

# Strengthening Banking Systems: Lessons From Around the World and Across the Ages

Dr. Kristin J. Forbes

Council of Economic Advisers

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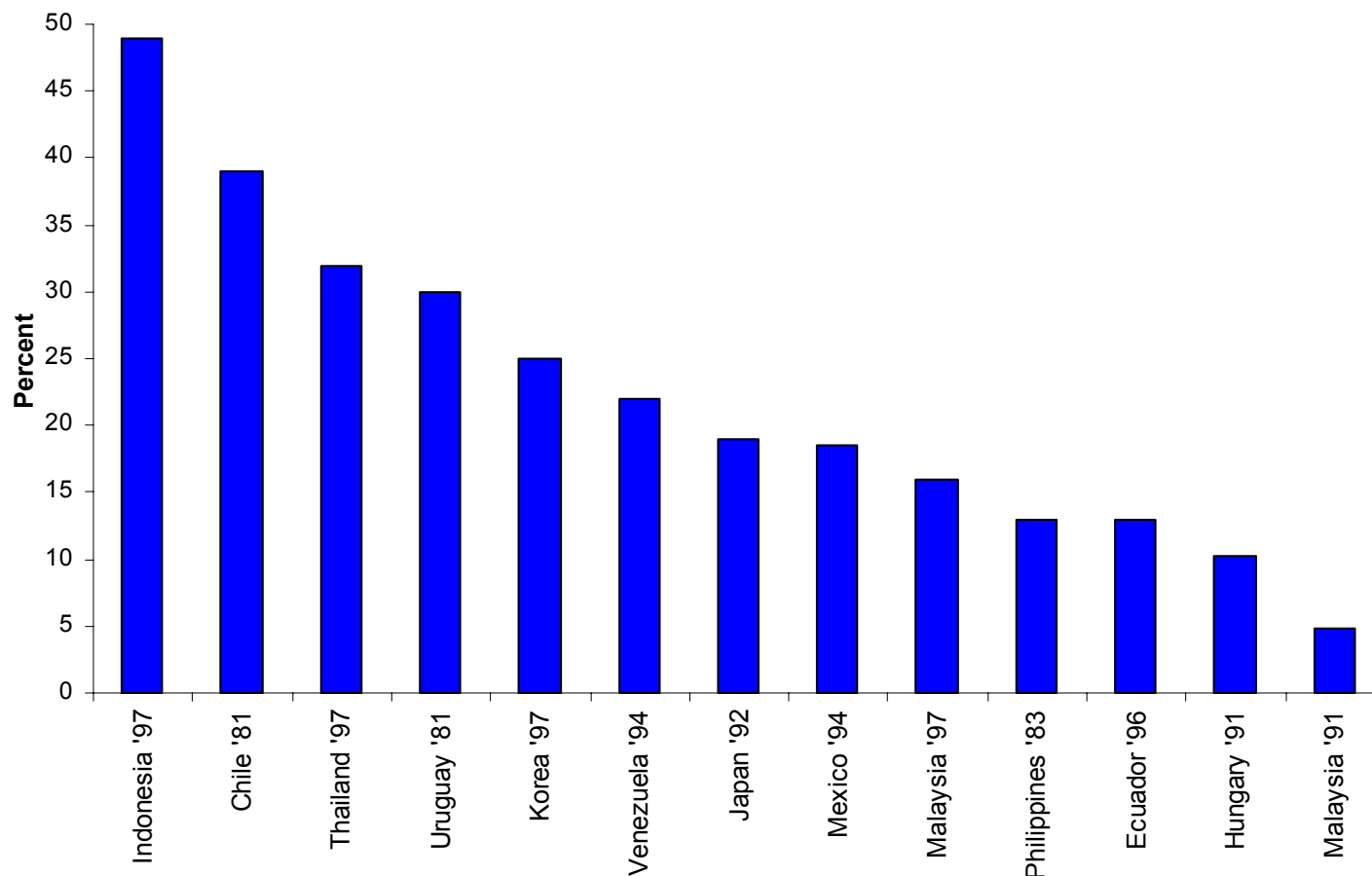
# Early Banks and Currency



# An Early Banking Crisis



# Cost of Banking Crises (% of GDP)



Source: Honohan and Klingebiel (2002). "Controlling the Fiscal Costs of Banking Crises." In Daniela Klingebiel and Luc Laeven, eds. *Managing the Real and Fiscal Effects of Banking Crises*. World Bank Discussion Paper No. 428.

