Japan's "Big Bang" and Japanese Consumers

By Hamano Takayoshi

Japan announced in mid-June an outline of deregulation measures designed to achieve Prime Minister Hashimoto Ryutaro's pledge to carry out a sweeping "Big Bang" financial reform by 2001. Some critics say the reform program does not fully reflect the viewpoint of consumers. What is Japan seeking to achieve through the "Big Bang"? What impact is it going to have on the average consumer? The following analyzes the proposed overhaul from these perspectives.

What is the "Big Bang" for?

As is now widely known, the reform program is modeled after London's 1986 "Big Bang" securities market overhaul. The first step toward the Japanese version was taken in November 1996, when Hashimoto ordered his finance and justice ministers to jump-start the process. Its primary objective is, in a word, to do away with the conventional administrative policy of keeping all financial institutions—both large and small, strong and weak—afloat irrespective of their competitiveness. The policy, often compared to a convoy of vessels limiting its speed of navigation to the slowest of all the ships, was designed to prevent the weakest of financial institutions from going under, giving top priority to maintaining order in the financial sector and thus allowing smooth funding for Japan's economic machine. The "Big Bang" program was blueprinted by five advisory panels reporting to the Minister of Finance, including the Financial System Research Council, the Securities and Exchange Council, and the Insurance Council, on the basis of three principles—free, fair and global—which were little heeded under the old "convoy-style" policy.

One question that might be asked about the "Big Bang" is "why now?" One major factor is the sense of crisis harbored by the Hashimoto administration over Japan's tightly-controlled financial markets. The government is concerned that an increasing number of foreign financial institutions including brokerage houses may find it unattractive to do business in Japan because of many restrictions, eventually opting to abandon the Japanese market and thus causing a "hollowing out".

Another factor is the pressing need to revitalize the Japanese financial markets in order to make full use of swollen personal financial assets in Japan, totaling ¥1,200 trillion.

Details of the "Big Bang"

Reform measures sketched out in the "Big Bang" program are highly technical and not easy for the average consumer to understand. The following are issues that are considered closely associated with consumers. In the first place, foreign currency dealings, which are currently limited to financial institutions authorized as foreign exchange dealers, are to be liberalized in April 1998 and appropriate legal revisions have been enacted. The decontrol means there will be no limits on who can deal in foreign currencies. Since anyone can do so, small shops buying and selling U.S. dollars may crop up one after another.

The reform blueprint also calls for liberalization of banking, securities and insurance businesses. Most sweeping are overhaul proposals for the securities sector.

In the sphere of deregulation, for example, any new company seeking to enter the securities market is currently required to obtain a license from the Ministry of Finance. But the program calls for the licensing system to be scrapped and for newcomers to be allowed to start securities business merely by registering with the ministry, beginning in fiscal 1998. The switch from licensing to registration will make new entry easier and thus promote competition. It will also lead to a change in the conventional policy of preemptive control that is primarily designed to fend off problems in the securities industry. Preemptive regulations tend to result in restrictions on competition. Under the proposed registration system, it is expected to become easier for the securities industry to step up competition—the kind of performance that the industry should display as its natural mechanism.

The reform program also suggests that securities companies be allowed to introduce comprehensive accounts in which consumers can have their portfolio investments like better-yielding money market funds (MMF) deposited, and charges for electricity, gas and other utilities withdrawn. Such accounts are limited to banks at present.

Commission fees investors pay to brokers in stock trading are freely decided for deals exceeding ¥1 billion each. The reform proposals contain one calling for the minimum amount to be lowered gradually and for brokerage commission rates to be completely liberalized, like in the U.S. and Britain, by the end of 1999. Some criticize the plan for being too slow-paced, but the eventual liberalization is bound to make commissions less costly.

In a move associated with the commission issue, the reform package recommends that the legal obligation to have all securities transactions conducted through authorized markets be abolished after 1999. This will allow investors to trade listed securities outside the market.

The commission decontrol will also make it possible to launch "wrap accounts" which are reportedly popular with U.S. investors. Through such accounts, securities companies manage and invest assets of customers, at their own discretion or by referring such services to investment advisory firms, in return for specified commissions. In the U.S., it is reported to be general practice for brokerage houses to levy no charges on their clients for each specific securities deal once investors pay commissions for the whole of wrap account services.

