

Changing Climate for Foreign Banks

Interview with Raymond Wareham, vice president of Morgan Guaranty Trust Co. of New York, Tokyo Office by Glenn Davis

Historically, foreign banks in Japan played the role of marginal lenders, meeting the incremental borrowing needs of Japanese companies, especially during the capital-short growth period of the '60s and '70s.

So says Raymond Wareham, vice president of Morgan Guaranty, one of the United States' largest and most successful banks. In this interview, he described how foreign bank participation in Japan is changing, and where Japan's current liberalization of its capital and financial market could lead.

Q: *Could you give us some background information on how and when Morgan Guaranty got started in the Japanese market and some personal information about yourself?*

Wareham: On the second part first, I have been in Japan for about three and one half years. I came here from New York where I was involved in U.S. domestic banking activities. I did an MBA at Harvard University after having served as an officer in the U.S. Navy. Before entering the navy I earned a degree in industrial engineering at Northwestern so I guess that I came to banking with a varied background.

Morgan Guaranty, assetwise, is about number five among banks in the United States, although we rank higher on a profitability basis. Our bank is committed to primarily serving corporations, central banks, and governments around the world. Our strategy is rather narrowly defined in that our customer base is a smaller group than many of our competitors'. That strategy exists for us at most of our locations throughout the world. Although we do work with individuals and smaller companies, the primary thrust of our business is with larger institutions. J.P. Morgan & Company is our holding company whose principal asset is Morgan Guaranty Trust Company of New York. We strive to maintain the capital position of the bank as large as possible as this gives us a larger lending limit.

Morgan Guaranty originally established a representative office in Japan in 1961. Later, we received a license to open a



Vice president Raymond Wareham of Morgan Guaranty

branch here (1968). We were the first "postwar" bank (a foreign bank granted a new license to operate in Japan after World War II) to come into the Japanese market. There were a few licenses granted long before the war...

Q: *Was your bank involved in Japan before that?*

Wareham: Yes. Our bank has had a relationship with the Japanese government for a long time, dating back to the old days of Mr. Morgan himself, when the original J.P. Morgan & Company underwrote national bonds. Probably the most famous of these were the earthquake bonds issued after the Great Kanto Earthquake (1923). Fortunately, our relationship with the Japanese government has always been very warm and cordial. When our branch actually started up operations here in early 1969, Japan was a capital-short country so our job then was to provide foreign capital. We were restricted as to how much we could bring in, however. In the late '70s, and increasingly since then, Japan has started to become a capital-exporting country. The financial needs of the country therefore have changed dramatically. Our principal function here now is really a mirror-image of our role in other major markets. We are seeking to provide a full range of banking services, whether "asset" or "liability" related. By referring to "asset" related, I mean banking products to assist in the management of money and investment portfolios of clients, while "liability"

related refers to borrowings that a company might make, either here or abroad. This is the same strategy that we have in the United States.

Q: *How would you evaluate the differences in your role in the United States and your role here?*

Wareham: In Japan, we are a small part of a big pie, while in the United States we are a big part of a big pie. In terms of differences, our position in Japanese banking activities is necessarily smaller because we are a foreign institution. Last year, however, we created a joint-venture leasing company specializing in computer leasing. Our partners are IBM Japan and Orient Leasing. That is a new venture for us in the Japanese market, and is slightly different from the business in which we're involved in the U.S. market. It has been very successful. Also, our subsidiary Morgan Guaranty Ltd. is a very substantial factor in Japanese Eurobond issuances these days and enjoys a larger market share than for the same activity in other markets.

Q: *Would that new leasing company be considered in the category of venture capital?*

Wareham: I don't think so. It is rather a business venture in a market already developed and in this case we felt that the partnership could bring resources to bear that would allow business to prosper. Orient Leasing, after all, is the biggest of all Japanese leasing companies, and IBM Japan has a premier position in office equipment.

