



Perbadanan Insurans Deposit Malaysia  
Malaysia Deposit Insurance Corporation

**Planning for a Seamless Transition from the  
Government Deposit Guarantee  
– Malaysia’s Approach**

## **Planning for a Seamless Transition from the Government Deposit Guarantee – Malaysia’s Approach**

**“On managing the exit, we have put in a lot of thoughts into developing a comprehensive and credible exit plan so that we can transition in a manner that would promote and enhance public confidence. With the level of detail and the attention we have given, the exit and the new way forward, we believe, will be a success story.”**

**J.P. Sabourin  
September 2010**

### **Introduction**

Ghost estates are now the most striking legacy of a once affluent nation, brought to its knees by the bursting of the house bubble, inflated by reckless bank lending. Ireland is that nation and it is the epicentre of the Government blanket guarantee tsunami. Hanging dangerously close to a complete financial meltdown, the Irish Government undertook to fully guarantee the debts and deposits of six major banks on 29<sup>th</sup> September 2008. Ireland’s action sent powerful shockwaves to other neighbouring countries, pressuring them to shore up their banks as the crisis intensified following the collapse of Lehman Brothers. Germany and Austria (retroactive to Oct 1<sup>st</sup>) were next followed by Denmark and Iceland. The blanket guarantee tsunami, eventually, reached the shores of East Asia, with Taiwan the first to announce a blanket guarantee on the 7<sup>th</sup> of October.

The next Asian country to announce a government guarantee was Hong Kong following similar announcements by Australia and New Zealand. Days later, given their financial inter-connectivity and to reduce the possibility of contagion arising from the global financial crisis, Malaysia and Singapore, in a coordinated effort, also announced a blanket guarantee on 16<sup>th</sup> October 2008.

Recognising that an uncoordinated withdrawal of support measures might have spillover effects on other countries, Malaysia, Singapore and Hong Kong pre-announced a common target exit date of 31<sup>st</sup> December 2010 and have also formed a regional tripartite working group to co-ordinate the scheduled exit.

On the 31<sup>st</sup> of December 2010, Malaysia successfully exited from the Government deposit guarantee (GDG). This case study outlines the Malaysian approach to a seamless GDG exit. The study highlights that careful and comprehensive planning, based on a thorough understanding of the consumer psyche and expectations, is key to a seamless exit.

This study is structured as follows. Section II explains why Malaysia implemented a blanket guarantee. Section III describes key considerations when planning for a seamless GDG exit. Section IV concludes.

### **Why a Blanket Guarantee?**

A blanket guarantee is often associated with high fiscal contingencies and moral hazard problems. Blanket guarantees may exacerbate risky behavior at banks and potentially increasing the costs of dealing with the problems at a later date. However, given the systemic nature of a crisis and the ensuing erosion of confidence, many governments, during the recent crisis, had no options but to introduce a broadly based guarantee of most bank liabilities to restore public confidence by eliminating the incentives to withdraw deposits.

However, in Malaysia's case, when the GDG was implemented, the banking institutions were sound and strongly capitalised with depositors' confidence still intact. There was ample liquidity to support economic growth. Capital flows were not significantly large or unusually volatile. And financial institutions were well-regulated and well-supervised by Bank Negara Malaysia, the Central Bank of Malaysia, with MDIC reinforcing financial discipline.

MDIC supports BNM in promoting financial prudence in the banking system through a number of ways. The first is through the implementation of its Differential Premium Systems, where deposit insurance premiums would be charged based on the banks' individual risk profile. Banks with higher risk profile are assessed higher premium rates, hence providing a financial incentive for banks to enhance sound risk management. The second is through the powers to impose premium surcharges for non-compliance and to terminate membership of non-viable banks and intervene promptly to find resolutions in a manner to minimise costs to the financial sector. And lastly, MDIC supports the supervisor through the imposition of its Terms and Conditions of

Membership, a regulation which sets out the obligations of its member banks as to MDIC's expectations with regard to their safety and soundness, liquidity requirements and information to be provided to MDIC.

Why then did Malaysia introduced a GDG? It was implemented as a pre-emptive and precautionary measure to prevent potential contagion effect stemming from cross-border capital flows, the possibility of deposit insurance arbitrage, and the competitive distortions among banks across jurisdictions.

Malaysia's GDG covered all ringgit and foreign currency deposits with commercial, Islamic and investment banks, and deposit taking development financial institutions regulated by BNM, were fully guaranteed by the Government through MDIC until December 2010. The guarantee was extended to all domestic and locally incorporated foreign banking institutions.