Entry to each other's turf

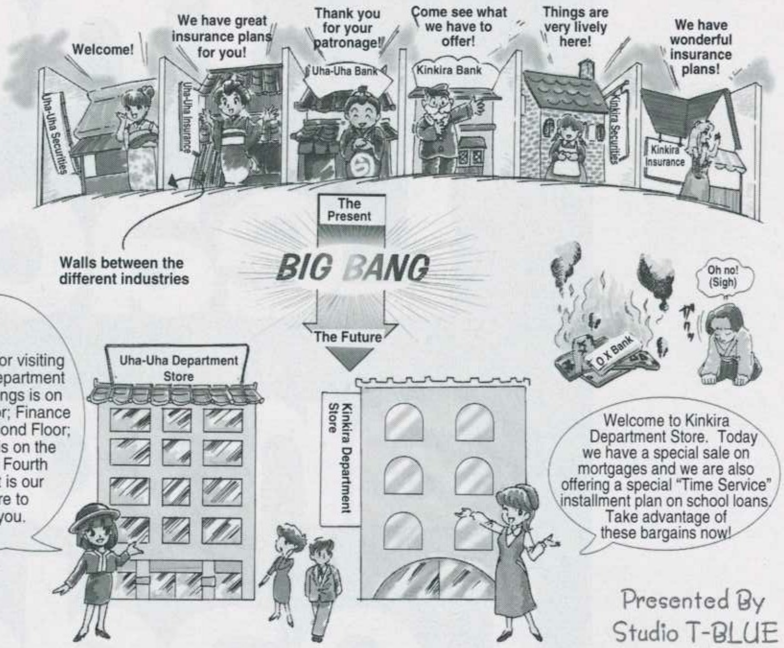
After the proposed "Big Bang" reform, it will become possible for the banking, securities and insurance industries to enter each other's turf to step up competition. Banks, trust banking companies and securities houses have already been allowed to do each other's businesses through subsidiaries, but there are restrictions on the scope of business those subsidiaries can undertake. The reform program calls for all restrictions to be removed by 2001. Mutual entry between the insurance industry and banking, trust and securities industries is also to be realized by that year.

Given the generally strong clout of banks in Japan, other financial industries are extremely sensitive to banks entering their domains. One contentious issue in this connection is the question of allowing banks to sell insurance policies over the counter. It is supposed that banks can only sell two types of insurance related to mortgage loans even in 2001—long-term fire insurance linked to property and credit-tied life insurance for borrowers. The insurance industry appears reluctant about liberalization, not just in connection with the banking sector, but in other aspects as well. However, Japan assured the U.S. under their insurance deal struck at the end of 1996 that it will liberalize fire and auto insurance premium rates by July 1998 so each company can set them freely. Thus, aside from its pace, the tide of liberalization cannot be reversed.

What if a failure occurs?

Uncertainty has spread among consumers over the financial soundness of insurance companies in the wake of Nissan Mutual Life Insurance Co.'s collapse.

If a bank fails, account holders are assured of having their deposits refunded for up to ¥10 million each under a deposit insurance system. But such pro-



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tective mechanisms are insufficient in the insurance and securities industries. The reform program singles out the need to institute a system to protect insurance policy holders and securities investors from unexpected losses in the event of companies becoming insolvent. For the insurance industry, a payment guarantee system is being discussed. The Securities and Exchange Council has proposed that new, comprehensive legislation such as a financial services law be considered to lay down across-the-board rules to protect a whole range of investors participating in financial markets, not just securities investors.

As mentioned above, the planned reform is an ambitious program intended to drastically change Japan's financial system, including securities, insurance, foreign exchange and corporate accounting, which has governed the nation for half a century since the end of World War II. But several challenges have yet to be addressed before the various reform proposals can be implemented. They include the question of whether a government panel of tax advisers will endorse the elimination of securities transaction and stock exchange taxes, as strongly sought by the Securities and Exchange Council. Another challenge will be how to lay down specific rules of conduct and tighten discipline for corporate executives to prevent a recurrence of banking and brokerage payoff scandals that have plagued the respective industries.

All five advisory councils to the Ministry of Finance involved in drafting the reform package have suggested that consumers bear responsibility for their own commitments to the financial sector, since the overhaul will make all vital information available to them. Consumers must make full use of disclosed information to select financial products with better returns. If consumers face dealers and brokers ignoring the rules of the game laid down after the "Big Bang" reform, they should penalize such wrongdoers in the marketplace by, for instance, terminating deals with them.

Regarding the effects of the "Big Bang" reform, some experts say it may end up like the prestigious Wimbledon tennis championships, which Britons seldom win. The overhaul may liven up Japan's financial markets indeed, but foreign competitors may dominate them. Aside from that prospect, what is vital is to make the overhauled market truly benefit domestic consumers. JJTI

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