1. Introduction

In May and June of 1991, two advisory councils of the Ministry of Finance ("MOF") announced the last of a series of reports bearing upon the future shape of Japan's financial services industry. The reports are a product of six years of study in the MOF and its advisory councils. Although leaving some details undecided, the reports present the outline of a system in which distinctions among ordinary banks, long-term credit banks, and trust banks will diminish. The reports further envision direct and indirect competition between securities firms and banks. Indirect competition will occur through newly established subsidiaries.

This article describes the political and economic forces that prompted the MOF to initiate the reform debate, explores the process by which this debate has been conducted and analyzes the areas of agreement and disagreement apparent in the reports. Moreover, points that remain unresolved are identified. The article then explains the planned procedure and timetable for the implementation of the proposed reforms and discusses the possibility that the MOF-initiated proposals will be superseded by responses to a series of recent financial scandals, some of which came to light only after the MOF advisory councils had completed debate. The article concludes by assessing the impact that the proposed reforms will have on financial institutions and consumers, with a focus on the politics of financial regulation in Japan.

2. Industry Structure and Reasons for the Reform Debate

The current debate follows a series of gradual, piecemeal reforms undertaken over the past decade or so. Before that liberalization, Japan's financial system could be characterized as highly compartmental-
ized, dominated by indirect finance, and subject to tight regulation of pricing, products, and new entry. These characteristics remain today, though in diminished form.

2.1. The Banking Industry

Statutory and administrative structures divide the banking industry into long-term and short-term financial institutions. Furthermore, trust banking activities are segregated. These divisions are explored below.

First, three long-term credit banks may issue three and five-year maturity bank debentures, accept long-term deposits, and generally raise long-term funds for lending to industry. Ordinary banks, on the other hand, are prohibited by the MOF from issuing such debentures or accepting long-term deposits. The long-term credit banks have only limited branch networks and view themselves as likely wholesale or investment banks in any future deregulated system.

Second, a single specialized foreign exchange bank, the Bank of Tokyo, played a unique role in international transactions during Japan's fast growth era. The Bank of Tokyo was the sole Japanese bank allowed to establish overseas branches in many locations, and it could issue three-year maturity bank debentures. However, the MOF severely restricted its domestic branch network.

Third, the trust banks have become specialized long-term financial institutions, raising funds through the exclusive power to sell long-term negotiable "loan trusts." Although a 1943 law authorizes all banks to engage in trust activities, MOF administrative guidance since 1955 has prevented ordinary banks from engaging in most trust activities.\(^1\) Until recently, trust banks and life insurers shared the exclusive power to manage pension fund assets.

Fourth, the largest ordinary banks are referred to as city banks. They have large branch networks and, since such banks were prevented from taking long-term deposits or issuing bank debentures, they traditionally specialized in providing short-term finance to major corporations. Although not legally distinct from smaller ordinary banks (referred to as regional banks), the city banks lend to a somewhat different market, serving as the "main banks" of large corporations.

Other small financial institutions and public institutions, such as

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the behemoth postal savings system operated by the Ministry of Posts and Telecommunications (with deposits approximately equal to the combined deposits of the five largest city banks), play a less important role in the following discussion.

2.2. Securities Activities

Although banks dominated the securities underwriting business in the prewar era, Article 65 of the Securities and Exchange Law of 19482 ("SEL") created a division between banking and securities activities similar on its face to the division found in the United States' Glass-Steagall Act.3 Securities firms hold the exclusive ability to underwrite securities of corporate issuers in public offerings and to purchase or sell such securities on behalf of customers.4 The creation of new securities firms is restricted by a license system, which is administered by the MOF's Securities Bureau.

Despite Article 65's prohibition against bank underwriting of securities, the cumbersome Japanese system for underwriting corporate

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4 SEL art. 65, ¶ 1 prohibits any bank, trust company or other specified financial institutions from engaging "in any of the acts enumerated in each item of Article 2 paragraph 8." SEL, supra note 2, art. 65, ¶ 1, at MA 51. SEL art. 2, ¶ 8 lists the following "securities business" activities:
(1)To buy and sell securities;
(2)To act as an intermediary, broker or agent with respect to buying and selling securities;
(3)To act as broker, agent or proxy with respect to entrustment of transactions on a securities market (including a similar securities market located in a foreign country. . . );
(4)To underwrite securities;
(5)To effect secondary distribution of securities;
(6)To handle offering or secondary distribution of securities.

SEL, supra note 2, art. 2, ¶ 8, at MA 4. The "securities" within the SEL's coverage are: Government bonds, local government bonds, bonds issued by a juridical person in accordance with a special law, secured and unsecured debentures, investment certificates issued by a juridical person established under a special law, share certificates or certificates representing subscription rights to new stock, beneficiary certificates of securities investment trust or loan trust, securities or certificates issued by foreign countries or foreign juridical persons, which are of the same nature as the foregoing, and other securities or certificates prescribed by Cabinet Order. SEL, supra note 2, art. 2, ¶ 1, at MA 2. Under Articles 10 and 11 of the Banking Law of 1981, banks are able to buy and sell securities for the bank's own investment portfolio or upon the written order of a customer, to lend securities, to underwrite and deal in Government bonds, local government bonds, and debentures guaranteed by the Government. Banking Law, Law No. 59 of 1981 arts. 10-11 (Japan), reprinted in Banking Law of Japan, VI Law Bull. Series Japan (EHS) BA 5-6 (1986) (English translation).
bank-intermediated finance has long been dominant in Japan.\(^\text{10}\)

Although no definitive legal interpretation of the applicability of Article 65 to overseas activities of Japanese banks and their affiliates exists, these activities have been limited since 1974 by the "Three Bureaus Guidance." The Three Bureaus Guidance is a vague agreement among the MOF's Banking, Securities and International Bureaus to the effect that an overseas subsidiary of a Japanese bank should not violate the spirit of the SEL and should not hold too much of any one issue in its own investment portfolio.\(^\text{11}\) After further securities industry

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\(^6\) Large corporations that satisfy stringent financial requirements may now issue unsecured debentures in the domestic Japanese financial market. The first unsecured convertible debentures were issued by Matsushita Electric in April of 1979. However, requirements for issuing unsecured convertible or straight debentures were so restrictive that only two companies qualified before the standards were relaxed in 1983. TDK issued the first unsecured straight corporate debentures in early 1985. See JAPAN SEC. RESEARCH INST., SECURITIES MARKET IN JAPAN 76 (1988). With the exception of a few electric utilities, railroads, and NTT, those corporations that qualify to issue bonds in Japan prefer the Euromarkets with their lower cost and greater flexibility. See N. SASSA & H. MATSUZAKI, GIN-SHO SENSO 93-100 (1987).

\(^7\) The "big four" securities firms are Nomura, Daïwa, Nikko, and Yamaichi Securities. See New Penalty is Planned for Japan Brokerages, N.Y. Times, Sept. 25, 1991, at D5, col. 1.

\(^8\) See N. SASSA & H. MATSUZAKI, supra note 5, at 72-96; see also F. ROSENBLUTH, FINANCIAL POLITICS IN CONTEMPORARY JAPAN 138-50 (1989) (discussing the development of the Bond Issue Committee and restrictions on the bond market).


\(^10\) See JAPAN SEC. RESEARCH INST., supra note 5, at 67.

\(^11\) In 1974, indirect finance accounted for 84 percent of financial assets in the personal sector in Japan and 48 percent in the United States. The banking sector accounted for 74.1 percent in Japan and only 28.0 percent in the United States. Y. SUZUKI, MONEY AND BANKING IN CONTEMPORARY JAPAN 18-19 (1980).

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\(^6\) The "big four" securities firms are Nomura, Daïwa, Nikko, and Yamaichi Securities. See New Penalty is Planned for Japan Brokerages, N.Y. Times, Sept. 25, 1991, at D5, col. 1.
complaints, the MOF issued another vague announcement, which, in effect, permits banks to “underwrite Eurobonds for Japanese corporations, as long as they did not upstage the Japanese securities houses.”12 Securities firms interpreted the MOF’s guidance as prohibiting banks from becoming lead managers. Even though foreign banks and securities firms now lead manage Eurobond issues for Japanese corporations, the securities firms have managed to preserve the “Three Bureaus Guidance” throughout the 1980s.13

Article 11 of the Antimonopoly Law prohibits banks, securities firms and other financial institutions from holding more than five percent of the shares of any company.14 Article 11 also gives the Fair Trade Commission (“FTC”) the power to grant exemptions from the five percent limit.15 The FTC has granted exemptions in cases that do not present antitrust concerns, such as where a bank establishes a wholly owned subsidiary to supply services to the bank16 or where a bank takes a temporary holding in a troubled company.17 Within the five percent limit, banks are major stockholders in companies with which they have business relationships, especially in a bank’s corporate group (keiretsu). Banks also hold large portfolios of stock for investment purposes. At the end of fiscal year 1986, Japanese banks held 18.9% of all private sector shareholdings in Japanese corporations, as compared to 2.1% held by Japanese securities firms.18

Each of the major banks has formed an informal affiliation with at least one securities firm. Although some of these affiliated firms are large, the big four securities firms have prevented them from breaking into the role of lead manager. In 1988, when a securities affiliate of Dai-Ichi Kangyo Bank attempted to lead manage an issue of the bank’s convertible bonds, the big four “blew it out of the water by assaulting the market with new issues of their own.”19 Moreover, the potential for further affiliation appears limited, as the MOF has instituted severe firewalls that restrict the ability of banks to lend personnel, supply cap-

12 F. Rosenbluth, supra note 7, at 153.
13 See id. at 153-54 (describing failed efforts to abolish the “Three Bureaus Guidance”).
15 Id. art. 11, ¶ 2, at KA 15-16.
16 For example, such a wholly owned subsidiary may serve as an employment agency or property management company for the parent entity.
ital, and exchange information with affiliated securities firms.\textsuperscript{20}

As a general rule, Japanese securities firms are prohibited from engaging in any business other than the securities intermediary businesses listed in Article 2, paragraph 8 of the SEL.\textsuperscript{21} Since a 1981 revision of the SEL, additional securities-related businesses may also be approved by the MOF for securities firm participation.\textsuperscript{22} Individual firms may apply to the MOF for permission to engage in these activities.\textsuperscript{23} As a result of this statutory framework, securities firms must receive MOF approval before they can enter a new business area or design a new product.

