



Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

**RESPONSE TO THE CONSULTATION PAPER ON
THE PROPOSED GUIDELINES ON THE
CRITERIA FOR DETERMINING INSURED DEPOSITS**

ISSUE DATE : 20 SEPTEMBER 2007



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GENERAL OBSERVATION

On 19 June 2007, the Corporation released the Consultation Paper. We requested for responses and the closing date for written comments was 31 July 2007. We received written responses from 13 Member Institutions (MIs).

Except for one, most MIs were generally supportive of the objectives underpinning the proposals set out in the Consultation Paper. The main issues which concerned respondents related to the potential delay in launching new products as a result of the certification process, as well as the insurability of structured products and mudaraba deposits.

There were also some concerns expressed that the certification process would be onerous and add another layer of bureaucracy. It was suggested that:

- (i) the turnaround time for processing be less than the 14 days stipulated by the Corporation with suggestions ranging from 7 calendar days to 3 business days;
- (ii) MIs be allowed to determine the insurability of products for the Corporation; and
- (iii) that the Corporation begin the process to determine insurability one month after the launch of the product.

PIDM's view is that the certification process is a requisite as it enables the Corporation to properly and correctly ascertain its obligations, should it need to make deposit insurance payments to depositors. Certification also determines the premium base for MIs to assess premiums to be paid to the Corporation. Furthermore, certification provides depositors with up to date information on deposit products so that they will know without doubt whether such products are insured or not.

On the certification process, the Corporation will work towards shortening the processing period in practice. However, for the time being, the Corporation will maintain the turnaround time for the certification of products of within 14 business days from the date of submission. We will incorporate the certification process into the Guidelines once we complete our current review of the existing products by the end of the year.



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We will also request that MIs work with the Corporation and begin discussions with us early, during the product development process, so that the Corporation can have a better understanding of the product and can expedite the processing period from the date of actual submission of the products.

The written comments on the Consultation Paper have been given due consideration and the Response Paper containing the Corporation's responses can be found in the *Attachment*.

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Attachment

PIDM'S RESPONSES ON THE CONSULTATION PAPER ON THE PROPOSED GUIDELINES ON THE CRITERIA FOR DETERMINING INSURED DEPOSITS

(In respect of paragraph 5 of the Consultation Paper, under the heading called "Proposed Criteria"):

5. PROPOSED CRITERIA

Para 5.1(ii) Monies received by an MI do not constitute eligible deposits if they are payable outside Malaysia or foreign currency deposits or money market deposits or bearer deposits or pursuant to a negotiable instrument of deposit or repurchase agreement;

MIs' Comments: An MI asked whether deposit products under the International Currency Business Unit (ICBU) are covered.

PIDM's Comments: As the deposits are in foreign currencies, they are excluded from deposit insurance coverage under the Malaysia Deposit Insurance Corporation Act ("MDIC Act").

Para 5.1(iii) Monies are received by an MI in the usual course of its business of deposit-taking. This criterion would exclude monies received from the money market, the central bank, and monies provided to the MI strictly for payment transaction purposes (e.g. payment through GIRO);

MIs' Comments: An MI asked whether deposits in transit for payment through GIRO are excluded.

PIDM's Comments: Para 5.1(iii) of the Consultation Paper already explains that "*monies provided to the MI strictly for payment transaction purposes, for example, payment through GIRO, are excluded.*" PIDM will insert the above sentence in a footnote under criterion 3 in the Guidelines.



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Para 5.1(iv) Repayment of the principal amount is not made in money's worth and includes repayment by way of cash or cheque payment or crediting into a deposit account with an MI. This would exclude equity-linked deposits that require the delivery of shares. Interest or return, if any, may be repayable in money's worth;

MI's Comments: Some MIs were unclear on the requirements of this paragraph, such as whether it includes or excludes "money's worth", whether deposit products that involve bond delivery but settled in cash are excluded and whether index-linked deposits (e.g. those linked to bond or commodity performance) other than the type mentioned in the above paragraph, are excluded. One MI considered it practical to incorporate into the Guidelines that the "interest or return, if any, may be repayable in money's worth."

