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**Plenary 2**

**Market Stability**

*10. The 'Big Bang' Reform for Financial Stability - Story of  
a Rip Van Winkle of the Japanese Financial Market,  
Speech by Mr. Katsunori Mikuniya*

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*27 June 2001*

*Panel two*  
*Mr. Katsunori Mikuniya*

# **The ‘Big Bang’ Reform for Financial Stability**

*- Story of a Rip Van Winkle  
of the Japanese Financial Market -*

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Thank you Mr. Chairman.

It is a great honor to be here together with the distinguished panelists. Let me first thank the Swedish financial authority for organizing truly great IOSCO Annual Meeting.

Today, I would like to talk about our determined pursuit for better market infrastructure, the so-called “Big Bang Reform,” firstly because I firmly believe that an essential condition for the stability of the global market is a stability of each domestic market, and secondly, because Japan is currently in the process of revolutinalizing its domestic market, and I have been right in the center of this process. I will explain to you why I am a Rip Van Winkle in a minute.

## What has caused the instability of the last decade?

- Risk and Returns have not been balanced.
- What can we do to solve this problem?



Let me begin by sharing with you a question which has always been in my mind. "What is the real challenge for stability in the Japanese capital market?" In other words, "what has caused the instability of the last decade?" My answer is that risk and returns have not been balanced in the Japanese market for a long time. The High Growth Period of 1950s and 1960s was a time of low risk and high returns, which, in retrospect, could not continue forever.

The bubble period of late the 1980s was a period of high returns, but the latent high risk was hardly noticed until the bubble burst. Currently, we are suffering from a serious lack of risk-takers.

I firmly believe now that Japan needs a financial market where risk and returns are balanced. A market where risk and returns are well balanced will enable us to attain domestic stability. Domestic stability is an essential condition for global stability.

## Brief History of Big Bang

- November 1996  
Instruction by  
Prime Minister Hashimoto
- June 1997  
Recommendations by  
Government Financial Councils



Creating a market where risk and returns are balanced is exactly what the Big Bang reform is intended to achieve.

Looking back, it was nearly five years ago, in November 1997, when the "Big Bang" reform started by the instruction of Prime Minister Hashimoto. Then, about seven months afterwards in June 1998, the government financial councils agreed on the recommendations that set the framework of the reform, which I still refer to regularly. The recommendations symbolized that something different had started in the Japanese capital market.

Next month, I came to the Securities Bureau of the Ministry of Finance for the first time in 12 years,...

And...



One month after the recommendations were agreed upon, I came back to the Securities Bureau of the Ministry of Finance for the first time in 12 years as the Director of the Corporate Accounting Division. When I briefly worked in the Securities Bureau in the 1980s, Japanese economy had been in the midst of the "Bubble". Stock prices as well as land prices were skyrocketing, and there was a scandal involving the shares of an IPO. In those days, my job was "introducing new regulations", rather than "deregulation". For example,

- 1) a regulation on insider trading,
- 2) a reporting requirement for large-scale shareholders, the so called "5 % rule".
- 3) rules for Initial Public Offerings. After a year in the Securities Bureau, I moved to the Budget Bureau and worked there for more than a decade.

I found an entirely different world of  
'Big Bang'

**June 1998**

Financial System Reform Law  
approved by the Diet

December 1998

Financial System Reform Law  
became effective



10 years later in the summer of 1998, on the first day when I came back to the Securities Bureau, I could not believe my eyes. I found an entirely different world of "Big Bang." I felt like the Rip Van Winkle of the Japanese financial market.

Changes since the start of the  
'Big Bang' is 10 times greater than  
those in the entire post-war period



Frankly speaking, changes since the start of the "Big Bang" are 10 times greater than those of the entire post-war period. I can guarantee this to you, as I worked in the Ministry of Finance for 24 years before the Big Bang and 3 years thereafter.

## Contents

1. Achievements of 'Big Bang'
2. Major Progress under FSA
3. Road Ahead



In this session, I will review how the Big Bang has changed markets participants' way of thinking and explain to you recent progress in the capital market. Then I will touch upon what I think are the challenges ahead.

