



Deposit Insurance Corporation of Japan

Role of DICJ in the Orderly Resolution Framework

**High Level Seminar on Bail-in and
Deposit Insurance System Interaction
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Disclaimer

- Any views expressed in this presentation do not necessarily reflect those of the DICJ.
- This English presentation is based on the relevant laws and regulations written officially in Japanese. The same terms may be translated into English differently in other publications.



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Outline

- I. Introduction: Overview of Japan's Resolution Framework**
- II. Orderly Resolution Mechanism**
- III. Conclusion**



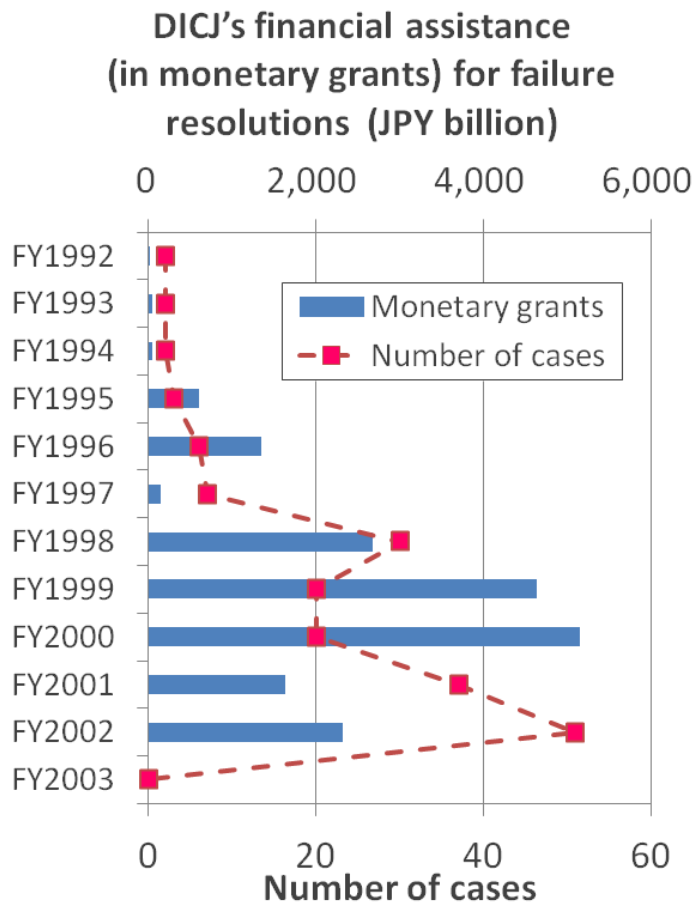
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I. Overview of Japan's Resolution Framework



