Feeling the Stones: Measuring the Potential of Deposit Insurance in China through a Comparative Analysis

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Feeling the Stones: Measuring the Potential of Deposit Insurance in China Through a Comparative Analysis

I. INTRODUCTION

The process of reforming China's banking sector has been described as "crossing the river by feeling the stones." In recent years, China has shifted from a strictly planned economy to a "market-oriented" system based on capitalist principles of privatization and competition. Such reforms resulted from China's accession to the World Trade Organization (WTO) in 2001, which requires China to open its banking industry to foreign competition by the end of 2006. Undoubtedly, the task is daunting. China's banking industry has been plagued by the inability to endure financial crises, poor bank management, risky loan practices, and scandals. As it attempts to remedy these problems, China is faced also with the fact that its banking industry has a fairly rudimentary structure. For many prudential and regulatory issues, China lacks any legislative history on which to rely; its banking market is a blank slate for reform. Therefore, China is not simply updating a pre-existing system, but instead importing mechanisms and policies entirely foreign to its banking industry.

3. Id. at 28.
6. See generally Professor Volker Behr, Managing Director, Inst. for Eur. Legal Sys., Lecture at the University of North Carolina School of Law (Sept. 20, 2006) (describing China's habit of importing legislation from other countries).
7. See generally id. (noting that reforms in China often do not have precursors in Chinese case law or statutes).
Deposit insurance is one such import. China has acknowledged the necessity of deposit insurance, and industry experts are evaluating various deposit insurance systems (DISs) from other legal regimes.\(^8\) As China prepares to implement a viable system, it will look to European nations, as well as the United States, for guidance in constructing a workable Chinese version of deposit insurance.\(^9\) China also likely will pay close attention to Russia's newly-implemented DIS, given the similar historical and political backgrounds of both countries.\(^10\) Russia's model may provide guideposts as China searches for a balance between its goal of a "market-oriented" system and its socialist heritage.\(^11\) These systems represent "stones" that China can examine and learn from as it transitions into a more advanced banking system.

Part II of this Note provides an overview of China's banking system and the major problems facing its banking industry.\(^12\) Part III explains deposit insurance generally and how China will benefit from implementing a DIS.\(^13\) Part IV will outline the DISs used by the United States, a sample of countries in the European Union, and Russia.\(^14\) In addition to discussing the basic features of each system, Part IV will explain how China may find each model relevant to its current problems.\(^15\) By way of comparison, Part V will discuss which features of these systems China should adopt with respect to coverage, funding, and membership regulations.\(^16\)

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9. See infra notes 117-87 and accompanying text.
10. See infra notes 188-221 and accompanying text.
11. Roy, supra note 1; see generally China is in Favor of More Reform, CHINA POST, June 14, 2006, available at 2006 WLNR 10253167 (discussing the tension between market-based reform and the relinquishment of governmental control).
12. See infra notes 17-58 and accompanying text.
13. See infra notes 59-105 and accompanying text.
15. See infra notes 106-16, 138-42, 180-87, 210-21 and accompanying text.
16. See infra notes 222-84 and accompanying text.
II. BACKGROUND: CHINA'S BANKING INDUSTRY

A. China's Banking Structure

China’s banking system is dominated by four state-owned commercial banks (the Big Four): the Agricultural Bank of China, the Bank of China, the Industrial and Commercial Bank of China, and the China Construction Bank.\(^\text{17}\) While the government has made efforts to divest state and commercial interests, the banks remain involved in both areas of banking.\(^\text{18}\) Currently, these banks possess around fifty-nine percent of both the total assets and deposits of all financial institutions in China.\(^\text{19}\) The rest of China’s banking industry is comprised of two private banks, twelve joint-stock commercial banks, and a vast array of rural and urban cooperative banks.\(^\text{20}\)

China has created several agencies to regulate the banking sector. China’s State Council issues banking-related policy and oversees the entire industry.\(^\text{21}\) The traditional banking authorities have been the People’s Bank of China (PBC) and the Ministry of Finance.\(^\text{22}\) In recent years, however, both agencies have been directed to focus primarily on fiscal and monetary policy.\(^\text{23}\) Amid efforts to reform, China created the China Banking Regulatory Commission (CBRC) in 2003, which assumed the supervisory duties of the PBC and the Ministry of Finance.\(^\text{24}\) CBRC is now the

\(^{17}\) Banks: Domestic Banks, COUNTRY FIN. CHINA, Aug. 21, 2006, available at 2006 WLNR 15382206. As their titles indicate, each bank was designed originally to provide financial assistance to a particular sector of the economy; however, such distinctions have disappeared in recent years. Id.

\(^{18}\) See Lawrence L. C. Lee, Integration of International Financial Regulatory Standards for the Chinese Economic Area: The Challenge for China, Hong Kong, and Taiwan, 20 NW. J. INT’L L. & BUS. 1, 30-31 (1999). In an attempt to disgorge the Big Four of policy-related loans, the government created three policy banks, each designed to service a particular area of governmental interest. Id.

\(^{19}\) Carol G. Liu, Note, Scaling the Great Wall: An Analysis of Foreign Banks' Entry into China, 9 N.C. BANKING INST. 397, 399 (2005).

\(^{20}\) Banks: Domestic Banks, supra note 17.


\(^{22}\) Id.

\(^{23}\) Banks: Domestic Banks, supra note 17.

\(^{24}\) Banks: Bank Regulators, supra note 21.
appointed "watchdog" over the banking sector. These groups collectively form the prudential supervision that monitors risk assessments and loan practices among China’s banks in order to prevent insolvencies, and, if necessary, to mitigate losses to depositors.

Noticeably absent in China’s banking policy is a formal DIS. Instead, the government acts as a de facto insurer for deposits in China’s domestic banks. Chinese officials have stated that a DIS will be implemented by the time its banking industry is opened to foreign competition at the end of 2006. Zhou Xiaochuan, governor of the PBC, stated simply that, “a deposit insurance scheme is being researched,” but few other details are known. The PBC established the Deposit Insurance Department in 2005 to regulate the system, and the CBRC hinted that the DIS may be funded by banks themselves.

