

# On the Introduction of the Deposit Insurance Cap for Demand Deposits in 2005

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## 1. Reinstatement of the Payoff Scheme

Approximately one year remains until the blanket guarantee on demand deposits ends in April 2005. When the “payoff” scheme is reinstated at that time, the government will no longer protect all deposits in the event banks fail, and place a deposit insurance cap of 10 million yen per depositor per bank, plus earned interest. (Prior to full deposit protection, the payoff system had existed though in different form in the early 1990s.)

The state-backed blanket guarantee on deposits was partially lifted in April 2002 for time and savings deposits, but preserved by special measure for current deposits, ordinary deposits, and special deposits. Next April, except for new settlement-specific deposit accounts, all deposits will be subject to the payoff scheme in what the government calls an “across-the-board reinstatement of the payoff scheme.”

Figure 1 Changes in the Deposit Insurance System

		~ March 2002	April 2002 ~ March 2005	April 2005~
Insured deposits	Current deposits Ordinary deposits Special deposits	Full protection		Full protection for new settlement accounts
	Time deposits Installment savings etc.			Deposits insured up to ¥10 million per depositor per bank, plus interest (refund of the rest depends on bank's solvency)
Uninsured	Foreign currency deposits Certificates of deposit etc.		No protection (Refund depends entirely on bank's solvency)	

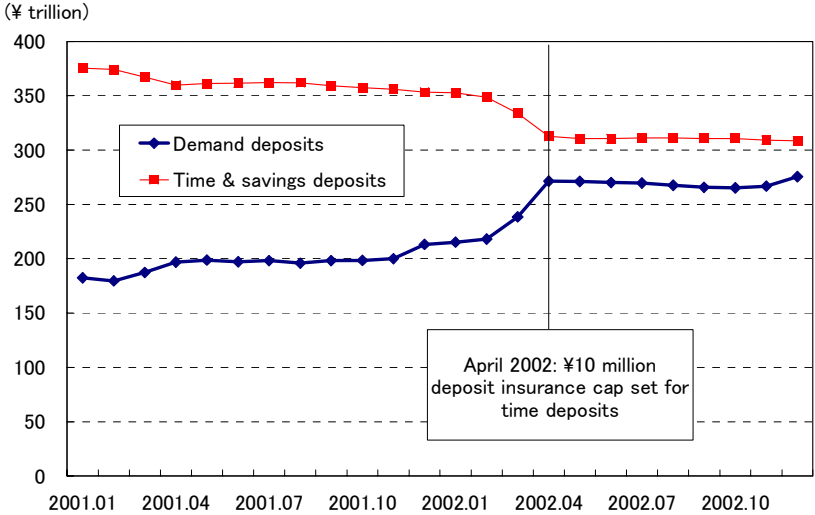
Source: Compiled from materials of the Deposit Insurance Corporation of Japan.

The new settlement-specific deposits must meet three criteria: (1) transaction settlement services are provided, (2) depositors can draw upon the account balance on demand, and (3) deposits earn no interest. Some of the current deposits and special deposits that already exist are expected to fill these criteria, and banks are also reportedly looking to establish new accounts that meet these criteria.

## 2. Predicting the Shift in Deposit Funds

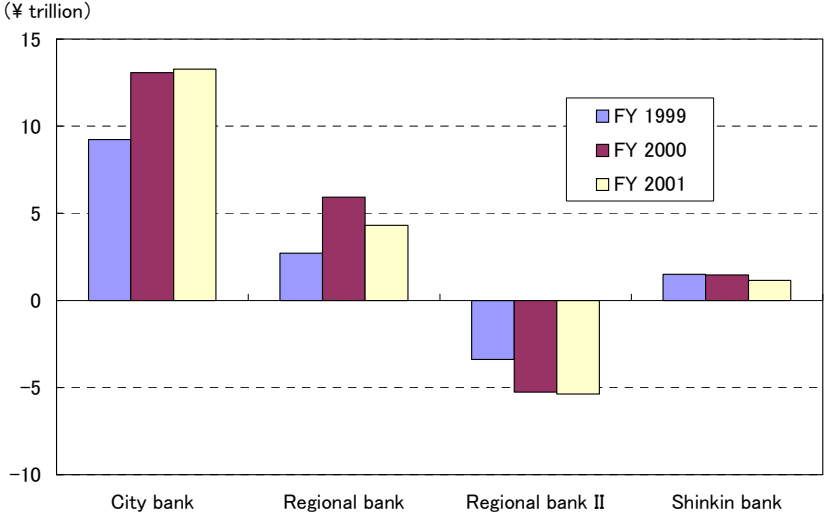
Prior to April 2002, two major shifts occurred in deposit funds. First, funds shifted from time and savings deposits, which would become subject to the payoff scheme, to demand deposits (current deposits, ordinary deposits, etc.), which would remain fully protected. Second, funds moved from smaller to larger financial institutions (Figures 2 and 3).

