

PIDM's Islamic Protection Systems

Part 1: Protection of deposits in the Islamic banking system

Thursday, 24th June 2021

Preservation of wealth is one of the objectives of Shariah; the other objectives being the preservation of the faith or religion, the preservation of life or human self, the preservation of the intellect or mind, and the preservation of lineage.

With this in mind, Malaysia, a multicultural country with a predominantly Muslim population, has adopted a dual banking system – where the conventional banking system operates side-by-side with the Islamic one, without inter-mingling – since the early 80s.

The economist and writer, Mushtak Parker, observed that "Malaysia's march towards achieving dual financial system parity in a mere three decades or so has been truly remarkable and impressive."¹ According to Fitch Ratings, the share of Islamic financing in the banking system reached 37% by end-2020, up from 35% at end-2019, with Islamic financing contributing nearly all of the banking sector's growth in 2020.² This was driven by household financing and banks that promoted Islamic products as part of their "Islamic First" strategy.

Nevertheless, at the back of such growth and the current economic challenges, many have asked if their deposits in the Islamic banking system are protected? The answer is "Yes". Such protection is for the purposes of promoting public confidence in Malaysia's financial system.

¹ Bernama article dated 10 March 2021, <https://www.bernama.com/en/thoughts/news.php?id=1938976>

² Fitch Ratings commentary dated 28 February 2021, <https://www.fitchratings.com/research/banks/malaysia-islamic-banking-sector-continues-to-expand-despite-pandemic-28-02-2021#:~:text=The%20share%20of%20Islamic%20financing,the%20%22Islamic%20First%22%20strategy.>

Deposit insurance is a system that protects savings or deposits in a bank in the unlikely event that a bank fails, or in other words, becomes bankrupt. In Malaysia, the Government established Perbadanan Insurans Deposit Malaysia (PIDM) in 2005 to administer the Deposit Insurance System (DIS) under Akta Perbadanan Insurans Deposit Malaysia. DIS protects eligible deposits up to RM250,000 per depositor per member bank in the unlikely event a PIDM member bank fails. The protection is provided by PIDM automatically, with no application or payment required.

In the event a member bank fails, PIDM will ensure that protected depositors will have continued access to their deposits. It is important for the public to be aware that their monies saved in member banks are protected by PIDM as this gives them confidence in the stability of the banking system. This in turn, would prevent significant deposit withdrawals when a member bank faces financial trouble or fake news and rumours relating to member banks goes viral on the media.

From the perspective of Shariah, although deposit insurance is acceptable, the system still needs to be administered in accordance with Shariah requirements. A deposit insurance system that conforms with Shariah requirements serves two purposes. First, if reimbursements were to be made by PIDM,³ it allows the reimbursement to be made from PIDM's Shariah compliant sources of funds. Second, it complements Malaysia's overall Islamic financial system for an end-to-end Shariah compliant banking system.

PIDM's Islamic Deposit Insurance System (IDIS) is Shariah compliant. This means that the end-to-end operations of the system, such as premiums collection and management as well as failure resolution of a failed Islamic member bank (IMB), needs to be free from prohibited elements such as interest, gambling and uncertainty (for example, uncertainty in relation to the terms or subject matter of the contract). For this purpose, PIDM refers to and applies the rulings of the Shariah Advisory Council of Bank Negara Malaysia – the highest Shariah authority that provides rulings on matters regarding Islamic banking and takaful in Malaysia.

The objectives and design features of IDIS and the Conventional Deposit Insurance System are the same. However, there are some unique features of IDIS due to Shariah requirements, as follows:

- ◆ Protection for Islamic deposits;
- ◆ Separation of premiums collected from its member banks' Islamic and conventional banking businesses and maintenance of these premiums separately in its Islamic Deposit Insurance Fund (IDIF) and its Conventional Deposit Insurance Fund respectively;
- ◆ Resolution of a failed IMB in accordance with Shariah requirements;
- ◆ Utilisation of IDIF for permissible day-to-day expenditures; and
- ◆ Investment or placement of IDIF surpluses in Shariah-compliant instruments.

The Association of Islamic Banking and Financial Institutions Malaysia (AIBIM) expects half of Malaysia's banking assets to be Islamic by 2030,⁴ and as Islamic banking continues to grow, PIDM, within its mandate, will continue to enhance our deposit insurance and failure resolution functions to ensure continuous protection of insured Islamic deposits.

Coming next:

Part 2: Shariah Arrangement for PIDM's Islamic Deposit Insurance System

³ In the event a failed member bank is wound up, PIDM will promptly reimburse depositors in respect of their protected deposits, based on the depositor records obtained from the member bank.

⁴ As stated in NST Online article dated 5 February 2020, <https://www.nst.com.my/business/2020/02/562894/half-malaysias-banking-assets-be-islamic-next-decade>