Banking Crisis in the 1990s and Reforms in DIS/Resolution Regimes

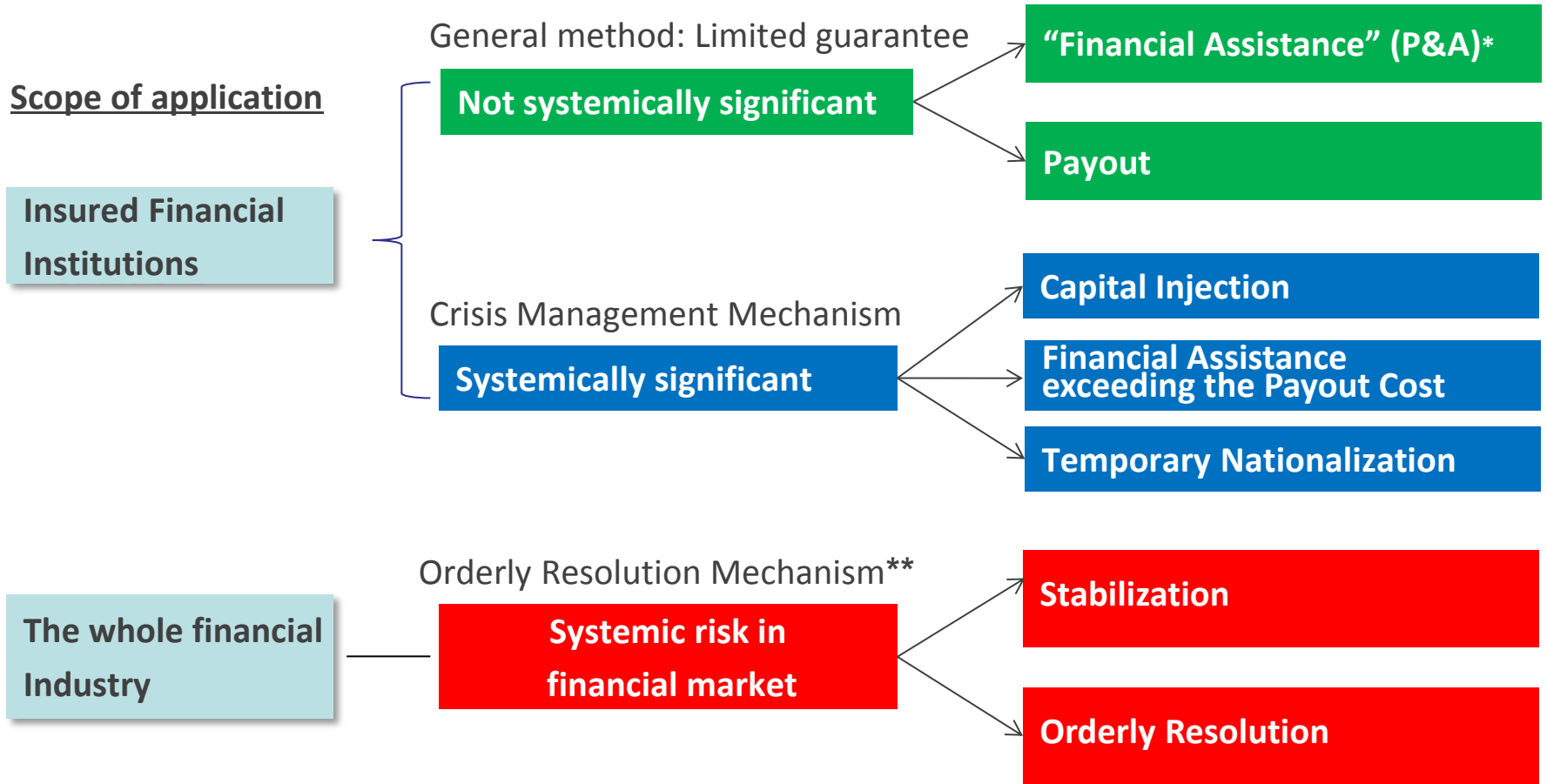
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Year	Major reforms in DIS/resolution regimes
1971	Establishment of DICJ
1986	Introduction of “financial assistance” (P&A) method
1996	Temporary blanket guarantee Asset purchase from failed FIs
1998	Temporary legislation - Capital injection - Financial Administrator - Bridge bank - Temporary nationalization
1999	Establishment of RCC, DICJ’s subsidiary for asset recovery, through a merger of its predecessors
2000	Permanent legislation (effective in 2001) - Financial Administrator - Bridge bank - “Crisis Management Mechanism”
2002	Expiration of the blanket guarantee
2005	Completion of the transition to the current DI coverage

Resolution Framework Overview

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* The Financial Assistance (P&A) method is the preferred approach in the General method for bank resolutions.

** The Deposit Insurance Act amended in June 2013 introduced the new orderly resolution mechanism. The amendment took effect in March 2014.



II. Orderly Resolution Mechanism

- 1. Basic Framework**
- 2. Funding and Loss Absorption**
- 3. Cross Border Cooperation**



Basic Framework

Procedures of Orderly Resolution Mechanism

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- Prime Minister's confirmation of the necessity of this measure, subject to consultation by the Financial Crisis Response Council (FCRC)
- Members of FCRC
 - the Prime Minister [chair],
 - the Chief Cabinet Secretary,
 - the Minister for Financial Services,
 - the FSA Commissioner,
 - the Minister of Finance,
 - the Governor of the Bank of Japan,
 - And if necessary, Ministers of related matters and the heads of related organizations may participate in the meeting as members.