B. Problems Facing China’s Banking Industry

As the PBC’s chief Zhou Xiaochuan noted, the four “incentives” for reforming the banking industry were economic crisis, scandals, competition from abroad, and shareholder interest in more sound banking techniques and standards. In 1997, the Asian financial community suffered a recession that exposed several inadequacies in China’s banking industry. The crisis was

25. Id.
33. Karl Lester M. Yap, Asian Crisis Repeat Unlikely, but RP Banks Remain Weak, BUS. WORLD (PHIL.), Sept. 6, 2006, available at 2006 WLNR 15388418. As one analyst noted, recessions are a “litmus test” by which to evaluate a bank’s financial
a wake-up call to banks, leading officials to consider updating China's primitive banking system.\textsuperscript{34}

1. Poor Lending Practices

Risky bank loans have proven problematic, especially with regard to funding state-owned enterprises (SOEs), which tend to suffer severe losses.\textsuperscript{35} The Big Four traditionally have financed SOEs at the behest of the government.\textsuperscript{36} When an SOE fails to repay its loan to the bank, the government acts a guarantor and simply writes off the debt.\textsuperscript{37} This policy has led to a significant increase in non-performing loans (NPLs).\textsuperscript{38} Moreover, such loans have stigmatized China's banking industry as being a risky market.\textsuperscript{39} This has prompted calls for the creation of a proper DIS, as it is predicted that China's government will not be able to bail out banks in the future.\textsuperscript{40}

In addition to lending to SOEs, the Big Four's poor loan practices include extending risky loans in exchange for short-term profits.\textsuperscript{41} Indeed, risk assessment in China seems nearly non-existent: "creditworthiness and objective assessments of risk are not the prime factors when it comes to deciding how and where to lend. More important are relationships and the political connections of the firms involved. In many cases, bank executives

\textsuperscript{34} See Anderlini, supra note 5 (citing JP Morgan's Jing Ulrich as referring to China's banking system as a "rudimentary market").

\textsuperscript{35} Banks: Domestic Banks, supra note 17; The Operating Environment: State Role in the Economy, COUNTRY COM. CHINA, Mar. 20, 2006, available at 2006 WLNR 5591995.

\textsuperscript{36} Banks: Domestic Banks, supra note 17.

\textsuperscript{37} See Tang, supra note 28 (noting that the State serves as the guarantor for deposits).


\textsuperscript{39} Asian Banks Face Cyclical Risks: S & P, supra note 33.


\textsuperscript{41} Keep the Lid on Bad Loans, CHINA DAILY, May 18, 2006, available at 2006 WLNR 8582388.
themselves hold powerful positions in the government.\textsuperscript{42} Such practices have led to a glut of NPLs, which account for roughly forty percent of the total outstanding loans in China.\textsuperscript{43} New statistics indicate that current reforms have not curbed such practices.\textsuperscript{44} For example, in the first half of 2006, Chinese banks accumulated eighty percent of their annual loan target, increasing their outstanding bank loans by U.S.$273 billion to a combined total of U.S.$2.7 trillion.\textsuperscript{45} NPLs have contributed significantly to such growth, rising by U.S.$150 billion per year since 2000.\textsuperscript{46} The lending spree highlights the overwhelming tendency for domestic banks to prioritize short-term profits over more conservative lending standards.\textsuperscript{47} The result has led to a growing concern that China's banking sector is too unstable.\textsuperscript{48} For example, the Standard and Poor's rating agency considers China to have a moderately high-risk banking industry.\textsuperscript{49}

2. Scandal and Corruption

In addition, various scandals have marred China's banking industry. In June 2006, one branch of China's Bank of Communications announced losses of approximately U.S.$25 million due to fraud.\textsuperscript{50} Several scandals have demonstrated that political connections, rather than a borrower's riskiness, are more determinative as to whether a bank issues a particular loan.\textsuperscript{51} For example, the China Construction Bank fired its chairman Zhang Enzhao for behavior stemming from loans issued to Qin Hui, one

\textsuperscript{43} Chen, supra note 38, at 239.
\textsuperscript{44} See Test of Bank Reforms, CHINA DAILY, July 17, 2006, available at 2006 WLNR 12307335.
\textsuperscript{45} Id.
\textsuperscript{46} Chen, supra note 38, at 241.
\textsuperscript{47} Prioritize Bank Reforms, CHINA DAILY, June 14, 2006, available at 2006 WLNR 10252600.
\textsuperscript{48} See generally Asian Banks Face Cyclical Risks: S & P, supra note 33 (describing the Asian banking industry's overall medium-high risk rating).
\textsuperscript{49} Id.
\textsuperscript{50} Prioritize Bank Reforms, supra note 47.
\textsuperscript{51} Cautionary Lesson from a New Bank Scandal, supra note 42.
of China’s media moguls. Allegedly, Zhang was taking kickbacks in exchange for Qin’s media-related companies’ obtaining several sizeable loans. Scandals also resulted from individuals serving simultaneously as bank executives and government officials. For example, local judges have been accused of forging legal papers at the direction of bank executives so that the banks can write-off bad loans.

While the government has undertaken to purge the industry of corruption, efforts have had only a marginal effect. In 2005, for example, Liu Mingkang, CBRC’s chairman, identified banking crimes as a focus for reform. CBRC addressed the issue by circulating a document among bank employees listing ways in which institutions can curb inappropriate practices. Over a year later, however, Liu observed: “[m]ost banks have not done a good job of reforming their middle and back-office management. In a great number of transactions, the operational risks are enormous.”

III. Deposit Insurance

A. DIS Generally

Banks interact with depositors in a delicate relationship based on good faith and confidence. Individuals entrust money
to an institution with the understanding that they may withdraw their deposits at any time. In order to make a profit, banks do not retain every deposit but instead loan the funds out to borrowers. Thus, a bank's profits are computed by deducting the interest paid on deposits from the interest earned from its loans. As a result, banks cannot honor a withdrawal of every account at once. Although a bank may liquidate all of its assets to repay depositors, a bank still does not have enough liquidity to pay every depositor at once, due to its outstanding loans. Under these circumstances, not only would depositors lose their money, the bank also would become insolvent. To counteract this risk in the United States, the Federal Reserve Board requires banks to maintain a fraction of its deposits in reserve. Currently, the minimum reserve requirement is around ten percent of all deposits at an institution. This amount, however, would still not satisfy all requests if more than ten percent of depositors demanded withdrawal at once. Moreover, a bank run at one institution can have ripple effects on other deposit institutions, sending a panic-stricken mob into the bank next door demanding withdrawal of its deposits as well.

Since banks do not retain all deposits in their cash vault, what keeps depositors from worrying about whether to race to their local bank and demand satisfaction of their deposit? The answer is deposit insurance. Deposit insurance generally refers to a limited guarantee that depositors will be repaid, at least in part, for any deposits lost as a result of a bank failure. Such guarantees

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60. **Lissa L. Broome & Jerry W. Markham, Regulation of Bank Financial Service Activities: Cases and Materials** 152-53 (2d ed. 2004).
61. *Id.* at 151.
62. *Id.*
66. **Broome & Markham, supra** note 60, at 156-57.
67. *Id.* at 158.
68. *See id.*
69. Suphap, *supra* note 64, at 835.
70. *Id.* at 833.
are designed to encourage consumers to open accounts at financial institutions. In general, an effective system of deposit insurance aspires to provide: (1) clarity and transparency among depositors regarding funding, coverage, and limitations; (2) strong prudential regulation and supervision over banking activities; and (3) limited coverage of particular institutions.

