Round Table Discussion:

Leading Speaker: Prof. Naoyuki Yoshino,

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Prof. Yoshino:

Thank you. We have a little bit more than one hour left, so let us have a good roundtable discussion. As a starting of this discussion, I just summarized some PowerPoint material and I would like to start from page one. This morning, Prof. Kanda presented a couple of very important points. He has discussed that in a small economy, the banking system may dominate, but in a large economy, the capital market should be developed. However, I think from the Japanese experience, the balance between the banking system and the capital market will be very important. And furthermore, the transparency and rules which covers both the banking system and the capital market have to be well balanced. The share between the two—the banking system and the capital market—should be determined by the market and also the investors' preferences. Number three is insurance, which is also very large in many Asian countries, and is very different than, I think, the United States. Insurance in Japan, especially life insurance, is regarded as long term deposits, so that is why it has been developed very well. Number four is bank regulations and number five is capital market regulations. These have to be very flexible so that in different environments it will be adjusted accordingly. Also, the regulation has to be market-oriented; otherwise the market will not be developed. Please open to the next page.

In the discussion this morning and this afternoon, we looked at bank, insurance versus number two, the capital market. For all the countries in today's presentation, banks and insurance were licensing and there were entry regulations. And there was continuous monitoring, which eliminates various risks. So those are the common characteristics of banks and insurance. But as for the capital market, it is different. It has to be transparent because the capital market is very easy to manipulate. Sometimes investors must have been misinformed. So there is information symmetry. So if the confidence is lacking, then the capital market will shrink. Confidence will be very important.

One example in Japan is the securitization of loans. It has been developed very rapidly in Japan, not only for loans, but also for real estate, buildings, and construction. This

Small and Medium Enterprise (SME) is a borrower, and private banks in this case are making loans, and it has been securitized to the investors. The same scheme can be applied to real estate. The blue one on the left-hand side is real estate. Then first, private banks make loans which have been securitized in the market, or from the beginning, a building company collects money from the market. But the problem in this kind of securitization scheme, which I think Japan will be facing, is a lack of confidence, especially in service. In this case, the private banks are services in this market. And at the initial stage, they are carefully monitoring SME or the construction of the building. However, whether that initial screening of the services role will be continued in the future is not sure. And sometimes, services will change one to another. Then the securitized products will be less qualified if the services will be changed and the companies will be changed. So the scheme has been developed, but there are lots of risks associated with this kind of securitization. But some people do not yet realize it.

This morning and also in the afternoon, we looked at how consumer loans are growing in many countries: Korea, especially after the 1997 crisis, in Thailand housing and consumer loans, and in China also housing loans are increasing. We have been discussing this issue in Japan as well. One way is in over-borrowing; many consumers lend much more than they have expected. The black market exists. Also there are interest rate ceilings—Korea's was 66%. The exchange of information between finance companies and banks was discussed. And consumer education has also been discussed this morning.

Then, there were a couple of questions this morning. What kind of interest rate will be appropriate for these regulations? Then if we look at the next page, there is a table. In order to discuss what the optimal level of the interest rate is, there are many factors which affect the interest rate. So if you look here, there are four major points on factors affecting the interest rate. What is the marginal propensity to consume? And second, the amount if initial borrowing divided by their income. Number three is the income growth rate. Number four is the number of years to return the principal. So these are the four conditions which affect the level of the interest rate at which a borrower can return. This is one of the simulations which I did. For example, the vertical axis is initial borrowing divided by their income. That is the vertical axis. The horizontal axis is the number of years in which they return their borrowed money. Then there are many interest rates—from 5%, which is the top to 70% which is the bottom. So depending on how many years it takes to return money and also initial borrowing divided by income. And furthermore, the growth rate will affect the ceiling of the interest rate. So for example in this case, the third line, triangle line is an interest rate of 15%. Then if one person has to return in about 10 years, then the amount they can borrow is about 90% of their income. That is the distribution. So we can not say a specific interest rate will be proper because there are many other factors which will affect the interest rate.

