Maintaining Confidence in the Financial System

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Wednesday, 2nd Dec 2020

Contagion. It's a word we have heard all too often in 2020, as the coronavirus continues to plunder and devastate public health and upend the world's sense of normality. COVID-19 has also highlighted the interdependencies of modern life. The global supply chains and just-in-time manufacturing processes for consumer goods. Food security issues related to a heavy dependence on imported food stocks, not to mention the global nature of many of our business practices and leisure pursuits. It has also shown that unpredicted shocks reduce our ability to provide agile responses to the disruption.

So far, contagion has not spread to global financial markets. The only major runs we have seen have been on toilet paper, canned foods and other essential supplies, sparked by fears of future shortages or supply chain interruptions. For financial shocks, deposit insurance schemes - like the one operated by PIDM - play an important role in protecting bank deposits and assuring depositors that the savings covered by such schemes are not at risk.

In 2005, the Akta Perbadanan Insurans Deposit Malaysia created the national authority Perbadanan Insurans Deposit Malaysia (PIDM) to run a Deposit Insurance System (DIS) to protect the interests and savings of retail depositors in Malaysia. That coverage was expanded in 2010, when PIDM was tasked with protecting takaful certificate and insurance policy owners under the Takaful and Insurance Benefits Protection Scheme (TIPS).

As most people are aware, when they look at their bank balances on the screen, the deposit balances they see are not physically held in cash by the bank. Only a small portion of those deposits are backed by liquid assets - physical money. The remainder of that deposited cash the bank then extends as loans, of variable duration, to borrowers.

Given the mismatch between a bank's expected return from borrowers (its long term assets), and its need to pay back depositors on demand (its short term liabilities), Bank Negara Malaysia (BNM) imposes prudential requirements on banks to ensure they do not run into situations when they are unable to pay depositors on demand. This is enforced through measures such as BNM's Statutory Reserve Requirement and tools like the Liquidity Coverage Ratio.

Fears about a bank's ability to repay depositors can lead to sudden and panicked mass withdrawals (bank runs), causing problems for the banks, and, if not managed, for depositors themselves. In today's climate, where uncertainties are swirling around many aspects of our lives, maintaining the confidence of depositors in banks is critical. PIDM's role is to contribute to public confidence in the banking system, so that banks can play their role as intermediaries, channelling deposits and other funds to productive use, providing the necessary capital for economic development.

Prompt access to funds when deposits are in jeopardy.

To be protected by PIDM, consumers don't need to sign up or pay for anything. Protection under PIDM's DIS and TIPS schemes is automatic and free of charge. Membership of PIDM, which now covers 92 banks and insurers, is mandatory for all commercial banks and insurance companies licensed under the Financial Services Act (FSA) 2013 and Islamic banks and takaful operators licensed under the Islamic Financial Services Act (IFSA) 2013.

The premiums for such protection are paid by PIDM's member institutions, individually calculated against their risk profiles. These are placed into PIDM's funds to insure depositors and policy owners against a member institution's failure.

In the case of the DIS operated by PIDM, the deposits of a liquidated bank are protected to a limit of RM250,000 per depositor per member bank. Coverage extends to savings and current accounts, fixed deposits, foreign currency deposits and Islamic deposit accounts. For TIPS, the benefits in the takaful certificates and insurance policies are protected up to a limit of RM500,000 per eligible benefit (based on the policy's aggregated guaranteed surrender value).

In Malaysia, 97% of all retail bank depositors are covered in full by PIDM's protections, having less than RM250,000 in their accounts. In the unlikely event that a bank under PIDM's protection fails and is liquidated - its assets sold off to cover its liabilities - savings in excess of RM250,000 are not necessarily unprotected. Those deposits may still be insured in excess of RM250,000 if they are deposited in different types of accounts within the same bank.

For example, if funds are held in Islamic accounts as well as conventional ones, in trust, joint accounts, or in several other types of account, like sole proprietor, these deposits are protected separately. Even if all of the savings are deposited in one type of account at the same bank, the depositor can still file a claim with the liquidator for the return of funds in excess of RM250,000, depending on the availability of the assets of the failed bank in liquidation.

Closure and liquidation is a worst-case scenario. In most instances, PIDM will use its resolution powers to enact measures to prevent a bank from having to declare itself unable to meet its liabilities and trigger payouts under the terms of those DIS and TIPS protections. Depending on a least cost assessment, resolution might involve a transfer and sale of assets and liabilities, or a sale of shares in the troubled bank, or the establishment of a temporary bridge bank to run the bank's business, which will later be sold to a private entity.

In these instances, consumers would be largely unaffected and continue their relationship with the restructured or sold bank, or the new entity, with minimal disruption.

Helping to minimise risks in the financial system

PIDM also helps provide incentives for sound risk management within the industry. Its differential premiums system imposes premiums on member institutions at differential rates, depending on their risk profiles. The better the sound risk management category in which the institution falls, the lower the premium rate imposed on that institution.

In some countries, deposit insurance operates as a 'paybox' system, meaning its role is only to reimburse depositors once an insured institution has been closed. In other nations, the mandate is wider, encompassing risk minimisation functions. Risk minimisers, such as PIDM, carry out monitoring of member institutions, obtain information about member institutions, and have a wide range of early intervention and resolution powers. Depending on the troubled institution and the circumstances, the earlier PIDM is able to intervene, the better its range of solutions and protection for depositors.

Which brings us back to contagion. This kind of early intervention can help to minimise those contagion effects, and reduce the wider, adverse implications of their spread to the rest of the financial system. PIDM works collaboratively and closely with Bank Negara Malaysia, as well as the Ministry of Finance, and continuously monitors the state of health of its member institutions on an ongoing basis to maintain the country's financial safety net,

No one knows for sure how long this current pandemic will last or what the consequences are likely to be. While we wait for the soon-to-be released COVID-19 vaccines to be widely available, we can at least be assured that PIDM will help support the stability of the financial system, and protect depositors against shocks and contagion.

More information about PIDM can be found at its website www.pidm.gov.my