B. Benefits of a DIS in China

1. Reducing Moral Hazard

"Moral hazard" refers to an institution's tendency to take excessive risks in the hope of achieving higher profits. Some critics of deposit insurance argue that by implementing a safety net for institutions, a DIS creates further "moral hazard." The introduction of deposit insurance, however, creates a sound basis for regulation and oversight by the government of the banking industry. As mentioned above, the banking industry in China is plagued already by poor management and needs stricter prudential regulation. A well-designed system can resolve these issues through greater transparency, adequate internal audits, and continuous external reviews of an institution's activities. Furthermore, a DIS provides leverage for a regulatory agency to impose penalties on poorly run institutions. The degree to which deposit insurance improves the banking industry is contingent upon the choices made by Chinese officials when designing the DIS. Thus, deposit insurance has the potential to address some of China's poor lending practices. The subsequent sections of this Note include a discussion of how particular features of deposit

71. Kaufman, supra note 65.
72. See Yokoi-Arai, supra note 59, at 65-66 (describing the desired elements of financial regulators regarding the oversight of a DIS).
73. Macey, supra note 59, at 10.
74. Yokoi-Arai, supra note 59, at 68.
75. Macey, supra note 59, at 10.
76. See supra notes 32-58 and accompanying text.
77. See Yokoi-Arai, supra note 59, at 67 (listing the various concerns regarding effective deposit insurance, as well as measures implemented to resolve such issues).
78. Id. at 68-70.
79. See infra notes 222-84 and accompanying text.
insurance will improve bank management, thereby reducing moral hazard.\textsuperscript{80}

2. Industry Sustainability

In addition to holding bank management accountable, deposit insurance will enable the banking industry in China to weather another financial crisis.\textsuperscript{81} As U.S. Treasury Secretary Henry Paulson noted during his recent visit to China: "[a] healthy, strong financial sector, strong capital markets, strong banking system, are absolutely necessary for long-term economic success."\textsuperscript{82} The International Association of Deposit Insurers found that most countries establish a DIS in response to, or in preparation for, a financial crisis.\textsuperscript{83} Since massive bank failures can lead to sharp economic recessions, in part due to the large amount of money removed from the economy as a result of bank runs,\textsuperscript{84} deposit insurance has often been implemented in reaction to an economic depression.\textsuperscript{85} "[D]eposit insurance . . . has an enormous impact in increasing the stability of the banking system. Simply because it exists, the threat against which it insures is much less likely to occur. It is as if life insurance somehow prolonged life."\textsuperscript{86}

For example, the United States introduced federal deposit insurance in the wake of a high number of bank failures during the Great Depression.\textsuperscript{87} Despite some criticism of the new system,\textsuperscript{88}

\begin{footnotesize}
\begin{enumerate}
\item \textit{See infra} notes 222-84 and accompanying text.
\item \textit{See Research and Guidance Comm., Int’l Ass’n of Deposit Insurers, Questions on the Design of a Deposit Insurance System} 4-5 (2004) (finding that most countries implement a DIS to maintain financial stability).
\item \textit{Research and Guidance Comm.}, \textit{supra} note 81, at 4-5.
\item Kaufman, \textit{supra} note 65.
\item See Macey, \textit{supra} note 59, at 4-10 (discussing the various regulatory responses of governments when faced with financial crises and bank failures).
\item Suphap, \textit{supra} note 64, at 835 (quoting professors Joseph Stiglitz and Carl Walsh).
\item Kaufman, \textit{supra} note 65.
\item Heidi Mandanis Schooner & Michael Taylor, \textit{Convergence and Competition: The Case of Bank Regulation in Britain and the United States}, 20 \textit{Mich. J. Int’l L.} 595, 618 (1999). Interestingly, many politicians at the time, including President Roosevelt, disapproved of deposit insurance on the grounds that it forced stronger banks to subsidize weaker banks. \textit{Id}.
\end{enumerate}
\end{footnotesize}
the FDIC proved successful at significantly reducing the bank runs that led to bank failures.\textsuperscript{89} In 1934, only nine banks failed.\textsuperscript{90} During the forty years after federal deposit insurance was implemented, an average of only thirteen banks failed each year.\textsuperscript{91} Similarly, the United Kingdom converted its informal, voluntary system of deposit insurance into a formal DIS only after suffering a financial crisis.\textsuperscript{92}

In addition to raising consumer confidence in banks, deposit insurance provides a mechanism through which the banking industry can repair itself.\textsuperscript{93} Rather than the implicit protection and help from the government, a DIS creates a substantive policy on which investors, lenders, borrowers, and depositors can rely.\textsuperscript{94} Therefore, China can expect that a DIS will improve its chances of sustaining its banking industry through times of trouble.\textsuperscript{95}

3. Opportunity for Foreign Investment

China is on the cusp of a very lucrative opportunity. By agreeing to open its banking market to foreign competition by the end of 2006,\textsuperscript{96} China is taking a critical step towards sustained economic growth.\textsuperscript{97} Foreign institutions have demonstrated an

\textsuperscript{89} Div. of Research and Statistics, FDIC, A Brief History of Deposit Insurance in the United States 1 (1998).
\textsuperscript{90} Id.
\textsuperscript{91} Mandanis Schooner & Taylor, supra note 88, at 618.
\textsuperscript{92} Id. at 629, 631. Prior to 1979, banks in the United Kingdom operated under an informal, voluntary system of deposit insurance. Id. at 629. During the Secondary Banking Crisis of 1973-74, however, a number of banks became insolvent, raising concerns that a formal DIS, among other things, was needed. Id. at 625. The Banking Act of 1979 responded to the insolvencies by creating the Deposit Protection Scheme, as well as a funding mechanism for the plan via the Deposit Protection Fund. Id. at 631.
\textsuperscript{93} John Raymond LaBrosse, Sec'y Gen., Int'l Ass'n of Deposit Insurers, Remarks at the Public Lecture of the First Deposit Protection Awareness Week (Sept. 15, 2005).
\textsuperscript{95} See generally Research and Guidance Comm., supra note 81, at 4-5 (discussing the stabilizing effect of deposit insurance).
\textsuperscript{96} Jirak, supra note 4, at 333.
\textsuperscript{97} McLaughlin, supra note 82, at 455.
eagerness to enter China’s market. In 2005, Bank of America invested U.S.$3 billion into the China Construction Bank. The same year, Goldman Sachs, Allianz, and American Express bought shares in the Industrial and Commercial Bank of China. Acknowledging this trend, a 2005 United Nations survey listed China as the favorite investment market for foreign direct investment. Thus, the potential to maximize its international appeal is at stake for China in its reform process. The success of an open market, however, is contingent upon the stability and sound structure of China’s banking and financial industries. As the European Union notes, deposit insurance is an essential element to a developed banking market planning to transact business both domestically and abroad. In order to provide a first-world banking market, China must align itself with these international standards. Additionally, replacing governmental support of banks with a DIS may be a necessary step for China to comply with WTO standards, so that foreign and domestic banks are treated equally by the government.

