Banks, Stockbrokers Step Up Competition

By Keiji Watanabe

The race between Japanese banks and stockbrokers to develop new financial commodities is escalating. In the past, such competition reflected the growing need to respond to customers seeking ever higher returns on their investments. However, the recent escalation in this competition stems more from the long-standing rivalries between the two sides than from any immediate consideration for customers.

An intensified competition to develop higher-yield financial commodities means greater cost burdens on banks and brokers. Hence the view in some quarters that restraint should be exercised to take the heat out of the competition and give greater attention to customer needs.

In the past, financial commodities were developed separately by banks and brokerage houses. Major commercial banks, for example, never tried to expand into the fields occupied by securities companies. By the same token, securities firms never attempted to trespass on the traditional business ground of commercial banks. Now, however, there are growing indications that all this is changing. There are even moves between competing banks and brokers to develop and market new money instruments on a joint basis.

A Tokyo stock brokerage firm: business competition with banks is heating up.

Mass production & marketing

"What's happening now is mass production and mass marketing of financial commodities," said an executive of a medium-sized city bank. "Sooner or later banks and brokers will have to pay the price." He made this grim remark in reference to the rush that began last autumn for the development of new financial commodities. Asked if his bank would stay out of the fray, the banker, however, replied, "No, we can't afford to sit on the fence. If my bank doesn't sell the same commodities that are available at other big banks, our image among our customers will suffer. Reason dictates that we stay away from the race, but reality demands that we join it."

The competition for new financial commodities was initiated by Mitsubishi Bank, the fourth largest city bank in Japan. Last August the bank offered a "national bond time deposit account" by combining a fixed-date time deposit plan, its mainstay commodity, and 10-year government bonds. The new account proved so popular that sales reached ¥15 billion (US$62.5 million) in a single day.

The secret behind the explosive popularity of this new commodity was the high yields, which averaged 9.366% a year at the time (8.91% as of January this year; tax exempt). That was the highest level of yields among the commodities offered by

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Japanese financial institutions at that time. Until then the highest yields had been offered by the new loan trust fund "Big" (8.92% on the average then), a joint plan of seven trust banks, and by the new bank debenture "Wide" (8.90%), sold by three long-term credit banks. Both commodities had a maturity of five years, compared with 10 years for the Mitsubishi plan. Given the longer period of the latter's deposit account, it was natural that it should yield a higher interest than the other two commodities. Mitsubishi's national bond time deposit account proved especially attractive to interest-sensitive customers.

The move by Mitsubishi Bank prompted its rival city banks and some local banks to offer similar accounts the following month. And in the same month trust banks and securities firms jumped on the bandwagon by selling higher-yield commodities of their own.

The commodity developed by the seven trust banks was a combination of money in trust and 10-year government bonds. Dubbed "Double," this national bond trust account, as it was formally called, yielded an average return of 10.92% a year at that time. The securities firms' plan, labeled "Hipack," was referred to as an "integrated compound-rate account," combining their public and corporate bond investment trust funds or medium-term national bond funds and 10-year national bonds. Its average annual yield at that time was 11.31%.

All of these commodities carried higher rates of return than the national bond time deposit accounts offered by the city banks. Trust banks, therefore, publicized their commodities on this point. The brokerage houses in turn emphasized the advantage of their own commodities over these trust bank accounts, in an obvious move to outrival the banks.

The race to develop higher-yield commodities continued. The sale of 10-year financial commodities in September was followed only a month later by the marketing of medium-term (2–4 years) commodities. Once again, the pace was set by city banks. October was the month in which banks were allowed to begin selling medium-term government bonds over the counter. Seizing this opportunity, major banks created a "medium-term national bond time deposit account" combining fixed-date time deposits and medium-term government bonds. The swift action revealed their irritation over the fact that Mitsubishi Bank had stolen the march on them in the field of 10-year bond time deposits. They felt they could not afford to lose out a second time.

Trust banks and brokerage houses lost no time offering their own plans incorporating medium-term national bonds. Trust banks offered medium-term national bond trust accounts, while securities firms created medium-term national bond integrated compound-rate accounts incorporating various types of investment trusts.

Three long-term credit banks also entered the fray. The Industrial Bank of Japan, the Long-Term Credit Bank of Japan and the Nippon Credit Bank offered their own commodities, called the "national bond discount bank debenture account," a combination of five-year discount debentures and 10-year government bonds. Their average yield at that time was 10% a year.

