Banking Industry Resolved to Cure Financial Woes This Year

– Aims to Restore Public Trust and Return to Starting Line as a Service Industry –

Interviewer: Ito Shuichi

Photo : Kyodo News

THE Japanese banking industry is at long last being breaking free of the hangover of the huge amount of non-performing loans (NPLs) left behind following the collapse of the bubble economy in the early 1990s. Japanese Bankers Association Chairman Nishikawa Yoshifumi, who also serves as president of Sumitomo Mitsui Financial Group Inc. (SMFG) and Sumitomo Mitsui Banking Corp. (SMBC), was asked about the current state of, and outlook for, the Japanese banking industry that greatly affects the fate of the Japanese economy. The interview focused on whether the banking industry will be able to secure stability even if the government imposes a cap of ¥10 million per bank per depositor on ordinary and other types of liquid deposits it will reimburse in the event of a bank failure, starting in April 2005 as planned, following the April 2002 imposition of a similar cap on time deposits under the so-called "payoff" limited deposit protection system.

Q: Major Japanese commercial banks seem to have disposed of the bulk of their NPLs. The banking industry is at a major turning point ahead of the introduction of a full "payoff" system next April. As chairman of the Japanese Bankers Association and president of SMFG, one of Japan's four megabanks, what do you think of the current state and outlook for the Japanese banking industry?

Nishikawa: About a decade ago, there were 21 major commercial banks (city banks, long-term credit banks and trust banks) in Japan. The number of banking groups has now been reduced to nine. The steep reduction, I think, clearly shows the drastic change that occurred in the banking industry over the past decade. Moreover, the amount of bad loans disposed of by banks, including regional banks, second-tier regional banks and *shinkins* (credit associations), during that period reached as much as ¥74 trillion. The Japanese economy at long last appears to be extricating itself out of deflation after remaining in the doldrums for 10 years, with bad loan woes beginning to ease. I believe, however, that developments in the current fiscal year will determine whether the Japanese economy is really heading for a genuine recovery. The banking industry plans to make this fiscal year the "final year" for the settlement of various financial issues so that no destabilizing factors will be left in the future.

Q: Is Japan's financial system safe even if the "payoff" system is implemented?

Nishikawa: Each bank has carried out measures to bolster its financial base and profit-earning capacity ahead of the introduction of a full "payoff" system. Moreover, the government has enacted new legislation to inject public funds into financial institutions in a preemptive way as a safety net for regional institutions.

Q: New realignment dramas are continuing on among megabanks, notably the planned merger between Mitsui Sumitomo Financial Group (MTFG) and UFJ Holdings. SMBC is also involved in such a drama. Why is the reorganization of megabanks under way?

Nishikawa: Large-scale realignments are aimed at substantially strengthening banks' earning capacity and financial bases as well. In particular, banks intend to bolster their international competitiveness with mergers and acquisitions. One aim of SMFG's proposal for merging with UFJ in a move to challenge MTFG is to enhance deals with Small and Medium-sized Enterprises (SMEs). Some critics say SMFG and UFJ share the same SMEs as their customers in the Kansai area (western Japan). But we believe that the SMFG-UFJ merger would rather bolster our ties with them there. Our belief stems largely from the fact that our presence has been strengthened markedly in the Kansai area as a result of the merger between Sakura Bank and Sumitomo Bank that resulted in the creation of SMFG. In addition, people and businesses in Kansai respond sensitively when we launch new businesses. Those who have no managerial experience often stress the need for mutually complementary relations and reducing duplications and waste. I am fully confident that the SMFG-UFJ merger would have the effect of raising efficiency and would not result in a drop in earnings per share at SMFG.

The Japanese Bankers Association's building

Q: What are the challenges facing the Japanese banking industry in the early 21st century?

Nishikawa: The tasks our banking circles need to address this fiscal year can be sorted out into two. First, we need to fully restore public trust in the Japanese financial system. Second, we should return to the starting line as a service industry. Concerning how to restore public trust, this fiscal year marks the final year for major banks to dispose of bad loans in a concentrated manner. Moreover, the full "payoff" system is to be introduced next April. Up until now, the banking industry has done whatever it can to restore public trust in the financial system. As a result, the industry has reached a point where it will be able to achieve the target of halving the ratio of NPLs to total lending at major banks by March 2005 ahead of the time limit set under the financial revival program. The banking industry should never decelerate the current momentum. We need to spur disposal of bad loans and continue to help revive ailing businesses in order to finally resolve the problems left behind following the burst of the bubble economy and leave no destabilizing factors. In particular, the acceleration of corporate revival is the most important task for this fiscal year. We not only need to fully restore public trust but to take a big, proactive step toward future development. I think the keyword is return to the starting line as a service industry.

Q: What kind of specific measures do you have in mind to improve services at banks?

Nishikawa: Needless to say, the banking industry belongs to the service sector. "Catering to customers, responding sensitively to customer needs, offering lucrative products and seeking to do jobs precisely and speedily so as to obtain customer trust." This is the starting line of the service industry. Returning to the starting line, each bank needs to make strenuous efforts to improve its services and continue to challenge innovation with bold ideas and with determination to carry through specific measures.