IV. MODELS FOR COMPARISON

China’s Communist history has precluded it from developing a reliable legal code on which to base its new policy. China’s desire to enter globalized markets during the 1970s required shifting from a planned economy to a socialist market.
The goal was not an abandonment of socialism, but instead a marriage of a planned economy and market principles. Although the transition has attracted substantial foreign investment into China, the government has been forced to create a legitimate and workable legal framework. Since most businesses operating in international markets are regulated by prescribed statutory codes, China has been faced with the challenge of adapting to these practices by establishing a system that guarantees predictability, transparency, and definite legal standards. As China has done with its criminal and civil codes, it reviews policies from other countries, and subsequently adopts them into Chinese law. Not surprisingly, some of the imported concepts from foreign law appear out of place against the backdrop of China’s legal history. Notwithstanding this awkwardness, China has benefited from this approach by learning from the mistakes of other countries. To be sure, this method is simple. After all, “you don’t have to invent the wheel, in the case that it already exists.”

The success of China’s DIS largely depends on the particular features of China’s anticipated system. While deposit insurance is as varied as the countries implementing it, three
characteristics help to provide a general basis for comparison: funding, coverage, and membership regulations. Existing systems in the United States, the European Union, and Russia may provide effective models which China may study as it creates its own DIS.

A. United States

1. Basic Structure

During the Great Depression, following a multitude of bank failures, the federal government introduced its first version of deposit insurance. While some states formerly had attempted to provide some form of insurance, none were successful in the long-term. The Banking Act of 1933, a part of which was the Federal Deposit Insurance Act, created the Federal Deposit Insurance Corporation (FDIC), which serves as the regulatory agency for federal deposit insurance.

In its original form, the FDIC provided 100% coverage to all deposits up to U.S.$2,500 per account. In order to pay for the insurance coverage, banks were charged a flat-rate premium that was one-twelfth of one percent of an institution’s total domestic deposits. To be insured, banks were required to apply for membership with the FDIC, which had rigorous criteria by which to measure an institution’s admission. The FDIC board determined an institution’s stability by evaluating its earning prospects and current capital, as well as the quality of its management and reputation within its community.

117. Mandanis Schooner & Taylor, supra note 88, at 616 (noting that between 1929 and 1933, the number of banks shrank from 24,026 to 13,949).
118. Kaufman, supra note 65.
119. Id.
121. Kaufman, supra note 65.
122. Id.
123. Div. of Research and Statistics, FDIC, supra note 89, at 37.
124. Id.
In its present form, the FDIC retains its fundamental principles of prudential supervision. Currently, deposits are covered up to U.S.$100,000 per depositor, per bank. The Federal Deposit Insurance Corporation Improvement Act of 1991 eliminated flat-rate premiums. Instead, the Act instituted a risk-based assessment of banks, charging premiums based on the risks they pose, which ranged from twenty-three to thirty-one cents per U.S.$100 of deposits. In 1996, the Deposit Insurance Funds Act fixed the designated reserve ratio at 1.25%. Provided the ratio did not drop below this level, well-capitalized banks were not assessed a premium.

The Federal Deposit Insurance Reform Act of 2005, however, adjusts the way in which rates are assessed. Instead of relying solely on whether the reserve ratio is satisfied, the FDIC board will assess premiums for each institution by weighing a series of factors, including the projected needs of the fund and the effects of assessments on depository institutions. Also, the reserve ratio may range from 1.15% to 1.5%. Accordingly, well-capitalized banks are not exempt automatically and may still be subject to assessments. The new guidelines are designed to give...

125. See generally id. (describing the chronological progression of FDIC since 1993).
128. DIV. OF RESEARCH AND STATISTICS, FDIC, supra note 89, at 54.
129. Id. at 63.
130. See id. (describing various concerns regarding the designated reserve ratio, including the exemption of highly-rated institutions from paying premiums).
134. Id.
the FDIC board greater discretion in charging assessments, which in turn should make the system more sensitive to risk.\textsuperscript{135} The FDIC board continues to monitor closely bank capitalization, management activity, and overall stability.\textsuperscript{136} It regularly reviews institutions for compliance with FDIC standards.\textsuperscript{137}

2. Relevancy: A Frequent Paradigm for China

The FDIC represents an established and tested version of deposit insurance, making it a logical framework on which other countries may base their own versions of deposit insurance.\textsuperscript{138} In fact, at a financial conference in September 2006, Vice Finance Minister Li Yong reported that administrators were studying the FDIC as China develops its own regulation methods.\textsuperscript{139} Not surprisingly, China has studied U.S. financial regulatory agencies in the past.\textsuperscript{140} The PBC is virtually a replica of the Federal Reserve, but with less autonomy.\textsuperscript{141} Similarly, China’s monetary-policy committee mimics its U.S. counterpart, the Federal Open Market Committee.\textsuperscript{142} It therefore would not be unusual for China likewise to imitate many aspects of the FDIC system. Even if China decides to implement an entirely different form of DIS, China’s system likely will be judged in terms of its deviation from the paradigm of the FDIC.

B. European Union

1. Basic Structure

In 1994, the European Union issued a Directive outlining the requisite provisions for deposit insurance in each of its

\textsuperscript{135} Federal Deposit Insurance Reform Act, 71 Fed. Reg. 41,910 (proposed July 24, 2006).

\textsuperscript{136} \textsc{Div. of Research and Statistics, FDIC, supra note 89, at 59.}

\textsuperscript{137} FDIC, supra note 126.

\textsuperscript{138} See generally Kaufman, supra note 65 (describing the long history of deposit insurance in the United States).

\textsuperscript{139} \textit{Minister: China to Set Up National Financial Regulator, supra note 8.}

\textsuperscript{140} \textit{Banks: Bank Regulators, supra note 21.}

\textsuperscript{141} \textit{Id.}

\textsuperscript{142} \textit{Id.}
member states, stating that a DIS is necessary for maintaining financial stability and for engaging in international banking. While the Directive allows each country substantial flexibility in terms of its scope, regulation, operation, and coverage, the Directive does enumerate several requirements. Article 3(1) of the Directive makes deposit insurance mandatory for each member country. Most notably, the Directive sets the minimum amount of coverage for each depositor at ECU 20,000 (approximately U.S.$25,000). Furthermore, the Directive makes clear that coverage is based on a per depositor, per bank basis.

