

**12<sup>th</sup> MALAYSIAN BANKING SUMMIT**  
**“Taking the Leap in Paradigm Shift of Banking – New Wave, New Ventures”**  
**5 & 6 June 2008, Prince Hotel & Residence, Kuala Lumpur**

**Session 7: Deposit Insurance –**  
**Protecting Malaysian Consumers and Promoting Sound Risk Management**

**Speech By**

**Jean Pierre Sabourin**  
**Chief Executive Officer**  
**Perbadanan Insurans Deposit Malaysia**

Good afternoon Ladies and Gentlemen.

I am delighted to be participating at this Summit to share views on measures adopted by PIDM to protect Malaysian consumers and promote sound risk management in commercial and Islamic banks. I would like to start by congratulating the organisers for coming up with a program that is relevant and of interest to the banking sector and members of the public.

The last 12 months have seen a period of turbulence in global financial markets that have affected financial firms across the world including developed economies. This has led to heightened concerns amongst depositors and financial services consumers with renewed interest in the contributions of an effective deposit insurance system. The recent challenges have also brought into sharper focus the need for greater cooperation and policy coordination amongst safety net players both internationally and nationally.

This is not surprising. A well designed safety net is central to the stability and smooth functioning of a financial system. Besides prudential regulation and supervision, and the lender-of-last-resort function, an effective deposit insurance system is a vital component of any safety net system. This is because an effective system complements and supports the supervisors in accomplishing their mandates. Deposit insurance systems

promote financial stability by providing depositors with an explicit protection over the safety of their deposits. This effectively contributes to enhanced public confidence in the banking system. Deposit insurance systems also work in tandem with bank supervisors to minimise the occurrence of bank failures by imposing sound regulations and compliance requirements on member banks, thereby contributing to financial system stability.

In the light of these global developments, I shall focus my remarks on:

- (i) PIDM's role in protecting depositors' interest by building depositor confidence through optimal coverage, minimizing moral hazard and how depositors can apply deposit insurance knowledge to benefit themselves; and
- (ii) PIDM's role in promoting sound risk management practices in the financial system as part of efforts to promote financial stability.

### **Protecting depositors' interest**

Ladies and Gentlemen,

Many of you in the audience may be aware that Bank Negara Malaysia has been the driving force behind the design and establishment of PIDM and the salient features of the deposit insurance system. Such a system is part of Bank Negara's Financial Sector Masterplan measures to further enhance consumer protection infrastructure. Additionally, Bank Negara specifically designed the deposit insurance system to complement its role in maintaining stability of the financial system by building depositor confidence in the safety of deposits in the banking system and by providing incentives for sound risk management. These objectives are built into PIDM's statutory mandate.

In respect of PIDM's consumer protection mandate, this is part of our broader mandate to promote and contribute to the stability of the financial system. As a deposit insurer, our role is to build depositor confidence in the safety and stability of Malaysia's financial system. To meet this mandate, the deposit insurance system has incorporated many

features that are designed specifically to protect the interest of depositors. I shall just highlight a few of these. They are:

- An adequate insurance limit of RM60,000 per depositor per member institution. At this limit, the majority of retail depositors are fully protected.
- Separate coverage for Islamic and conventional deposits, joint accounts, trust accounts and accounts held under a sole proprietorship, partnership or professional practice. Essentially, a depositor could also obtain a substantial level of protection by depositing funds in different accounts and in different member banks, if they so desire.
- And to ensure depositors are not unduly inconvenienced in the unlikely event of a bank failure, PIDM will make deposit insurance payments to depositors expeditiously without the need for depositors to file claims or make representations.

### **Optimal coverage level and limits**

Let me make a few observations on the appropriateness of the coverage and limits of deposit insurance protection. In determining the coverage level and limits, two issues were considered, namely minimising moral hazard and protecting retail depositors. A limit that is too low would fail to meet PIDM's objectives to promote and contribute to public confidence. On the other hand, a limit that is too high reduces the incentives for depositors to exert market discipline while increasing incentives for our member banks to take higher risks. The current limit of RM60,000 was established based on two deposit surveys conducted by Bank Negara. And under this coverage limit, the Malaysia deposit insurance system also provides for a wide coverage of separate accounts. The surveys indicated that at this coverage limit the majority of retail depositors could be fully protected. From PIDM's perspective, the present coverage limit is optimal as it balances the two issues of moral hazard and consumer protection highlighted earlier. At this limit, about 95% of retail depositors are fully protected but covers only 35% of total value of bank deposits. Therefore, while retail depositors are protected, there remain financial incentives for more high net worth, commercial enterprises and other sophisticated depositors to discipline member banks.