PIDM's Comments: The term "money's worth", as used in the MDIC Act, refers to something other than money, such as other types of assets e.g. gold, shares and bonds. The "equity-linked deposits" mentioned in Para 5.1(iv) of the Consultation Paper is merely intended to give an example to explain the preceding statement in the said paragraph and not intended to be exclusive. Index-linked deposits, whether linked to equity or bond or commodity performance or otherwise, may be insured if they satisfy PIDM's set of criteria. In particular, PIDM notes that the *principal* amount must be repaid by way of cash and not by way of delivery of other types of assets. In respect of interest or return in money's worth, PIDM will monitor the development of deposit products in the market and will consider whether such developments necessitate coverage for interest or returns in money's worth.

For clarity, criterion 4 in the Guidelines will be amended to read, "*Repayment of the principal amount is made in Malaysia and in Malaysian Ringgit currency, by way of cash or cheque payment or crediting into a deposit account with the MI.*"

Para 5.1(vii) In the case of a conventional product only, the contract between an MI and the depositor includes a term that the MI shall repay in full the monies received by it from the depositor at such time or in such circumstances as provided by the contract;

MI's Comments: A point was raised that for normal savings and current accounts, it is trite law that monies deposited in a bank are repayable on demand and that it is not necessary for this additional term to be incorporated into the contract in relation to savings and current accounts between banks and customers.

PIDM's Comments: This criterion is necessary given the evolution of deposit products in the market and is intended to apply across the various types of deposit products, not just normal savings and current accounts but also structured deposits.

For better clarity, criterion 8 in the Guidelines will be amended to read, *"In the case of a conventional product only, the agreement between an MI and the depositor includes a term that the MI shall repay in full the principal amount to the depositor at such time or in such circumstances as provided by the agreement."*

Para 5.1(viii) In the case of an Islamic product only, all monies deposited shall be used for one or more of the banking business purposes as specified by Bank Negara Malaysia ("BNM") in its Framework of the Rate of Return namely, provision of finance, investment in securities, interbank placements, or such other business prescribed by BNM that complies with Shariah.

MI's Comments: Some MIs suggested that this criterion be removed as it would restrict the use of the monies deposited with the MIs and would create confusion in compliance with the various guidelines of BNM and PIDM.

PIDM's Comments: This criterion is consistent with and reinforces the said BNM guidelines i.e. the Framework of the Rate of Return. The underlying principle of the Framework of the Rate of Return is that such deposits shall only be used in the provision of finance, investment in securities, interbank placements and such other business prescribed by BNM that complies with Shariah requirements.

Para 5.2 For clarity, structured deposit products would be eligible for deposit insurance coverage provided they meet all the above criteria. However, deposit products linked to credit derivatives, which are instruments designed for the trading/hedging of credit risk by corporations, are excluded.

MIs' Comments: Some MIs were of the view that structured or index-linked products should be excluded from deposit insurance coverage. A few asked whether non-principal guaranteed structured products are insured and what would be the position if a portion of the principal is deducted for the investor's early redemption prior to the maturity date. One MI asked whether a Malaysian Ringgit deposit would be covered if the deposit was linked to the performance or exchange movement of foreign currency or involved a potential repayment in foreign currency.

PIDM's Comments: Index-linked deposits are not automatically excluded from deposit insurance coverage because the coverage of such structured products is contemplated by Section 62 of the MDIC Act.

A structured deposit product, with a guaranteed principal if held to maturity, may still be considered an insured deposit despite the contract providing for a deduction to be made from the principal amount on account of early withdrawal or redemption by the investor.

So long as the structured products satisfy PIDM's set criteria, they are treated as insured deposits. Hence, a Malaysian Ringgit deposit may still be considered an insured deposit despite being linked to the performance or exchange movement of foreign currency. However, it would not be treated as an insured deposit if it involves a potential repayment in foreign currency.

For certainty, the following will be incorporated as criterion 9 in the Guidelines, "A structured or index-linked product is eligible for deposit insurance provided:

- (a) *it satisfies the criteria set above; and*
- (b) *the monies deposited are not used for the trading or hedging of credit risk of or by the depositor."*



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There will also be a footnote inserted under criterion 8 in the Guidelines to explain that deductions may be made from the principal amount to account for the costs of unwinding the investment on early withdrawal or redemption by the investor prior to the maturity date of the investment.

