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Visioning on Deposit Insurance*

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(Speech delivery on behalf of DICJ Governor Shunichi Nagata)

The honorable Chairman Choi, the excellent officials of the KDIC, ladies and gentlemen, please let me extend my cordial congratulations on the 10th anniversary of the Korea Deposit Insurance Corporation. I assume that ten years after the establishment of the KDIC mean the significant years for the financial stability in Korea. I do wish the KDIC to play the center role of keeping further financial stability for next 10 years, 20 years or more than that as well as past ten years.

I deeply regret that the unexpected schedule change in our national parliament forces me to stay in Tokyo and prevents me from attending this important event and ceremony to which Chairman Choi kindly and thoughtfully invited me. From Tokyo, please let me wish the great success of today's event and ceremony.

I am going to talk about today's topic "differential premium

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system” in the light of this session “Visioning on deposit insurance”, referring to the case of our country.

Since its inception in 1971, the deposit insurance system of our country has adopted the flat rate premium system considering various circumstances such as situation of domestic financial sector and our deposit insurance fund. Meanwhile, the DICJ already has recognized and discussed the importance of the differential premium system as one of the issues to be carefully examined its advantages and effectiveness.

Financial System Council, which is the advisory panel of the Prime Minister, the Commissioner of the Financial Services Agency, and the Minister of Finance, made a report, in December 1999, stating that it was desirable to proceed with the examination of the framework of differential premium system in a timely manner even though the introduction of the system still needed deliberate and careful consideration for the time being. Meanwhile, a report in September 2002 said the examination concerning the impact of the system on deteriorating financial institutions, should be required from the various viewpoints in case of the immediate introduction of differential premium system in Japan. Corresponding to the purport of these reports, "Deposit Insurance Premium Research Group" had been set up as a private advisory group of the Governor of DICJ since October, 2003 by inviting academic experts and finance practitioners including the official and staff of DICJ to discuss a mid and long-term measures we should take for the deposit insurance premium system in our country and the Research Group made an interim report in June 2004.

The interim report pointed out the continuous need of examination and discussion on this matter, while it introduced positive opinions for introducing some concepts of differential premium into the deposit insurance system from a mid and long-term perspective.

The interim report raised the following three points as the main advantages enjoyed by the differential premium system. First of all, it makes it possible to control an incentive for risk preference to the banking management by deposit insurance system. Accordingly, it may provide a positive effect on improving and strengthening the financial condition of the insured financial institutions. In other words, differential premium system may reduce “moral hazard”. Consequently, it is also expected to obtain the loss control of the deposit insurance fund and to minimize the public burden through the financial stability.

As the second advantage, it can increase the sense of fairness among the insured financial institutions in terms of the level of insurance premium. And thirdly, the differential premium system may increase the effectiveness of the capital-adequacy regulation.

On the other hand, there are various issues to be paid due attention in terms of the introduction of the system. For instance, there was a remark, at the "Deposit Insurance Premium Research Group", that the differential premium system tends to levy heavier insurance burden on a financial institution in trouble, and it may result in further weakening of the troubled

financial institution.

In 2000, the Deposit Insurance Law was amended and it has been legally accepted in Japan that a deposit insurer may apply different category of insurance premium according to soundness of the management of banks. However, in a real world, I must admit to say it is not the best solution if we would reduce the premium rate only with the reason for, for example, the soundness of an insured financial institution under the current state of the large amount of deficit in the DICJ. Therefore, the DICJ currently does not have the idea of appealing the immediate introduction of the differential premium system. In my opinion, it is necessary to continue further examination and discussion as our future significant issue.

I understand that the KDIC has introduced the plan of the differential premium system development and has been seeking to reflect the advantages in the deposit insurance system of Korea from the viewpoint of better risk monitoring and to construct the more sophisticated deposit insurance system. I do expect this plan ultimately contribute to the further development of Korean deposit insurance system. And I would like to closely follow the progress in Korea, since this case would be a good example for us to examine the influences and effects by the introduction of the differential premium system.

Finally, let me conclude my statement by showing my gratitude to Dr. Choi and the excellent officials of the KDIC, and congratulating again on your 10th anniversary. I, as the Governor of the DICJ, am very pleased

with and proud of the excellent and close relationship which has been built and kept by the KDIC and DICJ. I am convinced that this relationship between two organizations facilitates the further development of each deposit insurance system, and ultimately will contribute to financial stability in the future.

Thank you very much.