2006 International Open House of
Korea Deposit Insurance Corporation
Seoul, Korea, June 16, 2006

Visioning on Deposit Insurance*

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Chairman Mr. Choi, ladies and gentlemen, Good afternoon! Today it is indeed a great honor for me to be participating in the 10th Anniversary Celebration of the Korea Deposit Insurance Corporation (KDIC). On behalf of CDIC (Taiwan), I would like to extend my congratulations to KDIC, and thank KDIC for providing me with this opportunity to exchange opinions with the many specialists on deposit insurance present here.

The deposit insurance mechanism is one means by which the financial supervisory authorities allow failed financial institutions to withdraw from the market. Internationally, the design of the deposit insurance organization has shifted from that of being a pay box to that of serving as a risk manager. For this reason, being responsible for controlling risk and dealing with problem insured institutions both are important for the deposit insurance mechanism to have its full effect.

Participation in the deposit insurance mechanism in Taiwan was initially administered under voluntary basis that could cause the problem of adverse selection. This system also limited the extent to which the scope of the deposit insurance system could be enlarged. Because of this

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as well as the inadequacy of the deposit insurance fund, the deposit insurance system in Taiwan could not have its full effect. Following serious financial mishaps of several financial institutions in 1999 that might trigger potential financial crisis, there was no alternative but to make participation in deposit insurance mandatory. Furthermore, the government in 2001 successively appropriated a total of about US$7 billion for its Financial Restructuring Fund, which was designed to provide blanket guarantee over a period of four years from July 2001 to July 2005, with CDIC (Taiwan) responsible for its implementation. 48 problem financial institutions smoothly withdrew from the market, without precipitating any further financial crisis.

Since the government's four-year policy of providing blanket guarantee expired in July 2005, the CDIC (Taiwan) has faced a tremendous challenge as a result of reverting to the former policy of limited coverage. There has been much discussion on amending the Banking Act and the Deposit Insurance Act to strengthen the functions of the deposit insurance mechanism. The main points of these proposals have been as follows:

(1) Improving the financial environment and promoting an exit mechanism based on risk capital

Taiwan has actively promoted financial reform, has strengthened corporate governance among enterprises and financial institutions, and has improved their internal controls and accounting and management systems, in order to encourage the transparency of information in relation to the financial affairs of firms. It has also requested that financial institutions abide by the Basel II Accord to strengthen their controls over risk. In line with the changing financial environment, CDIC (Taiwan) is panning to establish an exit mechanism based on risk capital to enable the failing or failed financial institutions to withdraw from the market.

(2) Establishing a mechanism for handling systemic financial crises

Along with financial liberalization, internationalization and the diversification of banking operations, the number of privately-owned financial institutions has significantly increased. The risks faced by financial institutions have also greatly increased and become more complex. CDIC (Taiwan) in order to adapt to the changing environment has progressed in revising the Deposit Insurance Act to set up a mechanism in handling systemic crises. While disposing of an individual failing or failed bank that might cause domino effect or even systemic risk, CDIC (Taiwan) could exempt from the restrictions on limited coverage of deposit insurance.

(3) Setting up a target ratio of deposit insurance fund

In order to increase the confidence of depositors and strengthen the deposit insurance mechanism’s ability to deal with problem financial institutions, Taiwan has been planning to set up a fund target ratio at 2% of insured deposits. In order to replenish the deposit insurance fund, CDIC (Taiwan), apart from raising the premium rate in the future, will also be provided with business tax revenue of insured institutions.

(4) Setting up a separate deposit insurance account for agricultural financial sector

The credit departments of farmers' and fishermen's associations are quite different from other banking institutions. Compared to the general banking sector, the agricultural financial sector is relatively weak, the scale is relatively small, and it is easy for agriculture to be affected by natural disasters. Thus, risk tends to be concentrated, and the ability of the sector to bear risk is limited. For this reason, in 2004 Taiwan established a separate supervisor for the agricultural financial institutions. In order to respond to this need for change, the amendments to the Deposit Insurance Act will also make provision for the establishment of a separate deposit insurance account for the agricultural financial sector. This again differs from the deposit insurance fund for the general banking institutions, in order to make CDIC (Taiwan) easier to control its deposit insurance risk.

(5) Strengthening interrelationships among financial safety net players and sharing information

Following the implementation in Taiwan of a unified financial supervisory system in July 2004, the CDIC no longer conducts general-scope on-site examinations. For this reason, in order to strengthen the deposit insurance institution's ability to control risk, besides raising the deposit insurance premiums as well as enlarging the spread among the different premiums charged, the CDIC is also enhancing its financial early-warning system and other off-site monitoring mechanisms, to effectively keep abreast of insured institutions' overall operating conditions and control over risk. In addition, the CDIC is strengthening its communications and information sharing with other financial safety net players, so as to obtain financial supervisory information needed on a timely basis.

Conclusion

The deposit insurance system in Taiwan has already been in existence for over two decades. While its mechanisms have become more and more complete, but there is still lack of clear legal basis regarding the division of responsibilities among each participant of the financial safety net in terms of its governance. Furthermore, in regard to the independence and policy-making ability vested in the deposit insurance organization, there likewise remains much room for improvement.

In closing, I would very much like to thank KDIC for providing, on the occasion of its 10^{th} anniversary, this precious opportunity to exchange experiences with deposit insurance organizations and media representatives from all over the world. I firmly believe that such a gathering can effectively enhance international cooperation among deposit insurance brethren, and significantly contribute to fostering financial stability at the international level. Thank you very much!