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Malaysia: Government Deposit Guarantee

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Abstract

On October 16, 2008, following the collapse of Lehman Brothers and regional expansions of deposit insurance, Malaysia announced its Government Deposit Guarantee (GDG), an unlimited guarantee of deposits held at eligible institutions. Given the "soundness and strong capitalization" of the banking sector, the preemptive program was meant "to maintain the stability of the Malaysian financial system." Prior to the crisis, the Perbadanan Insurans Deposit Malaysia (PIDM), Malaysia's deposit-insurance agency, guaranteed up to MYR 60,000 (USD 17,291) per depositor per insured institution. The PIDM was tasked with administering the GDG. Under the GDG, the PIDM insured all ringgit and foreign-currency deposits. All domestic and locally incorporated foreign banks were eligible for the GDG, including commercial, Islamic, and investment banks and deposit-taking development financial institutions. The GDG insured instruments that the PIDM had not previously covered, such as foreign-currency deposits, and insured previously uninsured institutions, such as investment banks. To fund the GDG, the PIDM acted on behalf of the government, levying fees on participating institutions that were then remitted to the government. The GDG ended as scheduled on December 31, 2010. Ultimately, no claims were made on the GDG. The Malaysian government passed legislation in 2010 to expand its precrisis deposit-insurance scheme, which framed how Malaysian officials planned to exit the GDG.

Keywords: account guarantee, Global Financial Crisis, Government Deposit Guarantee, Malaysia

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[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering account guarantee programs. Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

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Overview

In response to the economic downturn that followed the collapse of Lehman Brothers in 2008, several jurisdictions introduced or expanded deposit-guarantee programs. Among these, on October 14, 2008, Hong Kong announced an unlimited deposit-protection scheme (Marks and Yao 2008; Tsang 2008). Singapore and Malaysia followed suit on October 16, 2008, coordinating their own unlimited guarantees (MOF and MAS 2008; BNM 2008; Marks and Yao 2008; Lim 2011).

In the first half of 2008, Malaysia recorded GDP growth of 7.1%, thanks to strong internal and external demand (BNM 2009). However, as demand decreased and economic uncertainty mounted, Malaysia's GDP growth slowed (BNM 2009). The Bank Negara Malaysia (BNM), Malaysia's central bank, said Malaysia's diverse economy, low external debt, and high surplus, along with its liquidity and capital buffers, put the country in a relative "position of strength" in the Global Financial Crisis (GFC) (BNM 2009).

Before the crisis, the Perbadanan Insurans Deposit Malaysia (PIDM), Malaysia's deposit-insurance agency, guaranteed up to 60,000 Malaysian ringgits (MYR; USD 17,291) per depositor per insured institution (Schich 2009; Lim 2011).[3] The PIDM was originally created in 2005 to coincide with the end of Malaysia's temporary blanket guarantee, which was a response to the Asian Financial Crisis of 1997–98 (World Bank 2013). To fund this precrisis deposit program, the PIDM levied fees on insured institutions (PIDM 2009b).

Key Terms

Purpose: To maintain the stability of the Malaysian financial system

Launch Dates	Announcement: October 16, 2008 Authorization: October 16, 2008 Operation: October 16, 2008
End Dates	December 31, 2010
Eligible Institutions	Commercial, Islamic, and investment banks and deposit-taking development financial institutions regulated by Bank Negara Malaysia
Eligible Account(s)	All ringgit and foreign-currency deposits
Fees	Fees were charged on the sum of deposits guaranteed by the GDG. Fees totaled MYR 180 million
Size of Guarantee	Unlimited
Coverage	Figure not publicly disclosed
Outcomes	No claims made
Notable Features	Expanded powers of the PIDM: To implement the GDG, the Malaysian government expanded the PIDM's powers Cooperation with Singapore: Malaysia cooperated with Singapore to announce their guarantees

[3] On October 13, 2008, 1 USD was equivalent to MYR 3.47.

