

capital requirements without affecting their existing commercial relationship with the counterparty. In tandem with efforts to promote sound risk management practices by banking institutions, Bank Negara Malaysia had issued the *Guidelines on Regulatory Treatment for Credit Derivatives Transactions* in September 2005 which specify prudential rules and regulatory capital treatment for the four most common types of credit derivative products, namely, the credit default swap, first-to-default basket, total rate of return swap and credit-linked notes. The regulatory capital treatment aims to ensure sufficient allocation of capital by banking institutions, either in their position as buyers or sellers of the credit derivative products. In addition, the products offered must be subject to approval by the Bank and be supported by a robust risk management framework.

#### **Enhancing Infrastructure for Consumer Protection and Further Promotion of Consumer Education**

In 2005, the thrust of the initiatives on consumer protection and education continued to be directed towards empowering consumers to be better positioned to take responsibility for their own well-being. The strategies adopted were two-pronged. Firstly, strengthening the consumer protection regulatory infrastructure and secondly, enhancing consumer education initiatives.

One of the key elements in building the foundation for an effective consumer protection as outlined in the FSMP is the setting up of an explicit deposit insurance system. Following

the completion of the development of a deposit insurance framework which culminated in the passing of the Malaysia Deposit Insurance Corporation Act 2005, the Malaysia Deposit Insurance Corporation (MDIC) commenced its operations in September 2005. This significant milestone marked a change in the approach towards providing protection to depositors and augured well with the continuous objective of enhancing the financial soundness of banking institutions through the promotion of sound financial, business and risk management practices.

Under the deposit insurance system, explicit deposit protection is provided to eligible deposits up to the prescribed limit of RM60,000 per depositor, per member institution. This amount is inclusive of principal and interest. A separate coverage of the same amount is provided for Islamic deposits, accounts held under joint ownership and trust accounts, sole proprietorships and partnerships. It is envisaged that the level of coverage will provide full protection for up to 95% of depositors. In addition to its payout function, the MDIC will also, under certain specific circumstances, undertake the resolution of banking institutions, when the need arises.

Another central objective of consumer protection is to ensure that consumers are not disadvantaged amidst the move towards a more market-driven financial sector. In strengthening consumer protection, efforts were directed towards ensuring that the public continue to have access to basic banking services at reasonable costs. Towards this end,

#### **The Deposit Insurance System in Malaysia**

One of the significant milestones achieved during the year was the successful establishment of the Malaysia Deposit Insurance Corporation (MDIC) in August 2005. Malaysia now joins more than 95 countries that have explicit deposit insurance systems. The establishment of the MDIC further strengthens the consumer protection framework in Malaysia and represents a major step forward in the ongoing development of the Malaysian financial system through enhanced discipline and strengthened risk management practices of member institutions, in line with the recommendation outlined in the Financial Sector Masterplan. The deposit insurance system has been carefully designed to meet the needs of Malaysians, and in particular, to provide equitable coverage for conventional and Islamic deposits. As an important component of the safety net, the deposit insurance system complements the role and functions of Bank Negara Malaysia in preserving overall financial stability.

##### **Mandate**

The MDIC is an independent statutory body established under the Malaysia Deposit Insurance Corporation Act 2005 (MDIA) with mandates to:

- (i) administer a deposit insurance system;
- (ii) provide insurance against the loss of part or all deposits of a member institution;
- (iii) provide incentives for sound risk management in the financial system; and
- (iv) promote or contribute to the stability of the financial system.

In carrying out its mandates of (ii) and (iv), the MDIC is required to minimise cost to the financial system.

### **Membership**

Membership in the deposit insurance system is compulsory for commercial banks (including locally-incorporated subsidiaries of foreign banks operating in Malaysia) licensed under the Banking and Financial Institutions Act (BAFIA) 1989 and Islamic banking institutions licensed under the Islamic Banking Act (IBA) 1983. Banking institutions that focus mainly on wholesale deposits, namely merchant banks, discount houses and investment banks are automatically excluded from membership. The branches of domestic banking institutions operating abroad and other deposit taking institutions namely, development financial institutions, provident and pension funds including the Employees Provident Fund and Lembaga Urusan Tabung Haji (Pilgrimage Fund Management Board) and cooperative societies are also excluded from the deposit insurance system.

### **Coverage**

Deposits which enjoy deposit insurance coverage include savings, demand, fixed, Islamic deposits (general investment and special investment deposits), banker's cheques, bank drafts and other payment instructions. Deposits that are not payable in Malaysia, foreign currency deposits, negotiable instruments of deposit or other bearer deposits, repurchase agreements and money market placements are not insured by the MDIC.

Eligible deposits are insured for up to RM60,000, inclusive of principal and interest. This limit is applied per depositor per member institution. Separate coverage is available for deposits that are held jointly or in trust, and deposits of sole proprietorships, partnerships or professional practices.

