

IADI Annual Conference 2011

The Role of Deposit Insurance Schemes
in Financial Safety Net

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Today's Topics

I. Changing Role of Deposit Insurance Schemes

II. Three issues

1. Payout vs. purchase & assumption (P&A)

2. Limited coverage vs. blanket guarantee

3. Risk minimizer vs. pay box

III. Japan's Experience

IV. Issues for Discussion

I. Changing Role of Deposit Insurance Schemes

Protection of Depositors
(Micro-economic role)

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Stability of the Financial System
(Macro-economic role)

DICJ

I. Changing Role of Deposit Insurance Schemes

Three Issues

1. Payout vs. Purchase & Assumption
2. Limited coverage vs. blanket guarantee
3. Risk minimizer vs. pay box

DICJ

II. Three Issues

1. Payout vs. Purchase & Assumption

- For protection of depositors
 - => Little difference between payout (liquidation) and purchase and assumption (P&A)
 - For the continuity of financial functions
 - => Liquidation may not be desirable, as protection of counterparties—e.g., borrowers—as well as maintenance of payment and settlement functions should also be considered
- => If the continuity of financial services is emphasized, is liquidation of failed banks (payout) more difficult an option ?

II. Three Issues

2. Limited coverage vs. blanket guarantee

- Limited coverage

 - => Balance between insurance premiums and payout as well as prevention of moral hazard

- blanket guarantee

 - => Stability of the financial system

DICJ

II. Three Issues

2. Limited coverage vs. blanket guarantee

- Recent Global Financial Crisis led to the unwillingness to use government's money to bail out even Too Big To Fail financial institutions



- ✓ Orderly resolution process for TBTF institutions (“Living will”)
 - ✓ more stringent capital requirements (Global Systemically Important Banks)

=> Emphasis on stability of the financial system appears not necessarily to result in blanket guarantee

II. Three Issues

3. Risk minimizer vs. pay box

- Risk minimizer
 - => Supervision, decision on insolvency, and resolution of failed banks
 - => Consistency and Efficiency of the resolution process
- Pay box
 - => Payout, leaving the remaining roles to other safety-net players
 - => Involvement of other safety-net players in resolution process may be desirable from the macro prudential point of view

III. Japan's experience

1. Insurance payment vs. Purchase & Assumption

- Financial Advisory Council Report (1999)
=> P&A should be the first choice in order to minimize confusion caused by failure of financial institutions
- Resolution of the Incubator Bank of Japan (2010-)
=> P&A so that financial functions such as lending should be maintained by transfer of business; there were a substantial number of small-and-medium-sized companies which had business relations with the failed bank.