2.3. Reasons for the Reform Debate

2.3.1. "Objective" Factors

A combination of political, economic, technological and legal factors have driven the piecemeal reforms of the past decade and led to a debate over more fundamental reform. A number of these factors are stated in the advisory council reports. The first interim report to discuss bank-securities firm competition reviews broad trends that favor financial liberalization.\textsuperscript{24} These trends include: the diversity of financial needs that has accompanied the maturation of Japan's economy, a shift in raising corporate capital from bank loans to securities, technological innovations, new financial products, integration of world financial markets, and the "hollowing out" of the Japanese domestic market for straight corporate bonds.\textsuperscript{25}

The report notes two developments in bank regulation that favor additional reform. First, interest rate liberalization has diminished bank returns and increased the risk city banks face from a mismatch of short-term deposits and longer term loans.\textsuperscript{26} Second, capital adequacy ratios, promulgated in 1988 under the auspices of the Bank for Inter-

\textsuperscript{20} See Nihon Keizai Shimbun, Sept. 14, 1990, at 1, 7. For example, for securities firms capitalized at over ¥3 billion, no more than five percent of that firm's executives shall be persons on loan from the bank affiliate. For firms with capital in excess of ¥10 billion, the MOF has set a gradual goal of eliminating all exchanges of personnel with bank affiliates, as well as limiting loans from the bank and securities trading tie-ups. \textit{Id.}

\textsuperscript{21} SEL, supra note 2, art. 2, ¶ 8, at MA 4; see supra notes 2-4 and accompanying text.

\textsuperscript{22} \textit{Id.}

\textsuperscript{23} See id. art. 43, at MA 40-41. As of the end of 1987, there were twelve such approved securities-related businesses. Yoshikawa & Harada, \textit{Kokunai CP Shijo Sosetsu ni Tsuite, KINYU ZASEI JIJO}, Nov. 23, 1987, at 34, 37.

\textsuperscript{24} \textit{SECOND COMMITTEE'S REPORT}, supra note 1, at 3-8.

\textsuperscript{25} \textit{Id.}

\textsuperscript{26} \textit{Id.} at 9-10.
national Settlements, have encouraged the securitization of assets to remove such assets from bank balance sheets.\textsuperscript{27} These factors undoubtedly affect financial institutions. Further, these factors may have shaped the MOF’s stated goals for the reform project, which include: meeting the needs of consumers, maintaining financial stability, and the “internationalization” of Japan’s financial system. The aforementioned trends and factors are best considered in light of the political landscape surrounding the reform.

2.3.2. The Politics of Reform

The advisory council reports accurately recount these trends, but understandably fail to consider the underlying political situation. The recent history of financial regulation in Japan demonstrates that reforms seldom proceed without the widespread support of the regulated entities. This support may come in the form of a bargain among the regulated entities. Alternatively, the support may be the result of pressure from a combination of sources, which may include foreign governments, the MOF, and institutions of the financial services industry.

MOF officials may have an independent regulatory agenda, but the MOF’s role has been accurately characterized as “acting preemptively to equilibrate among groups in the financial sector, rewarding them in proportion to their political resources.”\textsuperscript{28} As the regulator with primary authority over all banks and securities firms, the MOF can negotiate compromises among institutions under its broad regulatory umbrella.

If the MOF fails to gain the agreement of a powerful industry group, however, it risks an appeal by that group to the ruling Liberal Democratic Party (“LDP”). On the other hand, the complaining group will hesitate before resorting to the LDP. Such an appeal can be expensive, both in terms of political contributions and the danger of creating an adversarial relationship with the MOF. Moreover, the interest group has no way of knowing in advance whether it can prevail against the political resources of the MOF and any opposing interest group. If the debate takes place in the Diet, rather than in the MOF, groups that are underrepresented within the MOF (such as industrial companies, trading companies, and consumers) may win additional concessions. As a result of this political reality and the MOF bureaucrats’ desire that the MOF remain the principal forum for decisions concerning financial regulation, successful initiatives tend to be compromises mediated by

\textsuperscript{27} Id. at 10.

\textsuperscript{28} F. ROSENBLUTH, supra note 7, at 226.
the MOF. However, these compromises "speak[] not of MOF omnipotence but of the MOF's sensitivity to political reality."29

The nature of MOF negotiated compromises among interest groups is most evident in the battles between the Japanese banking and securities industries. Many anomalies of Japanese financial services regulation, such as the "Three Bureaus Guidance," the inability of securities firms to engage in foreign exchange trading, and limitations upon the ability of corporations to raise significant capital through bond issuance, result from the failure of these two industries to compromise. Most of the banking-securities reforms of the past decade have been the result of successful compromises.

Under the existing framework, if a new product is proposed, a turf battle erupts over the necessity of the product and which institutions will participate in the new market. In many cases, the only politically acceptable method of introduction is to allow both the banking and securities institutions to handle the product. Alternatively, one industry may "allow" the other industry to participate in the new market only if the nonparticipating industry receives some power that it desires. If both banks and securities firms will handle the product, the MOF must agree not to seek a Cabinet Order designating the product as a security under SEL Article 2, paragraph 1.30 This is standard practice. Indeed, the MOF has never sought such an order.

However, if the product is not designated as a security, investors lack the legal protection of the SEL’s disclosure requirements and remedies against fraud or manipulative practices. For example, when commercial paper was introduced in Japan in 1987, the MOF issued legally nonbinding notifications (tsutatsu), which allowed both bank and securities firm participation and established the market framework for commercial paper. Investors, however, are denied the protection of the SEL, and the MOF lacks the ability to directly enforce its requirements upon issuers, underwriters, and dealers. Instead, the MOF must rely upon its discretionary powers over financial institutions to ensure compliance.

Before focusing on the interests of the banking and securities industries with respect to financial system reform, several other conceivable sources of the impetus for reform should be considered. Despite inconvenient service, poor returns on deposits, and fixed commissions on securities trades, there has not been a consumer movement for reform in Japan. The absence of such a movement can be attributed to

29 Id. at 210.
30 See SEL, supra note 2, art. 2, ¶ 1, at MA 2.
the diffuse nature of consumer interests and the lack of political entrepreneurship by either the LDP or opposition parties. The only serious "consumer" pressure comes from large industrial and trading companies. These groups have been instrumental in improving access to the Euromarkets, introducing and subsequently liberalizing commercial paper, and slightly improving the restrictions on bond issuance. Industrial groups may support bank-securities firm competition, but there is no evidence that such groups instigated the reform debate.

Likewise, although the United States has pressed for interest rate deregulation and other liberalization measures in Japan, the United States has struggled with its own battle over Glass-Steagall reform and therefore deemed it inappropriate to advise the Japanese.\textsuperscript{31} Japanese participants in the financial system reform debate have rejected any intention to utilize foreign pressure in support of this reform.\textsuperscript{32} In the absence of foreign pressure, LDP intervention, and demands by industry, financial services providers must be the primary source of the reform movement. Those members of the financial services industry with political resources must favor reform or, at the very least, hope to strike a bargain that will benefit all sides. This explanation is borne out by the facts.

\section*{a. Declining Benefits to Banks}

Japanese banks have watched many of the benefits of the MOF's regulatory scheme disappear over the past fifteen years. Bank dominance of Japanese industry finance began to diminish in the 1970s, as Japanese economic growth slowed and corporations reduced their demand for bank loans. At the same time, large Japanese corporations increasingly sought cheaper capital supplies in overseas markets. Not only the Euromarkets, but new domestic products such as commercial paper, now compete with bank loans.

On the other side of bank balance sheets, foreign exchange and investment liberalization provided institutional investors with alternatives to bank deposits. Meanwhile, securities firms introduced medium-term government bond funds, which are marketed to individuals as a substitute for bank savings. In response to foreign pressure and in an effort to stem this leakage, the MOF began to deregulate interest rates, starting with the rates paid on time deposits in large denominations (for which there existed ready substitutes). This gradual interest rate liber-


alization is now well underway, and the MOF has promised further deregulation of interest rates by 1993.\footnote{See Nihon Keizai Shimbun, May 10, 1991, at 1; Ministry of Finance, Report of the Kinyu Mondai Kenkyukai (May 21, 1991). The Kinyu Mondai Kenkyukai is an advisory council which, since 1981, has issued reports on interest rate liberalization.} Deregulation has dramatically increased the cost of bank funds, with a resulting deterioration in the spread banks can charge borrowers.

Until the mid-1980s, Japanese banks emphasized growth in deposits and assets. As long as depositors had few alternatives and received only nominal, regulated interest rates, a bank needed only to gather more deposits to increase its profit. MOF regulation of branch locations, hours of business, products and nearly all other aspects of bank services limited attempts at non-price competition. The increased cost of funds that accompanied interest rate deregulation and agreement upon uniform international standards for capital adequacy (under the auspices of the Bank for International Settlements)\footnote{Committee on Banking Regulation & Supervisory Practices, Proposals for International Convergence of Capital Measurement and Capital Standards (1987), reprinted in 27 Int'l Legal Materials 530 (1988).} have caused Japanese banks to eschew deposit growth. Japanese banks have shifted their focus toward asset quality and fee income. The capital adequacy ratios have made Japanese banks eager to introduce products whereby they can securitize assets, for example pooling auto loan or credit card receivables in a trust and selling beneficiary certificates. Although there have been some attempts to introduce such asset-backed securities in Japan, they have, to a large extent, been delayed by legal and regulatory difficulties.

The stronger Japanese banks view the ability to engage in a broad range of activities as their best hope to maintain profitability and compete in international finance. The city banks expect to compete favorably in any new business. Such business may involve retail products, where their large branch networks provide an enormous competitive advantage, and wholesale finance, where their strong corporate relationships provide an edge. The long-term credit banks envision a future as wholesale investment banks with a central role in corporate finance. The trust banks, on the other hand, are in a more defensive position, having lost some protection for their regulatory niche of pension and trust fund management.\footnote{See A Survey of Japanese Finance, Economist, Dec. 10, 1988, at 13.} Further, trust banks have far smaller branch networks than the city banks.

