



Financial Regulation in Japan: A Fifth Year Review of FSA

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Financial regulation in Japan: A quick overview

Before June 1998: Ministry of Finance regulated all banking, insurance, and securities industries; MOF is also the fiscal authority

June 1998: Creation of Financial Supervisory Agency: financial supervision function separated from the MOF (policy formulation function remained in the MOF)

Dec 1998: Creation of Financial Reconstruction Commission: to lead the reorganizations of failed large banks (FRC supervised FSA)



Financial regulation in Japan: A quick overview (continued)

April 2000: Supervision of credit unions shifted from local governments to the (old) FSA

July 2000: Creation of Financial Services Agency; acquires the policy planning function from the MOF

Jan 2001: FRC abolished and absorbed by the (new) FSA



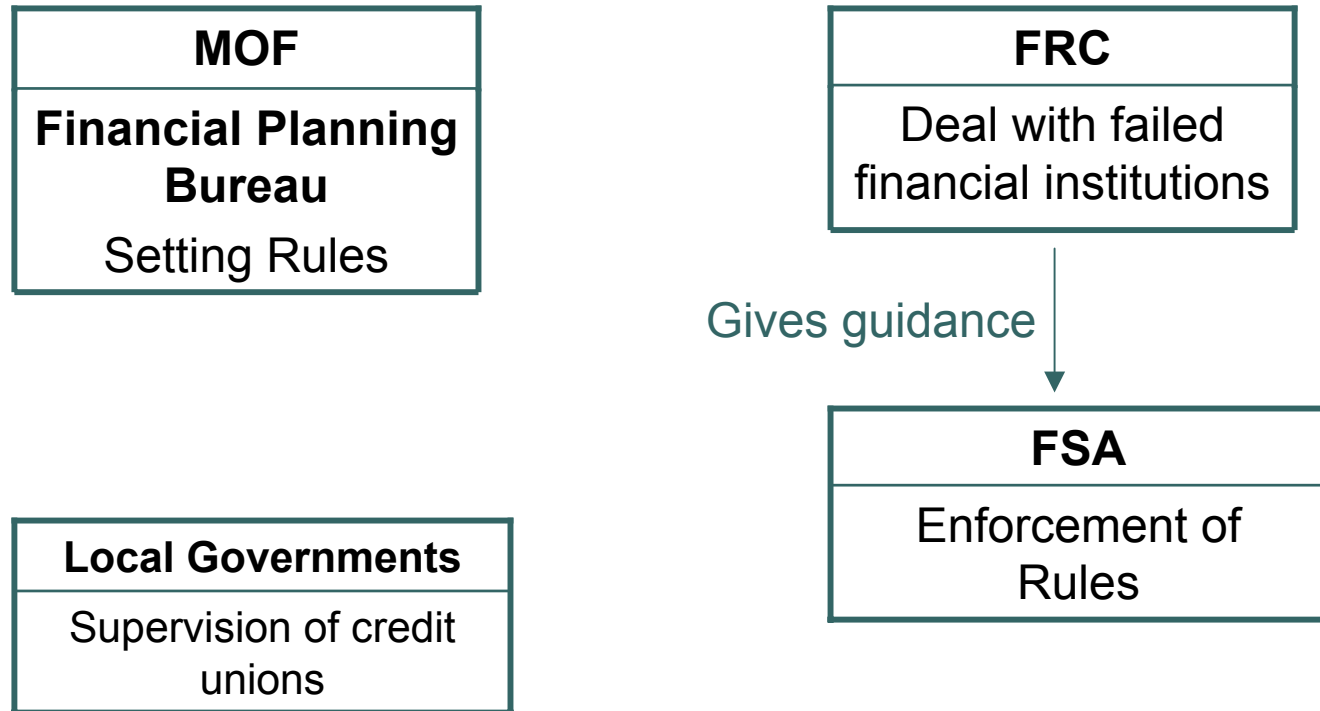
Financial regulation before the FSA

Ministry of Finance		
Banking Bureau	Securities Bureau	Insurance Bureau
Setting Rules Enforcement	Setting Rules Enforcement	Setting Rules Enforcement

Local Governments
Supervision of credit unions

Ministry of Agriculture, Forestry, & Fishery
Supervision of Agricultural Coop.

Financial regulation with FRC and (old) FSA





Financial regulation under the new FSA

FSA

Setting Rules

Enforcement

Cover banks, insurance companies,
securities companies, credit unions, and
others



What motivated the change?

- **Mostly political.** Politicians tried to do anything to reduce the power of the MOF (incl. giving legal independence to the BOJ)
- Some discussion on economic rationales
- Separation between financial policy and fiscal policy (reduce the tendency to forbear out of fiscal concerns)
- Separation between rule-setting and enforcement functions (make it easier to admit mistakes in *ex ante* policy design): only existed between 6/98 and 6/00



Consolidated financial regulation

- Creating a consolidated financial regulator was never an explicit goal
- MOF was a consolidated financial regulator
- More consolidation in FSA (1. added responsibilities, 2. no possible segmentation by bureaus)
- Has the FSA benefited from such consolidation?



Old FSA/FRC moved (relatively) quickly to resolve banking crisis

- Nationalization of LTCB and NCB (late 1998)
- Closure of 5 regional banks (1999)
- Capital injection to major banks (1999)
- Organizational change to separate the enforcement function from the rule-setting function seems to have paid off
- Separation may be especially important when the *ex ante* rules were set with the goal of “no failures”



Enforcement started to decline

- After October 1999, when the first chair of FRC, Yanagisawa was replaced, a series of chairs who were more reluctant to clean up the banking sector followed
- Bank closures and incidences of prompt corrective actions started to decline
- Yanagisawa came back when the new FSA started in January 2001, but new FSA was reluctant to admit the Japanese banking sector is in crisis again
- Problem of having both rule-setting and enforcement in the FSA?
- Can the new Minister Takenaka reinvigorate the FSA again?



Dealing with problem insurers

- Prompt corrective action introduced in 1999, but has been used only once (Taisho Life; February 2000) (although there have been failures of insurance companies during this period)
- More importantly, *de facto* double gearing between insurers and major banks has not been closely regulated
- Cannot see the benefits of consolidation in this area



Lessons from Japanese experience

1. Organizational change can matter. The separation of enforcement function from the MOF made FRC/FSA more aggressive in dealing with bank failures
2. Organizational alone may not change the policy very much. The FSA does not seem to have developed a comprehensive regulatory framework for both banking and insurance
3. A change in financial regulatory structure is dominated by political forces