The stated purpose of the Directive is to create "harmonious development" among member countries, while also "increasing the stability of the banking system and protection for savers." By requiring all banks to provide some sort of deposit guarantee, the European Union seeks to create a level playing field among EU banks. The Directive also includes a "topping off" provision, which allows foreign branches to voluntarily obtain

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144. Id. ("[W]hereas it is indispensable to ensure a harmonized minimum level of deposit protection wherever deposits are located in the Community whereas such deposit protection is as essential as the prudential rules for the completion of the single banking market . . .").
145. Id.
146. Id. at art. 3. The Directive applies to all banks taking deposits, including credit institutions, which may only take deposits if they are insured by a national DIS. Ingo Wallenborn, Competitiveness of U.S. Banks after Gramm-Leach-Bliley: A Comparison between the U.S. and European Regulatory Systems, 20 ANN. REV. BANKING L. 243,265 (2001).
149. Council Directive 94/19, supra note 103, at art. 7; see also Scheer, supra note 127, at 193 (noting that multiple deposits made at a single institution are aggregated for coverage purposes, whereas the same deposits made at different institutions would be insured exclusive of each other).
151. Id. at pmbl., para. 19.
extra coverage from the host state. This enables foreign banks that may receive less insurance from their home countries to offer equal protection to depositors in a host country offering greater deposit insurance coverage to its domestic banks. Also, the Directive enacted a temporary buffer period during which foreign banks were not allowed to offer more coverage than the host state. Such equalizing, according to the European Union, fosters a better environment for competition among foreign and domestic banks. The Directive also provides uniform guidelines for prudential regulations to ensure that banks ascribe to at least a minimum standard of sound banking practices. Another goal of the Directive's is to encourage bank personnel to disclose the coverage and operation of the DIS to depositors. Thus, the legislation reflects a concern both for the adequacy of institutions, as well as for educating depositors about deposit insurance.

Interestingly, the EU Directive does not prescribe any particular method of funding deposit insurance. As a result of this flexibility, many different types of DISs exist throughout Europe. For instance, in the United Kingdom, deposit insurance has existed both as a privately coordinated effort, as well as a state-enacted system. Originally, the Bank of England, the traditional banking regulator, developed an informal, voluntary form of deposit insurance. Recently, however, the United Kingdom has formalized its system by way of statutory authorization. In 2000, the Financial Services Compensation

152. Scheer, supra note 127, at 190.
153. Id.
154. Id. at 189. The provision was effective until December 31, 1999, after which foreign banks were allowed to offer more or less insurance coverage than the host state. Id.
155. Council Directive 94/19, supra note 103, at pmbl., para. 18; see Scheer, supra note 127, at 190 (noting that the intent of these provisions is to eliminate the disparity among banks as a result of varying levels of coverage).
157. Id. at art. 9, pmbl., para. 21.
158. See id.
159. Scheer, supra note 127, at 197.
161. Id. at 646-47.
162. Id. at 649.
Scheme marked a new phase of deposit insurance in the United Kingdom. This comprehensive program offers coverage of 100% of the first £2,000 and ninety percent of the next £33,000, up to a maximum of £31,700 per claim (approximately U.S.$59,000). The system represents a collaborative effort between commercial institutions and supervising authorities to regulate the industry, with banks funding the scheme. Alternatively, Italy offers two privately run DISs, with coverage up to ECU 100,000 (approximately U.S.$125,000). France guarantees deposits up to 400,000 francs (approximately U.S.$76,000) under its DIS, the Association Francaise des Banques.

Germany was one of the first European countries to offer deposit insurance, but never required it by statute prior to the EU Directive. During the late 1960s, Germany’s Private Banker’s Association formed the Deposit Insurance Fund, which provided optional deposit insurance to many banks. Although voluntary, most private banks became members of the Deposit Insurance Fund. In 1998, Germany complied with the EU Directive by passing the German Deposit Guarantee Act. The Act authorized the Compensation Scheme of German Banks, which extended insurance coverage to all institutions. Unlike the

164. Id. at 4.
169. In October 2006, this amounted to exactly U.S.$76,319.26. See id..
170. Colon, supra note 167, at 139.
172. Id. The system offered nearly complete coverage for most ordinary deposits. Id. at 10.
173. Id. at 10. Members are subject to regular audits and strict prudential supervision by the Private Bankers Association. Id.
174. Colon, supra note 167, at 139.
175. Binder, supra note 171, at 9.
private scheme, all banks must contribute to the statutory DIS.\textsuperscript{176} Aside from offering the minimum level of coverage as prescribed by the Directive (ECU 20,000 per depositor),\textsuperscript{177} the statutory scheme provides an extra layer of prudential supervision.\textsuperscript{178} As both schemes operate simultaneously, Germany’s banking industry undergoes significant regulatory scrutiny.\textsuperscript{179}

2. Relevancy: An International Standard

The overarching themes of the Directive reflect concerns about fair competition, extensive prudential supervision, and raising awareness among depositors in the context of transnational banking.\textsuperscript{180} China has already shown its willingness to consider international standards when developing economic policy. For instance, China has tightened its regulation of capital adequacy requirements according to the rules set forth by the Bank for International Settlements.\textsuperscript{181} Likewise, the EU Directive provides China with an idea of what an advanced banking market views as the essential elements of deposit insurance. From the principles set forth in the Directive, China may derive its own form of deposit insurance.\textsuperscript{182} Substantively, each country implementing the EU Directive provides China with a different template for a DIS.\textsuperscript{183} The variety of European models for DIS shows that basic principles enumerated in the EU Directive can exist under diverse governmental regimes.\textsuperscript{184} For China, this is a promising result, as it suggests that these principles may be transcendent enough to exist also under China’s socialist regime.

As China faces the prospect of a greater foreign presence in its banking market, the EU Directive’s guidelines on coverage

\textsuperscript{176} \textit{Id.}
\textsuperscript{178} Binder, \textit{supra} note 171, at 13.
\textsuperscript{179} \textit{Id.} at 10.
\textsuperscript{180} \textit{See supra} notes 150-58 and accompanying text.
\textsuperscript{181} \textit{Banks: Bank Regulators, supra} note 21.
\textsuperscript{182} \textit{See, e.g., supra} notes 159-79 and accompanying text (showing that the flexibility of the Directive allows a country to customize its DIS).
\textsuperscript{183} \textit{See supra} notes 159-79 and accompanying text (giving examples from the United Kingdom, Germany, Italy and France).
\textsuperscript{184} \textit{See supra} notes 159-79 and accompanying text.
among domestic and foreign institutions may also prove useful. The Directive enumerates provisions designed to prevent deposit insurance from being a source of a competitive disadvantage.\textsuperscript{185} As mentioned above, “topping off” provisions and standardized coverage are designed to place foreign and domestic banks on a level playing field.\textsuperscript{186} In addition to inter-institutional considerations, the interplay between host country and foreign branches is particularly relevant to China’s current situation.\textsuperscript{187} Hence, the Directive may serve as a valuable resource for Chinese officials forming policy regarding foreign banks competing in the Chinese market.