Securities industry products, such as commercial paper and government bond funds, may compete with bank products, but the banks
do not expect securities firms to be strong competitors in most core banking businesses. All but the largest securities firms lack the resources to establish bank subsidiaries, and the main attraction of banking—access to low cost depositors' funds—has diminished. The trust banks, on the other hand, fear securities firm inroads into their pension fund management business. In sum, with the exception of the trust banks, large banking institutions strongly endorse the relaxation of restrictions upon bank-securities firm competition.

b. The Rise of the Securities Industry

The securities industry reaped enormous profits during the 1980s, as volume and prices increased throughout the decade. At the height of the boom, Nomura Securities was the most profitable corporation in Japan.8 The public and news media began to complain about the extraordinary profits reaped by securities firms under the system of fixed brokerage commissions.7

The securities firms were concerned that the banks' strong relationships with corporate customers and large branch networks would prove decisive in any head-to-head competition for underwriting or retail brokerage business. Securities firms opposed any competition in retail stock brokerage, which represented their most profitable business and was the primary business of the smaller securities firms. On the other hand, securities firms had far less to lose if banks were allowed to compete at underwriting. Japanese banks already engaged in private placements and served as commissioned companies for public placements. In addition, the domestic market for corporate debt was severely limited by its lack of flexibility, high cost, and stringent financial tests for issuers. Securities industry representatives spoke of SEL Article 65's banking-securities division with reverence and warned of the dangers of universal banking and bank dominance over industry.8

3. Debate in the MOF Advisory Councils

The Banking and Securities Bureaus of the MOF mediate policy disputes on behalf of the industry groups they regulate. Within this scheme, the Banking Bureau communicates with and represents the banking industry in debates. It was therefore not surprising that discussions of Article 65 reform began within the standing advisory council of

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8 Interview with officials from the Japan Securities Research Institute (June 1988).
the MOF's Banking Bureau, the Financial System Research Council ("FSRC") (Kinyu Seido Chosakai). The advisory councils are the formal mechanism by which interests outside of the bureaucracy may influence the MOF's policy-making process. The advisory councils also serve to legitimize MOF decisions by making it appear as if such decisions are made by a group of respected persons that is not directly affiliated with the MOF. These advisory councils consist of representatives of regulated entities and other interest groups, as well as academics and the mass media. The MOF selects the members of the advisory council.

It is somewhat misleading to state that debate takes place in an advisory council, since the debate often occurs ahead of time in numerous informal meetings among interested parties, bureaucrats, and advisory council members. The process is very much under the direction of MOF officials.

3.1. The Process

In September of 1985, the FSRC established the System Issues Research Group (Seido Mondai Kenkyukai), which in December of 1987 concluded a report entitled "On the System of Specialized Financial Institutions" (Senmon Kinyu Kikan Seido ni Tsuite). The report describes shortcomings of the current system and recommends the study of various methods of financial system reform.39 This report set the stage for the debate over mutual competition among the specialized financial institutions.

In response to the December 1987 report, the FSRC established two other committees, the First Financial System Committee ("First Committee") (Kinyu Seido Dai-ichi Iinkai) and the Second Financial System Committee ("Second Committee") (Kinyu Seido Dai-ni Iinkai). The First Committee studied regional and mutual banks and smaller financial institutions.40 The Second Committee explored questions of bank-securities industry competition and competition among the city banks, long-term credit banks and trust banks. The Second Committee completed interim reports on May 26, 1989 and July 13, 1990. A reconstituted FSRC group, the System Issues Special Committee (Seido

40 The First Committee released a number of reports. See, e.g., First Financial System Committee, On the System of Mutual Banks (May 19, 1988). This report recommended that legal steps be taken to permit conversion of Japan's mutual banks into ordinary banks. The Diet enacted legislation in accordance with this recommendation, and 67 of the 68 mutual banks have since been converted to ordinary banks. See Report of the System Issues Special Committee, Seido Mondai Senmon Iinkai Hokoku 42-44 (June 4, 1991).
Mondai Senmon Iinkai), concluded the study and released its final report on June 4, 1991.41

Meanwhile, in response to the FSRC initiative, debates of a similar nature proceeded in the Securities Bureau’s advisory council, the Securities Transaction Council (“STC”) (Shoken Torihiki Shingikai), and its Fundamental Issues Research Group (“FIRG”) (Kihon Mondai Kenkyukai). The FIRG released interim reports on May 27, 1989 and again in June of 1990. Along the way, separate subcommittees addressed issues surrounding securitization products and reform of the disclosure system. The FIRG’s final report was completed on May 24, 1991.

The committees consisted of representatives of interested groups and persons knowledgeable about the subject of inquiry (bank, securities firm, industrial company, and insurance company executives, professors, commentators, journalists, representatives of the Bank of Japan, the Federation of Economic Organizations (Keidanren), and various others). Although the profusion of committees may seem confusing, each involved a fairly familiar cast of characters, including a common core membership. Ryuichiro Tachi, Professor (Emeritus) of the Tokyo University Law Faculty, chaired the FSRC’s Second Committee and the System Issues Special Committee. Shoichi Royama, Professor of Economics at Osaka University, chaired the STC’s FIRG. Both Tachi and Royama have written widely on questions of financial regulation and are veterans of MOF advisory bodies. For example, Tachi chaired and Royama served on the MOF’s ad hoc Commercial Paper Discussion Group, which in 1987 helped plan the introduction of commercial paper in Japan.42 In this case, they sat as members of each other’s committees, where most of the debate took place. When the FIRG formed two subcommittees for its 1989-90 debates, both Tachi and Royama sat on the subcommittee that discussed bank-securities competition and reform of the securities markets.43 In addition, all of the committees debating the reform included a core of common members from such institutions as the Bank of Japan, Keidanren, Nomura Research Institute, the Industrial Bank of Japan, Hitachi, the Nihon Keizai Shimbun, and the Yomiuri Shimbun.

This common membership, the presence on all of the committees

41 Report of the System Issues Special Committee, supra note 40.
43 Professor Hideki Kanda, a contributor to this volume, also served on this subcommittee.
of representatives of the banking and securities industries and professors from the major universities, and the fact that the deliberations and presentations were guided by MOF bureaucrats, make it very misleading to think of these debates as separate discussions. Nevertheless, the FSRC and the STC must represent the formal jurisdictions of the bureaus that they advise. Sensitivity to questions of jurisdiction, as well as the host bureau’s influence over deliberations and its role in representing the interests of its regulated industry, gave a different focus and flavor to the FSRC and STC reports.

3.2. The Interim Reports

The Second Committee began deliberation in February of 1988. On May 26, 1989, this Committee presented its first interim report entitled “On a New Japanese Financial System” (Atarashi Kinyu Seido ni Tsuite). The report acknowledges that Japan’s compartmentalized financial system was designed to meet the needs of the immediate postwar period, when Japan suffered a shortage of capital for industrial development. In typical understated fashion, the report suggests that in an era of developed capital markets and excess liquidity “the strict horizontal division of financial institutions’ activities no longer carries its full former significance.”

The report accurately characterizes past deregulatory measures as “allowing institutions to engage in the periphery of each other’s business.” The first interim report concludes that the “basic framework” of the present system results in “serious limits to the ability of business liberalization to keep pace with the needs of users and the trends of world financing.”

3.2.1. Five Possible Formulas

The essence of the report is found in the remaining chapters. The MOF presented the Second Committee with five alternative formulas for reform, and these proposals formed the basis for discussion in the Committee’s meetings. The report briefly states the perceived merits and drawbacks of each alternative and tentatively concludes that two of the formulas warrant further study. The five proposals and the report’s preliminary assessments are summarized below.

44 SECOND COMMITTEE’S REPORT, supra note 1.
45 Id. at 3.
46 Id.
47 Id. at 15.
48 Id.
a. The Piecemeal Approach

Reform could proceed as it had in the past, with gradually increasing competition in the gray zones between ordinary, long-term credit and trust banks, and between the banking and securities industries. This approach avoids major blunders and "provokes the least anxiety in users and those concerned." However, most of the peripheral products amenable to this approach have already been dealt with, and "the remaining problems are largely insoluble by the piecemeal approach." Further, this approach requires "huge expenditures of time and effort to effect mutually satisfactory adjustments." Piecemeal reform lacks transparency and is difficult for foreigners to understand. Reform, in this instance, becomes a bargaining process among financial institutions, while the original goal of better consumer services is lost in the process. Finally, piecemeal reform leads to distortions in the competitive environment, as institutions face different and somewhat arbitrary restrictions.

b. Universal Banking

Under a universal banking system, all types of banking and securities activities can be conducted within a single institution. Germany, France, Switzerland, the Scandinavian countries, the United Kingdom, Hong Kong and Singapore, among others, use this system. For Japan, however, "the leap to universal banking in one bound may be too drastic," and would result in serious dislocations.

Universal banks are efficient to operate and convenient for customers, since such customers can receive a range of services tailored to their needs from a single provider. New entries into the banking and securities businesses would promote competition. Universal banking also permits institutions to diversify and thereby limit risk. Banks already handle government bonds, private placements, and new securitization products without apparent difficulty.

Universal banking, however, suffers from several disadvantages. First, banks might increase their stock and bond holdings, which may

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49 Id. at 37.
50 Id.
51 Id.
52 Id.
53 Id.
54 Id. at 38.
55 Id.
56 Id.
raise concerns that stock price fluctuations would jeopardize deposits. Second, universal banking raises concerns about the acquisition and unfair use of inside information. Japanese banks already exercise strong control over their corporate customers through immense stock holdings, through the dispatch of personnel, and by close ties under the "main bank" system. Third, universal banks might eventually dominate their customers. Fourth, economies of scale and scope, which would be available to universal banks, might enable large institutions to eliminate smaller competitors and institute an oligopoly. Fifth, banks might not promote securities activities, as lending would remain their primary business. Sixth, securities firms would be at a serious disadvantage during the transition period because of banks' access to central bank funds and insured deposits. Last, universal banking would accentuate concerns about conflicts of interest, as financial institutions assumed a variety of roles.

c. Holding Companies

The holding company approach respects existing divisions and allows new entry through the formation of holding companies and subsidiaries, which operate in new areas. This system allows a group of companies to provide a wide range of services. While this formula is feasible in the United States, Article 9 of Japan's Antimonopoly Law prohibits the establishment of holding companies in Japan. The holding company alternative could not proceed without an amendment to the Antimonopoly Law. Japan is the only country that outlaws holding companies. This prohibition is a vestige of its prewar experience with huge industrial zaibatsu, each of which was held together by a central holding company. Article 9's prohibition applies not only to finance, but to all of industry, and "it does not, therefore, seem appropriate to propose amending the Antimonopoly Law to reform the financial system."
d. Multifunctional Subsidiaries

Under this approach, financial institutions could establish a single subsidiary, which would be able to enter into a wide range of new activities. Operations of the subsidiaries would be restricted, for example, to the wholesale market or to activities other than deposit taking. Large industrial firms and institutional investors would gain much of the efficiency of universal banking, while small depositors and consumers would continue to receive the protections of the current system, since new activities would be segregated in a different legal entity. The multifunctional subsidiaries system reflects the increasingly blurred distinctions among banking, securities, and trust products for wholesale consumers of financial services. The method of operation would be familiar to firms that already participate in the Euromarkets, where business is conducted in a similar manner. This approach would enable the creation of competitive, flexible, and low-cost providers of financial services, while preserving confidence in the conservative nature of banks' activities.