## **Applying deposit insurance knowledge**

Ladies and Gentlemen,

As the Malaysian economy evolves towards an increasingly market oriented financial system, where banks are expected to undertake greater responsibility for self regulation and less “hands-on supervision” by Bank Negara Malaysia, financial services consumers must know their rights and obligations as depositors. In respect of deposit insurance, at the very least, depositors must know the features, the benefits and limitations of the deposit insurance system. Unless they know, they cannot make informed financial decisions. Hence, depositor protection must start with public awareness. And, in our view, awareness and clear understanding by the public with regard to the main features of deposit insurance is a key element to PIDM's success as an effective best practice deposit insurer. An informed depositor who is aware and confident in the safety of their deposits contributes to the stability of the financial system.

## **Deposit insurance information material**

In PIDM, we have implemented several measures to build consumer awareness. As most of you would be aware, we have published information brochures which contain salient information on deposit insurance and PIDM, in six languages including Kadazandusun and Iban. These brochures are provided free of charge to the public and our member banks and are readily available to customers at all member branches. To date, we have distributed a total of 5 million copies of our information brochures across the country.

We have also other publications on deposit insurance which depositors will find of interest. These include our Deposit Insurance Handbook which explains the computation of deposit insurance coverage and limits. This is extremely useful for depositors who may wish to understand the amount of deposit insurance coverage for joint accounts and accounts held in a single depositor's name as well as trust deposit accounts. Our tagline for this year is ‘Do you know if your deposits are protected?’ As a depositor, you should find out for yourself! Collect a copy of our information brochure

and become an informed depositor. I also encourage you to visit our booth and pick up the relevant documentation.

### **Information Regulations**

To ensure depositors have access to deposit insurance information in a timely manner, we will be enacting a set of Information Regulations in the third quarter of this year. These Regulations will put in place minimum requirements to be adhered to by member banks pertaining to the dissemination of accurate information on deposit insurance and PIDM. Among others, member banks will be required to disclose to their customers in writing which of their deposit products are insured by PIDM and those that are not. Such information is important to enable depositors to make informed deposit-related financial decisions consistent with their risk appetite. Depositors would also be able to request a printout of the list of insured deposit products from their bank, free of charge. In addition, our member banks would be required to represent to the public that they are member banks of PIDM. Every branch will also be required to affix our membership sign on advertisements for deposit products. Furthermore, a depositor opening a new account will receive an information brochure from his bank at that time! This initiative is another example of our commitment to ensure that depositors are well informed.

### **Direct enquiries to PIDM**

Depositors may also make enquiries through our one-stop Call Centre that is dedicated to handling public queries free of charge. Our call centre operators are fluent in the four languages of English, Bahasa Malaysia, Mandarin and Tamil. PIDM also maintains a website in these four languages so that the public can have access to comprehensive information about deposit insurance through the internet at any hour of the day in their language of choice. Our Annual Report and Corporate Plan are also available in these four languages on our website.

We have also produced a PIDM Information Video which we screen in Malaysia and internationally as a way of disseminating awareness of deposit insurance and PIDM. The Video is available in both English and Bahasa Malaysia. Here it is!

Ladies and Gentlemen, I hope you have enjoyed our Information Video. It provides information on the benefits and limitations of deposit insurance as well as on PIDM. We believe that a lack of awareness of the deposit insurance system could have social and economic implications given the impact on public confidence. Depositors who are informed and confident of the safety of their insured deposits would be less susceptible to bank runs based on unfounded rumours or speculations relating to their bank.

### **PIDM's advertising campaign**

We also carry out a comprehensive advertising campaign through the mass media to promote awareness of deposit insurance. We recently launched our 2008 advertising campaign. This campaign is focussed and targeted to reach specific segments of the public. Prior to developing this campaign, we conducted a nationwide consumer survey subsequent to our 2007 advertising campaign. The nationwide consumer survey is conducted annually and is part of PIDM's policy of continuous validation and improvement. We can then set targets and key performance indicators for ourselves.