#### **Planning For a Seamless GDG Exit - Key Considerations**

In light of its potential distortions, a GDG is meant to be used only as a temporary measure and its withdrawal should be as quick as possible, although this would hinge on prevailing economic conditions.

It is much easier to introduce a GDG than it is to withdraw it. The difficulty lies in the complexity in managing public perception, which could be fickle. Hence, careful planning and execution are paramount. When should one start planning for an exit? From MDIC's perspective, the right time to begin developing an effective exit plan is at the conception of the GDG, as part of a comprehensive approach to the design of the GDG. Indeed, the task of withdrawing the GDG in Malaysia had been greatly facilitated with the inclusion of elements that eventually paved the way for its seamless removal, into the initial programmes that establish the GDG.

This section describes how MDIC had planned for a smooth exit from the GDG and the essential steps taken to ensure an effective execution of these plans.

Essentially, there were three steps in planning for a seamless GDG exit. The first was to set the

goals of the transition. The second was the design of an Exit Plan. The third was the selection of the right strategies, or the courses of action needed to achieve these goals, and their execution.

### **Step 1: Setting the Goals.**

There were three important goals essential to a seamless transition and all MDIC's initiatives were built around them. The goals were as follows:

- I. **Maintaining stability in the financial system** by ensuring public confidence in the safety of their deposits and developing an enhanced consumer financial protection package that could maintain public confidence with the expiry date of the GDG fast approaching. This is the primary objective in a transition from a blanket guarantee to normal conditions.
  
- II. **Maintaining and enhancing the credibility of the MDIC** during the period of the GDG. In many instances, the implementation of a blanket guarantee causes the deposit insurer to become inactive or to fade into the background during the period of the blanket guarantee. In Malaysia's case, the MDIC was not only heavily involved in planning and developing the whole GDG plan with BNM from the onset, it was also the agency responsible for administering the GDG and driving the GDG transition process. In this context, it was critically important for MDIC to be credible in the eyes of the public. Without depositors having confidence in the capability of MDIC, as the national deposit insurer, to ensure the safety of their deposits, it would be challenging to successfully manage and execute the transition plans. Therefore, a key part of our efforts revolved around promoting and reinforcing depositors' understanding of the role of MDIC within the safety net framework throughout the period of the GDG.

Measures implemented to maintain and promote the role of MDIC included:

- An official press statement by the Minister of Finance announcing that MDIC was responsible for administering the GDG on behalf of the Government. Hence, in the eyes of the public, MDIC was the official face or guarantor for all the guaranteed deposits;
  
- The responsibility given by the Government for MDIC to design the Exit Plan and drive the transition process;

- The continued functioning of MDIC's explicit deposit insurance system alongside the GDG. In other words, MDIC continued to administer the explicit limited deposit insurance system and insure deposits up to RM60,000 while the Government provided a blanket guarantee for deposits over and above the RM60,000 coverage limit and for other deposits not protected by MDIC. Transitioning were made easier as Malaysia only need to revert to an existing explicit deposit insurance system;
- The responsibility for MDIC to handle all media enquiries on the Enhanced Financial Consumer Protection Package and to deal with all depositors' queries on all matters relating to the GDG;
- A comprehensive public awareness campaign to promote and reinforce depositors' understanding of the role of MDIC within the safety net framework throughout the period of the GDG and to educate the public on the GDG. The campaign helped maintain MDIC's visibility with depositors; and
- Awareness campaign to promote and reinforce depositors' understanding of the role of MDIC within the safety net framework. The key message was to highlight the importance of an effective and efficient deposit insurer in contributing to the stability of the country's financial system at all times. Hence, in conjunction with MDIC's 5<sup>th</sup> anniversary in September, a five-part advertorial was also featured in English, Bahasa Malaysia and Chinese dailies to highlight MDIC's role and its achievements. In the last quarter of 2010, radio commercials were also aired to reinforce awareness on the role of MDIC as the protector of deposits.

**III. Mitigating moral hazard.** While potentially able to prevent bank runs during a crisis, Government guarantees are often associated with potential problems such as higher fiscal contingencies and moral hazard problems. Moral hazard arises because, with blanket guarantee, depositors no longer see the need to monitor and exert financial discipline on banks. And there is also incentive for banks to engage in risky activities while the guarantee is in place. Hence, regulatory scrutiny is necessary to mitigate such potential problems.