# 7 Key Lessons

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1. Enact sound prudential regulations, independent supervision & strong corporate governance
2. Provide partial, risk-adjusted deposit insurance
3. Ensure banks operate on a commercial basis, free from political interference
4. Encourage foreign investment in the banking system
5. Combine bank reform with corporate restructuring
6. Establish well-defined and speedy bankruptcy laws
7. Act promptly

# Lesson 1



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Enact

Sound Prudential Regulations,  
Independent Supervision, and  
Strong Corporate Governance

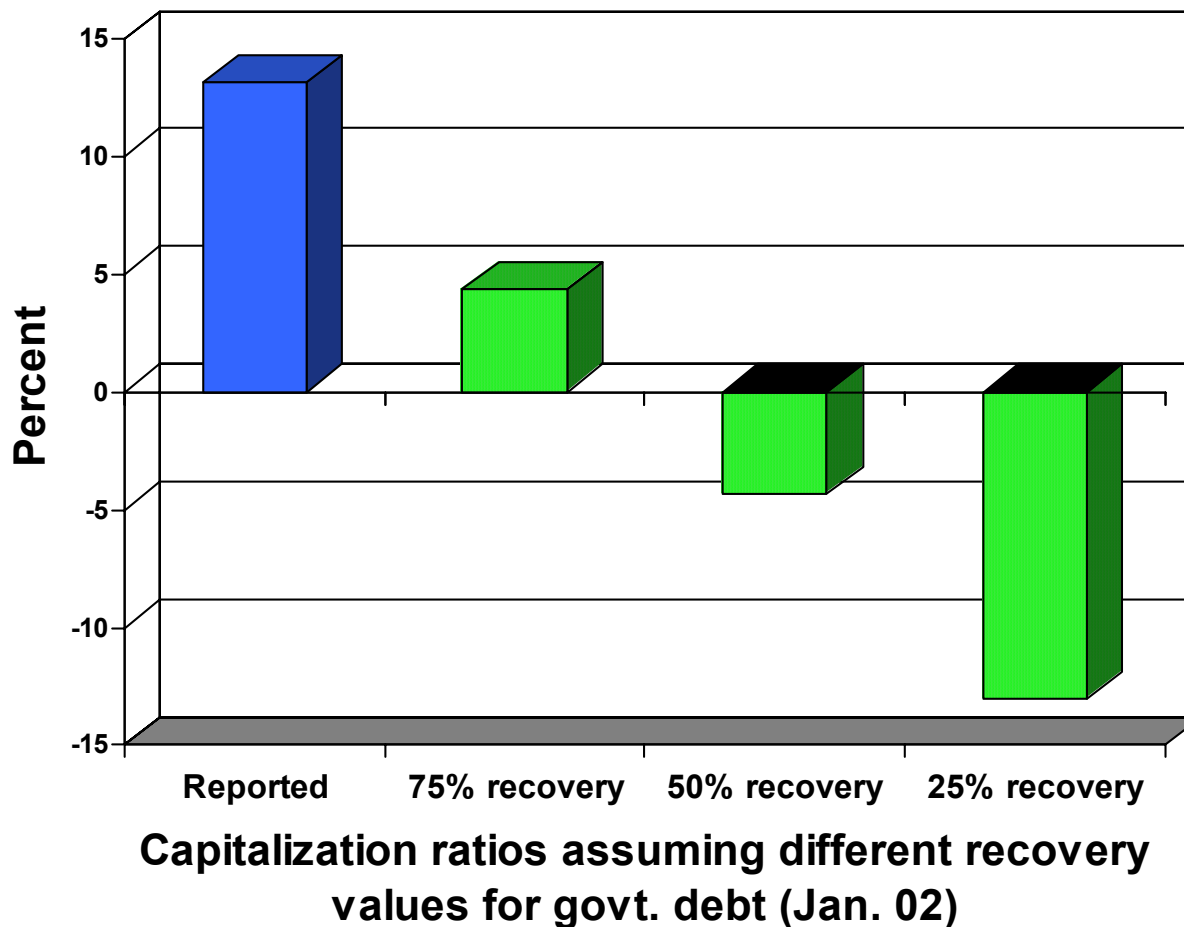
# The Basel Core Principles

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- Prudential guidelines on issues such as capital, liquidity, lending concentrations & asset valuation
- Comprehensive licensing rules
- Requirements for internal controls & risk management systems
- Requirements for effective corporate governance
- Requirements for periodic reporting and examinations, supervision, and public disclosure
- Corrective measures to overcome difficulties
- Guidelines for accounting & auditing standards

# Argentine Bank Capitalization: 2002





# Zero Tolerance for Fraud



# Lesson 2



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Provide  
Partial, Risk-Adjusted  
Deposit Insurance