As a result, we have introduced new print advertisements as well as new TV and radio commercials. Our print advertisements are featured in English, Bahasa Malaysia, Chinese and Tamil newspapers while our radio commercials are aired in English, Bahasa Malaysia and Chinese. Our new TV commercials in Bahasa Malaysia are being aired on various television channels. You may have seen them! Later this month, PIDM will be launching infomercials in Chinese language on Astro TV channels. In the second half of 2008, we shall be developing an education program focussed on students for implementation in early 2009.

As at end-2007, the level of public awareness of PIDM and deposit insurance had reached 15% which, by any benchmark requires us to continue to increase the level of knowledge. Going forward, we will continue our efforts to elevate awareness and understanding of deposit insurance in fulfilling our mandate as the national deposit insurer and as an integral component of the consumer financial protection framework in Malaysia.

## **Promoting sound risk management practices**

Ladies and Gentlemen,

I shall now move on to discuss PIDM's role in promoting sound risk management practices in the financial system as part of our efforts to promote financial stability. You may be aware that PIDM has a specific obligation under the Malaysia Deposit Insurance Corporation Act to provide incentives for sound risk management in the financial system. It is part of PIDM's statutory mandate. As the national deposit insurer, PIDM is exposed to the risks inherent in our member banks. Although bank failures may be remote, regulators and supervisors are constantly watchful for signs of vulnerability as even the best banks can be seriously challenged by a loss of public confidence. For PIDM, promoting sound risk management among our member banks is critical as a means to minimise its deposit insurance risk exposure. And as member banks fund the deposit insurance system, they also have a stake in how PIDM performs its mandate and its responsibilities and how it manages its insurance exposure.

The wisdom behind PIDM's mandate to promote sound risk management is based on one simple business principle which is that "*sound risk management is a fundamental condition for an entity to survive in business*". The responsibility for implementing sound risk management is the responsibility of the entity's Board of Directors and management. However, it is also part of PIDM's responsibility to provide appropriate incentives for banks to implement and adhere to sound risk management policies and practices.

Today's business environment is about managing risks. This is particularly important in the business of banking where poor judgments or lack of controls may cause severe financial impact for the entire organisation.

In today's business environment, it is not enough for financial institutions to rely on experience as a basis for managing tomorrow's business. The business of banking and finance has become more complex than ever before. To navigate successfully, banks need a sound risk management framework and strategy that will minimise bad business decisions while encouraging good ones. Such a framework must ensure the

identification and management of all significant risks in a systematic and consolidated manner, in alignment with the organisation's risk appetite, strategic and business directions.

### **Differential premium systems (DPS)**

One of our most recent measures introduced in this area is PIDM's differential premium systems. As you would be aware, PIDM had since our establishment in 2005 assessed premiums against member banks based on a flat premium rate of 0.06% on total insured deposits held by our member banks. The weakness of such a premium system is its inability to assess premiums based on the risk posed by individual member banks to the Deposit Insurance Funds, both conventional and Islamic. We therefore made a policy to implement a differential premium system within two years so as to provide us time to develop a sound system and consult extensively with our stakeholders. In May this year we implemented our differential premium systems or DPS in short. As would be expected, the DPS corrects the major deficiencies of the flat premium system. For instance, there are now four premium categories against which our member banks may be assessed, depending on their respective risk profiles.

I am mindful that all participants from the banking sector would be familiar with the DPS. For the benefit of our audience who may not be from the banking industry, I shall highlight very briefly the salient features of the DPS. Unlike the flat premium system, the DPS scores differentiate our member banks by assessing them against a best model bank. The DPS uses both quantitative and qualitative factors. The quantitative factors account for a score of 60 out of 100. These include capital adequacy, profitability, efficiency, asset quality, asset concentration and asset growth. The remaining 40 points are based on qualitative factors which include Bank Negara supervisory rating and other information. The quantitative and qualitative scores are then added up. The total score determines the premium category and the premium rate against which the member bank would be assessed. There are four premium categories, from 1 to 4, with 1 being the lowest risk category. The premium rates applicable to the four premium categories also reflect the risk profiles of each category. Accordingly, the premium rates are 0.03%,

0.06%, 0.12% and 0.24% for the respective premium categories – that is a double-up effect.