The distinction between wholesale and retail finance could be drawn in terms of (a) the identity of the party to the transaction, (b) the amount of the transaction, or (c) the number of offices. The difficulty of establishing a clear line between wholesale and retail finance presents one problem with the multifunctional subsidiary approach. Further, some of the potential disadvantages of universal banking might arise, such as possible bank domination of industry and troublesome conflicts of interest. The introduction of a new type of financial institution would complicate financial regulation, and this formula provides little direct benefit to small consumers of financial services.

The parent institution's ownership of shares in the multifunctional subsidiary would contravene Article 11 of the Antimonopoly Law. Accordingly, this approach would require an amendment to the Antimonopoly Law or the receipt of an exemption from the FTC. Additional special legislation would be required, since the new entities would not be able to conduct both securities and banking operations within a single entity under the current banking and securities laws.

67 Id.
68 Id. at 44.
69 Id. at 46.
70 Id. at 45.
71 Id. at 46.
72 Id.
73 Antimonopoly Law, supra note 14, art. 11, ¶ 1, at KA 15. See supra notes 14-17 and accompanying text.
e. Separated Subsidiaries

Under this alternative, existing financial institutions would enter new areas of business through wholly owned subsidiaries. For example, a bank could establish a securities firm subsidiary and vice versa. This formula bears some resemblance to the approach recently taken by Canada. Except as restricted by the MOF or other regulators, each type of new subsidiary would be permitted to engage in those activities that existing institutions of the same type are permitted to engage in. This approach would provide strong continuity with the present system. The ability to compete through subsidiaries would diminish resistance to the introduction of new products, because at least one entity within any financial institution group could handle any new product. The new entities would stimulate competition. Separation of operations in different legal entities would simplify regulatory supervision in the protection of depositors' funds and would avoid abuse of inside information and conflicts of interest.

On the other hand, as new subsidiaries are established, the system would duplicate some administrative functions and increase overhead costs. Further, this framework lacks the flexibility of the multifunctional subsidiary and universal banking approaches.

f. Elimination of Three Approaches

In a brief conclusion, the Second Committee's report rejects the piecemeal, universal banking and holding company approaches. The report recommends that further deliberation focus upon either separated or multifunctional subsidiaries. The Second Committee suggests that further analysis should consider how to benefit consumers by relaxing the regulations that are placed on parent institutions. The report concludes with the hope that the STC will study the matter further.

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74 Second Committee's Report, supra note 1, at 33-34, 47.
75 See id. at 22-23, 34.
76 Id. at 33-34.
77 Id. at 48.
78 Id. at 49.
79 Id. at 49-50.
80 Id. at 50.
81 Id.; see Committee on Asian Affairs, The Restructuring of the Japanese Financial Services Industry, 45(2) Rec. A. B. City N.Y. 194 (1990)(discussing the reform debate up to this point).
3.2.2. A Revised SEL

Meanwhile, on May 18, 1989, the STC’s subcommittee, the FIRG, issued an interim report entitled “The Securitization of Finance” (Kinyu no Shokenka). The report passed over questions of bank-securities competition and instead focused upon the appropriate regulation of markets in new securitization products. The report proclaimed the need to revise the securities regulation framework so that new products functioning as securities would be included within SEL antifraud and disclosure requirements. This goal could be accomplished through either an expanded SEL or a financial services law applicable to new products. At the same time, the FIRG recognized that if coverage of the SEL was to be expanded, disclosure requirements would have to be adjusted to accommodate nontraditional products, such as commercial paper and asset finance securities. Although the FIRG did not address the question of new entry into the securities business in this report, MOF officials and FIRG members insisted that the Securities Bureau and the FIRG were not purposefully evading this issue. It was made clear that the challenge of the Second Committee’s report would be addressed.

3.2.3. The STC Agrees to a Formula

In 1990, the focus of debate shifted to the STC’s committee, which, as predicted, took up the question of bank-securities competition. To the surprise of some commentators, the FIRG did not reject the concept of new entry. Rather, it accepted the separated subsidiary formula as the basis for bank entry into the securities business and proposed a number of conditions that would satisfy the securities industry’s concerns. These conditions were: (1) the scope of the subsidiaries’ business would initially be limited, then gradually expanded, and “for the present,” bank subsidiaries would be prohibited by law from engaging in retail stock brokerage; (2) the subsidiaries’ relations with their parent institutions would be subject to strict regulatory “firewalls” in order to ensure the safety of depositors’ funds and prevent conflicts of interest; (3) securities firms would be permitted to engage in foreign exchange sales and trading, a business long denied them by the MOF.

83 See Kinyu Zaisei Jiyo, June 5, 1989, at 22, 25 (interview with Mr. Matsuno, advisor of the MOF’s Securities Bureau); id., at 26-29 (interview with Shoichi Royama).
at the banking industry's urging; and (4) securities firms would be permitted to establish ordinary and trust banking subsidiaries.86

The securities industry accepted the separated subsidiary formula because, when combined with rigid firewalls between parent and subsidiary, it provides the best hope of segregating the new securities operations from the competitive strengths of the parent banks. In contrast, the multifunctional subsidiary approach would allow banks to take full advantage of their strong corporate relationships. Even worse from the perspective of the securities industry, multifunctional subsidiaries might prove to be an effective structure in a transition to universal banking, if the MOF was to reduce and eventually eliminate restrictions upon the scope of the subsidiaries' business.

In addition to addressing new entry, the FIRG continued to emphasize SEL reforms. It elaborated upon the SEL revisions that would accommodate securitization products.87 The committee proposed a new, functional definition of "security," which would include both traditional securities and new products.88 The discussion of this definition heavily relies upon comparisons with securities laws in the United States and United Kingdom. It is suggested that the functional definition will be similar to the definition of an "investment contract" adopted by the United States Supreme Court in the case of Securities & Exch. Comm'n v. W.J. Howey Co.89

The committee also proposed a new definition of a "public offering,"90 clearer and less subject to evasion than the existing law. As part of the price for bank entry into the underwriting business, the committee proposed a revision of the limits on corporate bond issuance and reform of the commissioned underwriting company and trustee system for underwriting corporate debt. Both changes are long overdue steps that could revitalize the Japanese bond market and increase the alternatives to bank finance.91

Meanwhile, the FSRC's Second Committee acquiesced to the FIRG's choice of separated subsidiaries, though not explicitly rejecting the multifunctional subsidiaries alternative.92 It also accepted the con-

86 See id.
88 Id.
89 328 U.S. 293, 298-99 (1946)(An "investment contract" is a "contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.").
90 KINYY ZAISEI JIJO, July 9, 1990, at 71-72.
91 See Nihon Keizai Shimbun, June 16, 1990, at 1; id., May 28, 1990, at 1. See also KINYY ZAISEI JIJO, July 9, 1990, at 50 (the 1990 interim reports of the FIRG and Second Committee).
cept of limited firewalls between parent and subsidiary, although members of the Second Committee strenuously argued that the details of the restrictions should be determined through administrative guidance rather than through inflexible statute or regulation.93

The FSRC's First Committee issued an interim report noting that smaller financial institutions would find it difficult to establish separate subsidiaries.94 The First Committee's report proposed that regional banks should be allowed to choose between establishing trust subsidiaries or engaging directly in a limited range of trust activities.95 By the Summer of 1990, the basic terms of the compromise had been accepted by the relevant advisory councils.

4. THE FINAL REPORTS

The final year of advisory council activity consisted of attempts, only partially successful, to agree on the details of the reform. The final reports contain details of the STC's proposed securities regulation framework and other matters not involving competition among industry segments. The scope of bank-securities firm competition, however, remains unclear and is disappointing when compared to earlier grand statements about a new financial system.

In 1990, the Bank of Japan's tight monetary policies finally burst the speculative bubble that had pushed Japan's real estate and stock market prices into the stratosphere. Prices of stocks listed on the Tokyo Stock Exchange fell forty percent below their 1989 peak, trading volume plummeted, and real estate companies and stock speculators entered into bankruptcy in record numbers. Both banks and securities firms suffered from this dramatic change in the financial environment. The securities industry lurched from an era of record profits into one of grave economic uncertainty. In particular, small and medium-sized securities firms were reported to be in dire straits. Banks suffered from troubled loans to "non-bank" lease or finance companies and real estate developers, while the value of their stock portfolios plummeted.96

93 See id.
95 See id.
96 As a result of the dramatic decline in the stock market, Japanese corporations are no longer able to issue convertible bonds in the Euromarkets at low interest rates, and equity financing has become difficult. These factors, combined with negotiated reductions in the fees paid to securities firms as underwriters and to banks as collateral agents and "commissioned companies," have resulted in an increase in primary issuances through the Japanese domestic bond market. This market, however, remains minuscule in comparison to its United States equivalent. See Nihon Keizai Shimbun, Nov. 1, 1991, at 7; id., Oct. 26, 1991, at 1; id., Oct. 22, 1991, at 7.
Members of the advisory councils blamed these economic circumstances for the conservative nature of the final reports. Given the MOF's role as protector of the entities it regulates, the weakened condition of the securities industry made the MOF responsive to securities industry arguments in favor of caution. The industry's most influential proponents within the MOF, three former MOF Administrative Vice Ministers who have gone on to serve as Chairmen of the Tokyo Stock Exchange, lobbied on behalf of the ailing industry and managed to "tip the balance slightly in favor of less change."

4.1. The Final Report of the FSRC's Committee

The System Issues Special Committee report was completed on June 4, 1991 and was adopted by the FSRC on June 25, 1991. The report sets forth a general principle of competition among the different types of financial institutions to the extent that it is consistent with the protection of depositors, the maintenance of financial order, and the avoidance of harmful conflicts of interest or financial institution domination of industry. However, in contrast to the interim reports of the FSRC's committees, the final report contains repeated references to the importance of preserving "fair competitive conditions," a euphemism for the protection of weaker institutions and existing niches.