Other Comments

MIs' Comments: An MI sought clarification on whether or not the following are insured, a) Hamish Jiddiyah (security deposit held as collateral), b) Urban (earnest money held after a contract is established as collateral to guarantee contract performance, c) dormant accounts/unclaimed monies. The MI was of the view that they should be excluded.

PIDM's Comments: Monies which are also provided to an MI as security (whether for a conventional credit facility or an Islamic financing facility) are also covered by deposit insurance if such monies constitute a deposit liability or are treated as a "deposit accepted" in the records of the MI. So long as the monies in the dormant accounts remain a deposit liability in the records of the MI and have not been transferred to the Registrar of Unclaimed Monies, such monies are also covered by deposit insurance.

Minor refinements

Criterion 5 in the Guidelines will be amended to read, "*The liability of the member institution in respect of monies received by it constitutes ~~or is treated as~~ a deposit liability or is treated as a `deposit accepted` in the records of the member institution including in its accounting records and the contract between the member institution and the depositor.*" This is to tie in with BNM's usage of terminology.

There will also be a footnote under criterion 5 to clarify that "*monies which are also provided to the member institution as security for a conventional credit facility or an Islamic financing facility are also included in this criterion if such monies are treated as a "deposit accepted" for purposes of FISS reporting to BNM.*"

Criterion 6 in the Guidelines will be amended to read "*The person entitled to a repayment by the member institution is identifiable from the contract ~~at the point of contracting~~ between the member institution and the depositor.*"

(In respect of paragraph 6 of the Consultation Paper, under the heading called "Certification Process"):

6. CERTIFICATION PROCESS

PIDM will hold further discussions with banks and thereafter publish a policy paper in relation to the certification process. The certification process will be incorporated into the Guidelines by the end of the year.

Para 6.1 PIDM's proposed process for assessing whether a product is an insured deposit is as follows:

(i) Before an MI offers a deposit product to depositors, the MI is required to submit to PIDM the following documents:

(A) The product brochures, pamphlets and application forms;

(B) The contract to be entered into between the MI and the depositor. (The contract contains the terms and conditions of the agreement made between the MI and the depositor including each party's rights or liabilities in relation to the product or the deposited monies.);

MIs' Comments: Some MIs were concerned that the certification process would be onerous and could potentially slow down product launch. They also commented that it would not be possible to submit the required documents to PIDM prior to product launch. One MI was unclear as to how product variations on previously certified products would be handled. Another was of the view that the requirements were repetitive of BNM's requirement and suggested that PIDM obtains documents from BNM through the Product Approval and Repository System (PARS).

Alternatively, some MIs suggested that there should be a self-certification process if products clearly meet all criteria of the Guidelines. Once introduced, the bank would update the Register of Insured Deposits if the new product was eligible for deposit insurance. Only in case of doubt would the MI write to or contact PIDM to seek clarification. For submission of documents, the MI suggested that it would be sufficient to provide the product term sheet/outline containing the product features and benefits, and mock-ups or soft copies of the product brochures which are still work-in-progress (where available). Some MIs also suggested that they should be given a specific time period after the launch of a product to submit the necessary documents to PIDM.



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PIDM's Comments: To protect the Corporation's interest, all new products and variations of existing products (whether involving any changes to their features or terms and conditions) are required to be submitted to PIDM for prior certification. If the brochures, application forms and contracts are not printed in time for the submission to PIDM, PIDM will accept mock-ups or soft copies of the product brochures, application forms and the full set of the terms and conditions pertaining to the product. PIDM will work towards an electronic filing system.

The certification by the Corporation prior to a product launch or sale, and the review of variations by the Corporation, are crucial to protect the Corporation's interest for the following reasons:

- If a deposit product is insured, depositors will know with certainty which products are insured or not insured by PIDM. Such information is important to protect depositors and is in line with increasing public expectations for protection of consumers in the financial industry. The availability of information on insured status of deposit products and access to such information will promote financial literacy and empowerment among depositors as well as encourage them to make informed decisions.
- If a deposit product is insured, then the deposit will be subject to assessments for premiums to be paid by the MI to the Corporation. The certification determines the premium base for MIs to compute and the Corporation to assess and collect premiums. MIs should note that there are financial implications for both the MI and the Corporation.
- The assessment of insured deposits would enable PIDM to ascertain its liability in the unlikely event of a bank failure, to meet its insurance payment obligations to depositors.
- Given the importance of building the deposit insurance fund and administering the deposit insurance system, as well as maintaining public trust and confidence in the MIs (including their practices and products), PIDM has to ensure that its policies are geared to the achievement of its mandate.

