



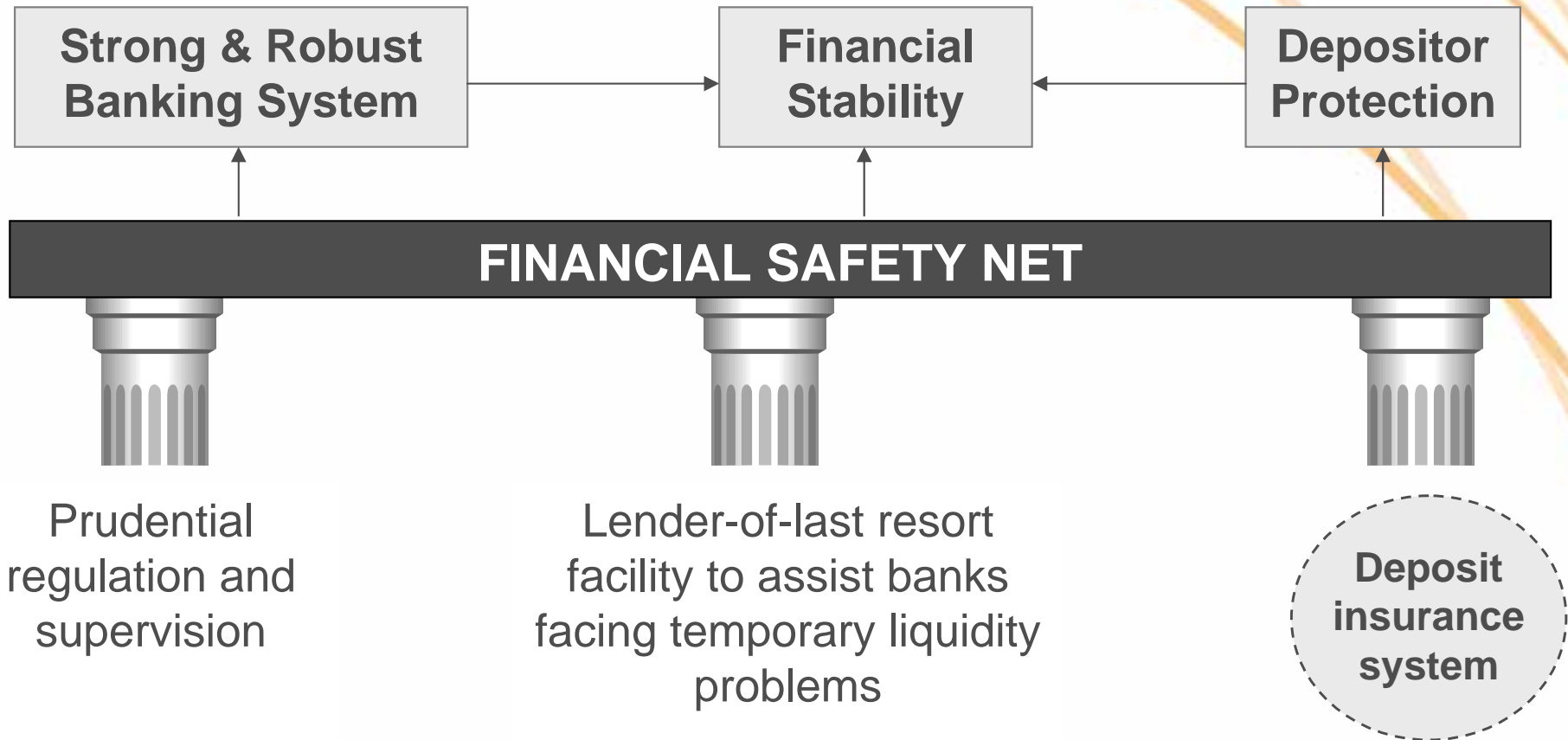
Deposit Insurance and its Role in Financial Stability

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component of the financial safety net



Deposit insurance enhances depositor confidence

It promotes confidence, savings habit, economic growth

In good times:

- Attracts savings into banking system.
- Builds confidence in overall safety of banking system.
- Facilitate bank intermediation process.
- Builds awareness of and promotes financial literacy through deposit insurer's awareness programs.