The report recommends a system of separated subsidiaries as superior to the multifunctional subsidiaries approach. The separated subsidiaries alternative, the report claims, allows broad participation in new areas of business, maintains financial stability, protects depositors, and avoids conflicts of interest. On the other hand, according to the report, the multifunctional subsidiary formula is an appropriate subject for "further study" because it permits synergies among businesses and added convenience for customers.

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97 See Kinyu Zaisei Jiho, June 17, 1991, at 18-19, 23 (interview with Shoichi Royama); id., at 44 (interview with Shinichiro Ohta, Senior Managing Director of Mitsubishi Trading Co., Ltd.).
100 Id. at 11, 20.
101 Id. at 21.
102 Id.
103 Id.
4.1.1. Competition Among Banking Institutions

The report acknowledges that conflicts of interest and increased risk to depositors are not major concerns in lowering regulatory barriers among ordinary banks, long-term credit banks, and trust banks.\textsuperscript{104} Thus, the report states that new activities might be allowed within the parent institution of such banks. Nevertheless, the report rejects this approach because of the differences in branch networks and the need to preserve fair competitive conditions.\textsuperscript{105} Instead, such new competition should occur through subsidiaries.\textsuperscript{106} In an important exception, the report suggests the study of additional legal reforms that would permit long-term credit banks and the specialized foreign exchange bank to convert into or merge with ordinary banks.\textsuperscript{107} These institutions, however, have not taken advantage of past MOF efforts to encourage mergers or conversions.

Despite this tentative statement in favor of subsidiaries, the report proposes measures that would diminish the distinctions among the different banking entities. First, ordinary banks would be permitted to offer savings instruments with maturities in excess of three years (to compete with trust and long-term credit banks).\textsuperscript{108} Second, terms and maturities of bank debentures issued by long-term credit banks would be diversified.\textsuperscript{109} Third, restrictions on trust products would be relaxed, and trust products of less than one-year maturity would be permitted (which would foster competition with ordinary banks).\textsuperscript{110} Meanwhile, the report acquiesces to securities industry requests that the MOF allow improvements in their medium-term government bond funds (to compete more directly with bank savings products).\textsuperscript{111} As a result of this liberalization, the practical distinctions between long-term and short-term banks will disappear making it likely that long-term credit banks will convert into ordinary banks.

\textsuperscript{104} Id. at 20-21.
\textsuperscript{105} Id.
\textsuperscript{106} Id. at 21-22.
\textsuperscript{107} Id. at 22.
\textsuperscript{108} Id. at 25.
\textsuperscript{109} Id.
\textsuperscript{110} Id.
\textsuperscript{111} Id. Many of the measures that would liberalize bank products accompany the MOF's program of gradual interest rate deregulation. According to the MOF's most recent schedule, released in May of 1991, time deposits of less than ¥500,000 will become linked to market interest rates in the Spring of 1992, and a year later the MOF will eliminate any regulation of interest rates or product design for time deposits. \textit{See} Nihon Keizai Shimbun, May 10, 1991, at 1.
4.1.2. Competition Through Subsidiaries

The report envisions ordinary bank, trust bank, and securities firm subsidiaries.\textsuperscript{112} City banks, regional banks, and other small financial institutions will be permitted to form trust bank and securities firm subsidiaries. Long-term credit banks and the specialized foreign exchange bank may establish trust bank and securities firm subsidiaries. Trust banks will be permitted to organize securities firm subsidiaries. Securities firms may create ordinary bank or trust bank subsidiaries. The report concludes that there is no need for specialized foreign exchange bank subsidiaries.\textsuperscript{113} It tentatively rejects any need for long-term credit bank subsidiaries, but the report holds this issue open for further study.\textsuperscript{114}

4.1.3. Scope of New Subsidiaries' Business

The report sets forth the principle that the subsidiaries may participate in all areas of business allowed to existing entities.\textsuperscript{115} Despite this principle, the business of subsidiaries will be severely restricted at the outset in order to preserve fair competitive conditions.\textsuperscript{116} Somewhat broader powers will be added to the subsidiaries over time. In fact, only the new ordinary bank subsidiaries will be able to engage in the full line of activities allowed existing entities. Trust banking subsidiaries initially will not be permitted to engage in the loan trust, pension trust, money trust or other unspecified businesses.\textsuperscript{117} "For the time being," securities subsidiaries will not be able to engage in retail stock brokerage or other unspecified businesses.\textsuperscript{118} Instead, banks' securities subsidiaries will focus on a broad range of securities activities in the primary market.\textsuperscript{119}

4.1.4. Timing of Entry

The report states that the timing of authorization to establish subsidiaries should reflect differences in the number of branches of the parent institution and the degree of the relationship between the business of the parent and the subsidiary.\textsuperscript{120} This statement is widely inter-

\textsuperscript{112} FSRC REPORT, \textit{supra} note 99, at 22, 23.
\textsuperscript{113} Id. at 22.
\textsuperscript{114} Id.
\textsuperscript{115} Id. at 22-23.
\textsuperscript{116} Id.
\textsuperscript{117} Id. at 23.
\textsuperscript{118} Id.
\textsuperscript{119} Id.
\textsuperscript{120} Id.
preted to indicate that the strongest competitors, the city banks, will be handicapped for at least one year. Long-term credit banks and trust banks will be given the first opportunity to establish securities subsidiaries, and securities firms will be allowed to establish trust bank subsidiaries.121

4.1.5. Activities Within the Parent Entity

Banks will directly handle private placement of corporate debt as under the current regulatory framework.122 Securitization products such as commercial paper should, to the extent possible, be handled within the parent entity.123 Many regional financial institutions cannot afford the cost of operating through separate subsidiaries. Such institutions should be permitted to undertake limited areas of new business within the main entity, including land trusts and public benefit trusts, to the extent consistent with financial stability. With some exceptions, regional financial institutions may choose between this method and the establishment of subsidiaries.124

The report is noncommittal on the ability of securities firms to engage in foreign exchange business. The report suggests that the matter be “separately examined” by the MOF and offers various factors that should be considered in that examination.125

4.1.6. Related Reforms

The report suggests a number of other reforms. Many of these reforms are included to indicate agreement with proposals of the STC’s committee, which are discussed below. Such reforms include the STC’s proposals to revitalize the bond market and to revise the securities laws to permit the introduction of asset-backed securities on a large scale.126 On its own initiative, however, the FSRC report proposes that banks should be granted the ability to issue domestic straight bonds (banks are now limited to convertible bonds) in order to raise enough capital to meet the stringent capital adequacy regulations.127 Finally, the report suggests that banks should be permitted to introduce floating rate sav-

122 FSRC REPORT, supra note 99, at 23.
123 Id.
124 Id. at 24-25.
125 Id. at 23-24.
126 Id. at 25-26.
127 Id. at 26.
ings accounts, and, at long last, the Three Bureaus Guidance should be eliminated.128

4.1.7. Foreign Financial Institutions

The report does not consider in detail the possible effects the reforms may have on foreign financial institutions, although at least some of the advisory councils heard presentations from representatives of foreign institutions.130 Instead, the report asserts that regulators will continue to apply the principle of equal national treatment to foreign financial institutions' operations in Japan, while making some adjustments to ensure effective participation by such institutions.131

4.1.8. Insurance Activities

The report notes that the Insurance Advisory Council, another MOF advisory body, has suggested the possibility of broad competition between insurance companies and other financial institutions.132 The FSRC agrees in principle with the idea of allowing insurance companies to compete through separated subsidiaries. The report further notes that the matter is now under study in the Insurance Advisory Council.133 A report of that body is expected by the end of 1991.

4.2. The Final Report of the STC’s Committee

The FIRG’s final report, released on May 24, 1991, considers questions of both bank-securities competition and securities law reform.134 Because portions of the report duplicate recommendations made by the FSRC, only those areas not covered by the FSRC and those areas in which the two reports differ are summarized below.

4.2.1. A New Definition of “Security”

The report recommends amending the SEL to adopt a functional definition of “security.” The report suggests the following definition: a

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128 See supra notes 11-13 and accompanying text.
129 FSRC REPORT, supra note 99, at 25.
130 See KINYU ZAISEI JIJO, July 2, 1990, at 27 (listing representatives of IBM, Citicorp, and Salomon Brothers among those who made presentations to a FIRG subcommittee).
131 FSRC REPORT, supra note 99, at 28.
132 Id. at 28-29.
133 Id. at 29.
134 SHOKEN TORIIHI NI KUKARI KIHONTeki SEIDO NO AIRIKA4 NI TSUITE (May 24, 1991), reprinted in KINYU ZAISEI JIJO, June 17, 1991, at 68 [hereinafter STC FINAL REPORT].
security is any contract or scheme under which (1) funds to operate a business or manage assets are contributed by an investor; (2) management is conducted by someone other than the investor; (3) the investor receives distributions from the profits or revenues of the business; and (4) the investor's contract or right is capable of transfer.  

The SEL's current list of products that are treated as securities should be maintained. New products, such as commercial paper, certificates of deposit, and transferable trust beneficiary certificates (for example, housing loan trust beneficiary certificates), should be added to the SEL's "securities" list in order to clarify their status. Under this system, partial or complete exemptions from SEL requirements should be considered when another applicable regulatory framework provides investors with protection that is substantially similar to the protection provided by the SEL.  

4.2.2. Protections Against Direct Sales Practices  

Because institutions that originate securitized assets are likely to sell the resulting products directly to investors, the report reasons that the SEL should be amended to provide additional protection against unfair or manipulative practices in the direct sale of securities. In addition, the report states that because the structures for securitizing assets are complex, SEL disclosure provisions and trust law and securities investment trust law provisions should apply.  

4.2.3. Revised Definition of "Public Offering"  

The SEL defines a public offering as the solicitation of many and unspecific persons on uniform terms and conditions. Current law fails to distinguish among types of investors, and the requirement of uniform terms and conditions makes it easy to avoid public offering status and its accompanying requirements.  