Para 6.1(i)(C) In the case of an Islamic product only, a written declaration by the MI, signed by the MI's designated senior officer ...

MIs' Comments: An MI asked for a clarification on "senior officer".

PIDM's Comments: Both conventional and Islamic products require written declarations by MIs' designated senior officers. A senior officer should be an MI officer holding a senior position in management or charged with the responsibility of a department within the MI, and is able to engage PIDM in discussions and clarifications on the product.

Para 6.1(i)(C)(a) The Shariah principle(s) under which the contract is made and that its Shariah Committee has duly approved the contract pursuant to the Shariah principle(s);

MIs' Comments: An MI considered this process to have been covered by BNM and that it should be excluded from PIDM's Guidelines.

PIDM's Comments: The MI is expected to make the submission to the Corporation as soon as possible after developing the product and is certainly required to submit to the Corporation either before or at the same time as the MI's submission to BNM.

Para 6.1(i)(C)(d) that the MI shall require the depositor to open a deposit account with it and the MI shall provide the depositor with regular statements or any document or confirmation in electronic form showing the account balance.

MIs' Comments: A respondent commented that while this is possible for some of the deposit products, it will not be possible for certain insurable deposits like manager cheques or bank drafts which are issued to beneficiaries who are not MI's customers.

PIDM's Comments: This requirement is in respect of a deposit product which falls within the criteria set by PIDM (i.e. an insured deposit) and not in respect of a mode of payment.



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Para 6.1(i)(E) Where applicable, a written opinion by an MI's solicitors or an MI's Shariah Committee on how the product satisfies the criteria set by PIDM; and

MI's Comments: Some MIs prefer the option whereby an opinion by the Bank's Legal Counsel and Compliance Department would be sufficient for this purpose as they are an independent party to the development of the product.

PIDM's Comments: PIDM is agreeable with the suggestion and will accept a written opinion by an MI's solicitors or an MI's Shariah Committee or the Head of the Legal/Compliance Department.

(In respect of paragraph 7 of the Consultation Paper, under the heading called "Transition Timeline"):

7. TRANSITION TIMELINE

Para 7.3 In relation to such new products offered from 2008 onwards, the product will be certified or endorsed by the Corporation within 14 business days from the date of a submission duly made (with complete documents). If an MI needs the Corporation to revert earlier, the MI must include the written opinion specified under paragraph 6.1(i)(E) above.

MI's Comments: A 14-business-day endorsement from the Corporation is considered excessive. An MI recommended no more than a maximum 3 business days turnaround time from PIDM on the product certification or endorsement. Another timeline suggested was 7 calendar days instead of 14 business days.

PIDM's Comments: As this certification process is newly developed and PIDM has not determined the various types of products currently or previously available in the market, PIDM is of the view that 14 business days are reasonable. The MI is expected to make the submission to the Corporation as soon as possible after developing the product (not at the stage when the MI is considering a launch or discussing the time for launching). PIDM will work towards shortening the certification period after implementing the process next year.



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(In respect of paragraph 9 of the Consultation Paper, under the heading called “PIDM’s Obligations”):

9. PIDM’S OBLIGATIONS

Para 9.1 In the unlikely event of a bank failure, for conventional and Islamic deposits, PIDM is required to make deposit insurance payments to depositors of up to RM60,000 (inclusive of principal and interest or in the case of Islamic deposits, principal and return) for monies that are specified as deposits by PIDM, on an aggregated basis for each depositor and based on the separate coverage provided under the Act (e.g. trust, joint or partnership deposits). Additionally, deposit insurance payments will be subjected to the priority ranking of Shariah products. Islamic deposits based on custody (e.g. Wadiah yad Damanah) will rank ahead of other Islamic deposits.

MIs’ Comments: Some respondents were of the view that there should not be a priority in term of the payment since aggregation is done across all types of Islamic deposits in term of determining the amount of insurable deposits save for the case made below for Mudaraba investments. Another asked whether the returns cover those that have been accrued but not paid under the General Investment Account.