In bad times (during bank failures):

- Provides incentive to depositors to retain savings in banking system.
- Maintains confidence among depositing public in safety of their deposits.

rerequisites to confidence building

- ❑ Public awareness is crucial.
- ❑ Depositors must be aware of deposit insurance (DI) benefits and limits.
- ❑ DI has to establish credibility in good times.
- ❑ Actions of DI during a bank failure also critical. Failure resolution method and speed of deposit insurance repayment builds confidence.

DI mandates vary

Pay claims of depositors after a bank has been closed

MDIC's Mandate

- Administers DI system
- Provide insurance
- Provide incentives for sound risk management
- Promote fin. system stability

Act to minimize cost to fin. system

POWERS: Assess & manage own risks

Conduct special exam

Regulate and enforce

Resolve troubled banks

- Control exit & entry
- **Assess & manage own risks**
- **Conduct examinations**
- **Regulation & enforcement**
- **Bank resolution**

Mandate continuum

Narrow "paybox" mandate

Bangladesh, Hong Kong, Singapore

Various combinations in between

Broad "risk-minimiser" mandate

USA, Canada, Japan, Korea, Taiwan, Philippines

complements and reinforces supervisor role

Deposit insurance need not have examination/supervisory powers.
DIC conducts assessment and risk monitoring of banking system based on information shared by supervisors.

Imposes higher premiums on banks that have low supervisory ratings - differential premiums system (DPS).

Imposes premium surcharges on recalcitrant banks in consultation with supervisors over -

- Non-compliance with regulations, orders, directives of supervisors
- Non-compliance with capital / liquidity requirements

Promotes sound risk management practices

Stability of financial system dependent on strong and soundly managed banks.

DPS - provides incentives for banks to improve risk management:

- Banks with riskier profile pay higher premiums.

- Reduces moral hazard issues.

- DPS components are indicators of sound risk management framework.

- DPS provides financial incentive to resolve deficiencies on timely basis.

Promotes effective resolution of troubled banks

Access to information critical in devising least cost resolution arrangements.

Banks should have the failure resolution expertise as receivers, liquidators and asset management specialists.