City banks move to bridge gap

Two reasons may be cited for the positive moves by banks and securities companies, particularly the latter, to develop new financial commodities. One was that customers had become highly sensitive to interest rates. The other was that the banks found it easier to sell new commodities because they could now sell government bonds directly to customers.

The Finance Ministry is usually reluctant to approve the sale of new commodities by banks and brokerage houses. However, it is willing to approve variations of commodities already in the market.

This *modus operandi* of the Finance Ministry has adversely affected the banks, particularly the ordinary banks (city banks, local banks, mutual loans and savings banks, and credit associations) which have only one conventional type of commodity—deposits. These are mainly time deposits (one or two years) and fixed-date time deposits (two or three years) incorporating a system of compound interest rate calculation.

However, none of the interest rates for these accounts exceeds those offered by the "Big" accounts in the trust banks or the "Wide" accounts in the long-term credit banks. Nor do these commodities of ordinary banks compete favorably with the medium-term national bond funds offered by the securities firms—accounts which carry higher interest rates yet can be withdrawn as conveniently as demand deposits. In a move to counter competition from these attractive commodities, major commercial banks applied to the Finance Ministry for permission to offer three-year time deposits. However, the application is still pending, on the grounds of opposition by the long-term credit banks and trust banks.

Nevertheless, the start of over-the-counter sales of medium-term government bonds at the banks last October, which followed a similar anthorization for 10-year bonds in April the same year, opened the way for them to develop variants of these commodities. In a way, the pent-up discontent on the part of the banks triggered an escalating race for new financial commodities.

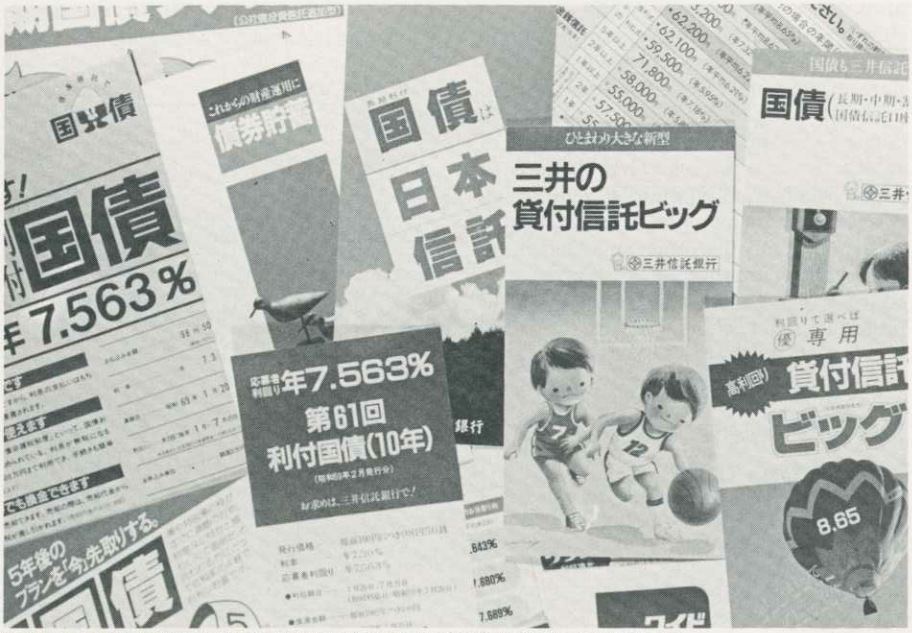
Expected Yields of Major Financial Commodities (as of end of January 1984)

Ordinary banks	
Demand deposit	1.5%
1-year time deposit	5.5%
2-year time deposit	5.75%
2-year fixed-date time deposit	5.915%
3-year fixed-date time deposit	6.086%
10-year national bond time deposit account	8.91%
Post offices	
Demand deposit	2.88%
1-year time deposit	5.5%
Fixed-amount deposit (1-1½ years)	4.5%
Trust banks	
5-year "Big"	8.65%
5-year loan trust	7.32%
10-year national bond trust account	10.42%
Long-term credit banks	
5-year "Wide"	8.624%
5-year interest-bearing bank debenture	7.30%
10-year national bond discount account	9.55%
Securities companies	
Medium-term national bond fund	5.475%
10-year integrated compound-rate	10.80%

Move toward higher-yield commodities

The growing customer preference for higher interest rates is evidenced by the fact that a huge volume of money flowed into the "Big" and "Wide" medium-term national bond funds that yielded higher rates of return, not into bank deposits.

