EUGENE H. ROTBERG

Vice President and Treasurer

The World Bank

Tokyo, Japan, January 1986

PRESENTATION TO THE JAPANESE SECURITIES TRANSACTION COUNCIL

INTRODUCTION

Thank you for the great honor you have given me to present my views on the structure of the financial markets in Japan. I think it may be useful, before discussing some of the controversial and important issues before this Council, to share with you this observer's view of some of the reasons why governments seek to regulate their financial markets. For, I would suggest, it is only by talking about those objectives and understanding the public policy implications in regulating financial markets, that we can reach reasonable conclusions as to why matters are controversial and why it takes so long, with so much time and attention, to change established practices.

I find it useful to ask two questions. First, why do all countries regulate their financial markets to some degree. And, second, why do countries differ from one another in their approach to regulation. The fact is that

while the United States, Germany and Japan may all strive for the same objectives of say, growth in a non-inflationary environment with an open trading system, there are important differences in history and culture and the organization of government and industry which may imply that the regulatory (or liberalizing) approach will be different among them.

Allow me to offer some brief illustrations. In the United States, for example, as in Japan, we have a so-called Glass-Steagall approach to banking and securities functions -- where banks may not underwrite corporate securities and securities firms are not direct deposit taking institutions. I will say more about the reasons for this division later. But, for now, let me simply point out that Germany, by contrast, has a universal banking system, in which all activities are permissible -- securities transactions, banking and trust management -- which has performed in a highly satisfactory fashion as an engine for economic growth within a stable financial context, for more than four decades.

Another illustration is the approach to "accounting" in the United States as contrasted, say, with Japan or much of Continental Europe. In the United States, the virtues of public disclosure and the discipline of the marketplace are claimed as the best protection for the individual citizen who saves and invests with public corporations. The United States is not dissuaded by what may appear to others as inefficiency (and even loss of public confidence) as a result of disclosing in an open way a multitude of financial and management mistakes by leaders in the private sector. Indeed, that same free market can

lead to the takeover or bankruptcy of major institutions with all that implies for both labor and management.

My point is not to contrast or weigh the merits of different systems. It is simply to say that wise decisions for the future must rest upon an understanding of not only what we hope to achieve but the context in which we must pursue it. There is, for example, no point in relying on the discipline of the marketplace if there is no disclosure (through accepted and consistent standards) of the performance of competing institutions, or if companies or financial institutions are not permitted to fail.

Given the need for each country to adopt its own regulatory approach, there still remains a certain consistency among governments which provides the basis for regulation and intervention. Generally, government seeks to protect the livelihood of present citizens, and to foster the basis for future economic growth. In the real life battles of every day, there is also the lively conflict among interest groups -- both within and outside government. Sometimes governments regulate to protect small savers; other times, in order to maintain control over the money supply; at times, we even regulate because we have always have done it that way -- at least for one generation -- and someone would be hurt, if we changed. Permit me to be more specific.

WHY GOVERNMENTS REGULATE FINANCIAL MARKETS

First, and perhaps most typical, it is often to limit savings from leaving the country in question to finance the deficits or private sector requirements of other countries. Most governments in the world, at many times in their history, have exercised control over the extent to which domestic savings finance another country's growth. An example in Japan would be the so-called 10% rule which limits investments by Japanese institutions in foreign institutions.

Second, governments for decades have sought to control the financial risks taken by their financial institutions -- the risks to their banks, to their insurance companies, to their pension funds -- whose financial viability is looked to by those who labor in the society as a safe haven for their savings. Governments often put restrictions on the activities of those financial institutions and the risks they take, so that they will not, in the interest of competition, take too many risks or unsafe positions. Government, in short, seeks to keep financial intermediaries as safe as possible since they are directly or indirectly the holders of the society's wealth. And governments have learned that they will have to bear the costs if mistakes in the private sector threaten the viability of major financial intermediaries.