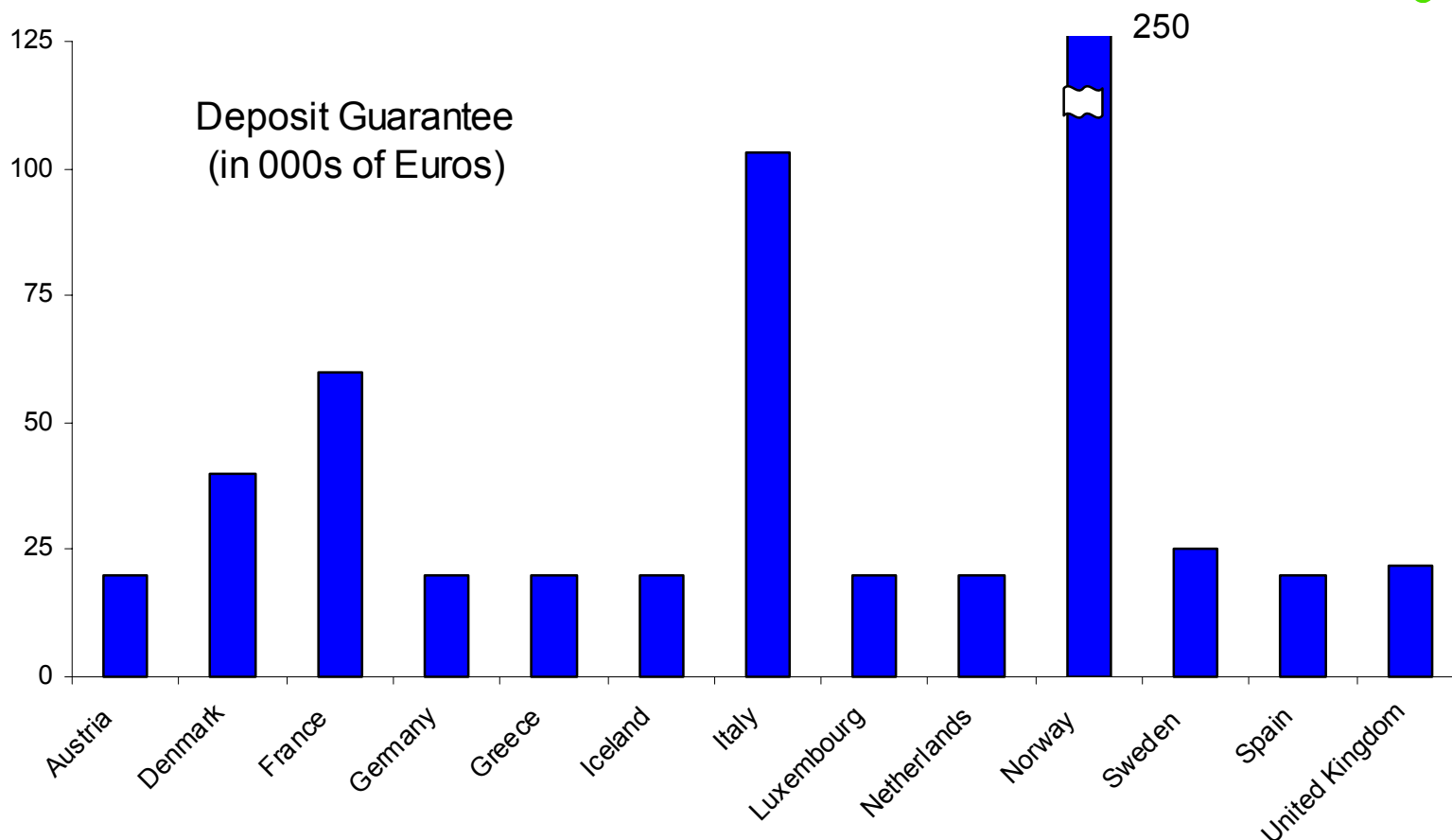
# Deposit Insurance Guidelines

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- Include insurance premiums that are risk-adjusted
- Be available only after banks meet certain regulatory requirements
- Provide limits or caps on the insurance coverage
- Include well-designed supervision and regulation