Q: *What happened after you opened up your branch here in 1969? Did you see rapid expansion or was it more gradual?*

Wareham: It was not rapid. We were constrained as to the amount of loans we could make. We were under the very strict scrutiny of the Bank of Japan (BOJ) and the Ministry of Finance (MOF) so on the whole growth was more on the gradual side. The changes in the regulations that have been occurring since December 1980 have really begun to expand our loaning capabilities but our competitive edge here has not improved because there are a growing number of financial intermediaries (Japanese and foreign) chasing an increasingly smaller amount of, for ex-

ample, loan business. We have had to look to other products and services to provide us with growth.

Q: *Did that altering of the rules in 1980 (revision of the Foreign Exchange and Foreign Trade Control Laws) have any effect on your funding swaps here in the Japanese market?*

Wareham: We have been operating until recently under the guidelines of the BOJ as to the amount of swap-yen that we could create to fund ourselves here. That is a limitation which was periodically reviewed by the BOJ, and our allocation of swap limits was periodically increased. From time to time that has been a very valuable way for us to finance our branch. As this limit steadily was increased, our ability to use the Euroyen market was enhanced. I don't think this is specifically tied to the December 1980 liberalization however. All banks are free to use this market under the new guidelines.

Q: *Could you describe the role or niche of foreign banks in the Japanese market and whether this is expanding or not?*

Wareham: Historically, the foreign banks have been marginal lenders who have come in to satisfy incremental borrowing needs that Japanese companies had, particularly during the capital-short period of growth during the '60s and '70s. In that sense, the foreign banks provided an important avenue for the introduction of new capital. Foreign banks have also acted as a stimulus for new ideas. We have been innovative in bringing in fresh concepts that were developed in other markets such as the U.S. and then helping teach Japanese clients how to use these new tools; concepts such as long-dated foreign exchange and hedging practices are examples. Interest rate swaps have become a big new market for Japanese companies now but this idea was first developed offshore, I believe. I expect that the foreign banks are going to continue to provide that kind of innovation. Japanese bankers are good learners and are astute in overseas markets so their ability to be more innovative will grow, with experience. As I mentioned earlier, Morgan Guaranty's total focus is on corporate-type business and the arrangement of monetary flows internationally, so we naturally think the trend toward liberalizing Japanese money markets is great since it provides us with the chance to operate in a more complete way in the markets that we want to be involved in.

Q: *In Korea, a foreign banker explained to me that their role there was to act as an intermediary of foreign exchange rather than deal in local currency. And so when the balance of payments levels out, when Korea is no longer a net borrower, their role there would be reduced to a marginal level. Is that sort of thing happening to you here in the Japanese market?*

Wareham: As far as we are concerned, the majority of our business here is conducted with domestic corporations, and is largely in yen. It may be that some of the smaller banks are feeling this sort of squeeze because the impact loan business became very competitive for foreign banks when the Japanese banks were permitted to enter that market several years ago. As foreign banks have had to respond to that change by creating new business opportunities, some have no doubt had trouble. One aspect of the new liberalization is to allow us an unlimited swap capability but it also allows Japanese banks, for the first time, the opportunity to create yen through swapping. There were times when the swap limit was very valuable to us because we could create yen cheaper for short-term lending than other domestic borrowing alternatives in the local market. Now that Japanese banks can source themselves overseas as well, our competitive advantage in that particular strip of business is gone and that will hurt those foreign banks that can't find other places to generate the lost profit.

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Q: *Since you don't have an offshore dollar market here in Japan like you have in Singapore and in Hong Kong, does this make overall Asian strategy easier or more difficult from the Japanese market?*

Wareham: Japan has developed as a very major economic force in Asia, not to mention the rest of the world. Trade involving Japan with other Asian nations is very substantial. With respect to financing opportunities from here for Southeast Asia which would be an important part of our Asian strategy, I would say that it is somewhat limited in the sense that there has been a relatively modest demand for yen by borrowers in Asia except for governments and semi-governmental institutions which have been increasing their yen borrowings. The yen loan syndication market is an area where we've participated in the past in a small way but we expect to play a bigger role in the future. The latest Indonesian yen private placement is a good example. Morgan Guaranty was a lead manager, a first for a foreign bank. There used to be controls on yen loan amounts to non-residents until only recently. The dollar market to non-residents in the region is not as interesting to us because we can fund these loans from other offices (like Hong Kong) more read-

ily, and cheaper, particularly due to withholding tax considerations applying to Japanese sourced loans to some private borrowers in certain countries. To the bank overall, not having an active offshore dollar market in Tokyo, therefore, is not materially detrimental to our Asian business. We are really focusing on the opportunities involving Japanese business from our Tokyo Branch because this market, as it interacts in a variety of ways with the markets of Europe and the U.S., Japanese domestic business opportunities, and growing overseas investment by Japanese, is enough to keep us all busy for a while.