Third, governments seek to control financial markets so that they can control the cost of funds -- the interest rate -- either for their own borrowings or for a segment of the investing or borrowing public. Governments seek to control the level of interest rates, sometimes at a level well below market rates, in order to create a low cost base for lending those funds to

favored sectors. A classic example may be observed in the artificially low interest rates paid by United States savings and loan associations -- the basic depository institutions -- who then had the responsibility and mandate to relend to finance residential mortgages for home buyers throughout the country. The government, in short, artificially controlled the return on deposits so that the society could have, certainly up until the mid-1970s, low cost, fixed rate funding for residential housing.

Other regulations seek to maintain funds in institutions which fall under the control of a central bank or monetary authority in order to exercise tighter control over domestic money supply. Governments have been reluctant to see a diversification of short-term instruments -- CDs, bankers acceptances, commercial paper and the existence of offshore markets, simply because it makes more difficult the control and even monitoring of money supply and interest rates. A related aspect is the restrictions on the use of bearer bonds or zero coupons because of an effort to maintain honesty in the reporting of taxes.

A fifth reason why governments seek to regulate markets, is to protect the various financial intermediaries in those markets, from competition -- to assure that each sector is financially successful and profitable. Governments often act to prevent competition between different sectors in the markets, for fear that excess of competition will lead to unsafe practices leading to increased risk which in turn, will lead to the need for increased government intervention or costs.

Often governments create various ministries, bureaus, departments and sections, each of whom has the responsibility for protecting and creating a wall to insulate their constituency from competition from a competing financial intermediary whose activities are regulated by another department; that other department in turn seeks to create a wall of protection around its constituency.

A sixth reason for regulating markets is to protect the public from buying questionable securities or to protect the public from conflicts of interest by financial intermediaries. In the United States, there are a proliferation of regulations dealing with disclosure and the kinds of investments that various financial institutions can make. In such case, government acts to protect the buying public by regulations which are designed to prevent intermediaries from acting in an inappropriate or self-dealing way with public savings.

I cannot question any of the above objectives nor have I exhausted the list. The objectives go to the heart of the role of government, its relationship to the financial sector and its relationship to savings and growth and safety in a society. I would like, however, to use this frame of reference to deal with some of the matters which this Commission is addressing and suggest how one might approach their study and resolution.

THE JAPANESE EXPERIENCE

I think it is useful first to admit that most of the controversies in Japan, dealing with financial matters, occur because of a difference of opinion over whether or not some of the objectives are wise, appropriate or workable, or whether they distort, in ways not intended, the operations of the financial markets, and its participants. The public debate, however, usually does not get to the heart of whether the underlying objective is appropriate; rather, most of the controversy deals with the surface event or activity being discussed. Worse yet, we too often focus on the impact of particular restrictions or regulations on the intermediaries (banks, trust institutions, securities firms) with little attention to the impact on savers, investors and borrowers.

What I would like to do here is set forth some impressions as to the nature of the controversies on a number of subjects, perhaps shed some light on how the controversy arose, and how one might consider what should be done.

The areas that I would like to comment on are as follows:

- the function of commission banks;
- the role of private placements;
- the long term prime rate;
- the application of the 10% rule,
- Glass-Steagall considerations;

- the implications of the existence or absence of short-term money market instruments
- matters dealing with technical regulations relating to the securities being offered, for example, maturity, timing, pricing, repayment schedules, warrants, zero coupon bonds, the structure of debt instruments, etc..

- <u>COMMISSIONED BANKS</u>

I must say first, the subject of commissioned banks is not very important to the World Bank and most international issuers. Commissioned banks do not do anything specific, aside from serving as paying agents, but they do not do any harm either. For international issuers, the cost is minimal. Nor do we look to the commissioned banks for advice. Their function as a fiduciary or trustee and safeguard of assets, should there ever be a liquidation, is irrelevant as a practical matter to high-standing issuers. Indeed, for most international issuers, their assets may not be collateralized for the benefit of Japanese yen bond holders because of the existence of what is called the "negative pledge" clause applicable to all of their obligations. This requires, legally, that no assets be collateralized unless they are pro-rata offered with every bond all over the world of that some issuer.