The STC Final Report notes these difficulties and offers the following revisions. First, the requirement of "many and unspecific persons" should be clarified to state that disclosure is required if an offering involves the solicitation of fifty or more persons within a certain period (for example, six months). Second, an offering made only to qualified institutional investors should not be considered a public offering, even if fifty or more persons are solicited. Third, in order to pre-
vent circumvention of public offering disclosure requirements, restrictions should be placed on the resale of securities that are distributed outside of a public offering. Fourth, the "uniform terms and conditions" requirement should be abolished.188

This portion of the report also deals with the private placement of securities. Private placements should be defined in the SEL to include all securities distributions that are not within the definition of a public offering. Privately placed securities should be subject to restrictions on resale, at least for a limited period following issuance.140

4.2.4. Revised Disclosure System

The report recommends several adjustments to the disclosure system. Even when securities are not distributed in a public offering, the SEL should grant regulators the discretion to demand limited disclosure in appropriate cases. In addition to current legal requirements for ongoing disclosure, the SEL should establish a continuing duty of disclosure for any class of security that is held by more than five hundred persons.141

Perhaps the most important recommendation is that current disclosure requirements should not be applied in toto to products that will be included under the new functional definition of security. Securities should be exempt from SEL disclosure requirements when other laws require similar disclosure or provide equivalent investor protection, or when no problem of investor protection is present. Disclosure content and procedure may be simplified for short-term securities with exemptions granted as appropriate.142

The report recommends that securitization products should be handled under the current disclosure system, but some adjustment will be necessary to account for the special characteristics of asset finance securities. The structure of such securities, the legal rights of investors, and details concerning the originator and the manager of the assets must be disclosed in a comprehensible form. Further, continuing disclosure may be simplified or an exemption granted for these products.143

140 Id. at 9-10.
141 Id. at 8-9.
142 Id. at 9.
143 Id.
4.2.5. Revitalization of the Market for Public Placement of Corporate Debt

The report declares the need to revise or abolish numerous regulations on the issuance of corporate debt securities. Revision of the corporate bond law is being studied by a subcommittee of the Ministry of Justice's advisory council. The Commercial Code's limitations on bond issuance must be eliminated, and the trustee system must be improved by, among other things, clarifying the duties of the commissioned underwriting company. The financial standards required for the issuance of bonds should be relaxed, and the bond rating system must be strengthened. Fees in the underwriting process should be reduced to levels comparable to other countries' markets. Restrictions upon the design of products should be discarded, as soon as possible, so that products can develop in response to the needs of issuers and investors.145

4.2.6. Revision of Article 65 to Permit Banks to Handle Nontraditional Securities and Private Placements

Since products handled by banks would be treated as securities under the revised SEL, the report suggests the introduction of a limited license system that would permit those entities not primarily engaged in the securities business to handle such products when appropriate. Under this limited license procedure, banks could continue to handle commercial paper, certificates of deposit and other short-term securities. At the same time, the report argues that restrictions upon non-securities activities of securities firms should be relaxed.146

Under the current SEL, private placement of securities is not considered a "securities intermediary business," and Article 65 of the SEL does not prohibit private placement activities by banks.147 The report proposes that the private placement of securities should be included within the scope of the revised SEL. Nevertheless, it acknowledges that private placement activities raise little risk of conflicts of interest or other problems. Further, privately placed securities are similar in function to bank loans. Banks should therefore be allowed to engage in private placements.148

144 See supra notes 8-10 and accompanying text.
145 STC Final Report, supra note 134, at 11-12.
146 Id. at 13.
147 SEL, supra note 2, art. 2, ¶ 8, at MA 4; id. art. 65, at MA 51.
4.2.7. Areas of Business Subject to New Entry

Instead of accepting the FSRC's suggestion that new entrants should be able to engage in all businesses permitted to existing entities, the STC report takes a far more conservative approach. It proposes that new entry be allowed only when necessary for the development of competitive markets that meet the needs of consumers. In the primary market, the big four securities firms have an extremely high market share, and issuers seldom shift business to a lead manager outside of these four firms. In order to effectively promote competition, the reforms must allow new entry, simplify the issuance and underwriting procedures, and enable a "strengthening [of] the competitive ability of securities firms."149

Secondary markets, on the other hand, have developed and diversified to meet the needs of consumers. The market share of the big four firms in secondary market trading continues to decline. In comparison to the primary market, the need for new entry in the secondary market appears small.150

4.2.8. Manner of New Entry

In order to safeguard the "independent management of securities firms," avoid conflicts of interest, and ease concerns about bank safety, the report suggests that new entry not take place directly, but through separate entities. Even if new entry occurs through subsidiaries, the market must be protected by ensuring the independent management and stability of securities firm subsidiaries, by protecting against conflicts of interest, and by preserving "fair competition."

New entry should be gradual so as not to upset market stability. The following should be avoided: First, the risk of the parent affecting the subsidiary; second, the subsidiary's business being excessively dependent upon transactions with a particular person; third, the subsidiary underwriting securities of the parent or underwriting securities of a financially troubled company in order for that company to repay debts owed to the parent; fourth, efforts by the parent to support the subsidiary by offering extremely favorable terms to customers of the subsidiary, or by exerting a direct power of influence on issuers or investors; fifth, agreements that a parent will lend money on the condition that the customer purchases securities from the subsidiary; sixth, transactions between parent and subsidiary on terms extremely favorable to

149 Id. at 14.
150 Id. at 14-15.
the subsidiary; seventh, purchases by the parent of securities underwritten by the subsidiary during a limited period following issuance; eighth, disclosure of nonpublic customer information by a parent to a subsidiary; and finally, the sharing of parent and subsidiary offices or interlocking boards of directors.\textsuperscript{151}

Firewall measures, which take into account the subsidiary’s business, should be implemented between the parent and the subsidiary. The details of regulatory firewalls should be flexible so as to permit responses to a changing market environment. As necessary, similar measures should be taken with regard to existing \textit{keiretsu} securities affiliates of banks.\textsuperscript{152}

4.2.9. Special Problems of Bank Entry into the Securities Business

The fundamental concepts underlying SEL Article 65—avoiding conflicts of interest, preventing bank domination of industry, and ensuring the health of banks—remain important principles and should be taken into account in formulating reform proposals.\textsuperscript{153} Because large banks hold a special position and are able to exert influence over corporations, regulations are necessary in order to prevent an adverse impact on the market.\textsuperscript{154}

The scope and tempo of bank entry into the securities business should be guided by the relationship between securities and the bank’s principal business and the status of different financial industries in the markets for each type of security. Adequate care should be taken to ensure that market disturbances do not result from new entry.

In particular, bank subsidiaries should be prohibited by statute from entering the retail stock brokerage business. Given the historical lack of bank involvement in that business, the large scale shareholdings of many banks, and the fact that retail brokerage is the main business of smaller securities firms, special care is needed to prevent market disturbances in this area.\textsuperscript{155}

The report concludes with its expectation that the FSRC will undertake appropriate responses to the question of securities firm entry into ordinary and trust banking and the foreign exchange business. The report asserts that measures will be taken to avoid distortion of markets

\textsuperscript{151} \textit{Id.} at 16.
\textsuperscript{152} \textit{Id.} at 16-17.
\textsuperscript{153} SEL, \textit{supra} note 2, art. 65, at MA 51.
\textsuperscript{154} For example, a securities subsidiary that underwrites the securities of a company which the parent bank has the power to influence may adversely impact the market.
\textsuperscript{155} STC Final Report, \textit{supra} note 134, at 17-18.
when securities firms enter the ordinary and trust banking businesses.\textsuperscript{158}

4.3. Unresolved Questions

Disagreements over the timing of new entry and the scope of business appear unavoidable. Few such disagreements were resolved over the course of the final year of debate. The reports contain incomplete lists of products that will be subject to specified treatment. For instance, each list that ends with an "etc. . ." indicates the failure to reach agreement on the list's contents. The reports also include matters upon which failure to agree was resolved only by a recommendation that the matter be left to the MOF's judgment. This apparent delegation to the MOF does not, however, foreclose the possibility that the Banking and Securities Bureaus will continue to press the viewpoints of their respective industries.

The STC report opposes the FSRC's proposal that new subsidiaries should be able to engage in all businesses in which existing securities firms are permitted to engage. Rather, it contemplates a two-tier system that would permit new entrants to engage in a particular business only when necessary to ensure that a particular market is competitive. Thus, the STC would place the burden of proof upon the new entrant, while the FSRC would place such burden on the party resisting competition. The final STC report softens earlier language that would have limited activities of the banks' new subsidiaries to underwriting. Instead, the STC report suggests that, with the exception of the sacred stock brokerage, the scope of new entry will be left to the MOF's judgment regarding the necessity of additional competition. This solution papers over a debate on the ability of new securities subsidiaries to enter secondary markets in corporate bonds, convertible bonds, bonds with warrants, and other hybrid products. These areas are likely subjects of future debate concerning the issue of gradual increases in subsidiaries' powers.

The scope of activities of trust banking subsidiaries remains uncertain, though the core of trust bank activities will be excluded in an attempt to protect the trust banks. The FSRC report lists excluded business areas as "some versions of money trust, such as loan trusts and pension trusts."\textsuperscript{157} The ability of ordinary banks to issue bank debentures in competition with the long-term credit banks also remains uncertain (a matter "for further study"). The regional banks' scope of

\textsuperscript{158} Id. at 18-19.
\textsuperscript{157} FSRC Report, supra note 99, at 20.
permissible activities, without a separate subsidiary, remains unclear. The position of the insurance industry also remains uncertain in its details. The language of the final FSRC report is noncommittal regarding the ability of securities firms to engage in the foreign exchange business.\textsuperscript{188}

The banks have yet to agree on the type of detailed firewalls that will be demanded by the securities firms. The FSRC final report only vaguely refers to firewalls, and the report recognizes firewalls as an alternative only when other regulatory measures prove inadequate. The STC, on the other hand, lists a number of situations it considers problematic. For example, the STC would attempt to prevent a new securities subsidiary from becoming the \textit{de facto} lead manager of public offerings by members of the parent bank's \textit{keiretsu}. The banks have requested that the details of firewalls be left to administrative guidance, so that they can be easily modified periodically.

If the Securities Bureau requires anything like the firewalls now administratively imposed upon bank relationships with \textit{keiretsu} securities firms,\textsuperscript{189} the banks will gain little from the reforms. In this instance, the banks, at the very least, will attempt to drive a harder bargain elsewhere or will gain a commitment that firewalls will be relaxed after an unprofitable initial period of securities subsidiary operations. Foreign financial institutions will likely resist firewalls that would increase the expense of their operations in Tokyo.

