

**IADI***International Association of Deposit Insurers*

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Opening Remarks

By

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1. I'm honoured to be here in Dalian to share my thoughts on deposit insurance. As Chair of the Executive Council of the International Association of Deposit Insurers (IADI), I have been very fortunate as the scope of IADI's work necessarily involves engagements with many established deposit insurers as well as economies at the threshold of developing deposit insurance systems or mid-way into the process. I have found these engagements and the issues that are addressed very challenging, sometimes mind-boggling but always enriching. As a case in point, I have recently launched the Malaysia Deposit Insurance Corporation (MDIC) as its first Chief Executive Officer, having been its advisor for the last three years. In the light of these experiences, I would like to share some insights and draw some lessons that I hope would provide guidance on the approach that may be adopted in developing an effective deposit insurance system.

2. I shall draw closely on my experience and the approach used in Malaysia. I call this the OPT approach. OPT stands for Objectives, Process and Timing. It provides a practical approach to meeting the best practices that are set out in the Financial Stability Forum Report on "Guidance for

Developing Effective Deposit Insurance System". Malaysia has used this approach very successfully.

3. First, it is crucial that the objectives for the deposit insurer be clearly spelt out and that the principal safety net players are in agreement. In the FSF's guidance paper, the first step is to identify the public policy objectives for the deposit insurer. In my experience, clarity of mandate is the corner stone for setting other parameters. This determines the role of the deposit insurer within the financial safety net which in turn defines the interrelationships of the safety net players. The objectives could include policy statements or guiding principles that would shape the design features of the deposit insurance system.

4. Let me share how this was done In Malaysia. Before designing the features of the deposit insurance system, Malaysia adopted several guiding principles which later set the benchmark for determining the priority of each design feature. One such guiding principle required that the deposit insurance system be able to reinforce and complement the existing regulatory and supervisory framework. As a result, the deposit insurance system evolved from an initial narrow mandate to a broader mandate which empowered the insurer to resolve banks that have ceased or are likely to cease to be viable. Yet it was not set up as another regulator or supervisor. Instead the deposit insurer would rely on the supervisory and examination powers of the central bank. This is a fundamental design feature of the Malaysian deposit insurance system.

5. Another important criteria and guiding objective was that the deposit insurance system be able to comply with Syariah tenets for Islamic deposits. Guided by this objective, it was just a matter of making the legislation and system, Syariah compliant all the way, from premium collections to payouts. While this may sound simple, believe me, the actual crafting took some time.

6. But this is to be expected. Time is required to translate a design from the master architect's vision to paper and to the finished product. But it becomes easier if the craftsman knows what he wants.

7. Second, a sound development process matters. Sufficient resources should be deployed, if the project is to be successful. A dedicated multi-disciplinary team should be assembled and led by a strong leader who is fully supported by top Management, as only clear guidance can move the project forward.

8. A sound development process requires that policy papers be developed for each major design feature and issued for consultation amongst the key policy decision-makers and where necessary, for industry consultation. I should stress that it is important to also take cognisance of the needs of the existing financial system, the strategic directions for the system and the specific conditions of the economy. This is to ensure that the end results fit the financial system for which it is designed. While there may be short-term wins to adopt a ready-made deposit insurance system, in the longer term, if the deposit insurance system is not custom-built to a country's specific requirements, inefficiencies would arise.

9. Decisions must be made based on local needs and conditions. The FSF Report states that the choice of how a deposit insurance system is to be operated depends on many factors that are unique to each country and its governmental and financial system. For Malaysia, during the development process, all features were considered carefully to ensure that the system fits the "Made in Malaysia" objective. Bank Negara Malaysia instituted a strong quality control programme to ensure that the legislation was sound and workable in every respect.

10. The draft legislation was reviewed and studied several times by a multi-disciplinary Task Force, comprising a team of persons from within the Bank and from other organizations. The Task Force was also given the necessary time to do it right and to get it right. There was always strong leadership and support provided by the executive management and Governor Zeti of Bank Negara Malaysia.

11. Third, Timing is crucial. Deposit insurance is not the "Mother of all solutions". Lest we forget – deposit insurance is a tool. It is only as good as the craftsman who wields it. And the best product, if launched at the wrong

time, or launched ahead of its time, would not be effective. The Malaysian system was developed and implemented in a stable economic environment, after the financial system had been restructured, and the financial system was strong and robust. There also exists strong and appropriate regulation, effective supervision of the financial system, and strong legal and accounting regimes.

12. In contrast, there are many examples of countries which had established deposit insurance systems without the necessary foundation or the right conditions. Some countries have introduced deposit insurance at a time when their banking systems were unstable and when banks were failing. In such circumstances, the deposit insurance system has little chance to promote or contribute to the stability of a country's financial system.