But the commissioned bank controversy deals not so much with international issuers as with domestic issuers. But the issue is not the <u>role</u> of the

commissioned banks, the issue is whether or not there should be restrictions imposed by government on the amount and type of corporate debt that can be issued. The controversy arises today because government has decided that borrowers should limit their debt issued in the form of securities to assets that can be collateralized. The issue that should be subject to debate and discussion, therefore, is whether borrowers should be constrained in structuring their debt. This is the issue that deserves attention, rather than peripheral matters such as whether the commissioned banks' fees are justified and their importance to the profitability of long term credit institutions. On the important point whether it should be the role of government to set a limit on the amount and quality of corporate debt, arguments can be forwarded on both sides.

Let me note, by the way, that the market [illegible] now developed in a manner in which, at increased inefficiency, the Japanese corporation that wishes to issue <u>more</u> debt than would be permitted domestically can do so out of, say, London and avoid the entire controversy. But the controversy again, I repeat, deals with whether, at this stage of Japan's economic development, the government should decide how much and what kind of debt is safe for a corporate issuer. The problem, of course, is made more complex since borrowings from sources other than the bond markets -- from banks -- permit a corporation to evade the restriction -- even domestically. And, it is even further complicated when government makes exceptions for "qualified" domestic borrowers, who then may issue unsecured debt domestically. I would only urge that in resolving the question, the parties discuss the real issues at hand -- the role of

government in determining the amount and quality of corporate debt; not the surface ones -- like the role and profitability of commissioned companies.

- PRIVATE PLACEMENTS

I now turn my attention to the question of private placements . As you are no doubt aware, in countries other than Japan, private placement markets have developed along two different lines. In the U.S., the government has taken no position with respect to the credit quality of issuers participating in either the public issue or the private placement market; instead, it has taken steps to insure that only large and sophisticated investors make placements that do not carry with them the extensive disclosure required in public offerings. In certain European countries, on the other hand, governments have restricted borrowing in the private placement mar[illegible] only the highest quality issuers, relying on the creditworthiness of these institutions to protect investors in transactions with comparatively little disclosure. While these approaches are fundamentally different, I can recognize the logic behind them.

In Japan, however, I must confess that I have been unable to determine the reasons why the government, until recently, has sought to limit the amount, maturity, pricing, and the credit standing of issuers of private placements. For example, it was ironic that less qualified issuers enjoyed access to the streamlined procedures and less rigorous disclosure requirements of the private placement market. Indeed, there have been instances in which less qualified borrowers, who do not have access to public markets, have is-

sued unlisted obligations (which are not readily transferable) at a lower cost than high quality issuers. This, I think, was an illogical outcome.

I can think of no reasons serving the public interest why a government would wish to control private placements, assuming that the investors consist of a relatively restricted number of institutional and sophisticated institutions. I would think that under those circumstances, any issuer, either domestic or foreign, should be permitted to arrange or have arranged on its behalf, a private placement of bonds (or a credit) of any maturity at either a fixed or floating rate, with a relatively small, well-informed group of investors. The restrictions on amount, or price, are best left to the parties and the intermediaries who act as agent. The transaction can be done quickly, with little publicity or market pressure. A private placement is both an alternative and a complement to the cumbersome process of a publ[illegible]e, as well as to the indirect financing provided by banks.

This last observation leads to the real issue: I believe that private placements are controversial because they present the possibility that <u>issuers</u> will deal directly with <u>investors</u>, thus effectively bypassing the agent securities firm or bank. Again, there is a fundamental question here: should government protect financial intermediaries from competition? Why should there be a financial intermediary between investors and issuers -- particularly where the intermediaries are often the investors.

I would also note that the large syndicated loans arranged and purchased by trust banks, city banks, insurance companies, and long-term credit banks would be called private placements -- for that is what they are -- in every country of the world -- except Japan.