Coordinating with Singapore, Malaysia announced the GDG's unlimited guarantee "to maintain the stability of the Malaysian financial system" (BNM 2008; Lim 2011). The minister of finance and the BNM emphasized that such a measure was "pre-emptive and precautionary, since Malaysian financial institutions [were] well-capitalised with ample liquidity, and confidence of depositors remain[ed] intact" (BNM 2008). The PIDM was tasked with administering the GDG (PIDM 2009a). In 2010, the Malaysian government augmented the PIDM's powers, allowing it to expand the instruments guaranteed and to increase the limit of its guarantee (Parliament of Malaysia 2010). Malaysia also extended access to the central bank's liquidity facility to insurance companies and takaful operators (BNM 2008).[4]

Under the GDG, the PIDM and the government insured all ringgit and foreign-currency deposits (BNM 2008). The PIDM insured deposits held by member institutions, pursuant to the Malaysian Deposit Insurance Corporation Act of 2005. The government, during the PIDM's operation, insured deposits that the PIDM did not insure (i.e., deposits exceeding the PIDM's guarantee limit) and deposits at institutions that the PIDM did not guarantee. The PIDM therefore had no financial exposure to the GDG (PIDM 2009b).

All domestic and locally incorporated foreign banking institutions were eligible, including commercial, Islamic, and investment banks and deposit-taking development financial institutions (BNM 2008). The GDG covered a total of 39 previously authorized institutions. It also covered 15 investment banks, five deposit-taking development financial institutions, and two international Islamic banks (PIDM 2009b; Lim 2011).[5]

To fund the GDG, the PIDM entered into a Loss Coverage Agreement with the government that set out the terms and conditions of the GDG. As the GDG's administrator, the PIDM levied fees on participating institutions on behalf of the government (PIDM 2009a; World Bank 2013). The PIDM remitted these fees to the government. The PIDM did not publicly disclose the specific guarantee fee rate. These fees were charged on deposits guaranteed under the program (PIDM 2009a). During the program's operation, the PIDM collected MYR 180 million in fees (World Bank 2013).

The GDG ended as scheduled on December 31, 2010 (BNM 2008; BNM 2011). Malaysia cooperated with Hong Kong and Singapore in what was known as the Tripartite Working Group to phase out each jurisdiction's respective expanded deposit guarantee (Tripartite Working Group 2009). Ultimately, no claims were made on the GDG (World Bank 2013). The Malaysian government passed legislation in 2010 to expand the precrisis deposit-insurance scheme (BNM 2011). This new scheme guaranteed MYR 250,000, an increase from the pre-crisis guarantee of MYR 60,000 (BNM 2011). Although the new scheme did not insure more institutions, it did insure new instruments, including foreign-currency deposits (BNM 2011;

[4] Takaful operators are institutions sanctioned by Sharia law that insure products through a communal fund, as opposed to through individual premiums.

[5] The PIDM's 2008 annual report notes that only two international Islamic banks were covered (PIDM 2009b). However, another PIDM document suggests that three international Islamic banks were covered (Lim 2011). It is possible that a license may have been granted to other international Islamic banks after 2008 while the GDG was still in operation.

IADI 2012a). These protections, it was said, would cover about 99% of all depositors (BNM 2011).

Summary Evaluation

Malaysia introduced the GDG to "maintain the stability of the Malaysian financial system" (BNM 2008; Marks and Yao 2008). The Malaysian government, though, said that this measure was solely "pre-emptive and precautionary," given its financial institutions' liquidity and the country's strong regulatory framework (BNM 2008; PIDM 2009b). Consequently, the government said that use of the guarantee would be unlikely (BNM 2008). As predicted, during its operation, no claims were made on the GDG (World Bank 2013).

Several considerations have been cited as contributing to the GDG's success. First, Malaysia cooperated with authorities in Hong Kong and Singapore to formulate an exit strategy (IADI 2012b; Tripartite Working Group 2009; FSB 2010). This regional cooperation, known as the Tripartite Working Group, has been cited as a mechanism that led to a smooth crisis response (IADI 2012b).

Second, the International Association of Deposit Insurers (IADI) praised Malaysia's publicity around the GDG (IADI 2012b). Features of Malaysia's publicity campaign included brochures in various languages, a call center, and government training on the GDG (IADI 2012b).

