



Presentation of Labor Medal to the DIV

Deposit with Financial Institutions A SPECIFIC OBJECT FOR INSURANCE

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Deposit insurance (DI) was first mentioned in the first decades of the twentieth century and marked by the birth of Federal Deposit Insurance Corporation (FDIC) – the world's first organization of this kind – in the U.S. in 1933. At present, alarming problems and bad consequences to the socioeconomic life keep making their appearance when runs on banks take place: in the last decade, the Argentine Government had to resigned because of a bank run; the English Government in late 2007 had to nationalize the Northern Rock Bank suffering a loss of some EUR50 billion; and Bear Stearns – one of the biggest American banks was declared bankrupt in 2007. Preventing and handling risks involving bank deposits are still topical today.

Deposit insurance is a risk-preventing measure taken by many governments to protect deposits in case of bank insolvency. Most DI systems are established by governments or some department of the

central bank. This makes the system a safe institution that can win confidence and trust from depositors in the most difficult times. It makes depositors feel sure when depositing their money with banking institutions. Besides protecting depositors, the DI system also aims at preventing panic in the banking system, ensuring safety for the banking – financial sector, and thereby stabilizing the economy.

1. An access to the DI

Deposit, as an object of the insurance business, has its own special features and is one of new objects. The DI business appeared later in comparison with others although in fact, risks relating to bank deposits made their appearance in parallel with risks involving other objects. Moreover, seriousness of risks relating to deposits causes increasing worries.

Risk for deposits as a cause for insurance business is treated in a multilateral relation much bigger than that found in treatment of risks relating to other

objects. This is a systematic risk for banking institutions and involves chain reactions of large scale. This feature forces the related insurance to solve even macroeconomic problems that are beyond reach of participants in the insurance contracts. That is why the DI receives clear and strong support from the Government for the good of community.

First of all, deposits are main assets of the majority of population and interests of small depositors who lack knowledge and information and expertise in financial and banking issues. They deserve active protection from the Government; and they are the most active in protecting their interests when the banking institutions meet with problems. "Waves" of withdrawal of money that lead to collapse of a bank or the whole banking system are also caused by them.

Another problem is the deposit in foreign exchange because private persons are allowed to make such deposits. Then the question is whether they are insured or not. In any case, the relation between the insurance policy and such deposits always leads to attitudes at macroeconomic level.

One of factors affecting the DI relation is banking institutions, including banks, non-banking institution, savings associations, insurance and stock broker firms. Which ones of them are covered by the DI policy is also a matter of great importance.

The market economy forces the Government to publicize all of its policies. In the past, many policies, including the DI one, were not publicized. But treatment of risk relating to deposit is partly made known to the public. Public policy on the DI is also perfected by degrees.

2. Achievements of the DI business in Vietnam

From 1986 on, the economic reform started a new period of development of Vietnam. The banking system changed from a centrally-planned and subsidized mechanism to independent accounting mechanism. Number of commercial banks and credit cooperatives increased fast but many of them went bankrupt in the years 1989-90, and 1995-97. The 1997 Asian financial crisis forced the Vietnamese banking system to carry out an overall reform to improve its performance, competitiveness and public image. Collapses in the system of credit cooperatives and the Asian financial crisis show that any risk requires measures to prevent and handle it. The more

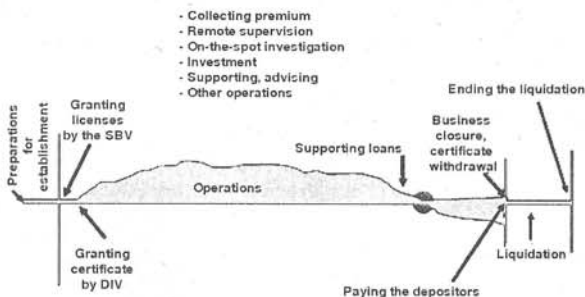
the banking system integrates into the world economy, the riskier it becomes, especially among credit unions and commercial banks, therefore preventing measures are necessary. The DI business is one of financial institutions that provide such measures to limit losses and prevent serial collapses of banking institutions. To achieve this aim and help banking institutions develop stably, ensure safety and stabilize the national financial sector, the Government issued Decree 89/1999/ND-CP on Sep. 1, 1999 on the deposit insurance. This Decree provided a basis for Decision 218/1999/QĐ-TTg made by the PM on Nov. 9, 1999 to establish the Deposit Insurance of Vietnam (DIV).

DIV is a tool for implementing the DI policy. It is a governmental agency with non-profit objectives and an initial capital of VND1,000 billion granted by the Ministry of Finance. It is also the only publicly-established institution in this field. Its appearance is an important event because it was the first time the banking system had an agency specializing in protecting legitimate interests and rights of depositors, maintaining stability; and healthy and safe development of banking institutions. This is an appropriate step in the effort to integrate into the regional and international markets.