Despite the MOF's attempt to seal a grand bargain, the industries will press their interests throughout the implementation stage of the reform, as is apparent from the comments of industry participants that accompanied the release of the final reports.\textsuperscript{160} On the other hand, the promise of a gradual easing of restrictions means that all parties can hold out hope of subsequent entry into areas that are initially foreclosed to them. The banks can seek a rehearing if a reform proposal is ineffective, and the securities firms can delay further liberalization if the new competition results in a serious deterioration of their business.

This approach comports with the established practice of gradual financial liberalization in Japan. Gradual reform lessens dislocations to established businesses, ensures the stability of the financial system, and creates a steady stream of discretionary MOF decisions.\textsuperscript{161} Thus, grad-

\textsuperscript{188} See \textit{supra} notes 86, 126 and accompanying text.
\textsuperscript{189} See \textit{supra} notes 18-20 and accompanying text.
\textsuperscript{160} See \textit{KiNYU ZAISEI Jijo}, June 17, 1991, at 40-45.
\textsuperscript{161} See \textit{Politics, supra} note 42, at 427-28; for a discussion of a similar attempt to diminish the political opposition to reform, see Ramseyer & Nakazato, \textit{Tax Transitions and the Protection Racket: A Reply to Professors Graetz and Kaplow}, 75 VA. L. REV. 1155 (1989) (arguing that the use of grandfather clauses is an effective transitional
ual reform facilitates agreement among the regulated entities, who would otherwise utilize all of their political resources to veto a change. Further, the steady stream of MOF decisions bolsters the MOF's power in its relationship with the regulated industries. The regulated entities must return regularly to the MOF with requests for relief, which allows the MOF to monitor the progress of such entities in the new activity.

The STC hopes to shield retail stock brokerage from any future gradually negotiated reform by placing the restriction on new entry in the SEL. The FSRC has agreed that "for the time being" new securities subsidiaries of banks will not be able to engage in retail brokerage. However, the FSRC did not recommend that the prohibition be written into the statute. A disagreement on this question could slow drafting of the statutory amendments, which is the first step toward implementation of the reforms.

Even if the interested parties accept the details of the reforms, the FTC has yet to agree that financial institutions should be exempted from Article 11 of the Antimonopoly Law. Such an exemption would allow financial institutions to establish wholly owned subsidiaries that compete in each other's businesses. If the FTC does not acquiesce, an amendment to the Antimonopoly Law would be required, which would result in further delay. In fact, however, Article 11 seems aimed at preventing financial institution control of non-financial companies, while Article 65 of the SEL is intended to achieve similar goals within the financial sector. Because the statutory reforms will include an amendment to Article 65 of the SEL, and should increase competition in financial markets, it seems somewhat unlikely that the FTC would object to either an exemption from Article 11 or an appropriate amendment of the statute. Moreover, because Article 11 of the Antimonopoly Law requires that the FTC consult with the MOF regarding exemptions, it seems unlikely that the separated subsidiaries proposal would have made it this far without MOF-FTC consultation and the tacit acceptance of the FTC.

5. TOWARD IMPLEMENTATION

5.1. The Contemplated Schedule

The final reports request that the MOF resolve undecided matters
and draft legislation necessary to implement the proposed reforms. The MOF's schedule contemplates drafting of legislation during the Fall of 1991, a process now underway, and enactment in the Spring of 1992. This would be followed by the drafting of detailed rules and "notifications" to the regulated entities. The first subsidiaries would begin operating in 1993. There is, however, at least one reason to doubt whether the MOF's program will remain on schedule.

5.2. The Banking and Securities Scandals of 1991

Under ordinary circumstances, the ruling LDP has tended to leave financial policy questions to the MOF. Since the banking and securities industries are major sources of support for the LDP, the MOF's negotiation of an agreement with representatives from these industries will ensure passage of the legislation and implementation by the MOF, without the interference of politicians. In May of 1991, the LDP's Financial Policy Committee established a subcommittee to study the advisory council reports and any resulting MOF legislative proposals. On May 17, 1991, the Chairman of that group, LDP Diet member and former MOF bureaucrat Tetsuo Kondo, released a statement accepting the separated subsidiary approach as an appropriate, practical step toward reform. The MOF proposals, however, will not be debated under normal circumstances. After approving the MOF proposals as a step toward reform, Representative Kondo's statement goes on to criticize the lack of consumer input into the process and to suggest universal banking as a goal for later reforms. The Nihon Keizai Shimbun reported that the LDP hopes to pass the MOF proposals. However, after such enactment, the LDP seeks to complete a more fundamental reform package, which would include government financial institutions, within the next two years. The LDP's apparent eagerness to enter the reform debate can be best understood by examining the intense public attention now focused on the regulation of financial institutions. This widespread public concern resulted from a series of major scandals that came to light in the Spring and Summer of 1991.

165 See Politics, supra note 42, at 408; see also F. ROSENBTH, supra note 7, at 135-36, 212-15 (discussing the lack of political entrepreneurship on financial issues).
166 Statement of Tetsuo Kondo, Member of the House of Representatives and Chairman of the LDP's Kinyu Mondai Chosakai (May 17, 1991)(copy on file with the author)[hereinafter Statement of Tetsuo Kondo]; see Nihon Keizai Shimbun, June 6, 1991, at 7.
167 Statement of Tetsuo Kondo, supra note 166.
The securities industry scandals include revelations that the major securities firms paid at least ¥172 billion in “loss compensation” to favored clients to offset losses suffered in the 1990 stock market decline, while leaving the small investor unprotected. Also, it was recently revealed that Nomura and Nikko Securities lent huge sums of money to Susumu Ishii, the former boss of one of Japan’s largest organized crime groups, to finance the purchase of shares of Tokyu Railroad Corporation.

The admitted loss compensation payments may prove to be only the tip of the iceberg. Securities firms may have offered informal guaranteed returns on trillions of yen invested in one type of tax avoidance trust fund (eigyo tokkin). The loss compensation schemes may not be illegal under existing law, so long as investment returns are not guaranteed in advance. When the question first came to the MOF’s attention in 1989, following the October 1989 decline in Tokyo stocks, the MOF issued a notification directing that the securities firms not engage in such schemes. Apparently, the MOF failed to detect the massive payments and was unable to enforce its own administrative guidance. Only after intense pressure from the press and public did the MOF begin a serious investigation into the allegations that Nomura and Nikko Securities engaged in illegal manipulation of Tokyu Railroad Corporation shares. The MOF has also hurriedly presented the Diet with legislation that would prohibit loss compensation payments regardless of whether they were promised in advance as a guaranteed return.

Meanwhile, banks have been implicated in several multi-billion dollar schemes to avoid administrative restrictions on real estate and construction lending. Recently announced frauds involve the issuance of false certificates of deposit—in two cases, in excess of $1 billion face value—to speculators who would present the certificates as collateral for additional loans to support their activities. These incidents have added to an environment in which the media has begun to question the MOF’s will and ability to supervise the industry that it promotes and protects. The MOF has been severely criticized for failing to prevent seemingly endless wrongdoing.

In July of 1991, Prime Minister Kaifu suggested that considera-

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171 See id.
174 See, e.g., Sanger, Four Firms Penalized by Japan, N.Y. Times, July 9, 1991, at D1, col. 6 (criticizing the MOF’s failure to prevent the financial scandals and its reluctance to investigate the scandals).
tion be given to the idea of an independent securities regulation enforcement agency or "Japanese SEC." The Prime Minister's administrative reform advisory council has indicated its support for a new regulatory body, though probably as a "separate bureau" under the Finance Minister.\textsuperscript{175} The National Tax Administration Agency is such a separate bureau. This bureau is under the supervision of the Minister of Finance, yet it has segregated functions and personnel (though young MOF officials traditionally serve one rotation as the head of a local tax bureau, and the agency remains under the strong influence of the MOF). The MOF has responded with a proposal to strengthen its own supervisory and enforcement powers, thereby reducing its reliance on informal notification, which is of questionable effectiveness. Meanwhile, \textit{Keidanren} and other similar groups have stated their opinions, favoring either the "separate bureau" approach or an independent agency framework similar to the system in which the FTC functions.\textsuperscript{176}

The scandals have highlighted weaknesses in the MOF's supervisory and enforcement functions. The immediate problem is not with the substance of the MOF's regulatory program. The MOF may shift away from regulation by administrative guidance and move toward statutory command and Cabinet Order. Thus far, the significant substantive reforms proposed as a result of the scandals include: (1) legislation to prohibit loss compensation schemes (enacted in October of 1991); (2) a plan to gradually deregulate brokerage commissions, beginning with commissions paid for large transactions; (3) the establishment, by the MOF, of clear standards for the licensing of new securities firms, which will end at least some of the industry restrictions against new entrants; and (4) an MOF proposal to strengthen banking regulations, first by expanding the scope of restrictions on transactions with single borrowers,\textsuperscript{177} and second, by including existing limits on bank real estate lending, capital ratios, and other guidelines in regulations, as opposed to the current practice of placing such restrictions in the form of administrative guidance.\textsuperscript{178}

An end to fixed commissions would eliminate a source of the securities industry's extraordinary profitability in the 1980s and would place further pressure on the industry. The plan apparently contains a flavor of retribution against the securities firms for their failure to obey

\textsuperscript{175} \textit{See} Nihon Keizai Shimbun, Sept. 12, 1991, at 1.
\textsuperscript{177} These restrictions would apply to ordinary loans and bill discounts and would restrict transactions by affiliated nonbank finance companies as well as banks.
MOF guidance. The reforms must also be viewed as a response to intense pressure from the Diet and the media. The MOF has temporarily been forced into an adversarial posture in an effort to retain its authority and regain its reputation.

Despite these proposed reforms and sanctions levied against the big four securities firms, U.S. officials in the U.S.-Japan Financial Markets Working Group have indicated a deep skepticism that such measures will resolve the United States’ complaints concerning the Japanese financial system. These complaints focus on the underlying system of regulation by opaque administrative guidance, the slow pace of interest rate deregulation, the inability to design and introduce new products, and the lack of access to the Japanese pension fund management business.