Prompted in part by the government's deregulation and liberalization of the banking sector, Japanese commercial banks have implemented a wide array of measures to improve services, such as the extension of service hours, establishment of joint outlets with other industrial sectors and over-the-counter sales of investment trusts and insurance products. In order to boost the benefit of customers, I hope more deregulatory measures will be implemented. Specifically, the stage was set in FY 2003 for the entry of financial institutions into the securities brokerage business as well as for the expansion of sales of insurance products at banks. Specific measures, including those to forestall adverse effects, will be considered and implemented from now on. I strongly hope that effective deregulation will be carried out in the interest of customers. Concerning over-the-counter sales of financial products at banks, discussion is under way over concerns that customers may be pressured to buy such products. But no particular problems have yet occurred regarding over-the-counter sales of individual pension insurance policies at banks since such sales were permitted one and a half years ago. Given the drastically changed relations between banks and borrowers to ban on sales of insurance products to particular businesses seems excessive. Such a regulation will not satisfy both banks and corporate customers. Japan lagged far behind other industrial nations in financial system reforms, hampered by barriers thrown up by vested interests. With this fact in mind, I hope genuine deregulation will be implemented in the interest of bank users.

Q: How does Sumitomo Mitsui Banking plan to address tasks in the current financial environment?

Nishikawa: Three years have passed since SMBC was founded through the merger of Sakura Bank and Sumitomo Bank on April 1, 2001. At that time, we vowed as our basic principle to strive to become a bank with the highest level of public trust by meeting the great expectations of our customers and investors and fulfilling our responsibility. Our newly created bank, however, was then surrounded by the severer-than-expected managerial environment as exemplified by prolonged deflation, a renewed fall of stock prices and a major shift of the government's financial policy, particularly the adoption of the financial revival program. Obviously, one of the major tasks facing us is to put an end to the bad loan problem as soon as possible in the current fiscal year. As a greater task, however, we are now doing whatever we can to bolster profit-earning operations. Especially, we attach importance to two business areas – lending to SMEs and consulting business for individual customers.

Traditionally, Japanese banks have asked corporate borrowers to put up assets as collateral on loans and screened loan applications in an individual, uniform way. In addition, they have maintained the strict credit management policy of causing no loan losses. High growth cannot be expected in lending, however, as long as banks stick to such an attitude. It is also difficult for banks to supply funds smoothly to SMEs. Concerning lending to smaller businesses, we need to adopt a portfolio-based credit management policy, under which many small-lot loans are managed as a whole to earn profits while taking risks on the premise that we will incur some loan losses.

We plan to provide loans to businesses with high growth potential but and invest actively in the shares of such companies, and also support them in terms of personnel, managerial know-how and computer systems. We plan to boost investment in growth businesses starting this fiscal year.

Turning to on consulting business for individuals, demand is growing gradually for advice on life plans and financial management as well as for securing convenience in financial deals among individuals against the backdrop of our declining birthrate, the rapid aging of society, changing lifestyle and the development of IT technologies. We do not directly ask customers to buy investment trusts and other financial products and services but offer consulting services so that individual customers can select the most suitable products and services. Our efforts have begun to bear fruit. For instance, the balance of investment trust sales at our bank reached about 2 trillion yen at the end of March 2004, the highest among Japanese banks and the fourth highest among banks and securities companies. Also, sales of pension products for investment purposes at our bank came to ¥380 billion in FY 2003 alone, the highest among Japanese banks and securities houses.

On June 21, we announced a business partnership with consumer finance firm Promise Co. This is because we have not yet accumulated the risk-engineering know-how for individual customers although such know-how is essential for the consumer finance business. We have decided to enter into partnership with Promise to buy time.

Q: Prime Minister Koizumi Junichiro has put the privatization of postal services in FY 2007 as the core of his reform drive. Heated discussion is continuing between the government and the ruling Liberal Democratic Party. The privatization, if realized, may create mammoth corporations. What does the banking community think of that?

Nishikawa: It is an urgent task to reform this gigantic public financial institution because it hampers efforts to improve the efficiency of the financial markets and revitalize them. This year marks a very important year in that the blueprint for privatizing postal services will be adopted. Contentious issues on the privatization of postal services, including postal savings, are being sorted out through talks at the Council on Economic and Fiscal Policy. The banking industry has called for taking appropriate measures to stem the risks involved in each postal service and for minimizing the hidden national burdens. These calls were clearly reflected in the discussions. In addition, council discussions are heading toward our proposal that the government guarantee for new savings at a privatized postal savings entity be abolished. We can give high marks to these points. But some council members maintain that the postal savings system should be privatized while keeping the balance of its savings – ¥200 trillion – unchanged. The principal aim of postal service reform is to shift the huge amount of funds amassed in the public sector through postal savings and kampo postal life insurance to the private sector, thereby improving the efficiency of fund flows. The destabilizing effect of postal savings on the nation's economy will remain even if the postal savings system is privatized and given greater managerial leeway while keeping its current huge size of savings, because the risks involved in privatized postal savings will increase significantly. The privatization of the postal savings system may also adversely affect regional finances. Taking account of these concerns, council members should continue to discuss how best to reform each function of the postal savings system. This, I think, is the main point in postal service reform. I strongly hope that the Council on Economic and Fiscal Policy will discuss these difficult questions from the viewpoint of national economic interests and resolve them one by one with the aim of carrying out fundamental reform in line with Koizum's basic policy of entrusting what can be done by the private sector to that sector before drawing up a final reform plan in a few months. JS

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