Basic Framework

Scope

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- Financial industry-wide scope, including:
 - Banks and other deposit-taking institutions, and branches of foreign banks
 - Insurance companies, including foreign insurance companies
 - Financial instruments business operators (FIBOs) providing securities services (i.e. securities firms)
 - Bank holding companies, insurance holding companies, designated parent companies of FIBOs and their group entities
 - Securities finance companies and other systemically-important entities designated by a Cabinet Order

(amended Deposit Insurance Act, Article 126-2, paragraph 2)



Basic Framework

Newly introduced Resolution Features

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- Stay of early termination rights of financial contracts
- Contractual Bail-in
 - Under the Japanese regulatory capital guidance, a Point of Non-Viability clause of Additional Tier 1 instruments or Tier 2 instruments is triggered by the Prime Minister's confirmation to take Orderly Resolution measures.



Basic Framework

Stabilization Measures

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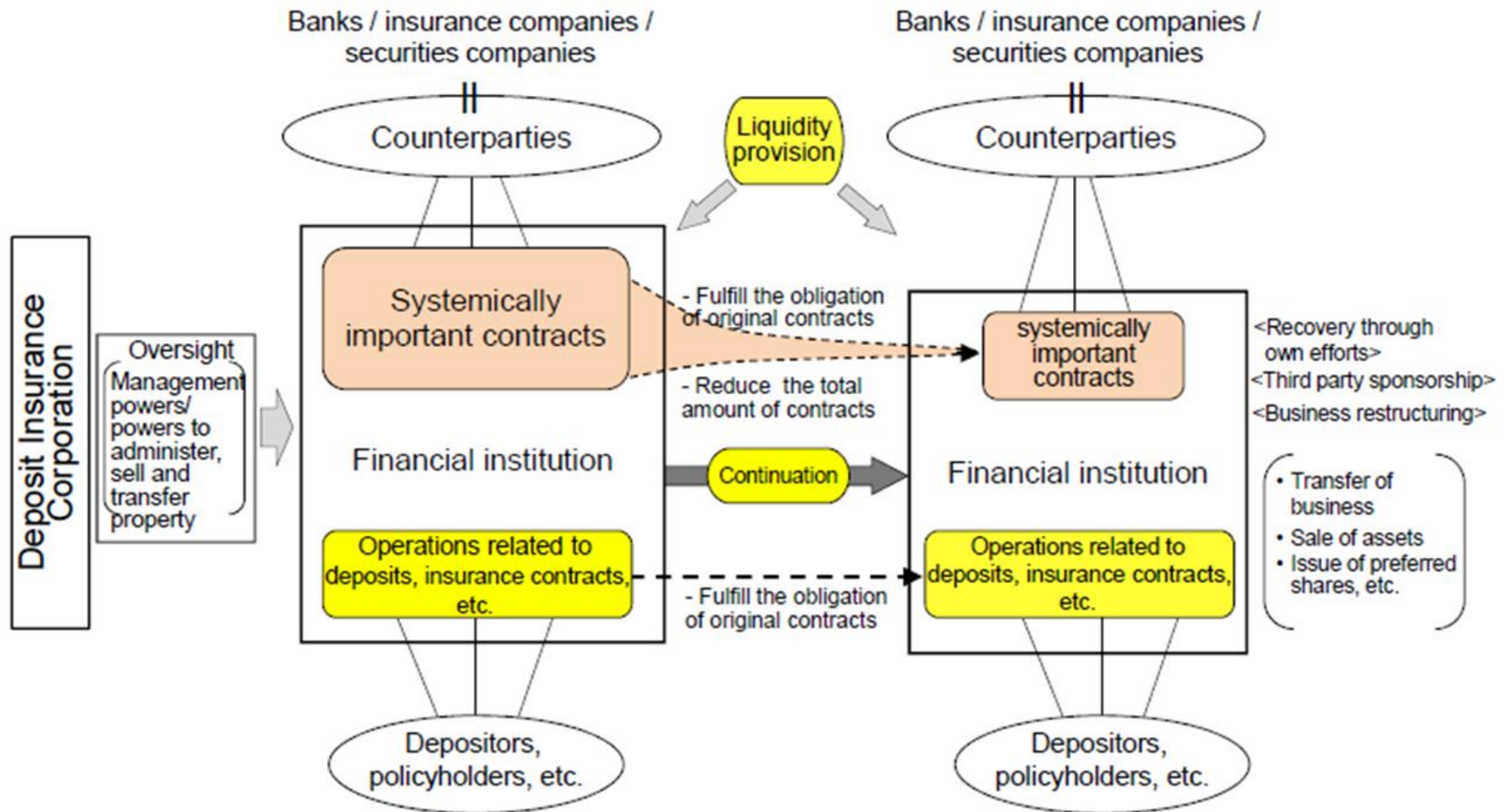
- Stabilization measures (*amended DIA, Article 126-2, paragraph 1, item 1*)
 - ✓ *In other publications, stabilization measures may be phrased as Specified Type I Measures.*
 - When and in what circumstances?
 - » The measure may be invoked when it is recognized that serious disruptions could be caused to the financial market and other parts of the financial system in Japan
 - » and the financial institutions in question are solvent.
 - What measures? (in typical cases)
 - » Putting the FI under “Special Oversight” by DICJ, and urging it to reduce market transactions in an orderly manner.
 - » Providing necessary liquidity to perform obligations. Injecting capital, if necessary.