**Figure 2 Volume of Demand Deposits and Time & Savings Deposits**



Notes: Shows aggregate of domestically licensed banks, foreign banks with branches in Japan, *shinkin* banks, and other financial institutions.  
Source: Bank of Japan

**Figure 3 Change in Deposits, by Type of Bank**



Source: BOJ

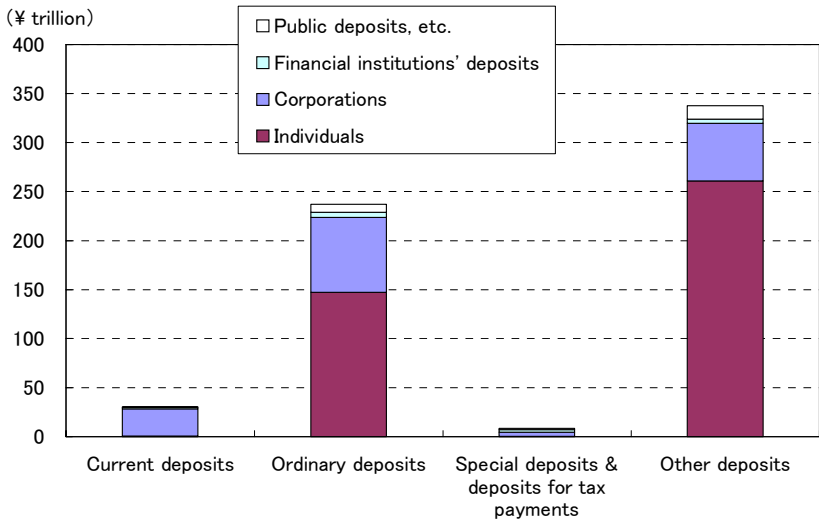
Ahead of the payoff reinstatement, funds are likely to shift out of ordinary deposits, which do not meet the criteria of settlement deposits.

Figure 4 shows the amount of outstanding deposits by depositor (aggregate of domestically licensed banks and *shinkin* banks). Ordinary deposits amounted to approximately 240 trillion yen at the end of September 2003. Individuals comprised approximately 150 trillion yen, or almost twice the amount of corporations (approximately 80 trillion yen). Whereas most corporate deposits exceed 10 million yen, 70% of individual deposits are below 10 million yen and remain fully protected. Taken together, approximately 100 trillion yen of ordinary deposits (30% of individual deposits and all corporate deposits) will thus be affected by the deposit insurance cap.

This figures represent the high end of the potential shift in funds. However, considering that a sizable shift of funds already occurred to large banks in April 2002, the shift this time is expected to be smaller.

Nonetheless, there remains the risk of an unexpectedly large movement of funds and possible confusion. This could happen for various reasons: lack of understanding by depositors of the payoff scheme, poor financial condition of banks, or lack of confidence by depositors in the slow disposal process of failed banks.

**Figure 4 Amounts Outstanding of Deposits, by Depositor**



Notes: Shows aggregate of domestically licensed banks and shinkin banks. "Other deposits" is the aggregate of other demand deposits, time & savings deposits, non-resident yen deposits, and foreign currency deposits.

Source: BOJ

### 3. Depositors' Poor Understanding of Deposit Insurance

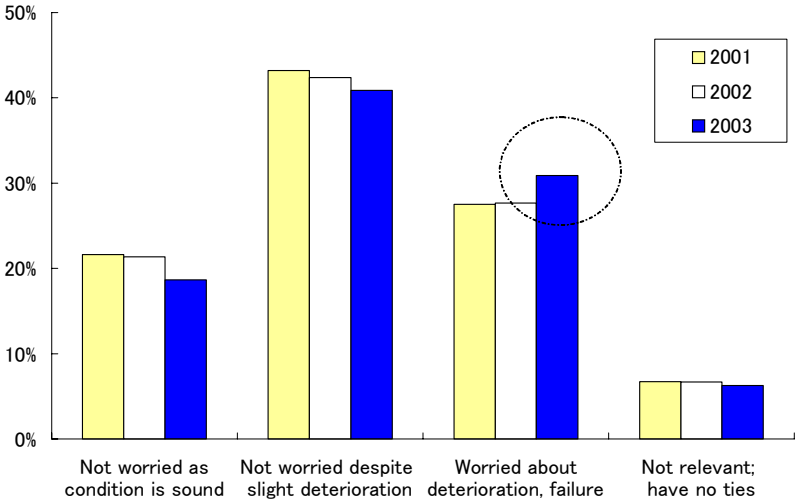
According to a survey by the Central Council for Financial Services Information (*Public Opinion Survey on Household Financial Assets and Liabilities*, conducted from June 27 to

July 7, 2003), 80% of households are aware of the deposit insurance system; among households with deposits of over 10 million yen, almost all know of the system, and almost 50% even know its contents. Surprisingly, however, even among households who know of the system, less than 30% know of the new measure in April 2005 that will cap deposit insurance at 10 million (plus earned interest) yen per person per bank, excluding settlement-specific accounts, which will be fully insured. Clearly, the public's understanding of the deposit insurance system is hardly adequate.

#### 4. Anxiety of Depositors

In addition, a growing number of depositors harbor anxieties about the operating condition of private financial institutions (Figure 5).

**Figure 5 Households' Opinion of the Financial Condition of Private Financial Institutions**



Source Central Council for Financial Services Information, *Public Opinion Survey on Household Financial Assets and Liabilities*.

These anxieties relate to many levels of the financial system, such as the shaky financial condition of banks and slow disposal process of failed banks. The government is working hard to improve the financial condition of banks and the bank disposal process, including measures such as a new framework for injecting public funds and strict inspections of local financial institutions. However, many issues must still be resolved to alleviate the anxieties of depositors, including the slow progress as reported in the media of efforts to determine the total deposits of depositors with multiple accounts.