How did MDIC incorporate mitigating factors into the plan to address moral hazard? The measures were as follows:

- Deposit-taking members were subjected to heightened oversight and supervision to prevent excessive risk taking;
- Guaranteed institutions were prohibited from using the GDG as a marketing device to attract deposits;

- An annual guarantee fee, which MDIC collected on behalf of the Government, was imposed on the guaranteed institutions. The fee was computed based on the amount of deposits protected under the GDG;
- While announcing the GDG, the Government made it clear that the guarantee was temporary and that it would expire on 31<sup>st</sup> December 2010. This was reinforced by MDIC's communications programmes during the GDG period;
- MDIC was empowered to impose premium surcharge on non-compliant guaranteed institutions and could terminate membership and petition for the winding-up of a member bank; and
- MDIC's existing Differential Premium Systems provided incentives for sound risk management by discouraging banks from taking excessive risks.

## **Step 2: The Exit Plan**

Work began on the Exit Plan within six months after the implementation of the GDG. The Exit Plan included an Enhanced Financial Consumer Protection Package and measures to boost MDIC's efficiency and effectiveness in promoting financial stability via legislative initiatives.

### **I. The Enhanced Financial Consumer Protection Package**

Central to the Exit Plan was an Enhanced Financial Consumer Protection Package, designed to mitigate public concerns about the expiry of the GDG. Deciding what would replace the GDG was one of the most critical transitioning issues. Hence, MDIC invested much time and thought in developing an appropriate package. The Enhanced Financial Consumer Protection Package had four components, as follows:

- a. The first component was to substantially raise the deposit insurance limit and scope of coverage. To exit the GDG successfully, MDIC thought it was important to provide for a much higher limit, to create a sense of "feel good" among depositors and to keep in tandem with the growing economic wealth of Malaysian depositors. The aim was to provide a limit that would likely exceed the public's expectations. Also, the new limit would need to be adequate to meet depositors' needs for the next few years since the limit would not be reviewed until 2016. To provide adequate deposit insurance coverage, a general yardstick suggested covering between 85% and 95% of depositors in full. Therefore, a new coverage limit of RM250,000 was proposed, which covered 99% of depositors in full;

- b. The second component was to expand the scope of deposit insurance coverage to include foreign currency deposits in support of a broader plan to develop a more vibrant foreign currency market in Malaysia;
- c. The third component was to extend MDIC's protection to owners of takaful certificates and conventional insurance policies. The explicit Takaful and Insurance Benefits Protection System (TIPS) provides protection against the loss of part or all of takaful or insurance benefits in the unlikely event of a failure of an insurance company or a takaful operator. The primary aim is to ensure takaful certificate and insurance policy owners enjoy government-backed financial consumer protection, similar to that provided for depositors. The implementation of TIPS is also expected to promote the growth of the insurance and takaful industry. The insurance industry in Malaysia plays an important economic role as intermediaries for mobilising savings and Malaysians are increasingly using insurance policies as a savings option. The TIPS was designed to protect 95% of all insurance policy and takaful certificate owners;
- d. The fourth component was the introduction of a new Provision of Information on Deposit Insurance Regulations 2011 that enhances financial protection through greater product transparency and disclosure. MDIC has an obligation to ensure depositors receive accurate, relevant and timely information on deposit insurance matters. These Regulations, among other things, require deposit-taking members to deliver clear representations about their membership in MDIC in their advertisements; disclose, at the point of sale, whether a deposit product is eligible for deposit insurance protection or not; and provide accurate information on deposit insurance and its benefits to depositors. And deposit-taking members are required to provide depositors with a copy of MDIC's information brochure on the opening of a new bank account.

The underlying key considerations for these Regulations were to ensure product transparency for depositors and to give them easy access to relevant and timely deposit insurance information. For this purpose, deposit-taking members are required to provide information about the features of their new deposit products to MDIC before they are marketed so that MDIC can determine whether the products are eligible for deposit insurance coverage or not. All such information is captured by its Product Registry System, an IT system which is integrated with MDIC's payout system. This system rates the insurability of such deposit products based on a set of criteria. It also provides a record of all deposit products offered by deposit-taking members that have been certified by MDIC as eligible for deposit insurance coverage. MDIC and depositors will be able to check, at any point in time, the list of deposit insurance protected products. Hence, at the time of payout, there will be no confusion about which products are insured and which are not. This will also shorten the process for computing the amount of payment due to a depositor.