What is at controversy here is who should be allowed to be an intermediary between borrower and lender, and whether borrowers should be allowed to deal directly with institutional lenders. That is a subject which always generates great controversy, since it basically affects the business profits in a particular financial sector. The uncertainty is whether an extended use of private placements will take business away from banks or from the securities firms. No one now knows the answer to that question. Some issuers have felt that the restrictions on private placements were designed to prevent loss of business to the securities firms, -- even though the result was to permi[illegible] institutional investor to expose itself to low credit standing issuers (w[illegible] did not issue bonds) and not to an issuer enjoying a high credit standing.

I have noted, of course, with interest the recent liberalization in respect to private placements. I am not sure, however, very frankly, whether this is a step forward. I am concerned that issuers, of the highest credit quality, will have to pay arrangers, from many different financial institutions, a large fee for making a placement with life insurance companies with whom we already have direct and frequent contact. I am also concerned about fixing a minimum spread of 60 basis points over the most recent primary issue of Japanese Government bonds. I find it puzzling to explain why the yield of

World Bank bonds sold to retail customers and small investors throughout Japan, should be virtually the same as the yield on Japanese government bonds, while the yield to large institutions on our obligations for the exact same maturity in a private placement must be 60 basis points higher. I would have thought this might be one area where such matters could have been left to market forces.

- LONG TERM PRIME RATE

I think it may be useful to talk about why the long term prime rate (LTPR) still exists. It exists because there is a constituency of the largest fixed rate lenders in Japan, who want a mechanically determined reference rate that guarantees a fixed spread over their funding cost, in good times and in difficult ones. This constituency originally forestalled competition by having the LTPR imposed on the entire banking community -- even those institutions whose funding sources would have permitted them to lend at lower rates. Over the years, all Japanese banking institutions have come to appreciate the safety net inherent in the LTPR, because they do not need to use it in good times and they can rely on it at other times, as if it were an insurance policy. We know, for example, that today -- which are good times -- that banks are negotiating their lending rates on a competitive basis with borrowers by packaging an LTPR loan with other loans priced below market (such as short-term loans and non-yen loans without compensating balances).

We all understand why banks wish to preserve the protection provided by the long term prime rate. In difficult times, when deposit rates rise, especially when the growing component of short-term, unregulated CD rates rise, it is comfortable to have the protection of the long term prime rate. I do not understand, however, why the risk which this policy aims to cover is not addressed directly. I speak of the regulatory constraints on banks' liability structure -- the constraints that prevent banks from borrowing at fixed rates, thereby creating a so-called "interest rate mismatch" on banks' balance sheets when they lend at fixed maturities.

I would have thought that this matter could have been dealt with directly, by simply authorizing banks to borrow at fixed rates if they are to make fixed rate loans. The solution to bank risk, I would argue, is not to place a high minimum rate on long-term loans (it will not be effective to withstand market pressures over the next 20 years in any event) -- but rather to ensure flexibility in bank funding .

It is important to consider the fixed rate funding option -- particularly since recent changes in short-term markets -- namely the expanded use of money market instruments -- will likely make the cost of deposits more costly and volatile. A lesson can be learned from the United States where fixed rate loans were made, particularly for home mortgages, which caused banks to have great financial difficulties when the average fixed rate return on assets did not cover the escalating high cost of short-term deposits in the late 1970s

and 1980s. A solution to this risk may be more flexible funding at fixed rates.

What I would suggest therefore, would be to encourage commercial banks to borrow at fixed rates and at various maturities, so that they might have a liability structure, with known and certain costs, which would permit them, in turn, to be more comfortable (and safer) in making long-term fixed rate loans.

I might also note that the LTPR, to the extent that it "protects", temporarily, the profitability of banks, may be unwise as a basic principle since it may cause a bank to look only to the spread between its deposits and the LTPR. There is the risk that banks will seek to capture that spread and not pay sufficient attention to credit quality, as was the case in the Euromarkets in the 1970s. Guarantee of a short-term profit, I would suggest, is inversely correlated with attention to creditworthiness.