# Deposit Guarantee Schemes



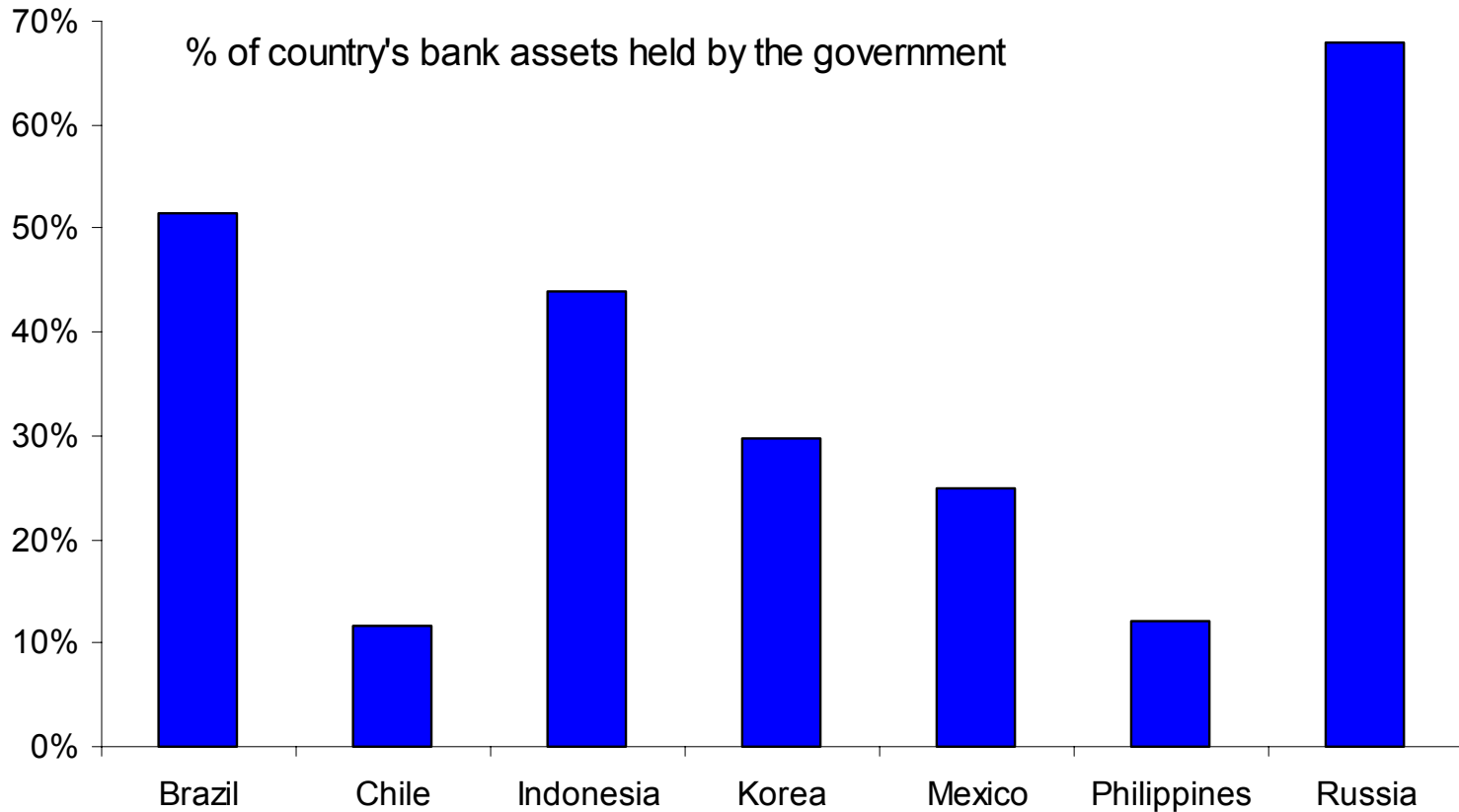
# Lesson 3



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