Third, the World Bank and the IADI also praised Malaysia's exit from the GDG. The World Bank argued that Malaysia's communication efforts helped ensure a smooth transition from the program (World Bank 2013). The IADI highlighted that its clear goals, detailed planning, and expansion of the PIDM's powers contributed to a seamless exit (IADI 2012a).

Malaysia took various steps to mitigate concerns about moral hazard (PIDM 2009b). Among these, it prohibited institutions from using the GDG in marketing campaigns, increased risk assessments, and amended Malaysian law to give the PIDM more power (PIDM 2009b; IADI 2012b). The legislature also gave the finance ministry the authority, in a future crisis, to create additional insurance on a temporary basis upon consultation with the BNM and the PIDM.

Context: Malaysia 2008–2010	
GDP (SAAR, nominal GDP in LCU converted to USD)	$231.6 billion in 2008 $202.7 billion in 2009 $255.6 billion in 2010
GDP per capita (SAAR, nominal GDP in LCU converted to USD)	$8,475 in 2008 $7,292 in 2009 $9,041 in 2010
Sovereign credit rating (five-year senior debt)	Data for 2008: Moody's: A3 S&P: A+ Fitch: A+ Data for 2009–2010: Moody's: A3 S&P: A+ Fitch: A
Size of banking system	$227.0 billion in 2008 $236.9 billion in 2009 $295.3 billion in 2010
Size of banking system as a percentage of GDP	98.0% in 2008 116.9% in 2009 115.5% in 2010
Size of banking system as a percentage of financial system	100% in 2008–2010
Five-bank concentration of banking system	82.4% in 2008 82.0% in 2009 100% in 2010
Foreign involvement in banking system	18% in 2008 17% in 2009–2010
Government ownership of banking system	Data not available for 2008 Data not available for 2009 Data not available for 2010[6]
Existence of deposit insurance	Yes in 2008–2010
Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.	

[6] There is ambiguity between "state-owned" and "public sector" banks more broadly. In Malaysia, there were Development Financial Institutions authorized by the BNM to perform social mandates. Some of these institutions were under the ministry of finance's purview and covered under the GDG. Moreover, although federal and state governments could not hold direct shares in banks, some government-related entities held significant positions in these institutions, including pension and mutual funds under the ministry of finance's purview.

Key Design Decisions

1. **Purpose: The Malaysian government introduced the Government Deposit Guarantee to protect deposits and ensure a level playing field with other countries that were taking similar steps.**

Because of global financial uncertainty and a regional expansion of deposit guarantees, on October 16, 2008, Malaysia announced the Government Deposit Guarantee (GDG) (BNM 2008; Marks and Yao 2008). The Malaysian government said that such actions were solely "pre-emptive and precautionary," given Malaysian institutions' liquidity and Malaysia's strong regulatory framework (BNM 2008; PIDM 2009b).

2. **Part of a Package (A): The GDG was announced alongside an expansion of the institutions that could access the Bank Negara Malaysia's liquidity facility.**

The GDG was announced alongside an additional liquidity measure, which allowed insurance companies and certain takaful operators to access the Bank Negara Malaysia's (BNM) liquidity facility (BNM 2008).[7] As with the GDG, the government said that this measure was solely precautionary and likely would not need to be used (BNM 2008).

Part of a Package (B): Malaysia coordinated with Singapore in announcing its guarantee; the two countries later formed a cooperation agreement with Hong Kong focused on exit strategy.

On October 14, 2008, Hong Kong announced an unlimited deposit guarantee (Tsang 2008). This prompted Malaysia and Singapore to coordinate their own unlimited guarantees two days later, on October 16 (Marks and Yao 2008; MOF and MAS 2008; Lim 2011; IADI 2012a). In July 2009, Singapore, Hong Kong, and Malaysia formed the Tripartite Working Group, which aimed at coordinating an exit strategy from the unlimited guarantees (IADI 2012a; Tripartite Working Group 2009; FSB 2010). This regional cooperation, it has been argued, helped ensure a smooth crisis response (IADI 2012b).

