

## The Proposed Deposit Insurance System in Malaysia

In 2003, substantial progress was made towards finalising the features of the proposed deposit insurance system for Malaysia, thus paving the way for its establishment. The improved strength, competitiveness and resilience of the banking system following the comprehensive restructuring and capacity building initiatives support a positive environment for the effective implementation of a deposit insurance system that will contribute to the stability of the financial system.

As an integral component of the financial safety net, the deposit insurance system will further strengthen incentives for financial institutions to adopt sound financial and business practices and enhance public confidence in the financial system by providing explicit protection of deposits. The proposed features underpinning the Malaysian deposit insurance system fully support these objectives.

In developing the design features, Bank Negara Malaysia has considered various models adopted in other countries that operate explicit deposit insurance systems, adapting them as appropriate, in order to achieve a system that will function efficiently, equitably and in a manner that provides the appropriate economic incentives for all participants within the Malaysian context. Key elements of the proposed design features include:-

- (a) a **legislated mandate** for the agency responsible for the administration of the deposit insurance system (hereafter referred to as 'Agency'). This will ensure clarity of its role and responsibilities within the financial safety net and provide the basis for the statutory powers to be accorded to the Agency;

*The proposed mandate for the Agency is to:-*

- (i) administer the deposit insurance system;*
- (ii) protect depositors from the loss of their deposits up to the insured limit in the event of a bank failure;*
- (iii) strengthen incentives for sound risk management in the banking industry; and*
- (iv) promote or otherwise contribute to the stability of the financial system.*

*Within its proposed mandate, the Agency will have the role, in certain circumstances, to undertake the resolution of banking institutions, as may be required based on the assessment of Bank Negara Malaysia. In this role, the Agency will also be responsible to minimise the costs of bank resolutions to the financial system, taking into account factors affecting financial system stability.*

- (b) **compulsory membership for commercial banks** (including subsidiaries of foreign banks operating in Malaysia) and **finance companies** licensed under the Banking and Financial Institutions Act 1989, and **Islamic banks** licensed under the Islamic Banking Act 1983, to accept deposits (hereafter referred to as 'member institutions'). This will avoid risks associated with adverse selection whereby only small and perceived weaker institutions participate in the system. This is important to enhance the viability of the deposit insurance system;
- (c) **protection** up to the prescribed limit (for eligible deposits) for **all depositors** of member institutions. Provisions will be made for the Agency to approve additional financial instruments as being eligible for deposit insurance to accommodate new types of deposit products that may be introduced in future. Deposits that are not payable in Malaysia, foreign currency deposits, negotiable instruments of deposit or other bearer deposits, repurchase agreements and money market placements would not be insured;

- (d) an **adequate basic level of protection** provided **for every depositor's deposits in each member institution**. Depositors with deposits in more than one member institution will be insured separately for their deposits in each institution. Joint and trust deposits will also be separately insured, providing additional coverage within the system for depositors with such accounts. The deposit insurance limit will be set at a level that is sufficient to protect the vast majority of depositors in full. At the same time, the deposit insurance limit will retain sufficient incentives for the larger and institutional depositors to monitor the financial condition of member institutions. This is important to promote sound financial and business practices, thereby further enhancing financial stability;
- (e) **equivalent protection for Islamic and conventional deposits** which will be separately insured up to the deposit insurance limit to avoid any competitive distortions between the Islamic and conventional banking systems. In this respect, extensive consultations have been held with the National Shariah Advisory Council on elements of the deposit insurance system relating to Islamic deposits to ensure consistency and compliance with Shariah principles;
- (f) **annual premiums** to be paid by member institutions to the deposit insurance fund to be **based on** the institution's total **insured deposits**. The annual premiums will be borne entirely by member institutions and should not result in the imposition of additional service charges, either explicitly or implicitly, on consumers. The deposit insurance fund may be used to reimburse the depositors of a member institution that is unable to meet its obligations to depositors or otherwise provide financial assistance for the resolution of the institution. The annual premiums may be supplemented by additional premiums imposed on member institutions to cover any loss resulting from the implementation of resolution schemes; and

*An Islamic deposit insurance fund, funded by premiums collected on insured Islamic deposits, will be separately maintained to ensure that the coverage accorded to Islamic deposits fully comply with Shariah principles.*

- (g) the implementation of a **differential premium system** to determine the premiums payable by each member institution. Consistent with the Agency's mandate to strengthen sound risk management practices among member institutions, financial consequences (through higher premium rates) will be attached to practices of member institutions that increase the risk of loss to the deposit insurance system. In line with the basic structure of proven and tested rating systems employed in other countries, both qualitative and quantitative criteria will be taken into account to determine the premium category in which a member institution is classified.

It is envisaged that the deposit insurance system will be administered by a separate statutory body established under an Act of Parliament to accord greater focus and clarity to the fulfilment of the deposit insurance mandate. The Agency will be supported by an independent board comprising relevant representatives from the public and private sectors. As separate components of the financial safety net, appropriate institutional arrangements will also be put in place to facilitate effective co-operation and co-ordination of actions between Bank Negara Malaysia and the Agency.

Following a consultation process with the banking industry, the deposit insurance system will be implemented subsequent to the passing of legislation in Parliament, and the establishment of the necessary infrastructure.