## **II. Enhancing the capacity and capability of MDIC to meet its mandate**

MDIC has an internal policy to stress-test our legislation to ensure that the Corporation is able to meet its mandate effectively and efficiently. The review proved to be timely as

the 2008 global financial crisis highlighted one important lesson, which is that depositors lack confidence in deposit insurers that do not have or cannot demonstrate capacity and capability to meet their mandate, whether in making a payout or in resolving troubled banks. And MDIC saw the crisis as a good opportunity to seek broader support from public policy decision makers in areas which would make the Corporation stronger and more effective in fulfilling its enhanced mandate and support the supervisors in promoting and contributing to the stability of the financial system.

For this purpose, a comprehensive review of the MDIC Act 2005 was conducted, leading to the tabling of the new MDIC Bill 2010 in Parliament on 30<sup>th</sup> November 2010 to enhance MDIC's capacity and capability and also to enable MDIC to fulfil its enhanced mandate in respect of TIPS and its broader mandate to promote and contribute to the stability of the financial system.

The new MDIC Act provides MDIC with adequate powers, a wider toolkit and greater flexibility to fulfil its mandate of maintaining and promoting public confidence and the stability of the financial sector.

The new legislation included a package of stabilisation measures aimed at providing flexibility to respond to the needs of depositors in the event of a crisis. The key provisions of the new MDIC Act are highlighted below:

- Authority to increase deposit insurance beyond the regular limit and scope of coverage. This authority enables MDIC to specify the new stabilisation limit and coverage by way of subsidiary legislation. The objective is to give MDIC speed and agility to respond to and neutralise emerging threats to financial stability. In line with this authority, the new MDIC Act no longer specifies a statutory limit or coverage, even for normal conditions. The Minister of Finance is now empowered to set the limit and scope of coverage by an Order, on the recommendation of MDIC;
- Financial institutions which are not member institutions of the regular deposit insurance system can be prescribed as members of the deposit insurance system. Under the repealed Act, "member institutions" referred only to commercial and Islamic banks. There are, however, other financial institutions which could conceivably become systemically important in future. To maintain public confidence in the overall stability of the financial system, it may be necessary to provide deposit insurance

coverage for such institutions. Hence, the provision for the Minister of Finance to prescribe other financial institutions as member institutions of MDIC on the recommendation of BNM and MDIC;

- Authority for the Minister of Finance to prescribe the rate of annual premiums. The repealed Act provided for the annual premium rate to be capped at 0.5% of the total insured deposits held by a deposit-taking member. Given the lessons learnt from the recent financial crisis with regard to challenges in rebuilding Deposit Insurance Funds, the cap for the premium rate was removed so that the Minister of Finance may prescribe any rate, for greater flexibility; and
- Authority for MDIC to establish and implement a “bridge institution”, as part of its powers to deal with troubled deposit-taking members so that it may fulfil its mandate more effectively and efficiently. Under the Act, MDIC was conferred with certain intervention and resolution powers in respect of a troubled deposit-taking member, once BNM had issued a “non-viability” notification to MDIC. These powers include the authority for MDIC or its appointed person to assume control of the deposit-taking member, to appoint a receiver, or to apply to the court for a winding-up order.

Under the “bridge institution” option, MDIC is empowered to transfer certain assets and liabilities from the troubled deposit-taking member to a “bridge institution”, which will operate as a bank. The “bridge institution” will be stabilised and rehabilitated to be sold to a private sector purchaser.

MDIC has also continued to enhance its operational readiness to undertake intervention and failure resolution activities. In this regard, good progress has been made in the development of an integrated payout system to enable us to conduct a prompt and accurate reimbursement of insured deposit claims, when called upon.

### **Steps 3: Development and Implementation of Strategies**

Developing execution strategies was a critical part of the MDIC’s planning process. Without a set of well-thought-out strategies, the objective of a smooth transition could be undermined. Hence, MDIC had placed considerable efforts on formulating the exit strategies for implementing the Exit Plan.

MDIC’s **first strategy involved an early announcement by the Prime Minister of Malaysia on 11<sup>th</sup> May 2010 on the Enhanced Financial Consumer Protection Package.** The advance notice of an exit plan, its objectives and timelines, made more than seven months before the expiry of the GDG was first, to reiterate the Government’s commitment to exit the blanket guarantee by 31<sup>st</sup>

December 2010. Second, it was to ensure that the public was fully informed about the exit and its related timelines as well as the enhanced deposit insurance arrangements well before the exit, to avoid unnecessary surprises. This provided certainty for depositors so that they would be better prepared and provided MDIC with enough time to facilitate adjustments to the benefits of the enhanced package, ahead of the exit. Otherwise, if the public reacted negatively, this could culminate into financial instability through bank runs and capital flight. This would seriously derail the exit plan. Third, an early announcement of the enhanced package also afforded MDIC a good opportunity to monitor public sentiments on the transition back to limited guarantee.