3. **Legal Authority: The PIDM was empowered to administer the GDG under the Malaysian Deposit Insurance Corporation Act of 2005. The Malaysia Deposit Insurance Corporation (Amendment) Act of 2010 made this explicit and set out the details and provisions of the GDG framework.**

Part two, chapter one, of the Malaysia Deposit Insurance Corporation Act of 2005 established the PIDM as Malaysia's deposit-insurance authority (Parliament of Malaysia 2005). Article 25(2[a(iv)]) of the act allowed the PIDM to extend guarantees to the deposits of member institutions with the goal of "reducing or averting a risk to the financial system" (Parliament of Malaysia 2005). Article 25 (2[e]) empowered the PIDM to guarantee the payment of

[7] A takaful operator is an institution, established according to Sharia law, that insures products through a communal fund.

monies or the performance of any obligations. As such, the PIDM had the authority to administer the GDG (PIDM 2010).

However, in announcing the establishment of the GDG in October 2008, the ministry of finance and the BNM did not describe the legal basis for the program.

In 2010, Malaysia's parliament explicitly provided that legal basis in the Malaysia Deposit Insurance Corporation (Amendment) Act of 2010 (Parliament of Malaysia 2010). Section 4 of the act retroactively validated the ministry's and the PIDM's actions in creating and implementing the GDG: "All acts or things done or purported to be done by the Minister or the Corporation in anticipation of the enactment of this Act shall be deemed to have been validly and lawfully done" (Parliament of Malaysia 2010).

This amendment gave the PIDM the authority to provide temporary "stabilisation insurance" for "the purpose of protecting and promoting or maintaining the stability of the financial system and promoting or maintaining public confidence" (Parliament of Malaysia 2010). The act as amended included an order retroactively giving the PIDM the authority to create stabilization insurance between 2008 and 2010, which supplied a legal basis for the GDG. It also gave the ministry the authority, in a future crisis, to create "any other stabilisation insurance" for those purposes upon consultation with the BNM and the PIDM.

The 2010 act defined "stabilization insurance" as any extension of deposit insurance to financial instruments not previously guaranteed, beyond the limit of existing guarantees, or to previously uninsured institutions (Parliament of Malaysia 2010; Lim 2011).

4. Administration: Malaysia's existing deposit-insurance agency administered the GDG.

The PIDM, which ran Malaysia's existing deposit-guarantee scheme, administered the GDG (PIDM 2009a). The PIDM worked with the BNM to ensure that guaranteed institutions did not take excessive risks or relax capital requirements (PIDM 2009b). Moreover, owing to the nature of the GDG, the PIDM had to oversee "a larger number of financial institutions, to complement BNM's supervisory oversight" (PIDM 2009b).

Additionally, the auditor general audited the PIDM, pursuant to Malaysian law (Parliament of Malaysia 2005).

5. Governance: The PIDM was subject to domestic audits.

Pursuant to Malaysian law, the auditor general audited the PIDM (Parliament of Malaysia 2005).

6. Communication: Malaysia's government said that the GDG was a precautionary measure meant to ensure financial stability and that its financial system remained robust.

On October 16, 2008, the GDG was announced as part of an effort to "maintain the stability of the Malaysian financial system" (BNM 2008; Marks and Yao 2008). The Malaysian government said that such actions were solely "pre-emptive and precautionary," given Malaysian institutions' liquidity and Malaysia's strong regulatory framework (BNM 2008; PIDM 2009b).

The International Association of Deposit Insurers (IADI) has praised Malaysia's publicity around the GDG (IADI 2012b). Malaysia's publicity campaign included brochures in various languages, a call center, and government trainings on the GDG (IADI 2012b). The World Bank and the IADI also praised Malaysia's exit from the GDG. The World Bank argued that Malaysia's communication helped ensure a smooth transition out of the program (World Bank 2013).

7. Size of Guarantees: The GDG covered eligible accounts with an unlimited guarantee.

The PIDM, through the GDG, covered eligible accounts with an unlimited guarantee (BNM 2008).

8. Source(s) and Size of Funding: The GDG was funded through fees charged to participating institutions, with the Malaysian government responsible for any shortfalls.

The PIDM insured deposits held at member institutions, as required by the Malaysian Deposit Insurance Corporation Act of 2005. The government insured deposits above the PIDM's guarantee limit or held at institutions outside the PIDM's coverage. As such, the PIDM had no exposure to the GDG (PIDM 2009b).

