



Perbadanan Insurans Deposit Malaysia
Malaysia Deposit Insurance Corporation



Challenges for Deposit Insurance in Promoting Financial Stability

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Introduction

- ❑ Deposit insurance - policy tools to build public confidence:
 - Preventing bank runs.
 - Protecting the payments system.
 - Promoting financial stability.

- ❑ Role of deposit insurance still under appreciated, misunderstood and not fully recognised by small segment of our stakeholders.

- ❑ Often associated with moral hazard.

- ❑ Argued that deposit insurance should stay at the peripherals and tinker only at the margins.

Blanket Guarantees

- ❑ Country without deposit insurance would normally have implicit deposit insurance or blanket guarantees.
- ❑ Under blanket guarantees:
 - incentives for increased risk taking are greater.
 - cannot prevent bank runs.
 - wrong party made to bear the full brunt of payout.
- ❑ Justifiable that financial institutions and their clients pay for the benefits of financial stability. Should include paying premiums to fund the operations and losses borne by a deposit insurance system.

Moral Hazard – the Reality

- ❑ Moral hazard is everywhere.
- ❑ But moral hazard can be mitigated with an effective deposit insurance system.
- ❑ A Deposit Insurance system needs to:
 - Be well designed.
 - Offer only explicit and limited coverage.
 - Make banks responsible for a share of the costs and allow bad banks to fail.
 - Be supported by good institutional environment.
 - Be given powers for early interventions and resolutions.

Two Challenges Facing Deposit Insurer

- ❑ The first challenge is independence.
- ❑ There are three aspects to this issue:
 - political capture.
 - regulatory capture.
 - safety net capture.
- ❑ Why must deposit insurers be independent entities?
 - Independence builds credibility. And credibility speaks to the integrity and stability of the whole financial system.
 - Creates healthy competition amongst safety net players. A natural system of checks and balances.
 - Maximise role in financial system stability.

Two Challenges Facing Deposit Insurer (cont'd)

- ❑ The second challenge is the misalignment and inadequacy of powers.
- ❑ The fallacy of having a paybox deposit insurer not being responsible for the optimisation of recoveries and claims, and leaving it to disinterested third parties, substantially increases the costs to the deposit insurer and the financial system.
- ❑ Being able to deal with bank failures pro-actively can translate into substantial savings to the financial system.

Education Programs

- ❑ Failure of stakeholders to fully appreciate our contributions to financial stability - partly failure of our education programs in reaching out to them.
- ❑ Should make sure that every single stakeholder fully understands the functions, features, benefits and limitations of a deposit insurance system.
- ❑ Well developed deposit insurance systems are a prerequisite to ensuring a sound and robust financial system.

Conclusion

- ❑ Still have a lot of hard work to meet the challenges.
- ❑ Need to work closely and pull our collective resources together, to be more effective in meeting these challenges and in convincing our various stakeholders of our integral role in the safety net in safeguarding the stability of the financial system.
- ❑ An effective deposit insurance system is not an option but a necessity.

THANK YOU