Then I would like to talk about each country in my final part of the kick-off presentation. I found out Korea is very close to Japan and we are moving in the same direction. The asset side is banking and insurance and other financial products. Especially securities and new financial products will be consolidated together. On the liability side is consumer loans. So Korea and Japan are heading in the same direction.

Then Thailand and China are on the next page. Both countries are still dominated by deposits and insurance markets. Even though the Thailand equity and bond markets are developing, still consumers are facing deposits and insurance. Then, number two, deposit and insurance schemes will be very important. But it seems to me in Thailand's case, small depositors are protected, but corporations are not protected at all. In the Japanese case, about three years ago, special transaction accounts were introduced. It is mainly targeting corporations. It is a full guarantee of transactions accounts, but the interest rate has to be zero. So that is a new kind of deposit protection and it is unlimited protection for everybody. I think small depositors have to be protected, but also corporations may have to be protected because they have a huge amount of transactions every day. So if you limit the protection of deposits to a certain amount, small businesses and large companies may be affected. Number three, insurance protection. This applies to many countries. And number four, this is a big issue in Thailand, Indonesia and other countries, whether there are multiple regulators or single regulators—Ministry of Finance, Bank of Thailand, Securities Exchange Commissions, and so on—and whether a single regulator will be helpful or multiple regulators will be important. And number five, this morning Prof. Rhodes was going to do that which is related to Prof. Kanda's presentation: the growing role of equities and the bond market in both Thailand and China. However, a gradual approach in these capital markets will be important. But it seems to me many countries are going from one to another, just jumping.

Lastly, which is not in my PowerPoint presentation, in the previous discussion, we have been talking about globalization and in characteristic of Asian countries, its home country bias. Many people just invest their home assets. Overseas investments are very few. Recently Japanese households are increasing their overseas investment, but they are just picking up one product rather than looking at diversification of portfolios because many securities companies are introducing specific products of overseas products. So I think number one is the exchange of information among Asian countries in various macro figures and financial figures will be important. That could enhance the home country bias and also the transactions among various countries. Asian Development Bank (ADB) has started to issue bond market information, but that is just restricted to the bond market. It does not cover the equities market, deposit market, or (number three) tax rules, entry regulations, or accounting rules. I think Asian countries should issue these kinds of rules all together, which could also enhance cross-country investment.

The last one is number two, regulators' continuous dialogue will be important. Each country has regulators. In Japan it is the FSA, and each country has regulators. They should probably meet at least once a year and exchange information, market conditions, monitoring, and so on. And that could enhance cross-border capital flows, especially in Asia and across the world. So that is my brief summary of today's discussion.

Then I would like to ask Prof. Yanagawa if he could provide some comments.

Prof. Noriyuki Yanagawa, Associate Professor, Graduate School of Economics, the University of Tokyo:

Thank you very much. We just heard from Dr. Yoshino comprehensively the summary of today's discussions. It was such a well organized presentation, and I do not have anything more to add to the summary. But there are certain points that came to my attention today. I could share them with you as well as my personal impression.

First of all, with regard to Dr. Kanda's presentation at the very outset, as well as regarding the presentations on the Japanese system reform, I could say that each country has similar experiences— the definition and the scope of the financial industries, financial products and financial services have changed greatly over time. Many complex financial instruments are available on the market now, whereas previously we just had bank deposits and equities. It was very easy to understand, but nowadays we have products in between as well as intricately complicated products combining various features.

This is in a way the fruit of development in financial technologies and also the economic progress. Consumers have greater opportunities to get access to various products, investors have more opportunities to invest in various products and companies have more opportunities to raise funds through these products, so it is very important to take advantage of these new products for the progress of the economy. But the emergence of complex financial instruments makes it necessary to develop relevant laws for the protection of consumers and investors. That is precisely what we have been talking about today. It is indeed a difficult task, and right now, a flexible, cross-sectional system is being called for.