To fund the GDG, the PIDM and the government entered into a Loss Coverage Agreement, which laid out the GDG's terms and conditions. The agreement set the PIDM as the GDG's administrator, allowing the PIDM to levy fees on participating institutions on the government's behalf (PIDM 2009a; World Bank 2013). These fees were ultimately remitted to the government, pursuant to the agreement. The government did not publicly disclose the specific guarantee fee rate charged. Under the GDG, institutions paid a total of MYR 180 million in fees (World Bank 2013).

Under its precrisis deposit scheme, commercial and Islamic banks paid fees to the PIDM, which were separated into two distinct funds, one for conventional, interest-bearing deposits and one for Islamic deposits (Parliament of Malaysia 2005). The Malaysian government could lend money to the PIDM, and the PIDM also built up funding through investments, primarily in government securities (Parliament of Malaysia 2005). The total size of the two funds rose from MYR 275 million at the end of 2008 to MYR 370 million at the end of 2009 (PIDM 2010). Total insured deposits were MYR 202 billion at the end of 2008.

Since the PIDM was only founded in 2005, its deposit-insurance funds were low relative to the insured deposit base at 0.2%. Its target was a range of 0.6% to 0.9% (World Bank 2013). It is not clear if the PIDM defines the insured-deposit base to include all deposits or just those deposits under the insured limit.

9. Eligible Institutions: All institutions authorized by the BNM were automatically enrolled in the guarantee.

All domestic and locally incorporated foreign banks were eligible, including commercial, Islamic, and investment banks and deposit-taking development financial institutions regulated by the BNM (BNM 2008). The GDG covered 22 conventional commercial banks and 17 Islamic banks that were covered by the precrisis PIDM insurance schemes. It also automatically covered 15 investment banks, five deposit-taking development financial institutions, and two international Islamic banks that were not previously covered (PIDM 2009b; Lim 2011; BNM 2008).[8]

The GDG did not cover foreign branches and subsidiaries of domestic banks (PIDM 2009b).

All commercial and Islamic banks were required to be members of the PIDM. Some deposit-taking institutions are not part of the PIDM (World Bank 2013). Some of these institutions are covered by explicit or implicit government guarantees, though some are not covered by such guarantees, including credit cooperatives (World Bank 2013). Credit cooperatives were not covered by the GDG (World Bank 2013). The Malaysian Co-operative Societies Commission supervised these cooperatives (World Bank 2013).

10. Eligible Accounts: The GDG covered most deposit accounts in eligible institutions.

When announced, the Malaysian government said that the GDG would cover all ringgit and foreign-currency deposits (BNM 2008). In 2009, the PIDM clarified which deposit accounts were covered by the GDG (PIDM 2009a). Among those covered were fixed deposits, current accounts, savings accounts, joint and trust accounts, all Islamic deposits, principal-guaranteed conventional structured deposits, foreign-currency deposits and negotiable instruments of deposits held by nonbanks (PIDM 2009a). Those not covered included conventional structured products that were not principal-guaranteed, deposits payable outside Malaysia, interbank money-market placements, nonnegotiable instruments of deposit held by banks, and repurchase agreements (PIDM 2009a).[9]

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[8] The PIDM's 2008 annual report notes that only two international Islamic banks were covered (PIDM 2009b). However, another PIDM document suggests that three international Islamic banks were covered (Lim 2011). It is possible that a license may have been granted to other international Islamic banks after 2008 while the GDG was still in operation.

[9] For the purposes of the GDG, the PIDM defined "structured products" as "a structured product with embedded derivatives (e.g. options) that are normally linked to the performance of an underlying asset such as interest rates, equities, foreign currency rates, etc.," which "may be principal protected or non-principal protected" (PIDM 2009a).

Prior to the GDG, the PIDM covered conventional and Islamic deposits (PIDM 2007). The PIDM did not insure foreign-currency deposits (PIDM 2007). The GDG covered this previously excluded instrument (PIDM 2009a). Moreover, prior to the GDG, the PIDM covered principal-guaranteed conventional structured deposits but not conventional structured products that were not principal guaranteed.

An amendment to the Malaysia Deposit Insurance Corporation Act of 2005 retroactively allowed the PIDM to extend deposit insurance to financial instruments not previously guaranteed (Parliament of Malaysia 2010; Lim 2011).