DIV has step by step affirmed its role in the economic reform, restructuring of the banking system, protection for legitimate rights and interests of depositors, stability of banking institutions, healthy and safe development of the banking sector and political security and social order. It's worth noting that in the years 1994-96, the DI business was carried out in a pilot scheme by Bảo Việt Corporation but it didn't produce intended results.

The basic achievement in the DI business is a legal infrastructure for the DI and transparent information about DI policy and national budget. Banking institutions have to buy DI, the insured deposits are the ones in the domestic currency, and not the ones in foreign ones. DIV is responsible for granting and revoking DI certificates, collecting insurance premium (0.15% of total deposit), supervising all banking institutions; providing financial investment and support to these institutions; collecting debts and handling assets; and paying compensation (VND50 million at most) to a depositor in a bankrupt institution. DIV operations have become necessary and important to banking institutions.

Figure 1: Effective deployment of DI functions – Life circle of participants in DI system



The DI policy has been implemented in Vietnam for nine years. The DIV, up to Dec. 31, 2007, has established relations with 1,077 banking institutions comprising five state-owned commercial banks; 34 joint stock commercial banks; 32 branches of foreign banks; five joint venture banks; 10 non-banking institutions; 990 credit unions and the Central Credit Union, and has provided all of them with DI certificates.

DIV has kept a close watch on operations of banking institutions and provided them with timely warnings with a view to helping them take measure to prevent or reduce risks. Many inspections have been carried out regularly in insured institutions. Supervision and inspection are the most important operations of DIV, which turn it into an indispensable part of the financial supervision system. It has supervised effectively to ensure that all banking institutions observed DI and banking regulations, and given timely warnings against potential risks in order to help banking institutions avoid them and improve their performance. At present, DIV is considering applying international standards and models of supervision; and building electronic links with insured institutions in order to get their reports directly.

To help stabilize operations of banking institutions when they meet temporary shortage of fund, DIV launched a program, from August 2005 on, to give financial support to the system of credit unions through three DIV branches in HCMC, Northern Central and Eastern North. From then on, DIV has

received and handled 30 applications for loan but only two of them were eligible for DIV financial support.

Paying compensations to depositors is also an important operation of DIV. It is the last measure of extremely important meaning to insured institutions that are declared bankrupt because of insolvency. Up to now, DIV has paid VND16,815 million worth of compensation to 1,492 depositors in 34 dissolved credit unions. The payment reflects the DIV role in protecting legitimate rights and interests of depositors, winning public trust

in banking institutions, maintaining political stability and social order, and preventing further collapses in the banking system.

In the world community, DIV has tried to absorb foreign experience in this field and apply DI international standards.

3. Foreign experience of DI business

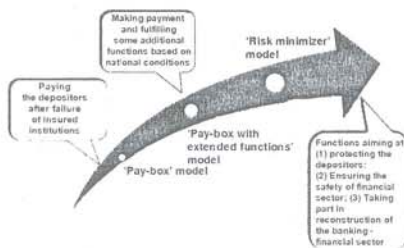
In 2002, the International Association of Deposit Insurers (IADI) was formed as a non-profit organization. It has 48 official members and observers, six cooperative organizations, nine partners, an Executive Council, nine Regional Committees, six Standing Committees, and 12 subcommittees under its Research and Guidance Committee. Its objectives are: Enhancing the understanding of common interests and issues related to deposit insurance; setting out guidance to enhance the effectiveness of deposit insurance systems taking into account different circumstances, settings and structures; facilitating the sharing and exchange of expertise and information on deposit insurance issues through training, development and educational programs; providing advice on the establishment or enhancement of effective deposit insurance systems; undertaking research on issues relating to deposit insurance and; and taking such other action as may be necessary or useful for its objects and activities, especially during financial crisis that takes place in each country member at regional or global level.

IADI has studied and issued standard guidance and advice on the DI system, such as General

Guidance for Developing Differential Premium Systems, General Guidance for the Resolution of Bank Failures, Core Principles for Effective Deposit Insurance Systems, Guidance for Effective Management of DI systems, Guidance on Interrelationships among Safety Net Players, Guidance for Public Awareness of Deposit Insurance Systems, Guidance for Determining Deposit Insurance Coverage Limit, and Guidance for Evaluation of DIF Sufficiency on the Basis of Risk Assessment. Particularly, different DI models are summarized and estimated clearly. In the past, most DI systems operated according to the "pay-box" model in which they provided depositors with passive protection (paying insurance when banking institutions go bankrupt). At present, many countries develop this model into a "pay-box with extended functions" model.

