



# 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



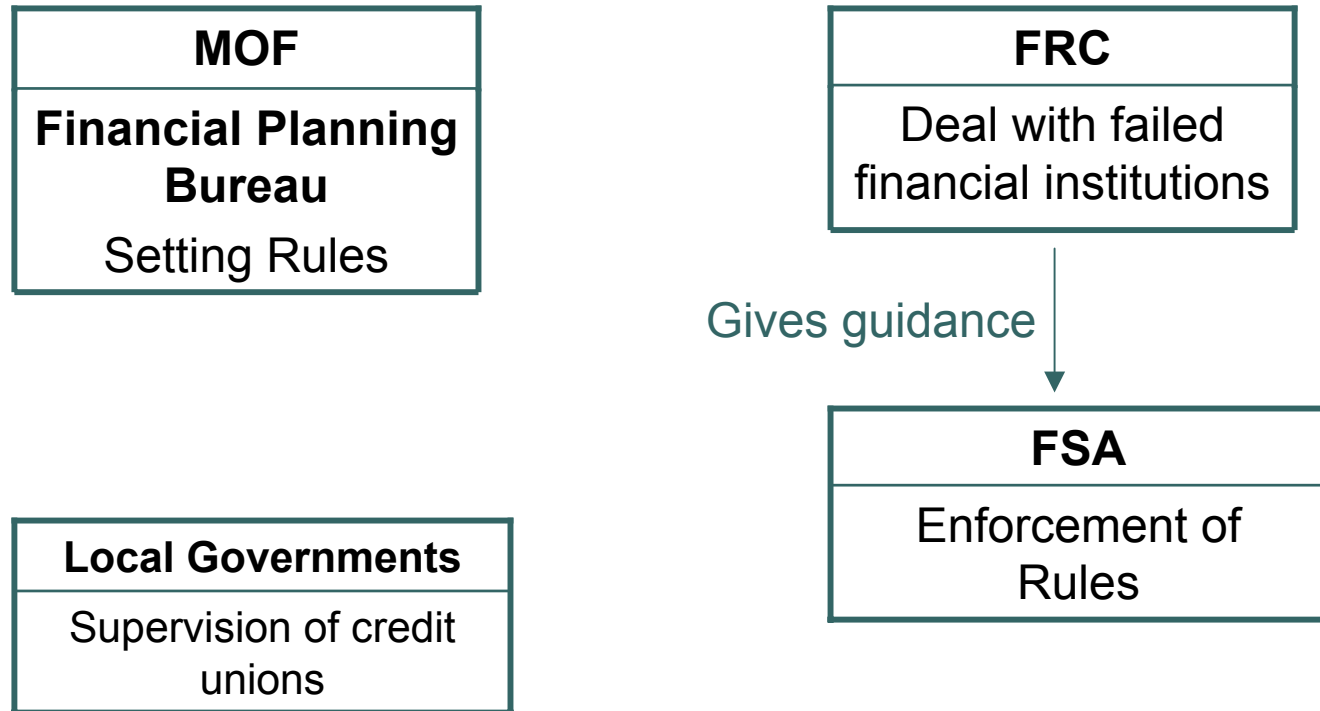
# Financial regulation before the FSA

<b>Ministry of Finance</b>		
<b>Banking Bureau</b>	<b>Securities Bureau</b>	<b>Insurance Bureau</b>
Setting Rules Enforcement	Setting Rules Enforcement	Setting Rules Enforcement

<b>Local Governments</b>
Supervision of credit unions

<b>Ministry of Agriculture, Forestry, &amp; Fishery</b>
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