## 1 Achievement of Big Bang (1)

- “Free, Fair and Global”
- Do every needed reform
  - Enhancement of disclosure system
  - Expansion in means of asset investment
  - Facilitation of corporate fund-raising
  - Provide a wider variety of services
  - Create efficient markets -Assure fair trading
  - Ensure soundness of intermediaries and prepare system for dealing with failures
  - Securities Tax Reform



Let me start with the achievements of the Big Bang. The fundamental philosophy of the Big Bang is "free, fair, and global." We have been undertaking every necessary reform we could think of. I do not have time today to explain each item of the reform even if the daylight here is nearly endless. However, I would like to underscore two points. One really convinced the participants in the Japanese financial market that the "Big Bang" is real, the other is causing fundamental changes in Japanese corporate behavior .

## 1 Achievement of Big Bang (2)

### *Liberalization of brokerage commissions*

- In October 1999, Brokerage Commissions were Fully Liberalized
- Incurred the competition and resulted in drastic decline of commissions.



One of the reform that really convinced everybody that the Big Bang is real was the liberalization of brokerage commissions. When I first worked in the Securities Bureau of the Ministry of Finance in the late 1980s, I could not find convincing reasons why brokerage commission needed to be fixed. However, it was taken for granted. Although brokerage commissions for large transactions were already liberalized when the "Big Bang" started, the process was accelerated, and brokerage commissions were fully liberalized in October 1999.

# 1 Achievement of Big Bang (3)

## *Reform in accounting system*

- Switch to consolidated reporting (April 1999)
- Accounting standards for tax effect accounting (April 1999)
- Revision in accounting standards for research and development costs (April 1999)
  - R&D cost accounted for as expenses when incurred
  - Software accounted for as an expense or an asset in according with the purpose of usage
- Accounting standards for retirement allowances (April 2001)
  - Obligation calculated by the accrued benefit method (projected Unit Credit Method)
  - Unfunded pension liabilities included in financial statements
- Accounting standards for financial instruments (April 2001)
  - Introduction of Market value measurement



The other reform, which has entirely changed Japanese corporate behavior, relates to the accounting system. The Big Bang recommendation of the Securities Exchange Council of June 1997 stated that "steps will be taken to reach the internationally most advanced accounting and disclosure standards." Measures have taken effect gradually as shown in the slide, and significant progress has resulted from the introduction of mark-to-market accounting for financial institutions starting this April. You may be of the view that Japan is constantly associated with corporate restructuring recently. In my opinion, one of the reasons why Japanese corporate management is undertaking these changes is the reform in accounting.

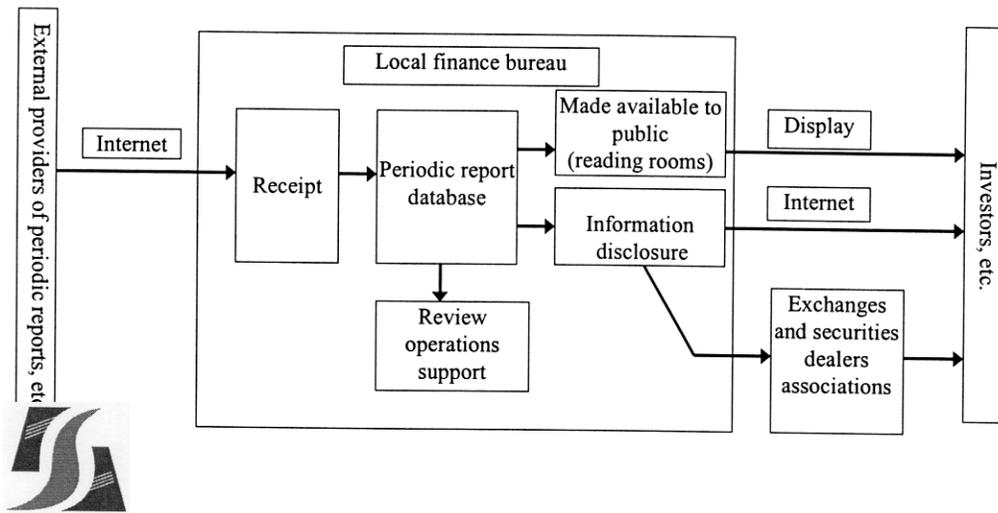
## 2 Major Progress under FSA (1)