These occurrences may delay the bank-securities reforms discussed in this article. Further, the scandals may diminish the MOF’s willingness to consider the securities industry’s concerns about “fair competitive conditions.” Indeed, the banking industry has used the loss-compensation schemes as an argument in favor of bank participation in secondary markets, and has renewed debate in the FSRC even as the MOF prepares to draft legislation. The scandals may result in the aggressive intervention of the LDP in the reform debate, as the LDP is compelled to respond to widespread public concern about the regulation of financial institutions. According to a recent report, MOF officials hope to bundle, in a single legislative package, the reforms proposed by the advisory council reports and measures responding to the recent financial scandals. The MOF hopes to reduce the risk of Diet opposition to the banking-securities reforms with this political maneuver. The timely discovery of these scandals may result in stronger reform legislation.

6. AN ASSESSMENT

6.1. The Stated Goals of the Reform

In its 1989 interim report, the FSRC’s Second Committee purported to examine the financial system from the perspective of “users”

of financial services, "[i]n the international context" and in view of the need to ensure "financial order: stability and impartiality." The Second Committee set forth many of the stated goals of the reform: promotion of competition, diversification of financial products and services, growth and vitality of markets, facilitation of entry into Japanese markets by overseas users and financial institutions, compatibility with financial systems in other countries, protection of investors, maintenance of an orderly credit system, prevention of harmful conflicts of interest, avoidance of obstacles to effective competition among financial institutions, and promotion of dealings on equal terms among financial institutions and with corporate clients.

Assuming that the reform is implemented on schedule and that several rounds of gradual relaxation of restrictions occur, the results of the reform should include: a significant improvement in the flexibility of available savings products, better protection for securities investors, the introduction of new asset finance securities, and some improvement in the primary market for corporate debt securities. Nevertheless, most of these benefits will not appear for several years, and those who do not have a vested interest in the current system recognize that the details of the reform fall far short of the stated goals.

The advisory council members who did not represent the interests of financial institutions were frank in their expressions of disappointment. Professor Royama graded his committee's effort a lackluster "C." Professor Tachi reportedly used extremely harsh language to vent his frustration at the STC's approach during the final FIRG meeting. Economic commentators, trading company representatives, and the Asahi Shimbun all expressed disappointment at a process driven by the interests of the banking and securities industries. The report fails its basic goals of eliminating the distinctions between first, long and short-term financial institutions and second, banking and securities activities. One advisory committee member noted that the "purpose/methodology" section of the final FSRC report and the details of the reform proposal bear little relation to each other, although a weak final report was inevitable given the adverse change in the busi-

182 Second Committee's Report, supra note 1, at 28.
183 Id. at 28-32.
184 See Kinyu Zaissen Jiyo, June 17, 1991, at 22 (interview with Shoichi Royama).
186 See Kinyu Zaissen Jiyo, June 17, 1991, at 44 (interview with Shinichiro Ohta).
ness of financial institutions. Others complained that the debate proceeded entirely in terms of which financial institutions would win or lose from the measures. Complaints also focused on the extensive use of the euphemism “fair competitive conditions.” The press echoed these criticisms.

Financial institution representatives expressed a mixture of pleasure and disappointment in the proposed reforms, which is an appropriate reaction to the compromise. These representatives reiterated the viewpoints of their industries and expressed hope for favorable decisions in the implementation of the proposal. The one group that remained entirely dissatisfied with the proposed reforms was the long-term credit banks. Rejection of the multifunctional subsidiary approach, the limitation on secondary market activities, the exclusion of many products, and the possibility of rigid firewalls dashed the hopes of the Industrial Bank of Japan and the Long-Term Credit Bank of Japan of becoming wholesale investment banks. Moreover, the final reports left open the possibility that ordinary banks would receive powers to raise long-term funds through the issuance of debentures, which would eliminate the special privilege of the long-term credit banks. Thus, the long-term credit banks may lose the feature that distinguishes them from the ordinary banks, thereby making it easier for the MOF to accomplish the conversion of long-term credit banks into ordinary banks.

6.2. The Reforms and the Politics of Financial Regulation

The reform proposals will promote at least some of the goals stated in the 1989 Second Committee report. These goals may explain why the MOF presented the Second Committee with five very different formulas for bank-securities competition in Japan. Further, these goals undoubtedly influenced the discussion of each alternative system in the May 26, 1989 interim report of the Second Committee. However, the stated goals provide little, if any, guidance in determining why one formula was accepted and the others rejected.

187 See id., at 45 (interview of Hiroko Ohta, Economic Commentator).
188 See id.
189 See id.
191 See KINYU ZASEI JIJO, June 17, 1991, at 40-43 (interviews with bank, trust bank, securities firm, and long-term credit bank representatives).
192 See id.
193 See id., at 41 (interview with Masao Hishimura, Managing Director of the Industrial Bank of Japan).
194 SECOND COMMITTEE'S REPORT, supra note 1, at 28-32; see supra notes 182-183 and accompanying text.
As an example, the reports praise holding companies, and as the debate neared its conclusion, there was renewed discussion of the holding company option as a better formula for reform. The holding company alternative was purportedly rejected because it would violate the Antimonopoly Law. Despite this contention, it is clear that the reform will require statutory amendments in any event, and the Antimonopoly Law could be amended to permit financial services holding companies. A more plausible explanation for the selection of the separated subsidiaries approach exists. Groups that hoped to preserve existing regulatory protection against other financial institutions (a category that includes all financial institutions except the city banks) must have realized that under a holding company system it would be difficult to explain distinctions between the powers of, for example, an existing bank and a new bank subsidiary of the Nomura Securities holding company or an existing securities firm and a new securities subsidiary of the Fuji Bank holding company. It is much easier to make credible arguments for regulatory advantages if financial institutions have different structures. This same political strategy of preserving differentiation explains why the FSRC concluded that, for the present, competition among the ordinary, long-term credit and trust banks should proceed through the establishment of subsidiaries. This political strategy also clarifies why the long-term credit banks have not cooperated in the MOF's attempts to convert them into ordinary banks.

Similarly, the multifunctional subsidiary formula was rejected, not because of any underlying flaw, but because of opposition from the securities firms through the STC. This opposition, although not stated in the STC reports, was articulated to the press in terms of an inability to limit multifunctional subsidiaries to an appropriate wholesale market or in terms of the necessity of firewalls to protect the stability of banking operations, even if wholesale customers could be trusted to look out for themselves. More likely, the securities firms realized that banks' multifunctional subsidiaries would compete on an equal basis against the multifunctional subsidiaries of securities firms, as a single type of new entity. Further, the securities firms must have recognized that after a period of gradual liberalization, these entities could potentially become universal banks.

The MOF debate over regulatory policy has until now been conducted largely in the form of bargaining among interested parties. The Second Committee's 1989 report hints at this in its rejection of further

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piecemeal reform, and commentators and industry representatives acknowledge the nature of the process. In an interview early in the reform process, Professor Tachi suggested that the MOF will never permit free development of products and pricing unless "turf" distinctions are eliminated. The end of a compartmentalized financial system, as envisioned by the reformers, was intended, in large part, to facilitate other reforms in the Japanese financial markets. For example, bank-securities reform will permit the introduction of asset finance securities and substantial improvements in the SEL.

For the most part, however, the reform proposals fail to transcend financial politics and seem instead to be a series of piecemeal accommodations that do not change the basic features of the system. Despite the hope that the MOF could mediate a grand, final bargain among specialized financial institutions, many divisions will persist. The vague final reports evidence an inability to agree upon the details of competition during the final year of debate. Instead, the reports delegate the decisions on the remaining details to the MOF.

It is ironic that a reform with the stated goals of reducing turf battles and increasing the transparency of Japanese financial regulation will grant the MOF additional discretionary power. A lengthy series of MOF decisions will be required to implement the reform. This profusion of MOF decisions will serve to increase the number of hard-fought turf battles, a result that is inconsistent with the stated goals of the reform. By agreeing to preserve trust and long-term credit banks and by limiting activities of new subsidiaries, the MOF ensures continued bank-bank and bank-securities firm turf fights for years to come.

Although these turf battles frustrate substantive reform, they should preserve the MOF's power. The MOF can mediate disputes and can enforce its administrative guidance indirectly through a stream of decisions concerning the scope of activities, the timing of license approvals, and the extent to which powers should be expanded in a gradual relaxation of restrictions. If reform should ever reach the stage where financial institutions can freely compete in each other's activities and can freely design and price products, then the MOF's power will decline dramatically. A similar decline in power and prestige occurred to the Ministry of International Trade and Industry ("MITI"). As Japanese industry matured, the MITI lost its political leverage over foreign exchange rationing and the steering of scarce investment capital. Admittedly, the MOF has many other areas of authority, even if its

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198 Second Committee's Report, supra note 1, at 37.
power over the banking and securities industries should diminish. However, the MOF should be content with the prospect of a gradual reform, which is to be implemented over many years.\textsuperscript{100}

7. CONCLUSION

The description of financial regulation in Japan as a political process driven by the interests of financial institutions is not novel. It is, however, a description worth repeating, given the powerful myth of Japan as a country where bureaucracy guides the shape of economic activity, where conflict is avoided, and where government-business consensus wisely steers the development of public policy. The real story in Japan is one of conflict among powerful private interests, which is accompanied by a bureaucracy that mediates these conflicts. The mediating bureaucracy has only a limited ability or desire to pursue its own substantive agenda.

This portrait of financial regulation in Japan—as a process in which powerful private interests often have their way, and the bureaucracy attempts to preserve its central position, turning against those private interests only when necessary to preserve that position—is not intended as a negative comparison with the state of affairs in the United States. Over the past decade and with particular intensity in the past year, the United States has battled with the concept of banking reform legislation. The ability of private Japanese interests to exact concessions and to slow efforts of Article 65 reform appear quite familiar to those who have observed the continuous process of banking reform legislation in the United States. Given the enormous costs associated with the savings and loan bailout and the troubled condition of the United States' banking industry, the United States' banking regulatory framework cannot serve as a model for Japan or the world.

This article's description of Japanese financial reform suggests that although institutions differ in Japan and the United States, the politics of financial regulation involve similar conflicting interests and, in a general sense, a similar process. This notion contradicts myths about government-industry relations in Japan. The effective use of this

\textsuperscript{100} Such gradual reform can be contrasted to the “big bang” approach. The latter was experienced by England in 1986. See, e.g., Regional Developments: United Kingdom, 21 INT'L LAW. 254, 254-60 (1987)(describing the wholesale deregulation of London's securities markets, which included the termination of fixed commissions and the division of stock brokerage functions among specialized entities).
knowledge can assist United States policymakers in formulating a positive response to the competitive challenge of Japan’s global success in the financial services industry and beyond.