

CHINA INTRODUCES DEPOSIT INSURANCE

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Executive Summary

1. China introduced bank deposit insurance scheme on 31 March 2015, two years behind schedule. The insurance scheme took effect on 1 May 2015.
2. The released proposals clearly indicate that up to 500,000 yuan in deposits made by all businesses and individuals per bank will be insured. This threshold ensures full protection for 99.63% of depositors. A fund managed by the People's Bank of China supports the insurance scheme.
3. The introduction of a deposit insurance scheme is key to further China's interest rate liberalisation. China's deposit rates could be liberalised by the first half of 2016, after almost 20 years of preparation.
4. China had adopted an implicit savings protection system for decades before the implementation of the explicit deposit insurance scheme. Under an implicit scheme, in the event of a bank crisis, the governments will bail out the troubled banks fully, or give 'blanket guarantees'.
5. Since the money used for government bailouts comes from government tax revenues, taxpayers are technically the lenders of the last resort. Considering the enormous deposit base and the heavy government debt burden in China today, the use of the implicit deposit insurance scheme is not sustainable.
6. The explicit deposit insurance scheme was first introduced in 1935 by the United States before it became popular around the world, especially since the 1980s.
7. The 2008 financial crisis had set the Chinese leadership working on the feasibility of establishing an explicit deposit insurance scheme that covers all deposit-taking financial institutions. The initiative was planned by the National People's Congress as early as October 2010.

8. As interest rate will be market-based soon, the competition among banks will intensify, leading to higher deposit interest rate levels, increased interest rate volatility and narrower deposit-loan interest rate spreads. Such changes will affect the whole banking sector and are reflected by the compressed net interest margin.
9. Interest rate liberalisation will also have varying impacts on particular banks with different asset sizes, sources of income sources, management capacities and business strategies.
10. International experiences suggest that large banks with solid reputation and stable customer relationships and benefit from economies of scale will likely face limited negative impacts.
11. The current version of the Deposit Insurance Act did not include foreign banks in China and overseas branches of Chinese banks in the programme. For the opening of its capital market, China could consider including foreign banks in the insurance scheme to support the process of renminbi internationalisation.