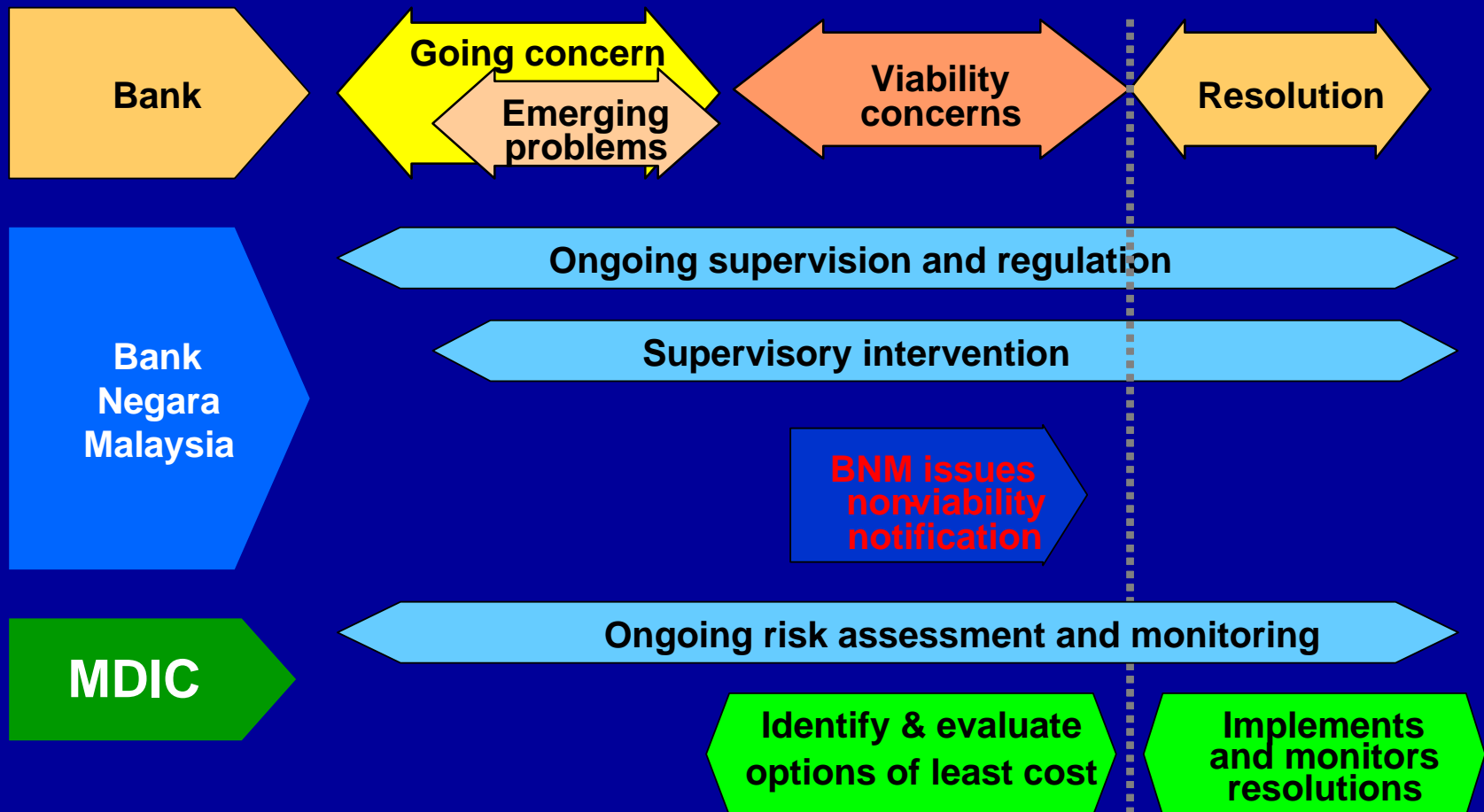
Banks have financial incentive to complete resolutions effectively and timely

Not easy for supervisors to shift to resolution mode. Not helped by wrong perception that supervisors are responsible for troubled banks.

Specialisation and division of labour between DI and supervisor improves efficiency and effectiveness.

relationship

Relationship with supervisor



Relationship building

The objectives and goals of a deposit insurer cannot be achieved without a strong clear mandate and strong alliances.

Highly critical to establish good interrelationships to minimise potential tensions and to ensure that joint-actions are properly coordinated.

Strong relationship with supervisors is critical.

Partnership in Malaysia formalised by legislation and the execution of a Strategic Alliance Agreement (SAA).

Build close working relationships with other relevant government agencies, such as the Ministry of Finance, Central Bank and other government departments.

guiding principles underpinning the SAA

- Dealing with issues in an open and transparent manner.
- Respecting the independence and accountability of each agency's scope of work within their respective mandates.
- Communicating effectively through timely and up-to-date exchange of information.
- Respecting and accepting the diversity of experience and skills of each agency when addressing issues raised by either agency.

LESSONS ON CRISIS MANAGEMENT.

in a Banking Crisis Management Plan:

Benefits

- Avoids knee jerk reaction to crisis.
- Have buy-in of major policy players.
- Clarity of parameters for action.

Objections

- Time consuming to pull together.
- Requires buy-in and leadership.
- Has to address turf issues.
- May require changes to legislation, practices.

Not a Business Continuity Plan although may contain certain elements.

COMPONENTS OF PLAN

TOR objectives.

Early warning system to identify potential crisis.

Early response capabilities.

Type of crisis to deal with (bank failure, wave of failures, systemic crisis).

Criteria for action.

Clear roles, functions and responsibilities of safety net players at each response stage. Who is to act?

Sources of funding – short and long term.

Banking sector restructuring options.

Coordination mechanism.