Basic Framework

Overview of Stabilization Measures (in a typical case)

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(In the case of a financial institution that is not in the state of insolvency)





Basic Framework

Orderly Resolution Measures

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- Orderly Resolution measures (*amended DIA, Article 126-2, paragraph 1, item 2*)
 - ✓ *In other publications, Orderly Resolution measures may be phrased as Specified Type II Measures.*

- When and in what circumstances?
 - Only when the measures are deemed necessary because of the risk of severe disruption in financial markets and the financial system.
 - FI is (or is likely to be) balance-sheet insolvent or has defaulted (or is likely to default).

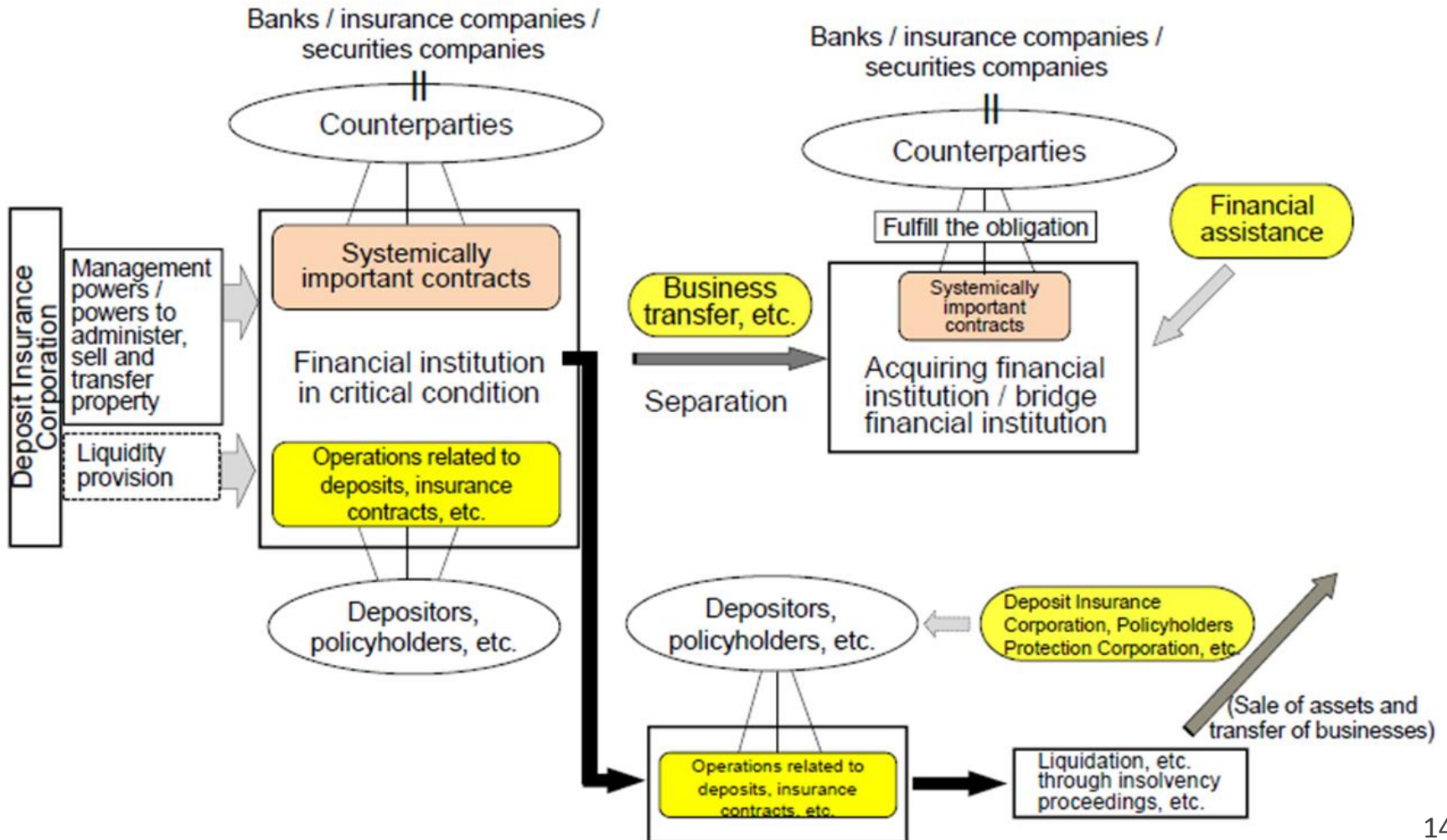
- What measures? (in typical cases)
 - Putting the FI under “Special Oversight “by DICJ
 - Ordering “Specified Administration” by DICJ: DICJ administers FI’s business and property.
 - Transferring FI’s systemically important assets and liabilities to an acquiring (or bridge) institution, to perform the systemically important obligations.