### **Promoting sound risk management**

A question that has been often asked is how the DPS promotes sound risk management in banks?

By imposing higher premiums on higher risk profile banks, there are financial incentives for member banks to enhance their DPS scores and the DPS is intended to assist bank's Boards and management in this area. The quantitative ratios that comprise the DPS basket were specially selected to provide a snapshot view of the financial health of banks. The quantitative ratios are objective. Banks are therefore in a position to monitor and enhance their financial performance and soundness in the respective areas identified under the DPS. This in turn, would enable them to directly improve their DPS score. Although the DPS is designed to assess deposit insurance premiums based on the risk profile of banks, we would expect banks to use the DPS basket of ratios to regularly benchmark and monitor their own financial health. They may wish to do this on a half yearly or quarterly basis instead of annually to avoid any undue surprises.

We would therefore expect bank management to pay greater attention to the DPS scores. They would be expected to closely monitor the reasons for their respective risk profiles, implement improvements and monitor closely their performance against the DPS. In managing their DPS risk profile, we would also expect Board Directors and bank management to consider the cost benefit of continuously paying high premiums versus paying the cost of addressing deficiencies. I should add however that the higher risk banks will not only pay higher premiums but will be subject to enhanced monitoring by their supervisor and deposit insurer.

We also expect that the DPS would be used as a tool for the Board of Directors of member banks to enhance corporate governance. One of the key principles of corporate governance is for Board Directors to exercise appropriate oversight of executive management decisions and performance. This requires Board Directors to be

appropriately qualified, have all necessary information to exercise their responsibilities and also act in the best interest of depositors whose funds are entrusted for safekeeping. Banks are different and directors owe responsibility not only to shareholders but to depositors also.

As we have heard yesterday, the Malaysian banking system is moving towards greater self regulation. An offshoot of this is for our member banks to adopt high standards of corporate governance. This new environment would be more challenging – requiring greater interaction with bank management, greater awareness of banking business and more insightful analysis of risks and opportunities. To meet the challenges, Board Directors must without doubt collectively take on more responsibilities than ever before. Additionally, they must be prepared and able to perform their increasing responsibilities by enhancing their skills and knowledge on an ongoing basis.

With regard to the DPS, Board Directors should note that the DPS is strategically designed to motivate banks to work towards the best premium category. In order for the motivation to be effective, the DPS rewards lower risk profile banks with a substantial reduction in premiums. For example, a bank in the first premium category pays premium at only 0.03% compared with 0.24% under premium category 4. Improvements in risk profile translate immediately to cash incentive for banks. There is therefore a very strong financial incentive for bank management to enhance their risk management practices in order to improve their DPS scores. A deterioration in one year would be noticed immediately.

In keeping with the move towards greater governance, we would also expect Board Directors to use the DPS as one of the tools to monitor their banks' performance. A deterioration in their DPS rating is also a signal to Board Directors that they need to ensure that identified deficiencies are addressed promptly. Governance is not only about how management performs. It is about how both Board and management together improve the ROI for shareholders and maintain a sound financial institution. With the DPS, there is now a basis for Board Directors to assess their bank against a common set of objective standards. And should Board Directors require more

information, we would be very happy to conduct information sessions on the application of the DPS for them.

## **Conclusion**

Ladies and Gentlemen,

I shall conclude by drawing an observation on the relationship between consumer protection and sound risk management. The relationship is intuitively obvious. Banks with sound risk management are inherently expected to be strong or to grow stronger. And strong banks do not pose risks for depositors or deposit insurers with regard to the safety of their savings.

Well informed financial services consumers can also be a force to develop stronger banks. Growing a business is about wooing and growing consumers. By seeking information and following through with rational decisions, consumers send a signal to their banks in respect of what they like or do not like about their banks' performance. It is in line with this perspective that PIDM has approached its public information and awareness programs.

On that note, I would like to invite you as a depositor to become an informed consumer. Please visit our PIDM booth. But first, please take a couple of minutes to enjoy our advertisements.

Thank you.

Perbadanan Insurans Deposit Malaysia

6 June 2008

E:\Draft speeches\ASLI\_June08\_6June08. 5 pm version.doc