\section{Russia}

\subsection{Basic Structure}

Like China, Russia has undertaken to reform its outmoded banking sector in recent years due to threats of future crises, poor management, corruption, and the prospect of foreign investment.\textsuperscript{188} In 2005, Russia introduced a general deposit insurance scheme (GDI).\textsuperscript{189} GDI provides full coverage of up to 100,000 rubles (approximately U.S.$3,700)\textsuperscript{190} of each deposit, along with ninety percent of the remainder up to 190,000 rubles\textsuperscript{191} (approximately U.S.$7,000)\textsuperscript{192} By 2007, the State Corporation Deposit Insurance Agency is planning to raise coverage to 300,000 rubles per

\begin{itemize}
\item \textsuperscript{185}See, e.g., Scheer, supra note 127, at 190 (discussing the benefits of the Directive’s “topping off” provision).
\item \textsuperscript{186} Id. at 189-90.
\item \textsuperscript{187} See Lu, supra note 27 (discussing the potential problems facing the Chinese government with regard to its treatment of foreign investment firms).
\item \textsuperscript{188} Russian Banks Hope to Cash in on IPO Rebound, SUNDAY BUS., Mar. 12, 2006, available at 2006 WLNR 4177364.
\item \textsuperscript{190} In October 2006, this amounted to exactly U.S.$7,046.13. See Universal Currency Converter, supra note 148.
\item \textsuperscript{191} Russia’s Deposit Insurance Agency Mulls Cutting Contributions, PRIME-TASS, Aug. 25, 2006.
\item \textsuperscript{192} In October 2006, this amounted to exactly U.S.$3,707.96. See Universal Currency Converter, supra note 148.
\end{itemize}
deposit \(^{193}\) (approximately U.S.$11,000).\(^{194}\) To obtain coverage, banks must apply for membership.\(^{195}\) All banks, however, must contribute 0.6% of the total annual deposits received into personal accounts to GDI.\(^{196}\) While GDI was intended originally to supply insurance only to well-capitalized banks, it has been extended virtually to all banks.\(^{197}\) As a result, GDI has grown to over 29.2 billion rubles (approximately U.S.$1.08 billion),\(^{198}\) and is expected to climb to 41 billion rubles by 2007\(^{199}\) (approximately U.S.$1.5 billion).\(^{200}\)

Though GDI is still in its nascent years, Russia’s banking industry has benefited already from its implementation.\(^{201}\) According to the U.S. Department of State’s Bureau of Intelligence and Research Electronic Affairs Publication Office in 2005, a lack of faith among depositors was a significant restraint on the growth of Russia’s banking industry.\(^{202}\) One year after the implementation of GDI, personal deposits increased by forty percent in Russia.\(^{203}\) This confidence was reflected in a recent survey, conducted by the Centre for the Study of Financial Innovation and PricewaterhouseCoopers.\(^{204}\) Russian respondents indicated their concerns for inherent risks of the banking industry were declining.\(^{205}\) Similarly, respondents showed greater

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197. *See Russia: Industry Forecast: Taking Off*, supra note 189. As of March 2006, 929 banks out of 1,150 that applied were admitted. Id.
202. Id.
205. Id.
acceptance of regulation, which also suggests that recent reforms have been successful. The extra deposits have stimulated growth within the banking industry, enabling institutions to increase both consumer and commercial lending. In turn, this demonstrated improvement in the banking industry has contributed to a 6.4% growth in Russia’s economy. Reaction to such improvements was not limited to Moscow; foreign investors also have been attentive to Russia’s banking sector in light of recent improvements.

2. Relevancy: A Familiar Situation

Russia serves as a guide from which China can learn how to implement its DIS for three reasons. First, both China and Russia wish to open their banking systems to foreign investments. Accordingly, both have adopted reform plans with the stated purpose of comporting with international standards. Second, China and Russia both struggle with the residual effects of a rudimentary banking system. Both must contend with high risk designations by the international community, as well as a lack of consumer faith in the banking industry. Moreover, both systems have been rife with bank mismanagement, poor lending practices, and scandal. Finally, both countries share a history of balancing

206. Id.
208. Russian Banks Hope to Cash in on IPO Rebound, supra note 188.
209. See generally id. (noting that the success of listing Russia’s banks on foreign markets has been successful as a result of reforms).
210. Id.; see also The Operating Environment: Foreign Investment, supra note 101.
211. The Operating Environment: Foreign Investment, supra note 101; see generally Russia: Industry Forecast: Taking Off, supra note 189 (referring to reforms in terms of Russia’s ability to gain entry into the WTO).
212. See Russian Banks Hope to Cash in on IPO Rebound, supra note 188 (referring to Russia as having an “antiquated” banking system); see also Fred Hu, Comment: The Truth about Investing in China’s Banks, FIN. TIMES ASIA, Nov. 18, 2005, available at 2005 WLNR 18641275 (referring to China’s banking system as “antiquated”).
213. Asian Banks Face Cyclical Risks: S & P, supra note 33; State Department Issues Background Note on Russia, supra note 201.
215. Prioritize Bank Reforms, supra note 47; Russia: Industry Forecast: Taking Off,
planned economies with market-oriented economies. Although soviet control in Russia ended in 1991, vestiges from the communist era remain. Similarly, Chinese officials have noted the delicate balance that must be struck between socialist ideals and the attraction of market-orientation. Capitalist innovations are not intended to replace communism in China. On the contrary, capitalist methods are often abrogated by socialist policy, demonstrating that China vigorously adheres to its Marxist ideals. Russia, therefore, may enlighten China as to the struggles facing a synthesis of these two ideologies.

V. DISCUSSION: DIS IN CHINA

Depending on the features of China’s DIS, deposit insurance can significantly alleviate problems regarding bank mismanagement and risky loan practices. In addition, deposit insurance may provide another layer of protection for China during future financial crises, as well as enable China to better compete with foreign banks domestically.

A. What Features Should China Adopt?

1. Funding

Any DIS must have adequate financing in order to work properly, and the method of funding is an essential element of a

supra note 189; see also State Department Issues Background Note on Russia, supra note 201 (noting that “corruption remains a serious problem” for effective regulation of many business sectors).

216. China is in Favor of More Reform, supra note 11; see generally State Department Issues Background Note on Russia, supra note 201 (describing Russia’s Soviet history, its demise, and the introduction of capitalism).

217. State Department Issues Background Note on Russia, supra note 201.

218. See id. (“Leftover attitudes from the Soviet period will take many years to overcome.”).

219. China is in Favor of More Reform, supra note 11.

220. See generally Wang, supra note 104 (explaining that property reforms in China, while based on democratic innovations, are always subject to the limitations of China’s pervasive socialist policy).

221. See Wang, supra note 104, at 619-20.

222. See supra notes 73-80 and accompanying text.

223. See supra notes 81-105 and accompanying text.
Since Chinese officials have expressed the desire to turn banks into freestanding institutions, the DIS likely will be funded by Chinese banks themselves, notwithstanding some contributions from the government. This form of DIS would best serve China because it would force banks to have a stake in improving banking practices. As seen in the newly-formed system in Russia, requiring all banks to contribute a percentage of total deposits to the DIS improves banking management.