Q: *How will the most recent economic package affect capital flows in and out of Japan, and will it directly contribute or detract from your business in the Japanese market?*

Wareham: From our branch liability side, by which I mean the way in which we fund ourselves, it expands our ability to source the cheapest funds locally. It also allows us to source more yen from sister offices, which was previously restricted. It will give us more freedom to issue yen-denominated certificates of deposit (CDs). The lowering of the ceiling for CDs from ¥300 million to ¥100 million is not in and of itself significant but the reduction of the term from three months to one month could very well be. Our international network should allow us to take advantage of the new market opportunities from here.

We will also be able to play a larger role in yen-loan syndications and direct loans to non-residents, as I mentioned before, thus expanding our asset base possibilities. On the foreign exchange side, the abolished "real demand rule" will allow Japanese corporations to cover risks in foreign exchange more freely. This will encourage offshore foreign currency bond issuance, for example, and hedge it back into yen immediately. All Nippon Airways just did this successfully. When we are allowed to trade in Japanese government bonds, this will give us another area of new opportunity. The same is true for overseas-issued commercial papers or negotiable CDs after they are allowed to be sold here, for investment purposes. Freedom is what we really are after here because that would allow us to do what we do best. I would have to add, however, that we are cautiously optimistic about the new liberalization package, as many details of its implementation must be resolved.

Q: *What about some of the other aspects of the package such as whether foreigners will be allowed to enter the Tokyo Stock Exchange?*

Wareham: Regarding entry to the TSE, we are not licensed to be a stock broker here (like some of the American investment banks) and this seems to be a prerequisite. We would certainly like that option in due course.

Q: *What about the point of opening up the trust business here to foreigners? Isn't that what you're most interested in?*

Wareham: Our understanding is that MOF will accept applications from "qualified foreign banks" for entry into the trust sector but the snag, of course, is that nobody knows how to exactly define "qualified." I would hope that if anyone is "qualified" it would be Morgan because we are the largest in that business in the U.S. and we have the international know-how to carry it off. Overall, it seems clear that MOF has designed this package in the best interest of Japan. The Japanese financial system itself is compartmentalized, in that different types of financial institutions play very specific roles and there was not too much overlap in the original design. Trust banks are concerned because this is their lifeblood. MOF must also be quite aware, however, of the demographic trends in Japan, and the growing need for funded pension liabilities and effective and flexible pension fund management that will evolve along with the needs of a greying of the society. The system, therefore, must be made more flexible. It will not be a bonanza for foreign banks; it's going to be tough... but we're optimistic.

Q: *Would you say that your current market share here is due to your competitive edge or to the need of the Japanese for foreign exchange?*

Wareham: Historically, our market share here has been a function of the need of the Japanese government for foreign exchange but in the future we'll have to carve out a larger share of the Japanese market with our own talent and innovation. The internationalization of the yen and the sophistication of the Japanese capital markets play into our strengths, so we are excited about our future here.

Q: *Do you believe that the so-called weakness of the yen is really the key issue in terms of trade imbalances?*

Wareham: Many economists would argue that the exchange rate will not find its proper economic level without the free flow of funds in international markets. The push to allow for the broader creation of the Euroyen market was aimed at giving investors a freer hand, thus allowing market forces to take care of themselves. Although many people feel that the yen is undervalued, the new package hasn't had any effect at all so far; in fact, it's been the reverse recently due to U.S. dollar interest rates. The Japanese authorities have indicated that they are not interested in allowing the Euroyen market to go wild with growth. I'm not sure it would, at least immediately. Until the withholding tax issue is settled, we won't see much development of the long-term Euroyen market, particularly for non-governmental private corporations.