11. Fees: Fees for the GDG differed according to the institution covered.

PIDM-insured institutions paid annual premium fees for coverage up to MYR 60,000 (Parliament of Malaysia 2005). These fees were charged on an institution's total insured deposits as of December 31 of the preceding assessment year and were credited to the PIDM. The maximum premium that could be charged to Islamic and conventional banks was 0.5% (Parliament of Malaysia 2005).[10] The PIDM implemented risk-based premiums in 2008, which it had planned before the crisis. The rates were 0.03%, 0.06%, 0.12%, and 0.24% for four categories, based on institutions' risk profiles. Prior to the change, banks paid a flat rate of 0.06% of total insured deposits (PIDM 2008). Premium revenues declined 18% in 2008, owing to the lower premiums paid by banks with lower-risk profiles under the new system and to provisions the PIDM made to ease the transition for banks with higher-risk profiles. Revenues rose almost 50% to MYR 132 million in 2009 as the risk-based system came into full effect (PIDM 2010; PIDM 2009b).

Pursuant to the Loss Coverage Agreement between the PIDM and the Malaysian government, the PIDM collected fees on behalf of the government to fund the GDG. The PIDM remitted these fees to the government. The PIDM did not publicly disclose the specific guarantee fee rate. For PIDM-insured institutions, the fee rate was charged on the total deposits and instruments guaranteed under the GDG minus the total insured by the PIDM. For non-PIDM-insured institutions, the fee rate was charged on all GDG-insured deposits. The PIDM separately charged premiums on conventional and Islamic deposits, though the calculation formulas remained the same for both types of deposits (PIDM 2009a).[11] During its two years of operation, the PIDM collected MYR 180 million in fees (World Bank 2013).

For the assessment year 2009, the cutoff date for the calculation of total guaranteed deposits and PIDM-insured deposits was December 31, 2008. Institutions captured two additional months in computing the guarantee fee to encompass the guarantee period in 2008. For the assessment year 2010, the cutoff date was December 31, 2009, adding up to a 12-month period.

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[10] This limit has been removed by subsequent amendments to the Malaysian Deposit Insurance Corporation Act.

[11] For more on the differing deposits for Islamic and conventional institutions, see PIDM 2009a.

12. Process for Exercising Guarantee: If an insured institution were to fail, the PIDM would pay depositors and liquidate assets to refund the program. Payouts could take up to three months.

The PIDM Act of 2005 sets out the guarantee's exercise procedure (Parliament of Malaysia 2005). In the event of an institution's failure, the PIDM would cover the first MYR 60,000 under the precrisis guarantee's terms (Lim 2011). For insured deposits exceeding the PIDM's guarantee limit or for deposits held at non-PIDM-insured institutions, the government would compensate depositors, likely through its remitted fee revenue or further government outlays (World Bank 2013). According to the PIDM Act of 2005, payouts would occur "as soon as possible and in any case not later than three months" after the date of an institution's winding-down order (Parliament of Malaysia 2005, Article 55[2]).

13. Other Restrictions on Eligible Institutions/Accounts: There were several other conditions associated with the GDG that were meant to mitigate moral hazard.

In addition to fees, the GDG had other conditions to mitigate moral-hazard concerns (PIDM 2009b). Among these, Malaysia prohibited institutions from using the GDG in marketing campaigns and increased risk assessments (PIDM 2009b; IADI 2012b).

14. Duration: The GDG ended on December 31, 2010, as scheduled.

When the GDG was announced on October 16, 2008, the government announced that it would end on December 31, 2010 (BNM 2008). The program ended as scheduled (BNM 2011). To promote a smooth exit from the full deposit guarantee, Malaysia took various measures, including expanding the scope and increasing the cap of its precrisis deposit program (Lim 2011).

Following the program's expiry, Malaysia's precrisis deposit-insurance program was expanded (BNM 2011). Under the scheme, the PIDM guaranteed up to MYR 250,000 per depositor per insured institution, an increase from the precrisis maximum of MYR 60,000 (BNM 2011). These protections covered about 99% of all depositors (BNM 2011).

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