PIDM’s Comments: Section 82(2) of the MDIC Act expressly provides for the priority ranking of Islamic deposits. PIDM’s coverage also includes returns that have been accrued but not paid under the General Investment Account.



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Para 9.2 For Islamic deposits, PIDM's legal obligations in respect of deposit insurance payments will be subjected to the terms of the respective Shariah contracts. Therefore, for contracts where the depositors bear the risk of losing part or all of their deposits (capital), PIDM will make insurance payments subject to such losses. For example, if a depositor invests RM60,000 in a Mudaraba deposit, and at the time of the bank failure, the current value of the investment totals RM50,000 only, PIDM will make an insurance payment of up to RM50,000 accordingly.

Mis' Comments: One respondent is of the opinion that this clause is difficult to apply to general investment deposit as it will be challenging to communicate to depositors as to the amount that are insured. Depositors would assume that since the deposits are insured that they are entitled to full coverage. The respondent felt that Mudaraba funds should be excluded from insurance coverage since investors are willing to take the risk. Another respondent is of the view that if the failure is due to the negligence of the bank, the payout should be up to RM60,000 even though the current value had dropped to RM50,000.

PIDM's Comments: The definition of an Islamic deposit under section 2(1) of the MDIC Act covers a Mudaraba deposit. PIDM will be developing a policy on how to assess and determine the amount of insurance payments to depositors, taking into account factors such as the nature of the deposits.



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PERBADANAN INSURANS DEPOSIT MALAYSIA

GUIDELINES ON THE CRITERIA FOR DETERMINING INSURED DEPOSITS

These guidelines are made pursuant to the powers conferred by subsections 36(a)(iii) and (F) and section 100 of the Malaysia Deposit Insurance Corporation Act 2005 (the "Act").

Criteria

In determining whether a product offered by a member institution is a deposit eligible for deposit insurance under the Act (the "insured deposit"), the Corporation will apply the following criteria:

1. Monies received by the member institution constitute an Islamic deposit or a conventional deposit, whichever is the case, as defined in section 2(1) of the Act;
2. Monies received by the member institution do not constitute insured deposits if they are payable outside Malaysia or foreign currency deposits or money market deposits or bearer deposits or pursuant to a negotiable instrument of deposit or repurchase agreement;
3. Monies are received by the member institution in the usual course of its business of deposit-taking;¹
4. Repayment of the principal amount is made in Malaysia and in Malaysian Ringgit currency, by way of cash or cheque payment or crediting into a deposit account with the member institution;
5. The liability of the member institution in respect of monies received by it constitutes a deposit liability or is treated as a "deposit accepted" in the records of the member institution;²
6. The person entitled to a repayment by the member institution is identifiable from the contract between the member institution and the depositor;

¹ This criterion will exclude, for example, monies received from the central bank and monies received by the member institution strictly for the purpose of payment transactions (e.g. payment through GIRO).

² Monies which are also provided to the member institution as security for a conventional credit facility or an Islamic financing facility are also included in this criterion if such monies are treated as a "deposit accepted" for purposes of FISS reporting to Bank Negara Malaysia.



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7. In the case of an Islamic product only, the monies deposited shall be used by the member institution for one or more of the banking business purposes as specified by Bank Negara Malaysia in its Framework of Rate of Return namely, provision of finance, investment in securities, interbank placements, or such other business prescribed by Bank Negara Malaysia that complies with Shariah;
8. In the case of a conventional product only, the agreement between a member institution and the depositor includes a term that the member institution shall repay in full the principal amount to the depositor at such time or in such circumstances as provided by the agreement;³ and
9. A structured or index-linked deposit is eligible for deposit insurance provided:
- (a) it satisfied the criteria set above; and
 - (b) the monies deposited are not used for the trading or hedging of credit risk of or by the depositor.

Effective Date

These Guidelines come into operation on 1 January 2008.

Issued on [] December 2007
Malaysia Deposit Insurance Corporation

³ Deductions may be made from the principal amount to account for the costs of unwinding an investment (e.g. a structured or index-linked deposit) on early withdrawal or redemption by the investor prior to the maturity date of such investment.