III. Japan's experience

2. Limited coverage vs. blanket guarantee

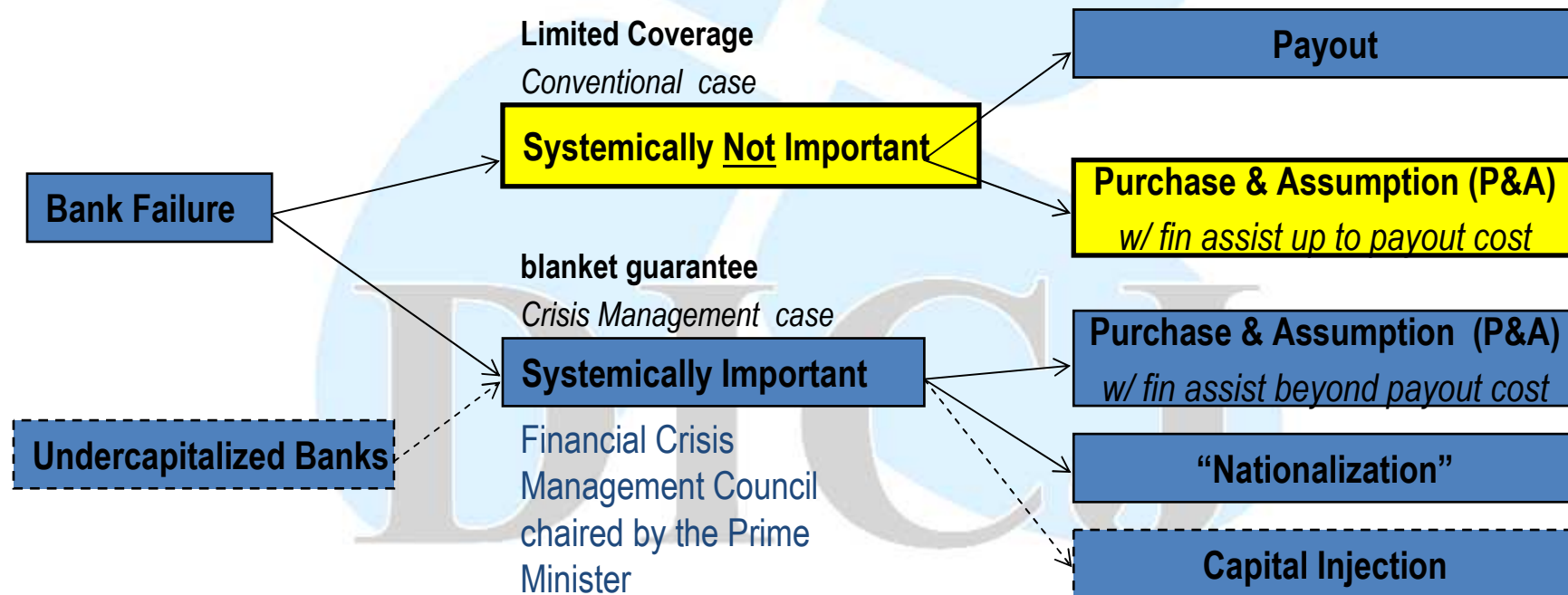
- Conventional bank failures
 - => Limited coverage
 - (1) Payout
 - (2) Financial assistance up to the payout cost
- Bank failures in the crisis situation
 - => blanket guarantee
 - (1) Financial assistance beyond the payout cost; or
 - (2) Acquisition by DICJ of shares of the failed bank (“nationalization”).

III. Japan's experience

2. Limited coverage vs. blanket guarantee

Bank Resolutions in Japan

- Our framework is equipped with full-fledged sets of resolution tools to deal with troubled banks in both conventional and crisis cases.



III. Japan's experience

2. Limited coverage vs. blanket guarantee

- The Heisei Financial Crisis (late 1990s to early 2000s)
 - => Blanket guarantee; stability of the financial system was at stake
 - => Mostly P&A, but 3 cases of temporary nationalization
- Resolution of the Incubator Bank (2010-)
 - => Limited coverage; the financial system was stable and disclosure of financial institutions had been improved.

III. Japan's experience

2. Limited coverage vs. blanket guarantee

- Current legal framework was established in 2000 .