Basically, under this framework, it is probably what the participants from various countries today that active use of the securities market is beneficial for the future economic growth, allowing for flexibility. And I think that is the direction in Japan, too. But as Dr. Kanda mentioned, we have to have an appropriate legal framework for the securities market to be functioning well. The securities market is characterized by high anonymity compared to the banking system, and products need to be standardized for circulation and negotiability.

For these two reasons, a proper legal and enforcement system is called for. It is not because we are with the FSA today, but in order to have proper enforcement, we need a good system and on top of it, we need to have people monitoring the market and activities of operators on a daily basis. For the sake of maintaining the enforcement system, we need good personnel on a permanent basis. At least in Japan, I think we need to have more people assigned to enforcement and monitoring, in addition to development of the enforcement system itself.

It is not only a matter of the legal system per se, but as Dr. Kanda and Dr. Yoshino mentioned, we need some kind of intermediaries who can deal with the issue of information asymmetry between depositors and investors on one hand and the institutions on the other. In the past, intermediary functions have been performed exclusively by the banks, but now that the securities market is used, it is very important to have intermediaries in the securities market, too. As Dr. Yoshino mentioned, servicers and SPCs in securitization may also be regarded as a kind of intermediaries.

In Japan and elsewhere, the intermediaries in the capital market will be increasingly important. How can we put a regulatory framework on the intermediaries then so that they function properly? That will be the next important step. I would like to elaborate on this further later. Mr. Sugiura made a presentation on combining regulations of the transactions with regulations of entities. This is a challenge Japan is facing; which framework would be more desirable in regulating the intermediaries? That is something Japan needs to address.

Thirdly, it may be too clear, but having listened to presentations today, I feel that investor protections or consumer protections must be implemented properly in order for the further development of the financial system and even the overall economy. I know you would all agree with me on this point, so I probably do not have to repeat this, but let us confirm that a well-functioning protection regime will be indispensable for vitalizing the economy.

How can we regulate the consumer protection? In Japan so far banks have played a dominant role, and they still do so. But we need to promote the development of the securities market. How should we do it? How should we balance it with good protection for the investors and consumers? This is the difficult challenge for us in Japan, and the main point of the presentations.

But in the final analysis we can say that it is easy to eliminate roles played by banks, as well as the entire deposit insurance system, and develop a new legal system altogether. But what we have to do is to let banks retain of the roles they are playing now, retain the deposit insurance system, and yet at the same time vitalize the securities market and increase volumes and transactions there.

It is important not only for Japan, but is applicable to developing countries and to other emerging markets as well. Many countries first let banks provide funds, and then vitalize the securities and capital markets. The issue is, at that time, how to build up the securities protection system that is consistent with the deposit protection system built on the bank-centered system. We are still far from being able to say that we have a good system for you to study and copy, if you please. Having said that, I believe Japan's experience can still offer certain information to other countries.

And lastly, although development of the securities market is important for the economic growth of a country, globalization, or having more cross-border transactions, is also important. Two of the major characteristics of the securities market are the anonymity and product standardization. If standardized products are circulated in the market, in a sense it attracts foreign investments, or supply of funds from overseas, and domestic entities will find it easier to raise funds. I would say that by shifting the funding and fund circulation function away from the banks to the securities market, it will be easier to attract foreign funds. Such technologies, including the securitization as presented by Dr. Yoshino, would promote fund circulation on a global scale. These are may impressions today. Thank you.

Prof. Yoshino:

I would like to open the discussion to the floor if anyone wants to make comments including our discussion and the previous discussions, not only from the main table, but other participants are welcome.

Prof. Ki Jeong Han, Associate Professor, Faculty of Law, Ewha Woman University, Korea:

I am Professor Han from Ewha Woman University in Korea. I have a question to ask to Japanese presenters. My question is whether the Japanese government has a grand plan to consolidate investment services law with insurance law and banking law. My question arises from the assumption that there may be some regulatory inequalities between investment, banking, and insurance laws. Maybe insurance, investment, and banking have common factors as well as different factors. As far as common factors are concerned, the same regulations should apply. To get rid of such regulatory inequalities, consolidation is an alternative. I want to know about the Japanese government's plan to solve that problem—regulatory inequalities. Thank you.