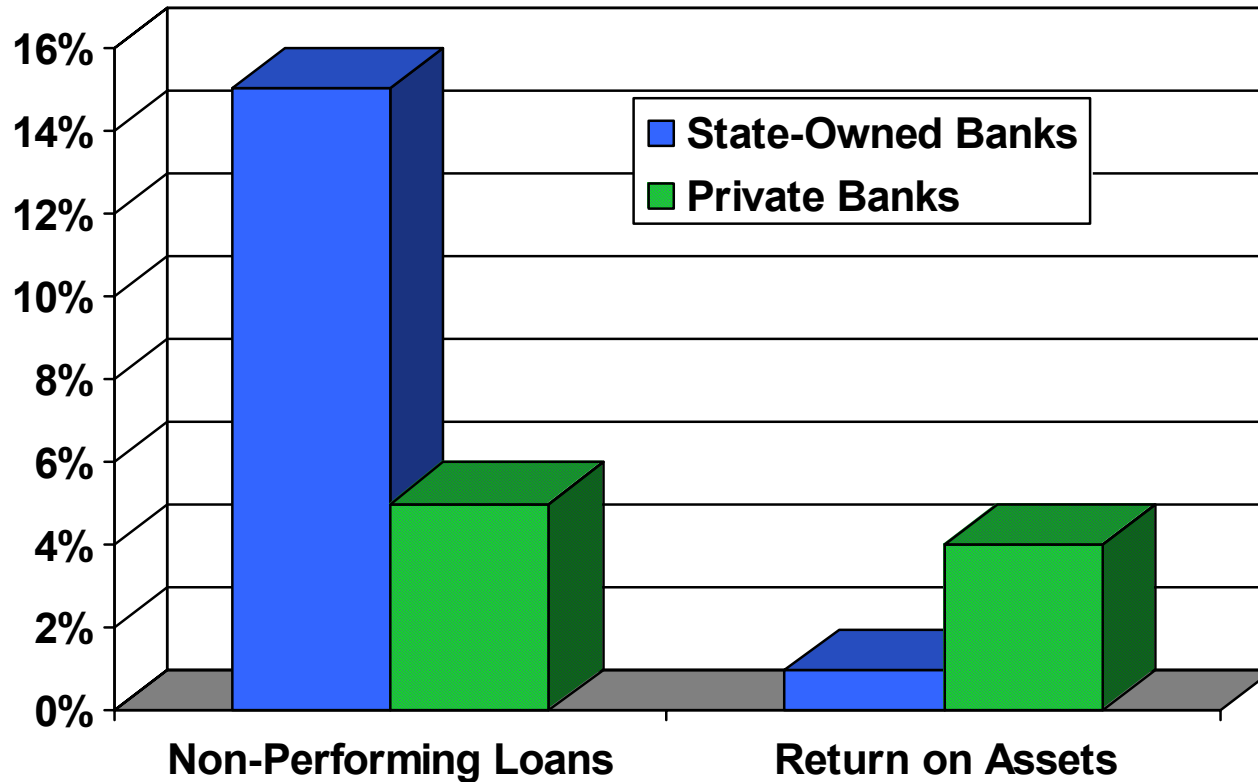
Ensure  
Banks Operate on a  
Commercial Basis,  
Free from Political Interference