Basic Framework

Overview of Orderly Resolution Measures (in a typical case)

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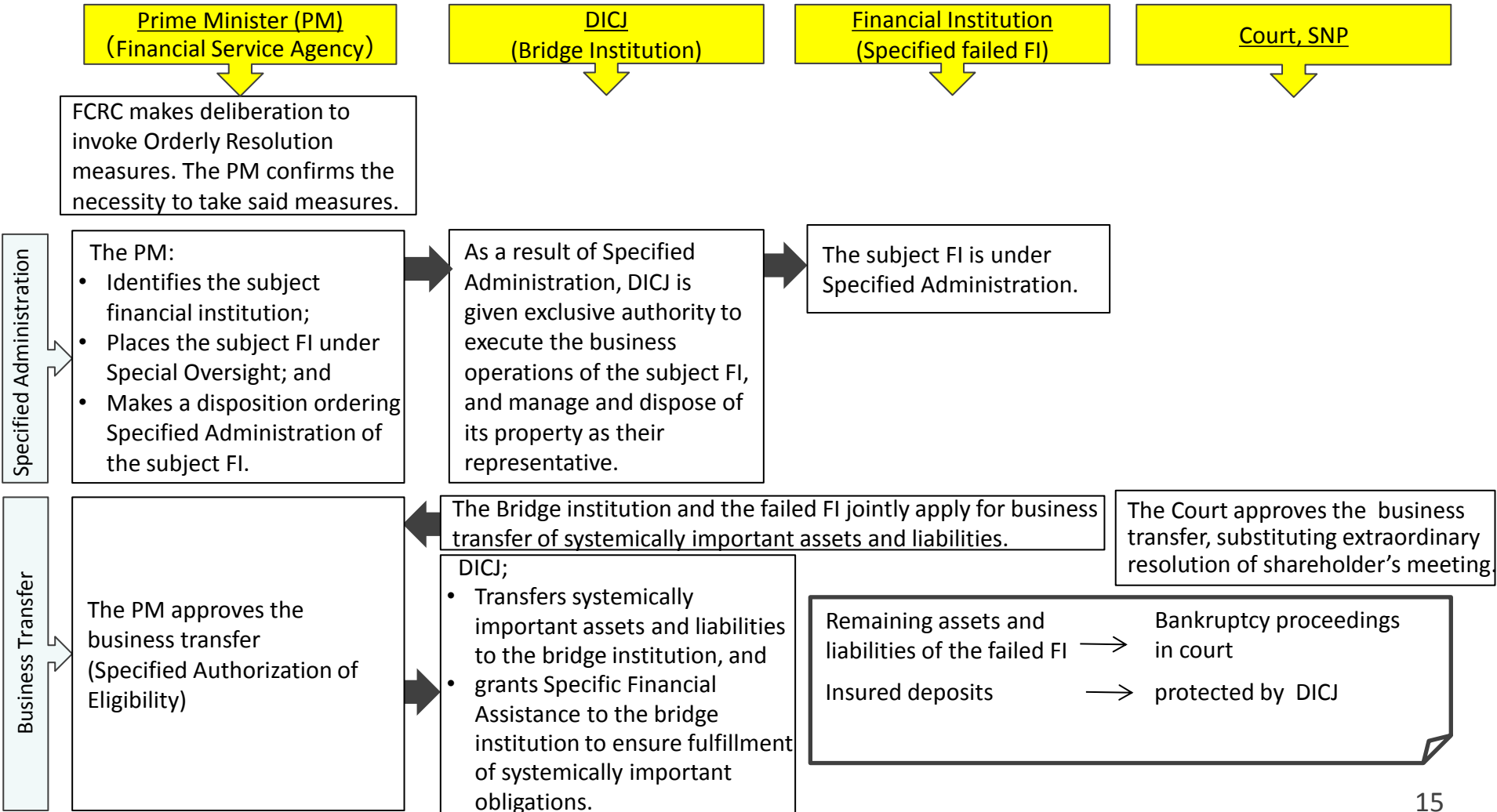
(In the case of a financial institution such as an insolvent one)