According to a report from the Bank of Japan, the aggregate balance of individual savings stood at ¥379,657.9 billion ($1,581.9 billion) at the end of March 1983 (the report covers fiscal 1982—April 1982 to March 1983), an increase of 10.5% over the year before. However, a breakdown by type of financial commodity shows a different picture. While bank deposits and postal savings increased by 8.6% to ¥251 trillion ($1,045.8



Banks and stock brokerage firms put out a wide variety of leaflets to attract customers.

billion), trust funds expanded by 14.5% to ¥21 trillion ($87.5 billion), and portfolio investments rose by 13.3% to ¥42 trillion ($175 billion). The central bank concludes that all this reflects the large increases in "Big" loan trusts, "Wide" bank debentures and investment trusts (medium-term national bond funds).

Subsequently, both banks and securities companies believe that developing higher-yield commodities is the only way to collect funds competitively. Major commercial banks are still calling for approval of their planned three-year time deposit accounts. In the meantime, banks and brokers alike are preparing to develop new commodities using maturing government bonds. This is because a large portion of the bonds issued in and after fiscal 1975 are due to mature beginning in fiscal 1985. It is widely expected in the financial community that "moves to develop higher-yield financial commodities will pick up momentum," as one city bank executive put it.

However, the escalating race for such commodities is causing many problems for financial institutions. One problem is competition with existing commodities. Another is the increased cost-push pressure on management.

The increased cost burden

For example, the medium-term national bond time deposit account created by banks in October competes directly with their existing mainstay commodities—two-year time deposits, fixed-date two-year time deposits, and fixed-date three-year time deposits. It is likely that some of these deposits will shift to the new bond time deposits. Similarly, the two-year loan and money trust funds of trust banks compete with their medium-term national bond trust accounts.

Bankers in charge of deposits, however, believe that development of new commodities is still necessary to prevent the flight of funds from banks to brokerage houses. Says one such banker: "We have to face the problem of competition. If we don't develop new commodities for fear of competition with our existing commodities, some of our deposit money will move to more profitable commodities offered by securities firms. If we are to prevent this and keep our deposit money within our own bank, we'll have to accept such competition."

Yet this positive attitude pales before the problem of higher costs that new commodities will impose on management. In the United States, now in the grip of a banking revolution, one ailing financial institution after another has gone under or been absorbed by larger institutions. Some in Japan's financial community now fear that a similar situation could develop in this country.

Liberalization of rates

In America interest rates have been deregulated under legislation enacted by Congress in March 1980. As a result, a variety of new free-interest commodities, such as MMF (money market fund), MMA (money market account) and Super NOW (negotiable order of withdrawal), has come into being. These new commodities, however, have increased the cost burden on U.S. financial institutions. A survey reported that the interest rate war in the United States could cause a sweeping shakeup of the country's banking industry with the number of banks, now at 15,000, reduced to 9,600 in 1990. Among the institutions likely to be hardest hit are smaller banks such as savings and loans associations.

A Bank of Japan official said that what is happening across the Pacific could also occur in Japan. "If the interest rate war continues, it will make a banking industry reorganization unavoidable, if not on the same scale as in the United States," he asserted. This view is now widespread in the Japanese financial community.

The Bank of Japan is moving, in fact, toward liberalization of interest rates. The central bank believes that the banking deregulation in the United States will spill over into Japan sooner or later. Now that foreign exchange transactions have been liberalized, capital will flow out of Japan into the U.S. to be invested in the high-interest commodities available there. Moreover, interest rates in Japan will be inevitably liberalized when a massive quantity of maturing government bonds comes into circulation from 1985. These are some of the reasons the central bank considers interest rate decontrol unavoidable.

A liberalization of deposit interest rates would give further impetus to the development of new financial commodities. The catchphrase being voiced by Japanese bankers on the eve of a Japanese-style banking revolution is, in the words of Yoshiro Araki, president of Fuji Bank: "Strong business foundations through efficient and rational management."

Former rivals join hands

As a result, some banks and securities companies are putting aside their traditional rivalries to join hands in the development of new commodities. An example is the linkup between Daiwa Securities and Kyoto Credit Bank designed to combine the medium-term national bond fund of a brokerage house and the fixed-date time deposit plan of a commercial bank.

The two companies, however, are still awaiting the approval of the Finance Ministry, in part because of objections in the banking community. The application for official approval, filed late last year, is expected to go through in due course. The prevailing view in banking circles is, according to a major commercial bank executive, that the Finance Ministry will have to approve sooner or later because the application involves no legal problem.

It appears that the mounting competition in the development of new financial commodities may be entering a new phase, with the initial pattern of rivalry between banks and brokers giving way to a new pattern of cooperation between these longstanding competitors. ●