# Govt-Owned Banking Assets



Most recent year available. Source: Reserve Bank of Australia (2003). "Foreign Participation in East Asia's Banking Sector."

# Indonesia: Bank Performance



Data for 1995. Source: Barth et al. (1998) "The Role of Governments and Markets in International Banking Crises: The Case of East Asia." Milken Institute Policy Brief. Note that the information on return on assets for private banks is largely foreign-owned banks.

# Lesson 4

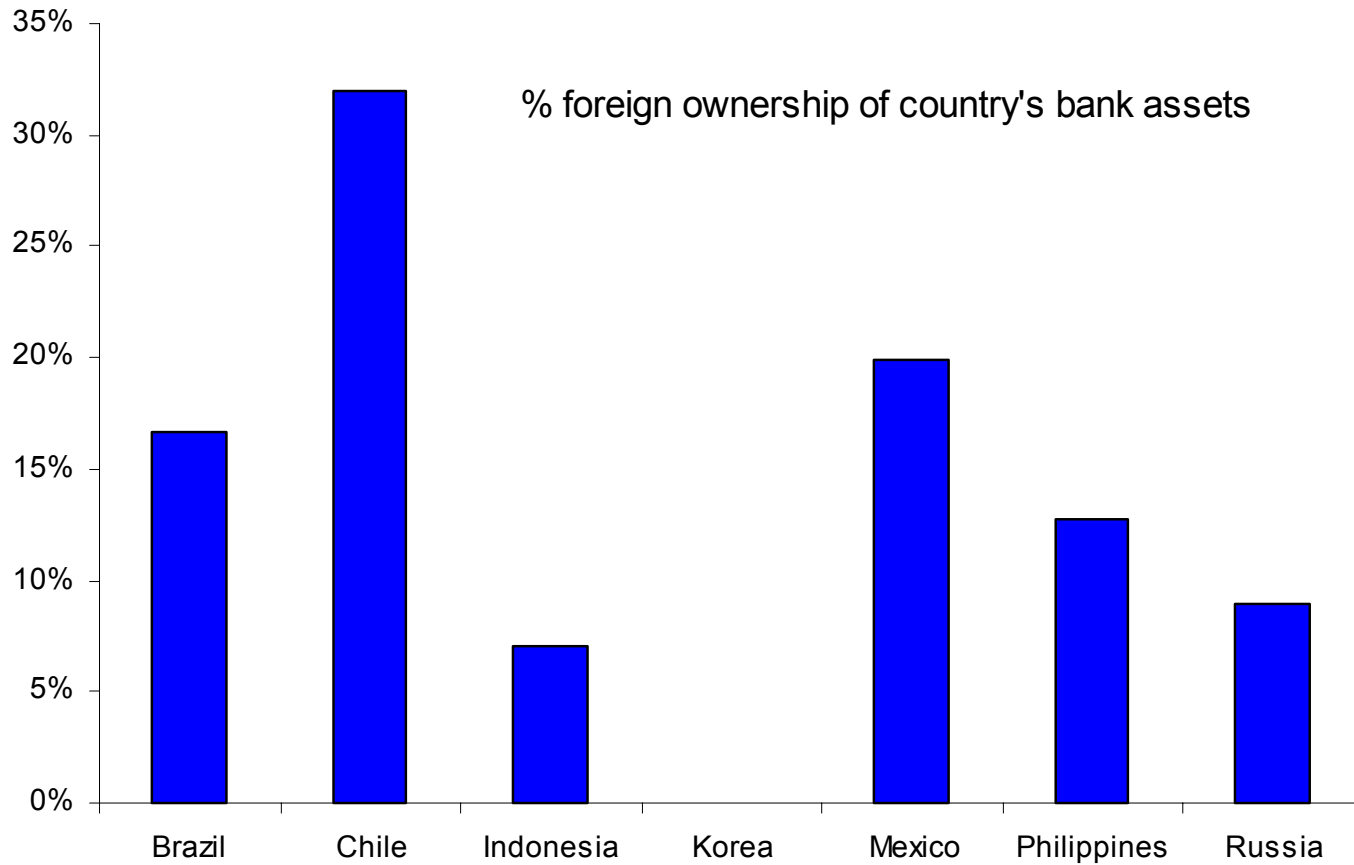


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Encourage  
Foreign Investment  
in the Banking System



# Foreign-owned Banking Assets



Most recent year available. Source: Reserve Bank of Australia (2003). "Foreign Participation in East Asia's Banking Sector."

# Lesson 5



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Combine  
Bank Reform  
with Corporate Restructuring

# Lesson 6



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Establish  
Well-defined and Speedy  
Bankruptcy Laws