I also suggest that, if banks are prepared to make fixed rate loans, they should do so at a cost negotiated freely between themselves and the borrower. If some banks make pricing mistakes by not earning a sufficient return, I believe that they can be held accountable -- whether by their stockholders, if they are assured access to this information, or management, or ultimately the government, if it would be prepared to limit its protection. And, if price competition becomes even more severe, then I think the regulatory authorities may have to establish further guidelines relating to the capital adequacy of the bank, as well as guidelines limiting bank size.

I think these alternatives are all preferable to a mechanically determined long term prime rate. Let me repeat, thought, that I would simply let the banks incur fixed rate liabilities at various maturities so as to make their financial structure more flexible and safer, before giving them the flexibility of making fixed rate loans.

- Ten Percent Rule

MOF guideline known as the "ten percent rule" limits portfolio investment by certain Japanese institutions in securities issued by nonresidents. As we know, one effect of this guideline has been that Japanese issuers have borrowed U.S. dollars, for example, at rates much lower than non-Japanese issuers of comparable quality. The reason for this is that Japanese investors have had a stronger desire for U.S. dollar securities than could be accommodated within the 10% limit on their purchases of foreign issues; these Japanese investors have been willing to pay higher prices therefore for the dollar obligations or securities of Japanese resident issuers that do not count against the ten percent ceiling. While I am sure that this guideline originally operated to protect Japanese institutions from the risk of investment in unfamiliar foreign securities, the rule today may in fact work to hinder, rather than encourage, prudent portfolio management. This is because investors, in their attempt to avoid the 10% limit in their purchase of non-resident dollar as-

sets, may tend to buy securities of lesser quality Japanese issuers rather than higher-quality non-Japanese securities -- and, at lower returns!

The constraints of the 10% rule on capital outflows, moreover, are questionable in an era in which Japan is oversupplied with domestic capital. Indeed, far from working to Japan's advantage, the persistence of the 10% rule creates an impression internationally that Japan is subsidizing its industry by providing Japanese borrowers an advantage in the competition for funds. The rule also has some costly results: The World Bank, for example, is owned in significant part by the Japanese government itself and is arguably more creditworthy than any private Japanese corporate issuer; yet it has to pay more for dollar borrowings than many Japanese corporations because of the 10% rule.

- "Glass-Steagall" Restrictions

Next, let me comment on the implications of what I might call "Glass-Steagall" restrictions on the business that financial institutions may engage in. These limit the scope of trust banks, insurance companies, commercial banks and securities firms in Japan. That is a very large and complicated subject which deals with the allocation of business in a financial industry which serves as intermediary between savers and borrowers, or between investors and issuers. Let me focus, however, on only one aspect: conflict of interest. Because of the unique nature of the Japanese financial system, in which there are close links among the corporate sector, the pension funds,

and the commercial banks, there exists a potential for conflicts of interest if each institution can perform all of the functions as agent and principal of buying, selling and managing financial assets -- not just for its own account but also for the accounts of its associated institutions.

The continuation of restrictions of this nature, I think, makes sense in a number of areas. Let me just mention two. I would not permit banks to manage corporate pension funds. The reason is the possibility that those pension funds could be invested in the debt or equity instruments of companies with whom the bank has an on-going lending relationship. I believe that creates a conflict between the interest of the bank depositors, stockholders and management on the one hand -- particularly if the company is in financial difficulty -- and its fiduciary duty to the pension funds employee whose contributions would be managed [illegible] same bank. My concern is that the company in difficulty would ask the bank from whom it had borrowed funds to make investments in its bonds or stock through the pension fund controlled by that same bank.

Nor do I believe that banks should underwrite or distribute securities, much for the same reason. The underwriting of securities by banks would mean that the buyers of the bonds or stocks being underwritten by the commercial banks will often be the bank depositors. The depositors of banks have established long-standing, almost automatic, relationships through their savings accounts and their deposits with those banks. Many are, in a sense, captive to those banks. If the banks at the same time underwrite the securities of corporations with whom they have a lending relationship, then one could envis-

age the bank stockholders wishing to protect their own interest by having the bank sell the obligations of those companies to the depositors of that bank rather than absorb underwriting risks themselves.