Islamic deposits are accorded a separate coverage limit of RM60,000, inclusive of principal and return on deposit. This separate coverage limit ensures equitable treatment and no competitive distortion between conventional and Islamic deposits.

### **Reimbursement of depositors' claims**

Where a member institution is unable to meet its obligations to its depositors, the MDIC is required to reimburse depositors up to the RM60,000 insured limit as soon as possible. Reimbursing depositors on a timely basis is crucial to maintain confidence in the financial system.

### **Funding**

The deposit insurance system is funded by annual premiums assessed against member institutions based on total insured conventional or Islamic deposits held as at 31 December.

The MDIC maintains and administers two separate deposit insurance funds for conventional and Islamic deposits. Investments held in the Islamic Deposit Insurance Fund are made in accordance with Shariah principles.

### **Governance structure**

The MDIC is governed by a seven-member Board of Directors, comprising:

- a Chairman;
- Governor of Bank Negara Malaysia;
- Secretary General of Treasury;
- a representative from the public sector; and
- not more than three representatives with relevant private sector experience and at least one with relevant banking and financial sector experience.

Members of the Board are appointed by the Minister of Finance, with the exception of the Governor and Secretary General. Directors, officers and employees of banking institutions which are members of the deposit insurance system and their related parties are not allowed to be represented on the Board to avoid conflict of interest and unfair access to confidential information. The Board of Directors is responsible for the conduct of the business and affairs of the MDIC and has a statutory duty to act in the best interests of the deposit insurer in accordance with its mandate.

### **Collaboration and coordination**

Bank Negara Malaysia is the primary supervisory and regulatory authority responsible for maintaining overall stability of the Malaysian banking system while the MDIC administers the deposit insurance system in a manner that contributes towards promoting public confidence in the financial system.

As part of its supervisory functions, Bank Negara Malaysia performs examinations on the health of financial institutions and provides the MDIC with reports on their findings. As such the MDIC relies extensively on the information provided by the Bank for assessing its risks. In addition, Bank Negara Malaysia may advise the MDIC that a financial institution is no longer viable. Upon such advice, the MDIC is required to find a least-cost resolution to deal with the troubled member institution. This may involve a wide range of intervention actions, including assumption of control, applying for the appointment of a receiver or presenting a petition for the winding-up of that member institution. This power, however, is only triggered when the Bank makes such a determination.

As a result, close collaboration and coordination between Bank Negara Malaysia and the MDIC is crucial to ensure the effectiveness and efficiency of both organisations in meeting their mandates. The importance of such a relationship dictates that a strategic alliance agreement be executed between the two organisations to clearly set out how they will collaborate and coordinate their activities in fulfilling their respective roles and responsibilities, with the objective of mitigating unproductive overlap and duplication of efforts. Such an agreement will also provide a platform for Bank Negara Malaysia and the MDIC to engage in active and continuous consultations to achieve optimal outcomes.

### **Conclusion**

The establishment of the Malaysian deposit insurance system strengthens the consumer protection framework in Malaysia. Great care was taken in its design to complement the role and function of Bank Negara Malaysia as the primary regulator and supervisor in promoting the safety and soundness of the financial system for the benefit of all Malaysians.

the Bank had in 2004, introduced the basic banking services framework which required the offering of a basic savings account and a basic current account to all Malaysians including permanent residents. Further to this, banking institutions were directed to automatically convert previously designated plain vanilla savings account into basic savings accounts (BSA) in August 2005. The mandatory conversion would facilitate greater banking inclusion of all segments of the community. Concurrent with efforts to ensure financial access was the emphasis on ensuring fair and equitable banking fees and charges. In recent years, in tandem with increasing technological innovation and consumer demand for more innovative products, banking institutions have made substantial investments on hardware and software infrastructure as well as product development to make available financial products and services that are aligned to consumer demands and which are more efficient, reliable and secure. To defray part of the costs of such investments, fees were levied on products and services provided. To ensure that the cost imposed is fair and equitable to both consumers and banking institutions, guidelines outlining the guiding principles for the imposition of fees and charges on banking products and services for individuals and, small- and

medium-sized enterprises (SMEs) were issued in mid-2005. Banking institutions were required to ensure that their existing fees and charges framework complies with these guiding principles and prior approval of the Bank was required for new fees or charges to be imposed on customers.

Another important component of the consumer protection framework is to put in place the appropriate institutional arrangements to ensure that consumers have sufficient avenues to seek assistance and redress when they face problems with their financial institutions. In this regard, the Bank is establishing a Credit Counselling and Debt Management Agency (CCDMA) that will provide an avenue for individual borrowers and potential borrowers to seek advice on managing their credit and to equip them with the necessary skills to manage their finances. In addition, the CCDMA will also assist consumers to proactively manage their debts via customised debt repayment plans. This service is available for all debts relating to housing loan, personal loan, credit card, charge card and hire purchase that have been obtained by individuals from financial institutions regulated by the Bank.