Prof. Yoshino:

Thank you. In the Japanese presentation, in the last presentation, I think Mr. Chihara has talked about the banking law and insurance law. I think he can readdress those issues. Thank you.

Mr. Nobuyoshi Chihara, Deputy Commissioner for International Affairs, FSA:

Regarding this question of whether we can go a step further from the Insurance Services Law and create a more consolidated law, there is no clear direction towards this at the present time. We now have to discuss whether such consolidation is possible, but if it possible to establish a law that is consistently integrated, I believe that this is one of the directions we could take in the future. But in that case, we will have to discuss how to resolve the issue of what to do about the barrier between banking and securities. I do not know how much time this will take, but this is certainly a problem we will need to address.

Prof. Yoshino:

There is a kind of national minimum. Deposits have to be guaranteed to a certain amount. So that is different from the securities market. In that sense, probably some kind of different protection scheme has to be established. Because unsophisticated consumers cannot invest in the securities market, but they can make deposits, so whether we should include insurance in that group or not is another discussion. That part will be different, as Mr. Chihara mentioned. But the other part could be integrated. That is my comment. Any other points? Okay, Prof. Kim.

Prof. Kim:

Yes, I would like to make some comments supplementing Prof. Kanda's statement that a large economy had better rely more on the capital market. Of course banks are important, but the capital market is also important in a large economy. Or only a large economy can afford to have a vibrant capital market.

I think the capital market is important. In order to have a demand for the capital market, I think at least we need to satisfy two requirements or two conditions. First of all, we need to have a sufficient number of people with some money to invest. If you do not have a number of people with money, you can't have a capital market. And these people should be rich enough to bear some risk. If they cannot afford to bear risk, they should go to banks. The second condition may be that business projects become more and more risky. In the past, about 30 years ago, when we first started our economic development, our business firms could look to Japan. We could just look at what Japan did in developing its economy and follow. We learned from Japan what kinds of sectors were appropriate for us at a particular stage. By doing so, we could minimize the risk involved. But now we have reached a stage where risks faced by Korean firms are becoming more and more substantial. For example, Samsung Electronics has reached a stage where they should create their own strategy. Of course, what is going in Japan, Europe, or the United States may be of some help, but they should create a business project on their own. So, the risk faced by Samsung Electronics is now bigger. This means that Samsung cannot continue to rely on banks alone because the business risk involved is now bigger. In a bank oriented economy, if firms go bankrupt, banks lending money to these firms may also go bankrupt. This creates a crisis. I think a cause of the financial crisis we experienced in 1997 is that Korean firms were heavily dependent on bank loans, especially on short-term loans.

The problem is that in order to have a vibrant capital market, we need infrastructure, which is very, very costly. The infrastructure is composed of lots of elements—first of all lawyers, sophisticated lawyers, sophisticated courts, reliable accounting profession and so forth. It is costly to develop these elements of infrastructure. Actually, it is to prepare this kind of infrastructure that Korea has made so many reforms in such a short period of time. I think those kinds of efforts are still underway. And maybe a smaller economy is not able to bear all the costs involved in such reforms. Thank you very much.

Prof. Yoshino:

Thank you very much. I think Korea used to have a catching up period. And then it is very easy to look at what Japan did. Then that road is already implemented. But since Korea is now as good as the Japanese level, then you have to find out what direction you would like. As far as banking is concerned, all Asian countries used to depend heavily on bank loans and bank deposits. So if the risks are growing, then, if I rephrase Prof. Kim's speech, the share of banking business should be come smaller. And they should concentrate on safer borrowers. Then capital markets should grow more. In that sense it is the balance of the banking and securities sector, so in that sense, Prof. Kanda's statement may be correct. If the economy is becoming larger, then the size of the deposit market becomes smaller, but at the same time, the capital market should grow further. Thank you very much for that nice comment. Are there any other comments or questions? Okay, from Thailand.