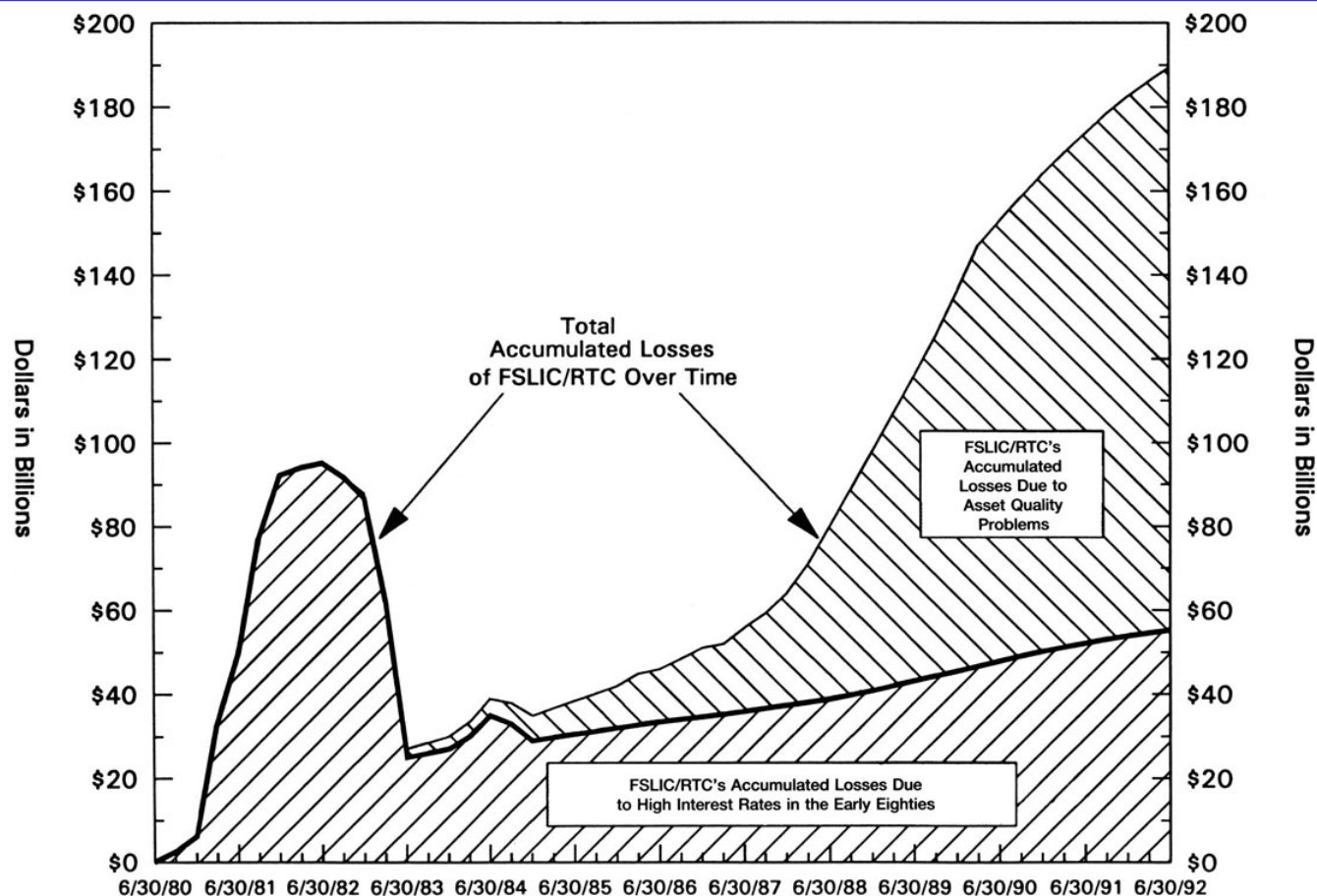
# Lesson 7



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Act Promptly

# Costs of the US S&L Crisis



Source: Ely, Bert. (2004) "Savings and Loan Crisis," *The Concise Encyclopedia of Economics*, Liberty Fund, Inc. Edition. David R. Henderson Library of Economics and Liberty.