Orderly Resolution Measures Flow

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Loss Absorption (1)

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- **Contractual bail-in**
 - Under the Japanese regulatory capital guidance, a Point of Non-Viability clause of Additional Tier 1 instruments or Tier 2 instruments is triggered by the PM's confirmation to be written down or conversion into equity.
- **Crisis Management Account (Resolution Fund)**
 - Funding arrangement for Orderly Resolution Mechanisms (Compensating expenses for liquidity support or specific financial assistance for fulfilling obligations of systemically important contracts through transfer, etc.)
 - Costs incurred are to be borne ex-post by the whole financial industry.
- **General Account (Deposit Insurance Fund)**
 - Providing financial assistance to protect insured deposits.
- **Loss absorption through insolvency proceedings**
 - Through the liquidation of the remaining entity, stockholders, subordinated debt holders and senior creditors including uninsured depositors are to take loss, according to hierarchy of claims.



Loss Absorption (2)

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- In Japan, the following items are of equal rank in the creditor hierarchy:
 - Systemically important liabilities to be transferred to the bridge institution
 - Insured deposits to be transferred to the bridge bank
 - Other senior liabilities to be left at the failed institution
- DICJ provides financial assistance to the failed institution (“equitable financial assistance”) to protect the rights of debt holders of remaining failed institutions on a **pari passu basis**.
- The equitable financial assistance is to be funded by the Crisis Management Account (i.e. resolution fund) and/or the deposit insurance fund, depending upon where shortage of assets exists.



Cross Border Corporation

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- Cross-border cooperation, including exchange of information, with foreign authorities is specified in the revised Deposit Insurance Act as DICJ's additional mandate.
- DICJ, jointly with the JFSA (supervisor) and BOJ (central bank), has been engaged in cross-border cooperation with foreign authorities through CMGs and other channels.
 - Japan is home of three G-SIFIs (MUFG, SMFG and Mizuho FG).



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III. Conclusion

Japan's Resolution Framework

- Japan is equipped with a broad range of resolution measures, to be appropriately chosen in accordance with the specific case:
 - Ordinary measures:
 - P&A, payout, bridge bank
 - Exceptional measures, subject to determination by the Prime Minister:
 - Capital injection, temporary nationalization
 - Orderly resolution mechanisms

- The newly-introduced orderly resolution framework is aimed at ensuring financial stability even in financial market crises, while avoiding taxpayer exposure to loss.
 - Broad scope of application
 - Utilizing insolvency proceedings in courts
 - Newly-introduced contractual bail-in
 - Resolution costs are to be borne ex-post by the whole financial industry



DICJ's Role in Financial Stability

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- The deposit insurance system is aiming at:
 - Protecting insured depositors
 - Contributing to financial stability
- DICJ is expected to fulfill its role for financial stability, and is to engage in the orderly resolution mechanism as one of the resolution authorities in Japan.



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Thank you!