China must determine whether to collect funds ex-ante or ex-post. Ex-ante collections create a reserve fund so that when a bank failure occurs, money is available for immediate disbursement. The FDIC, for example, is an ex-ante system. Alternatively, ex-post collections occur only after a bank fails. So long as no institutions fail, banks do not have to contribute to the fund. The ex-post form allows banks greater liquidity during stable periods, and it may encourage greater self-regulation among member banks. This form, however, involves a slow and more tedious reimbursement process. It is also criticized because the beneficiaries of the DIS—the banks that fail—may avoid ever paying into the system. As a result, the ex-ante approach is the

224. Suphap, supra note 64, at 835-36.
226. See Banks: Bank Regulators, supra note 21 (reporting that officials disclosed that the system would likely be funded by banks themselves).
227. See MacDonald, supra note 166, at 13 (noting that frequently the government of a developing nation partially funds the DIS).
228. See id.
229. Russia’s Deposit Insurance Agency Mulls Cutting Contributions, supra note 191.
230. PricewaterhouseCoopers Evaluates Russian Country Risks, supra note 204 (noting that risk management techniques have improved such that survey respondents do not consider it as big of a risk for the banking industry).
231. See Suphap, supra note 64, at 835-36. The author emphasizes that the collection of funds is a crucial part of forming a DIS. Id. Some countries also may use a combination of ex-ante and ex-post collection methods to build up the fund. Id. at 836-37.
232. Id. at 836.
233. Macey, supra note 59, at 8.
234. Id. at 4; Suphap, supra note 64, at 836.
235. Suphap, supra note 64, at 836.
236. Id.
237. Id.
238. Id.
popular choice.\textsuperscript{239} For China, an established fund likely would reassure its depositors that their accounts are protected.\textsuperscript{240} Since ex-ante collections are the preferred method,\textsuperscript{241} China also has more models from which to learn the benefits and potential pitfalls of ex-ante fundraising.

Assuming banks contribute to the DIS, China has a choice between flat-rate premiums and risk-adjusted premiums.\textsuperscript{242} A flat-rate premium charges banks a fixed amount per institution, making it easy to assess on banks.\textsuperscript{243} Usually, banks are charged at a rate of between 0.01\% and 0.50\% of total deposits.\textsuperscript{244} Flat-rate premiums are criticized for being unfair because the rate is determined irrespective of the institutions' riskiness or stability.\textsuperscript{245} Since China's banking industry is dominated by the Big Four, all of which share similar risk and stability problems,\textsuperscript{246} a flat-rate would not seemingly be unfair to impose on any of the banks. Moreover, flat-rate premiums have been consistently used in most DISs.\textsuperscript{247} Nearly fifty countries implement a flat-rate premium to generate funds for a DIS.\textsuperscript{248}

In contrast, risk-adjusted premiums vary by institution.\textsuperscript{249} The regulatory agency assesses how much a particular bank owes based on a series of factors, which may include, "the amount insured, estimated risk rating, solvency, profitability, and transformation and granularity measures."\textsuperscript{250} For example, France, Canada, Finland, Turkey and the United States have implemented

\begin{thebibliography}{99}
\bibitem{239} Demirguc-Kunt & Sobaci, \textit{supra} note 115; Suphap, \textit{supra} note 64, at 836.
\bibitem{240} \textit{See} Macdonald, \textit{supra} note 166, at 10-11 (describing the differences between an implicit versus explicit form of deposit insurance).
\bibitem{241} Suphap, \textit{supra} note 64, at 836.
\bibitem{243} \textit{Id.} at 3.
\bibitem{244} Macdonald, \textit{supra} note 166, at 19.
\bibitem{245} \textit{Int'l Ass'n of Deposit Insurers, supra} note 242, at 3.
\bibitem{246} \textit{See supra} notes 32-58 and accompanying text.
\bibitem{247} \textit{Int'l Ass'n of Deposit Insurers, supra} note 242, at 3 ("Most deposit insurance systems initially adopt an ex-ante flat-rate premium system because they are relatively simple to design, implement[,] and administer.").
\bibitem{248} Suphap, \textit{supra} note 64, at 837.
\bibitem{249} Demirguc-Kunt & Sobaci, \textit{supra} note 115.
\bibitem{250} Suphap, \textit{supra} note 64, at 837-38 (quoting France's DIS).
\end{thebibliography}
risk-adjusted premiums, although the FDIC was funded by flat-rate premiums for the first sixty years of its existence.\textsuperscript{251}

Chinese officials have indicated that banks will be charged differently based on a risk assessment.\textsuperscript{252} While a risk-adjusted premium scheme is more comprehensive and detailed,\textsuperscript{253} several disadvantages give cause for concern. First, the operating costs for a risk-adjusted premium are greater than for a flat-rate premium.\textsuperscript{254} Also, the methods involved in risk-assessment remain imprecise, as the information needed for assessment is often difficult to procure from institutions.\textsuperscript{255} A recent International Association of Deposit Insurers survey showed that, while many regimes found risk-adjusted premiums attractive, most developing countries chose flat-rate premiums in order to build up their insurance funds.\textsuperscript{256} Accordingly, risk-adjusted premiums usually have been introduced only in more advanced banking systems.\textsuperscript{257} Thus, while risk-adjusted premiums may ultimately become the preferred method, its implementation in China's banking system may be premature. Instead, China's banking industry would be served better by imposing a flat-rate premium initially, leaving open the option to switch to risk-adjusted rates in the future.\textsuperscript{258}

Risk-adjusted premiums, however, have one significant advantage particularly relevant to China. By basing premiums on the riskiness of the institution, banks have a greater interest in practicing conservative lending.\textsuperscript{259} In this way, risk-adjusted premiums reduce moral hazard.\textsuperscript{260} Similarly, risk-adjusted premiums require greater transparency among bank managers and

\textsuperscript{251} Id.; \textsc{Int'l Ass'n of Deposit Insurers, supra note 242, at 4.}
\textsuperscript{253} \textsc{Int'l Ass'n of Deposit Insurers, supra note 242, at 4.}
\textsuperscript{254} Suphap, \textsc{supra note 64, at 845-46.}
\textsuperscript{255} \textit{Id.} at 844-45.
\textsuperscript{256} \textsc{Research and Guidance Comm., Int'l Ass'n of Deposit Insurers, supra note 81, at 13.}
\textsuperscript{257} Demirguc-Kunt & Sobaci, \textsc{supra note 115.}
\textsuperscript{258} See \textsc{Int'l Ass'n of Deposit Insurers, supra note 242, at 3-4.} The author indicates that systems may begin initially as a flat-rate system, with a subsequent progression into a risk-adjusted system. \textit{Id.}
\textsuperscript{259} Suphap, \textsc{supra note 64, at 840-41.}
\textsuperscript{260} \textit{Id.}
compliance with regulations. For China, this feature is particularly significant because it further incorporates bank supervision into reforms. Thus, by charging a risk-based premium, China may improve its reputation as a high-risk market.