Q: *In the long-term perspective, do you see the yen internationalizing and becoming a world reserve currency?*

Wareham: It has to come because the yen's role is too small now, but it will not reach the level of the DM or the Swiss franc soon. We'll have to see more invoicing done in yen; the emerging yen banker's acceptance (BA) market here may contribute to that development. Japan's role economically is too large for the yen not to become more important.

Q: *Does the traditional Japanese system of administrative guidance cause problems for you in relation to MOF and other ministries?*

Wareham: We aren't treated unfairly because we are a foreign bank. My own feeling is that there has been a substantial change in the attitude of the Japanese government, particularly since the 1980 revisions. Generally speaking, we now inform ministries instead of asking permission, and that is a big change. The government now acts more as an overseer than as the traffic cop of yesteryear. The relationship with MOF and BOJ is very important here just as it is for us in the U.S. with the Federal Reserve Board.

"I think that Western corporations are revaluating Japan as a place to invest."

Q: *Does Morgan Guaranty also carry out philanthropical activities in Japan as it does elsewhere?*

Wareham: Yes, we do. We have a substantial budget for a variety of programs here. Funds are earmarked for contributions primarily to schools, and universities. We have an internal committee which reviews applications and provides allocations.

Q: *What is the possibility of an offshore dollar market being set up here in Tokyo in the future?*

Wareham: That idea has often been discussed. It was a hot topic a couple of years ago but it seems to have quieted down now. As Tokyo develops into a major center for international finance, this type of market will have to be set up but it is not critical at this stage, from our standpoint. The superstructure and communication aspects are already in place in Tokyo so it wouldn't be difficult to do. Tokyo could no doubt play a larger role with the proper freedom in this area, as New York has with its international banking facilities (IBF), particularly given Japan's political stability.

Q: *Do you find Japan's future role exciting or disappointing? Will you be involved in the technopolis idea, for example?*

Wareham: We will be involved in the

sense that we will be trying to finance this move to spread industrial production throughout the country. We are studying the possibility of working with the Export-Import Bank of Japan or Japan Development Bank on this effort. I think that Western corporations are revaluating Japan as a place to invest. Unfortunately, there have been relatively few success stories of foreign investment here, but American companies are now thinking that they want to get a stronger foothold in Asian markets because of the region's dynamic growth and vast human resources. We are now seeing these companies coming here again to take another long, hard look at Asia, and particularly at the Japanese sector. Japan, on the other hand, must continue to encourage these companies to invest and to be successful, since it is one way to diffuse the trade friction issue. The other way, of course, is for Japanese companies to invest more in overseas markets and this has indeed been happening over the past few years. The flow has to go both ways and our knowledge of international markets puts us in a good position to act as financial intermediaries for both sides. The Toyota-GM joint venture is an interesting example of the new cooperation between Japan and other countries. Nissan's commitment to overseas investment is impressive. The Merck-Banyu tie-up is yet another example of how the Japanese market is opening up. These developments are exciting not only in terms of finance but also in the realm of international relations. To answer your question... we are very excited about the possibilities, and we're optimistic.

Q: *Let me wind up by asking what have been some of your most rewarding and frustrating experiences in Japan so far.*

Wareham: My Japanese staff and clients have all been very patient with my slowness in mastering their language. I guess my biggest frustration has been in not being able to communicate in that way. A Westerner here has to be patient and diligent to get along. The Japanese way of doing business is unique so we, as guests here, have to try our best to learn the differences. We at Morgan have worked hard to develop a style of management comfortable to our Japanese staff. Since I came here, I have personally changed my approach in two ways: to speak more slowly, since I now understand how it feels for someone to speak to me in Japanese too quickly, and secondly, to be more patient. The Japanese way of relaxing is also different; take *karaoke* (singing songs while drinking) for example. We Americans are sometimes too inhibited, I suppose, but *karaoke* singing is one of the many aspects of Japanese culture which should be tried by foreigners here. It can be a good laugh! ●