**The second strategy was to adopt a quick exit (a Big Bang approach) from the GDG.** This was preferred over a gradual or staggered exit because of the long-tail challenges, the distortions that might arise, as well as the moral hazard risks if the GDG is not removed quickly enough. Furthermore, Malaysia's strong economic fundamentals allow the adoption of a quick exit. Malaysia's economic environment, and the banking sector in particular, had ample liquidity and our deposit-taking members were well-capitalised. In addition, BNM's foreign exchange reserves were strong and the financial safety net framework was credible in the eyes of the public. However, it should be cautioned that a rushed exit, especially where it is not well explained and understood by the public in advance, could be very damaging.

That is why **the third strategy involved a clear communication of the Exit Plan.** Essentially, this involved developing key messages to be conveyed to depositors during the transition to ensure that the public fully understands and is well-informed of the Enhanced Financial Consumer Package. This would guarantee greater public acceptance. MDIC is responsible for promoting public awareness about the deposit insurance programme it administers and the Corporation takes great effort to reach out to the public. Understanding and acceptance by the public is the key to public confidence during the transition and after the exit date. The communications strategy adopted was to position the enhanced package as a "good news" story, with strong emphasis on its benefits. This would create the perception of giving more, and not just taking away.

The public was encouraged to provide their views on the proposed enhanced deposit insurance limit and scope as well as the benefits proposed to be protected under TIPS. This was achieved

through our regular face-to-face meetings with depositors, holding focus group sessions across the country as well as communications with the public via our Call Centre and website at info@pidm.gov.my. Various channels of communications were used, including media and print advertisements. These meetings and sessions greatly helped MDIC to understand the consumer psyche, in particular their concerns and expectations with respect to the transition. These have greatly facilitated MDIC in testing and managing public perception and fine-tuning the Financial Consumer Protection Package and exit strategies.

**The fourth strategy involved determining whether economic and financial conditions were conducive to support the transition** to the existing explicit limited deposit insurance system. To achieve a safe disengagement from the GDG, certain economic preconditions must be met. BNM and MIDC remained vigilant to potential emerging financial risks and economic challenges throughout the GDG period, but more so during the run-up to the expiry of the GDG. BNM and MDIC monitored the economic and financial conditions closely, the public reaction to the proposed measures, as well as the movement of deposit liabilities in the financial system.

**The last strategy was close collaboration and coordination with other safety net players.** A smooth transition out of a GDG cannot be achieved solely by one safety net player but through the coordination and support of all safety net players. In Malaysia's case, the transitioning was made easier because MDIC had established a strong culture of collaboration with BNM and the Ministry of Finance. Close collaboration and coordination are important for the following reasons:

- Different safety net players were responsible for different tasks. In the case of Malaysia, while the design of the Exit Plan was MDIC's responsibility, its execution required team work from the other safety net players. The implementation of an exit plan is at its best only when each player within the safety net understands their respective roles. When all players know who is to do what and when, this would avoid unproductive overlap and minimise the likelihood of agencies sending out differing views, conflicting signals and

messages, which would not only seriously erode public confidence, but, in turn, affect the credibility of the safety net players;

- In any crisis, it is vital to assure the public that the government is taking the situation seriously and is capable of dealing with such problems. Hence, it is important that the government speaks with a single voice; and
- To ensure that the transition was carried out effectively, MDIC needed buy-in from the other safety net players to the Exit Plan. Hence, MDIC worked closely with the Ministry of Finance and BNM by keeping them informed of its Exit Plan and the execution strategies. With all the relevant safety net players taking part in the process, there is greater likelihood that they would accept and support the goals and the strategies to move the plan forward. And the efforts of all agencies would be aligned towards the same goal.

### **Conclusion**

Planning and executing an exit plan from a blanket guarantee can be complex. However, it can be successfully implemented with meticulous planning, effective public awareness campaign and close collaboration with other safety net players, as the Malaysian experience has shown. Malaysia exited from the GDG successfully on 31<sup>st</sup> December 2010. And central to the successful execution of the Exit Plan by MDIC was a credible Transition Package which was well-received, hence, mitigating public concerns about the expiry of the GDG and maintaining public confidence. The successful execution of the exit from the GDG further advanced the visibility and credibility of MDIC as a key component of the financial safety net.