# Conclusions



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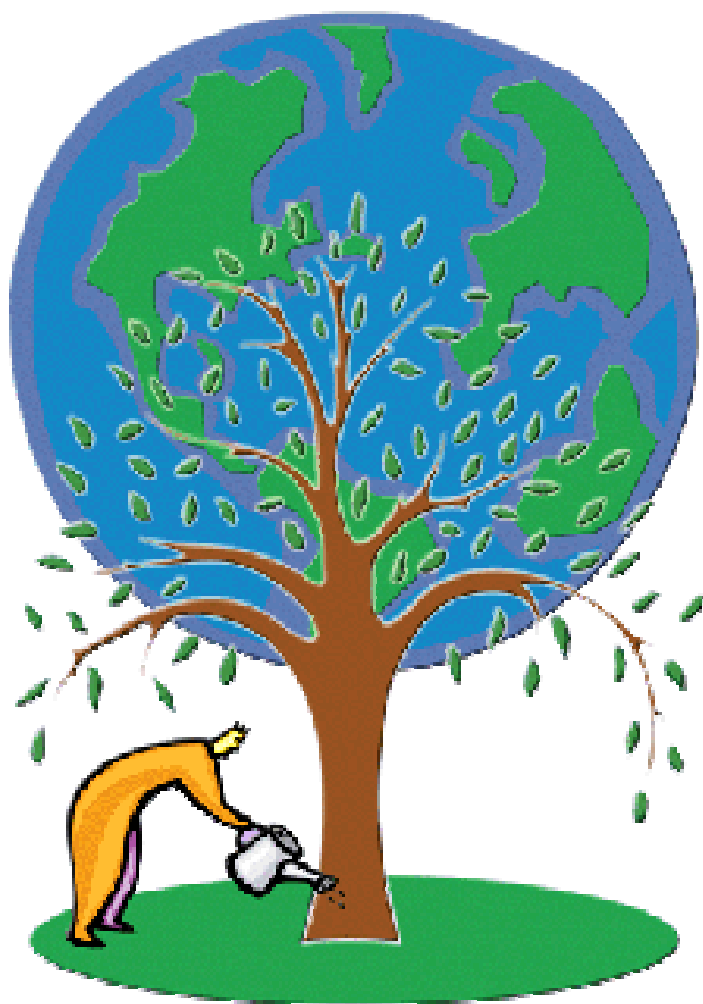
Lessons for  
Strengthening Banking Systems  
from Around the World  
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## 7 Key Lessons

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