Crisis communication strategy and plan.

APPROACH AND PREPARATION OF PLAN

Know your system:

- Review and test all financial legislation, regulations and policies.
- Identify bottlenecks in insolvency laws and court processes, policies and practices.
- Stress test legislation and policies against scenarios.
- Turnaround time - example to raise funds, sell bad assets.

Know yourself:

- Organisational powers and mandate.
- Organisational capacity and capabilities.
- Competencies of employees.
- What is the level of readiness required?

e Bold - change policies, laws, if necessary.

IMPLEMENTATION OF PLAN

Ongoing coordination of safety net players is important.

Consistency and transparency of actions/words/messages.

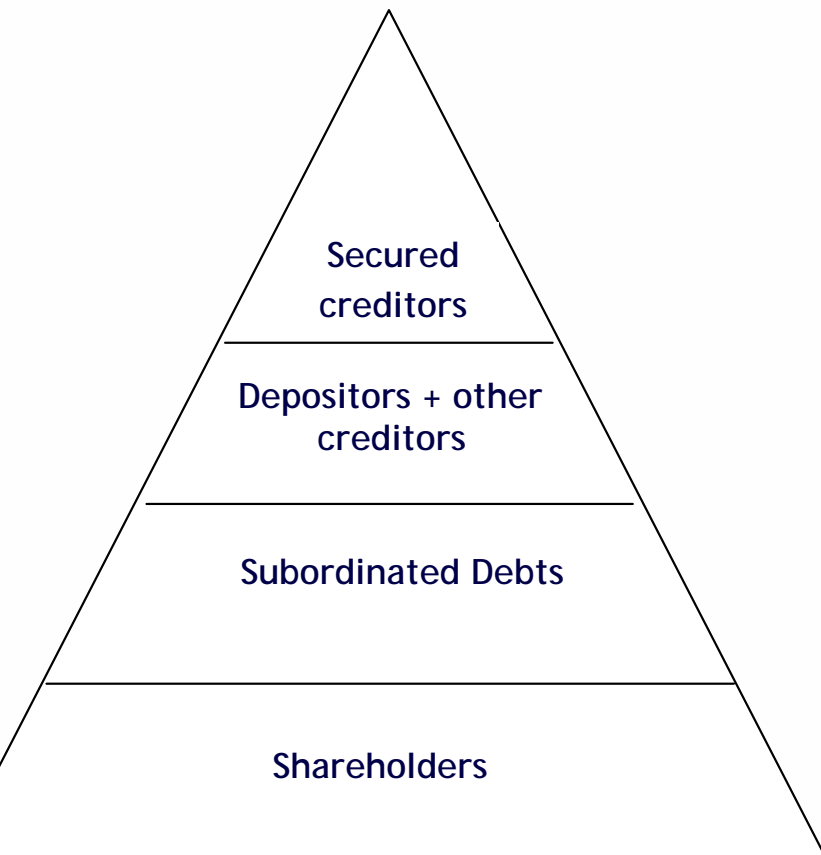
Minimise moral hazard perception.

Communicate to the public. Have one message - coordination.

In theory, workable. In reality, there are difficulties. Need to apply adjustments to the moment. Watch for public sentiments and political responses.

Accountability regime and reporting mechanism.

depositor preference



Depositor preference against-

- ❑ Primary objective - minimise loss to deposit insurer.
- ❑ Provide market discipline.
- ❑ Creditors (sub debt holders, wholesale) - find ways to go around the system or out of the troubled bank.
- ❑ Final effect - objective of depositor preference law may not be met.

Deposit Preference (cont'd)

- Be absolutely sure that the law is understood and that the legal interpretation is the most current.
- Consider the effect of netting agreements on your depositor ranking.
- The treatment of foreign depositors is critical.
- The ranking of Shariah deposits should be properly understood.

Conclusion

A deposit insurance system is designed to promote confidence and contribute to financial stability.

For quick and successful resolution of banks, alliance of all safety net players and effective resolution process are critical.

It is very important that we truly understand our system and be ready to act!