Mr. Suwanaporn:

I would like to offer some comments and suggestions on how we could strengthen consumer protection for users and investors in financial products and services. If we look at the parties involved in the consumer protection mechanism, we will see that we have consumers and investors on one end and we have financial services providers on the other end. And the party that has to bridge or try to balance the powers or the equality between the depositors, investors, and consumers and the financial services providers, the investment companies, would have to be the regulator and the supervisor. How could we try to promote, strengthen, and support the mechanism to balance the power of the two? I could try to offer some specific suggestions. For example, we may explore the roles of various groups.

Number one is the so-called consumer activist or consumer groups. These are also important because they are the ones to be alert and keep a close watch on what is going on—whether the industry is responsible, is accountable for their actions and for their liabilities. So maybe we should try to think about promoting the role of consumer groups. The second group would be the credit rating and credit scoring mechanism or companies, which I think are quite important to ensure a fair assessment or analysis of credit standing and the credit availability to proper consumers. So I think we should promote a good, efficient credit scoring mechanism. The third group is of course the lawyers group. I think we have to see that this is very important to ensure that legal protection is given to consumers and ensure that violations will be punished. The fourth group would be as I mentioned earlier, the credit counseling group. We need to have some more formal and informal channels where the people who are suffering from excessive borrowing or having credit problems can resort to some kind of remedial and counseling alternatives. So this is important to help lessen the problems as well as try to restore discipline and normalcy for the consumers.

The fifth one would be the importance of the appropriate legal framework. For example, as I mentioned earlier, the role of equality in terms of credit opportunities that have to be given to consumers as much as possible. Although we may not be able to make perfect solutions and answers for this, we need to try to promote equal credit opportunities regardless of origin, race, sex, and age. I think consumers are entitled to this kind of equal treatment. The sixth one would be, as I said the role of prior credit reports. The consumer needs to know their current standing, what are the problems, why are they denied credit, and what can they do to improve their credit opportunities. The seventh one—I have a lot, so you might forget about the previous ones—we may think about how some other countries like Australia have a separate organization to be responsible for consumer protection of financial products and services. In Australia there is an institution called ASIC, which is a sister organization to the Australian Prudential Regulation Authority or APRA. This organization is specifically tasked to help lay out guidelines, codes of conduct, and specific regulation concerning the transparency, disclosure and fair treatment of consumers.

The eighth one would be some form of anti-monopoly act, which I think could be important because if financial services providers could form and become bigger to the extent that they could form a monopolistic power over the market, thus they could jeopardize the justice and fair treatment that they could give to the consumers. Some examples that I have seen are in the case of Singapore with a growing, burgeoning growth of the hedge fund industry, the Singaporean government has come out with the regulation to ensure justice and fair treatment of investors. Three parties are encouraged and involved in terms of protecting the investor interest. They are law firms to ensure that the management acts according to what they have laid out when they tried to woo the investor. They have to work in accordance with the policy and the practice that they have laid out. The second group is insurance providers. The insurance company has to come in and provide insurance in case something is wrong with the investment of hedge funds to protect the investor interest. The third group is the auditing firm or the accounting firm which has to make sure that the reporting and the financial performance that has been published, that has been given is according to the actual performance of the hedge fund industry. These are the examples of how the authorities came up with a way to increase the best protection for the consumer. This is all the specific suggestions I can offer for the time being. Thank you.

Prof. Yoshino:

Thank you very much Mr. Chodechai. Eight important points have been raised. I will just give comments for your points. I think credit scoring is very important, and especially monitoring credit. But at the same time, equality of credit opportunities has to be well balanced. Because in many cases, especially in Japan, credit opportunities are better for those who have a good past record. Those who are coming initially into the market, those customers have great difficulty getting loans from banks because there is no past credit record. So I think a good credit record is also important, but sometimes newcomers may have some problems. And an anti-monopoly act is very important. That means competition among financial institutions is very important for consumers. But at the same time, too much competition will create some kind of fragile financial system. So the balance between competition and protection has to be well balanced. Lastly, as for the investors side, in the Japanese case, a new law which is prepared, will have two different kinds of investors—that is professional groups and individual groups. So should we have two kinds of investors in mind or the single investors? In the Japanese case it is professionals versus individuals. Any other comments to Mr. Chodechai's eight points? Then I would like to go to Dr. Tong.