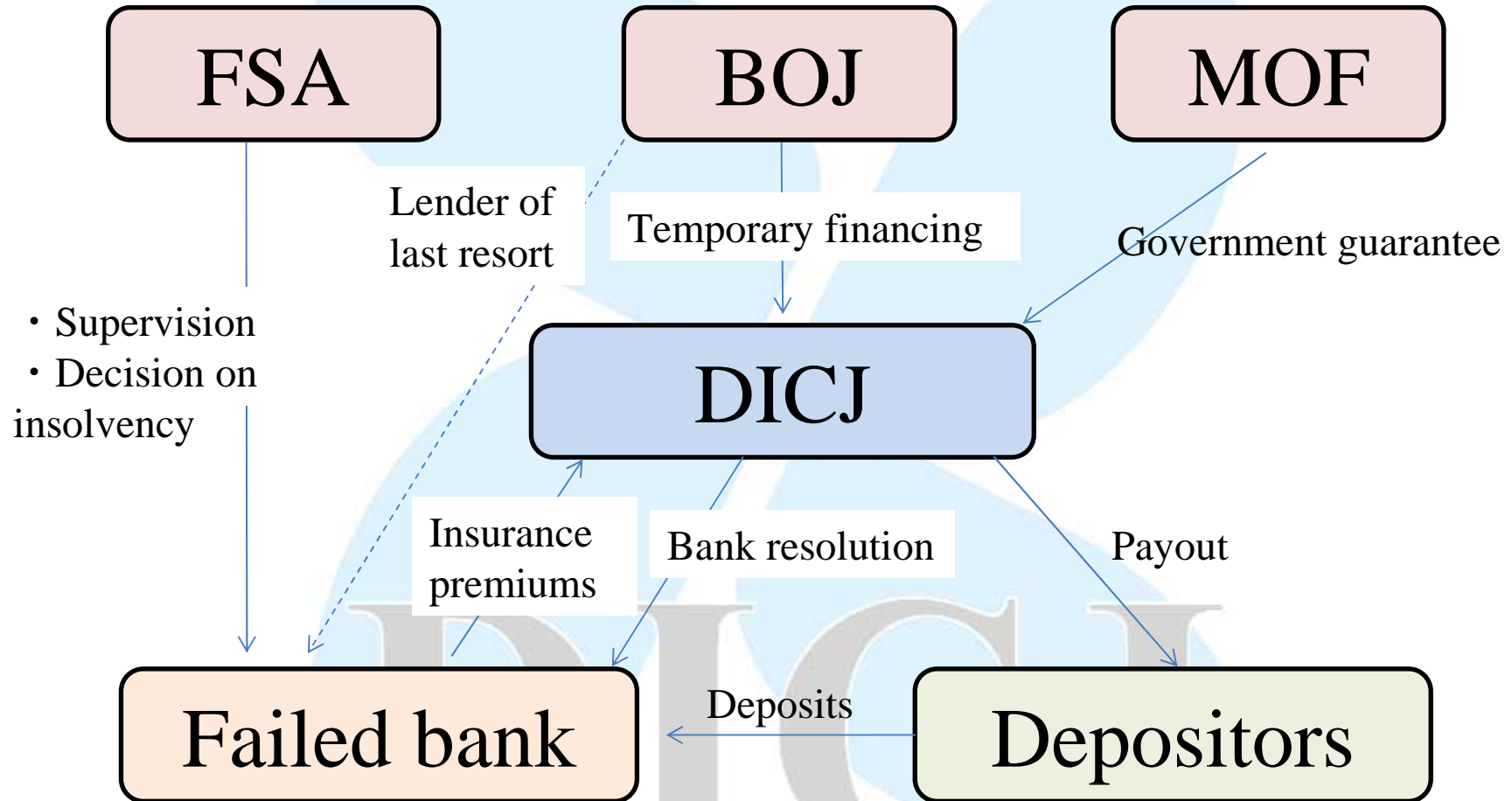
III. Japan's experience

3. Risk minimizer vs. pay box

- DICJ is close to the risk minimizer but not quite so.
 - => conducts resolution as the financial administrator, but does not have the supervisory power over financial institutions
 - => Financial Services Agency is responsible for supervision, and therefore, decides as to whether a financial institution is insolvent.
 - => Bank of Japan is also involved in the process as the provider of emergency financing to DICJ as well as the lender of last resort for banks.

III. Japan's experience

3. Risk minimizer vs. pay box



IV. Issues for Discussion

1. Payout vs. Purchase & Assumption
=> If the continuity of financial services is emphasized, is liquidation of failed banks (payout) no longer an option ?
2. Limited coverage vs. blanket guarantee
=> Do we have to choose blanket guarantee in a crisis when stability of the financial system is at stake?
3. Risk minimizer vs. pay box
=> What should be the division of labor among safety-net players?