- Overcoming the Financial Crisis
- Further Improving the Safety net system
- Creating a New Infrastructure for the 21st Century



In my opinion, Japanese FSA is now fighting on three fronts. 1) overcoming the financial crisis. 2) further improving the safety net system and 3) creating a new infrastructure for 21<sup>st</sup> century. Let me introduce you to recent measures underlying new infrastructure for the 21<sup>st</sup> century, relating to disclosure, investors and the settlement system.

## 2 Major Progress under FSA (2) EDINET (Electronic Disclosure for Investors' NETwork)



The first is the introduction of the Electronic Disclosure for Investors Network. A most up-to-date system of electronic submission and disclosure system has just been introduced as of the beginning of this month. After allowing for a transition period of a few years, electronic submission will become mandatory in 2004.

## 2 Major Progress under FSA (3) *For Investors*

- More Investor Protection
  - Bill on Sales of Financial Products (implemented in April 2001)
- Wider Selection of Financial Assets
  - Securitization for all property rights



The second set of measures is designed to benefit investors. The Bill on Sales of Financial Products that became effective in April 2001 clarified disclosure requirements to clients for financial service providers, and thereby improved investor protection. In addition, in order to grant investors a wider selection of financial assets, a reform regarding collective investment schemes was taken in November 2000. In the reform, assets that could be securitized using special purpose companies were expanded from loans and real estates to all property rights. The change also benefited those who needed financing by giving wider options for securitization.

## **2 Major Progress under FSA (4)** *Reform in Securities Settlement System*

- **A Comprehensive Report on Medium-term Reform in June 2000**
  - Dematerialization
  - Unified legislation for all kinds of securities
    - from T+3 to T+1
  - Delivery versus Payment -Straight through Process
- **Spearheading**
  - New law to dematerialize CP was just passed on June 20 and will be in force in April 2002. (Before this new legislation, CP needed to be a physical certificate.)



The third area involves the Securities Settlement System. I frankly admit that the current Securities Settlement System is not the most advanced, and there is lots to be done. The biggest problem in Japan, which has historical reasons, is the existence of multiple settlement systems for various kinds of securities. Clearly acknowledging where we are, a working group on the Securities Settlement System of the Financial Systems Council compiled a comprehensive report on medium-term reform in June 2000. Changes are being introduced step-by-step in accordance with the report. On Thursday last week, legislation enabling dematerialization of commercial papers and reform of custodians in charge of book-entry was passed.

## 3 Road Ahead

- A Dialogue with Each Domestic and Global Market Participant
  - Reform of Tax
  - Company's Attention to Shareholders
  - Securities Companies Act in the Interest of Clients



As I explained to you so far, I have been right in the center of the "Big Bang" reform. Together with the legislation I worked on in the Budget Bureau, I have taken part in more reform and legislation than anybody else in my generation. Looking back upon my experience, I do feel that reform and legislation in the financial sector is challenging because it is in a way a dialogue with each domestic and global market participant.

However, we have no time to stop. In addition to the reform already taking place, from the viewpoint of the financial sector, tax reform is needed. We have to make companies pay more attention to shareholders, which is essential to corporate governance. And it is necessary to make securities companies act more in the interest of their clients by virtue of the way companies are structured as well as in the way they work.

We are determined to continue  
towards  
both domestic & international  
stability



Let me conclude by reaffirming our commitment to further improving and creating a new infrastructure for 21<sup>st</sup> century .We are determined to continue until we can contribute sufficiently to the stability of global market. Thank you very much for your attention.

(end)