and mergers are prevalent, a failure of one bank conglomerate could be

[18] Cumming, C.M. 2004. "Trigger Mechanisms for Early Intervention and Failure Resolution: An Overview." Presented at the *APEC Policy Dialogue on Deposit Insurance,* Kuala Lumpur, Malaysia February 17.

disastrous to the economy. Regulators should keep on building their institutional capacities not only to keep pace with a dynamic sector but also to be able to anticipate the changing needs of the financial system.[19]

The new Charter of PDIC certainly has enhanced its role as a safety net of the Philippine financial system. At the same time, it has also revealed the possible future directions for the Corporation as it works towards a stronger financial system.

[19] Milo, M.S. 2002. "Financial Services Integration and Consolidated Supervision: Some Issues to Consider for the Philippines." *PIDS Discussion Paper.*

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