Many countries today are establishing or restructuring their DI systems with a view to offering an active protection to depositors, that is, the systems follow a risk-minimizing model with corresponding extended functions. The modern DI model requires an active role of DI system in supervising, evaluating banking institutions, handling institutions in trouble, supplying predictions and solutions to crises in the financial sector, including cooperation with domestic and international bodies, in order to minimize risks and handle problems at the possibly lowest cost.

Figure 2: DI operation model



At present, there are 99 countries with DI systems and 20 countries with plans to develop their own DI systems. Selection of DI model should be based on objectives of the public policy mentioned by the model.

4. Challenges to Vietnam

When Vietnam integrates into the world market, risks become more frequent and serious. Vietnam is trying to change from a 'ruling' administration to a serving one. Although the DI system is part of public policy, it is also affected by the market mechanism. In other words, its operations must be open, fair and transparent. Thus, the most important task in the DI policy is to select appropriate objectives for the public policy. Structure of these objectives reflects requirements posed by the economic development. After selecting these objectives, basic problems with DI operations must be solved. They are the following.

- Buying DI service is compulsory or voluntary,
- DI covers deposits in the VND only, or all deposits,
- Objects of DI policy are all depositors or small ones only,
- Flat-rate premium or differential one is applicable,
- Maximum coverage (or limited coverage), or unlimited coverage is reasonable,
- How to affirm supervision role of the DI system,
- How to determine the role of DI system in receivership and liquidation of failed institutions,
- How to determine the model for the DI system with its roles and functions,
- The role of the DI system in the national financial safety net.

One of the urgent requirements is to establish a mechanism for checking risks, especially systemic ones; supervising operations of banks; and active instruments (such as DI system, bridge banks, and asset management companies, etc.) needed for dealing timely with risks in banking institutions and the banking system as well.

The Government should develop the national financial safety net, or a system for supervision of financial services, according to a specific track suitable to international standards. Organizations that constitute the national financial supervision system today are incompetent and poorly connected. Many financial services, such as banking, stock exchange and insurance, are developing fast but unstably. In this sector, therefore, many problems of national level should be solved according to international standards, such as: supervision mechanism, supervision model, supervision methods, supervision criteria, data system, information sharing, appli-

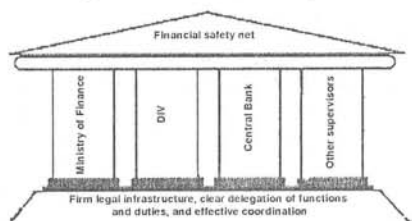
Table 1: Objectives of the public policy of the DI system

| | Objective | 'Risk-minimizer' model | 'Pay-box with extended functions' model | 'Pay-box' model |
|----|--|------------------------|---|-----------------|
| 1 | Protecting small depositors by providing compensations | * | * | * |
| 2 | Encouraging depositors with limited knowledge of financial matters to supervise banks and follow market principles | * | * | * |
| 3 | Reducing public expenditure and requiring good banks to cover costs of handling of bank failures | * | * | * |
| 4 | Promoting competition in the financial sector | * | * | * |
| 5 | Building an official mechanism for resolution of bank failures | * | * | * |
| 6 | Avoiding financial crises | * | * | * |
| 7 | Promoting financial stability | * | * | * |
| 8 | Encouraging thrift and supporting economic growth | * | * | * |
| 9 | Contributing to system of orderly payment | * | * | * |
| 10 | Promoting economic growth | * | * | * |
| 11 | Reducing impacts of economic recession | * | * | * |

cation of information technology, and development of human resource for supervision system.

Of course, all of these problems could only be solved by an unified point of view and included in the DI Law, including deposit-related relationships and DI system – the instrument for implementing the important public policy in the market economy.

Figure 3: National financial safety net



5. Expectations in this field

Vietnamese and foreign experiences, and needs for development of the market economy as well, show that requirements posed for the DI system are as follows:

- Building a modern model for the DI system (a risk-minimizing system with extended functions); enhancing public awareness of DI service; and implementing active public policy on the DI service.
- Integrating into the world community of deposit insurers: exchange of experience, technical cooperation, mutual support, development of standardized

operations of DI service, and treatment of related problems, etc.

- Making a DI Law to create a legal basis for implementation of the public policy on the DI service: technical operations, related relationships, organization and functions of the DI system, codification of challenging options.

- Building the national financial safety net with a clear operational and coordinating mechanism; supervising effectively operations of banking institutions; and developing ability to control and deal with different risks in the banking system.

- Ensuring an active and healthy environment for development of financial institutions and implementing well objectives set forth by the public policy.

Developing the socioeconomic life in a sustainable manner is a must to all countries. The DI policy is one of important part of the effort to achieve this aim. After all, the deposit is one special and import object for the insurance service ■

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