13. Ladies and Gentlemen, having highlighted some experiences of Malaysia, I would like to share some of my thoughts on how this may be relevant for China. China is at an important cross-road. As it advances into the new digital and techno-savvy global economy, the financial system is being modernized to support economic expansion.

14. Given the faster pace of liberalization, maintaining financial stability becomes an ever increasing important objective. Indeed, financial system stability is increasingly seen as a policy objective to be achieved together with monetary stability. Enhancing depositor confidence is a critical pillar for financial stability.

15. In developing an effective deposit insurance system, policy makers must first of all consider a number of public objectives. This included the scope of its role within the financial safety net. For instance, should it be a pay-box, a loss minimiser or a risk mitigator? Each has advantages and disadvantages.

16. In the Malaysian situation, the initial policy objective was to apply a pay-box. But as the policy discussions deepened, it was clear that the

soundness of the financial safety net would be better enhanced with a deposit insurer that had a broader role. The lessons of the past, the experience and success of Pengurusan Danaharta Nasional Berhad underscored the need for the deposit insurer to have powers to resolve problem member institutions with a view to minimise risks and in a manner that would minimise losses to the financial system.

17. Having resolved the scope of its role, a policy decision had to be made on the trigger mechanism for intervention, including how and when the deposit insurer should exercise its powers to resolve problem banks.

18. Recognising that the central bank could not, at any time, abdicate its responsibilities as the regulator and supervisor of a problem financial institution, we therefore devised a trigger mechanism which required the central bank to determine the viability of a member. If that determination is not made, the deposit insurer cannot exercise its resolution powers. This trigger mechanism provided a clear accountability framework between the two principal players within the financial safety net.

19. Another salient issue that requires close policy attention is the coordination and information sharing arrangement. In Malaysia, we were determined not to repeat the mistakes of others. Indeed, information exchange and information sharing arrangements are legislated in the MDIC Act. The Act also provides that a strategic agreement be entered into between MDIC and the central bank. The agreement will be a working tool to ensure the relationship remains collaborative, effective and symbiotic.

20. Ladies and gentlemen, as Chairman of the FSF Working Group on Deposit Insurance, my views on inclusion of state-owned banks are, of course, well documented. The Report outlines that in some countries, state-owned banks are included in the deposit insurance system since such banks,

depending on their size, may enhance the stability of the financial system. On this issue, I am aware that policy makers in China are giving much attention to the question of whether state-owned banks should be included as members of the deposit insurance system.

21. This policy decision should be considered in light of the overall public policy objectives that are chosen. I understand that Chinese state-owned banks are significant players in the financial system. In this regard, I would like to pose three questions.

- What is the market share of state-owned banks in the overall financial system?
- What is the strategic direction and objective of the national agenda and do state-owned banks have a role under this agenda?
- What key results or objectives does China hope to achieve with state-owned banks by including them into the deposit insurance system?

22. I would suggest four possible key results for discussion and broadly touch on the benefits that membership of state-owned banks would bring to the financial system.

First : To reduce the Government's 100% guarantee on deposits of state-owned banks.

Second : To enhance supervision and risk management practices of state-owned banks through an incentive based deposit insurance system;

Third : To transition state-owned banks towards higher best banking practices; and

Fourth : To facilitate leveling of the playing field in the banking system.

23. The benefits are clear to me. Deposit insurance will bring state banks onto the mainstream of bank regulation and supervision. Under an explicit limited deposit insurance system, state banks would be subjected broadly to the same market forces and the same level of market discipline as other banks. Such a system inevitably creates a class of depositors who would have clear incentives to monitor state banks' risk-taking. While it may not be possible to immediately apply the same regulatory standards to state banks, deposit insurance may be designed to allow state banks to transition towards higher regulatory standards. During this transition process, there will be opportunities for the regulator with the assistance of the deposit insurer, to develop comprehensive and integrated measures to provide incentives for state-owned banks that are in line with the national strategic objectives and to achieve the desired key results.

24. To summarise, my view is that state-owned banks may be included to ensure competitive equity and diversify the deposit insurer's risks. In such cases, prudential, regulatory and supervisory rules are applicable.

25. In addition, the rise of consumerism provides the perfect opportunity for regulators to re-assess the existing regulatory and supervisory structure. This opportunity enables regulators to address existing regulatory gaps in the supervisory system through new deposit insurance legislation. This gives a second chance to get things right. Why not seize the opportunity?

26. I am pleased to note that many of my friends and colleagues are also here today to give you their own perspectives on these and other related matters. It should be a highly interesting one and half day dialogue. I would suggest that you take advantage of the seminar and not hesitate to get into the discussions by asking questions. I would also suggest that you feel free

to discuss any matters during the breaks and meals. Building personal relationships should also be an important objective.

27. In closing, I wish to thank the organizers for putting on this forum. This is a great way to kick off discussions on the Objectives, Processes and Timing that are needed for building an effective deposit insurance system for the benefit of the people of China.

On that note, I wish you successful deliberations.

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