Also, a bank could free itself of questionable loans at the expense of the investing public depositors. A bank could replace questionable loans with the proceeds of securities issued by the troubled debtor, and underwritten and distributed by the bank. This abuse allegedly was widespread in the U.S. in the early '30s, and led to the passage of the Glass-Steagall Act.

I think these are potential conflicts of interest and are of considerable consequence since they shift the risk of the credit from the bank managers and stockholders to depositors. Further, I could take the argument one step further by saying that th[illegible] conflicts of interest between the banks and the government. For, ultimately, if too much risk is shifted from the banks to the depositors and other public investors, it is the government that may have to protect the banks.

Finally, financial institutions in Japan are at the heart of savings in Japan. Underwriting securities involves a risk. Often bonds or equities will not be able to be sold readily and must be maintained in inventory -- sometimes at considerable loss. These losses, in turn, could jeopardize the financial position of the bank. Banking is already a competitive business in Japan. An expansion of activity would involve new risk-taking activities, and this would

increase the risks to the depositors of those institutions. Nor is it necessary - given the extensive coverage and activities of the securities firms.

My sense is that, on balance, though I generally favor increased competition, I believe that banks should not underwrite the securities of the non government-guaranteed private sector. I would, in conclusion, only permit underwriting activity in the banking markets on a highly selective basis and then, only in areas in which there was little divided loyalty or conflict among the interests of pension fund holders, depositors, stockholders and corporate clients.

- Money Markets

Permit me to comment on the use of money market instruments in the Japanese financial system. That, too, is a large subject. Rather than reach a conclusion as to whether an expansion of the use of such instruments is wise or inappropriate, I think it may be useful to identify the incentives of some to support the emergence of a viable, active, money market, and the incentives of other groups to delay the emergence of such a market.

First, why have a short term market? Simply because corporations and governments may wish greater flexibility for financing their requirements. Not all corporations want to borrow at fixed rates. They may wish to borrow at rates which are shorter term, perhaps for 30-90 days, in order to provide

working capital. Corporations, indeed, may have a view on interest rates. The existence of short-term instruments also permits government, through the use of Treasury Bills, to take a more diversified approach to funding its own requirements -- an approach which is less disruptive during times of market weakness than the alternative of issuing long-term bonds.

Investors, too, may find greater flexibility in a viable money market. For example, if investors perceive that interest rates are about to rise, they may want to keep their investments liquid and short until their views of interest rates change. Rates are not always stable, and a financial system which gives investors choices, I would think, has much to commend it.

The existence of short-term instruments, moreover, provides an alternative to borrowing from, and investing in or depositing in, a commercial bank. It therefore diversifies funding away from commercial banks. It means, therefore, that if a corporation wants to borrow short-term, it can issue, say commercial paper instead of borrowing from a bank. Likewise, an investor wishing to invest short-term can invest directly in the corporation instead of in a deposit at a bank. In this way, investors such as corporate treasurers, pension fund managers, small savers and other holders of liquidity who wish to diversify their investments and sources of return will enjoy greater flexibility and therefore reduce the risk to the banking system.

Another group of potential participants in a short-term market are consumers and the businesses that cater to them. The availability of short-term

consumer credit in the U.S. has fostered the purchase of cars, home appliances, and much more. There is a question, of course, whether such purchases on credit is an advantage or criticism. It depends on whether a government wishes to foster consumption vs savings.

With all these forces at work to create a short-term market, it is little wonder then, one way or another, money markets have emerged in many countries. Market forces inevitably lead to the discovery of loopholes in existing regulations. We need only look at the size of the Eurocurrency markets as a case in point.