2. Membership Regulations

Subscription to the DIS in China should be mandatory, at least for the Big Four. With regard to financial cooperatives, smaller and more rural banks, membership should be determined by an extensive examination of the bank’s risk assessment and lending practices. Drawing from other countries, China should weigh factors such as net worth of the institution, quality of assets, potentially problematic financial practices, quality of bank management, and compliance with regulations. While China should thoroughly review an institution’s practices, the standards should not be so high that deposit insurance is available only to a minority of banks. Although China has taken steps to close

261. Id. at 846-47.
262. See id.
263. See generally Asian Banks Face Cyclical Risks: S & P, supra note 33 (discussing how reforms seek to lower Asia’s reputation as a high risk market).
264. See INT’L ASS’N OF DEPOSIT INSURERS, supra note 242, at 5-6. Under a quantitative approach to determining premiums, capital adequacy is the primary factor. Id. at 6. The Big Four would satisfy this factor, since they dominate industry. Banks: Domestic Banks, supra note 17.
265. See INT’L ASS’N OF DEPOSIT INSURERS, supra note 242, at 5-8. Banks may be subject to either a quantitative or qualitative examination, or a combination of both approaches. Id. Under the quantitative approach, factors include: capital adequacy, diversification and quality of assets, volatility of earnings, sources of funding, cash flow, and overall stability of operations. Id. Under a qualitative inquiry, factors are reflected in the CAMEL approach: capital, asset quality, management, earnings, and liquidity. Id. at 7. Officials may also weigh subjective factors, such as an institution’s reputation, track record in compliance, and expert opinions of industry analysts. Id. at 7.
266. See, e.g., DIV. OF RESEARCH AND STATISTICS, FDIC, supra note 89, at 34-35 (listing these factors for consideration); see also INT’L ASS’N OF DEPOSIT INSURERS, supra note 242, at 6-7.
267. See generally INT’L ASS’N OF DEPOSIT INSURERS, supra note 242, at 9-11 (discussing several problems relating to an overly scrutinizing examination of institutions).
especially problematic banks in rural areas, it probably will offer insurance to many of its smaller banks, much like Russia, because guaranteeing deposits will allow smaller banks to compete with larger institutions for deposits. The European Union noted this fact in its Directive by commenting that a DIS eliminates an unequal protection that gives larger institutions an unfair competitive advantage over smaller institutions. In this way, DIS may have an equalizing effect in the Chinese banking industry.

3. Coverage

While each country has its own special considerations regarding deposit insurance, research shows that countries developing a DIS consult international levels of coverage when determining the maximum coverage limit. On the one hand, the amount should be sufficient to cover most deposits. While setting a lower limit of coverage places the burden on depositors to scrutinize institutions, deposit insurance is intended to protect the unwitting, passive depositor. On the other hand, the coverage should not be so high that it creates a moral hazard for bank management. Also, 100% coverage of all deposits would place no burden on depositors to safeguard their own deposits. Amounts vary worldwide, with the United States offering some of the highest coverage at U.S.$100,000 per deposit. By comparison, the European Union sets a minimum requirement of

270. See, e.g., Council Directive 94/19, supra note 103 (noting that a DIS has an equalizing effect).
271. Id.
272. MACDONALD, supra note 166, at 17.
273. RESEARCH AND GUIDANCE COMM., INT’L ASS’N OF DEPOSIT INSURERS, supra note 81, at 11.
274. See Demirguc-Kunt & Sobaci, supra note 115 (noting that low coverage limits would force depositors to look elsewhere to deposit their money).
275. See id.
276. Suphap, supra note 64, at 840-41.
277. MACDONALD, supra note 166, at 9.
278. FDIC, supra note 126.
typically more developed countries offer higher coverage, which may be a function of the size of deposits being insured. Some countries, however, determine their level of coverage based on the size of the national economy. Under this approach, China likely would offer significant coverage. Since China is seeking to comply with international standards, it should offer at least as much coverage as the European Union mandates. Given the size of China’s economy, however, it could err on the side of providing proportionally as much coverage as the FDIC.

B. Other Factors Affecting the Impact of Deposit Insurance

In addition to the particular features of China’s DIS, the system’s success depends also on the further privatization of SOEs. China passed the Company Law of 1994 in an effort to turn SOEs into more autonomous entities. In doing so, SOEs bear the consequences of both the profits and losses they incur. In the first ten years since the legislation, China has closed 3,484 SOEs. Also, as China’s markets open up to foreign competition, the effects of SOEs on the economy—and the banking industry in particular—likely will diminish. Officials have indicated, however, that banks may still be required to provide loans to SOEs, even if the entity is unlikely to repay the loan. Consequently, this retention of power by the State may undermine the effectiveness of a DIS. Also, the government should

280. MACDONALD, supra note 166, at 17.
281. Id.
282. Wang, supra note 104, at 599 (noting that China’s economy is growing at a “record rate”).
283. See supra notes 146-49 and accompanying text.
284. See supra notes 126-37 and accompanying text.
285. See supra notes 35-40 and accompanying text.
286. The Operating Environment: State Role in the Economy, supra note 35.
287. Id.
288. Id.
289. Id.
291. See Jamil Anderlini, Bankruptcy System on Agenda for Banks, S. CHINA
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continue to transform banks into profit-oriented institutions, as profits provide bank managers with incentives to operate efficiently and with prudence.\(^{292}\) Finally, China must continue to close unstable banks.\(^{293}\) By removing such institutions, China improves the chances that a DIS will succeed.

VI. CONCLUSION

As it plans to introduce deposit insurance to its banking sector, China will continue to “cross the river by feeling the stones.”\(^{294}\) Deposit insurance exists in a variety of forms around the world.\(^{295}\) Accordingly, China has many sources from which to adopt a DIS.\(^{296}\) Given its history of adopting other countries’ legal frameworks, China likely will draw from the tested system in the United States, the guidance offered by the European Union, and the example of Russia.\(^{297}\) In doing so, China has the benefit of hindsight. Each model from which it draws to create its own system of DIS will provide China with the ability to pick and choose a custom DIS.\(^{298}\) The introduction of a DIS in China, especially one that incorporates vigorous prudential supervision, will help to alleviate industry problems regarding bank mismanagement and risky loan practices.\(^{299}\) In addition, a DIS will create a sound regulatory framework, giving China the best chance of capitalizing on the influx of foreign investment into its banking industry.\(^{300}\) A DIS will help China become a key player in the global financial industry. It is therefore fortunate that China has awakened to the fact that a DIS is one of many “stones” it must

292. See Chen, supra note 38, at 248.
295. See, e.g., supra notes 159-79 and accompanying text (describing various forms of DIS found in Europe).
296. See, e.g., supra notes 117-221 and accompanying text (describing the U.S., Russian, and European Union DIS models and each system’s relevancy to China’s current financial and political situation).
297. See supra notes 106-221 and accompanying text.
298. See supra notes 117-293 and accompanying text.
299. See supra notes 75-86 and accompanying text.
300. See supra notes 96-105 and accompanying text.
employ as it transforms itself from a rudimentary to advanced banking nation.

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