There are of course also incentives for limiting the creation of short-term instruments. The main incentive stems from the fact that deregulation and access to short-term markets clearly compl[illegible] the control of monetary policy. In an active, diversified money market, investors both internal and external can hold huge amounts of obligations, trade them, switch them into different maturities and make more difficult even the monitoring of the amount of money that is outstanding. It is therefore quite understandable why a central bank, responsible for monetary control, would prefer to limit the scope and size of an international money market in their currency. Second, virtually every country which has deregulated the short-term markets and permitted issuers and investors to use short-term instruments without price or rate controls, has found that it has also created increased competition for funds. That competition has typically raised the level of interest rates as banks compete with government and corporations for a finite pool of public

savings. With the increase in rates, inflationary pressures can increase and with that increase, the ultimate cost of borrowing can increase. Deregulation by definition means that governments will find it more difficult to maintain a low interest rate. Finally, it has the potential of having the least credit-worthy issuers -- either corporate or weaker banks "buying" money by offering higher and higher rates to the general public.

- Technical Restrictions

Permit me now to make some brief comments on the restrictions which relate to the technical operations of the market and/or the format of securities that are permissible in the market. These relate to controls or guidance that (a) limit the maturity of an instrument, (b) control the timing of bringing issues to market, (c) create artificial pricing, or requir[illegible] maintenance of a basis point spread over another issuer or type of instrument. There are also restrictions on transferability, repayment schedules, bullet maturities, whether or not bonds can be issued at deep discounts or as zero coupon bonds, etc. All of these restrictions stem either from the fact that the tax laws are not clear (and there are various elements at work which do not want to or cannot clarify the matter) or because of the interest of certain groups who what to maintain protection from other sectors in the financial system, or because the government is concerned about the profitability of a particular sector in the financial markets.

Whatever one's views about the appropriate role of government, I presume that government wishes to maintain control over what it wants to accomplish. But we observe that a system filled with regulations and constraints is quite difficult to control, because market participants are likely to discover loopholes or to make use of unregulated alternatives. The inevitable development of the Euroyen markets is a case in point. Borrowers have been able to tap, albeit indirectly and inefficiently, the same sources of funds that are available in the regulated domestic market. We are all aware that this has occurred, notwithstanding lock-out provisions aimed at insulating the domestic market from a reflow of funds from abroad.

Let me also say there is little public policy involved in whether a bond should have a 10-year maturity or a 15-year maturity, or whether it should or should not have a sinking fund or prior amortization. I can think of no public policy which would support government deciding that an issue should have a 20-year maturity but not a 25-year maturity. (The added five years has no effect on risk or volatility). I do not believe that government control, with respect to the matters that I have listed -- these technical areas -- are likely to provide long lasting protections; the pressure from the market generally will provide a brake on the more competitive instincts of market participants. In this connection, I think it may be useful to consider that there are three parties to financial transactions: the issuer, the financial intermediary and the investor. They do not have the same interests at heart; the conflicts between them, the adversarial relationships between them, might be relied on by government, to provide fair and orderly markets. The results

which will be derived from the balance between the desire for the financial intermediary to make money, the issuer to have the lowest cost and the investor to make the highest return surely are as reliable as are arbitrary restrictions which provide little protection and rarely penalize the error.

Conclusion

I am fully aware that, in Japan, there is a concern that there will be destructive price competition and that firms will have loss leaders in their effort to maintain market share. But soon losses will be recognized as jeopardizing the interests of the stockholders. They, in turn, will put pressure on managers not to do unwise transactions or take inappropriate risks. More likely, loss will occur if managers believe that official guidance will always protect them. I might also say that, given the opening up of markets in other countries, technology and the internationalization of financial markets, artificial domestic restrictions will simply create incentives to put resources either in other currencies or in other markets in the same currency. More generally, artificial constraints provide no opportunity for a testing ground for mistakes and error. And over time, managers will learn to look to government for guidance, rather than using their own judgement and experience. They will not learn to test their rationality if decisions are made for them. And if there are failures, they will blame government for inadequate attention and guidelines. That is not to be encouraged. For, to insulate against failure and error, will inevitably, because of the lack of independent, rational thinking and risk taking, lead to more mistakes -- not less.

Thank you very much for your courtesy.