Prof. Tong:

Thank you very much. I think I have a question. I was to ask an economic question to Prof. Kanda, however I believe Prof. Kanda has already left, so I hope that anyone sitting around the table could respond to my question. Speaking of financial systems, whether to use the existing system or focus more on the capital market, he said one point to take into consideration was the size of the economy. What is the meaning of the size of the economy? That was a question that I have had since I heard Prof. Kanda's presentation. To give an example, in the case of China, in terms of economic size, it is not that small, however, in choosing financial systems, there was a choice of bank system or capital market based system. It is a major choice that China has to make. Prof. Kim and Prof. Yoshino have already addressed this question almost 50%. Prof. Kim says that a certain number of people and a certain level of assets need to be accumulated. And there have to be people who are willing to take risks or business practices have to be mature to a certain extent. If that is the case, then that does not concern the size of the economy. I think it is more of an issue of the maturity of the economy. How mature the economy is I think is the question. But maturity could be defined in different ways, so it could be complicated.

In the case of China, if I may say, this is one of the very serious issues in constructing and designing financial systems in China, these are some of the very important questions China will have to address sooner or later. But since the end of the 1990s, China has closely monitored the situation in Japan and it has also closely monitored the effects of financial crises in East Asia, Southeast Asia, and South Korea. So although the government has been very cautious, academics may argue that China should introduce an American model. That is to day, China should focus on the capital market. Currently, liquid funds are being provided by the capital market, but in reality since the 1990s up until now, the Chinese securities market has undergone some damages. According to my own calculations, 70% of investors who have invested in securities have suffered loss; they have never enjoyed profit or gain. Although the Chinese economy has grown all the way, investors have not enjoyed capital gain by investing in securities. What about securities brokerage firms? There are already a large number of securities companies in China. However, more than 50% registered losses last year, out of which 50% have gone under. In 2005, I think Japan has had some influence on China, but market-oriented deposits, or in other words mutual funds (in China we call that investment funds) this is a scheme to use institutional investors as a vehicle, but since 2005, many of the funds have suffered losses as well.

So what I wanted to say was that looking at the Chinese situation in trying to design a financial system of a country, although it is my personal view, Chinese nationally owned banks do suffer losses and we do have a serious situation of securities companies. What do we have to do in China? Those are some of the challenges we face in China and I do not think there will be a panacea for these challenges. But if you have any good ideas, I would very much like to hear from you.

Prof. Yoshino:

In previous discussions, Prof. Kim and I discussed risks and the size of the deposit market and capital market, which would apply to Prof. Tong's question. But are there any other comments or questions? Yes, Dr. Chung.

Mr. Chung:

Yes. Actually I would like to add another question, perhaps to Prof. Kim related to risk question. My personal view is that when it comes to efficiency particularly, the capital market is much more efficient. That is why it is relatively much more important and growing faster. But then the capital market being such, there are some segments of the economy which cannot have access to it. My example is small and medium industry. They cannot list themselves on the stock exchange, so they cannot issue stocks. But when they have good projects they certainly need money so they have to go to the bank and hence the need of banking market. Also, very poor farmers and others who need microfinance to finance their small shops and such things, these small and medium industries and shops are critically important for employment generation and for the economy in general, but they do not have access to this capital market. So my question is, if regulators and government basically let the market decide and then the whole system is predominantly capital market-oriented, then how do you address or care about the needs of these small and medium industries and even small consumers? Please.

Prof. Kim:

As Prof. Kanda mentioned, even when the economy reaches a developed stage, this economy still needs a bank in addition to the capital market. So as he said, the capital market and the banks co-exist. But I would like to make two remarks which are related to Prof. Tong's question. I am not familiar with the situation in China, but when an investor purchases stock, it involves lots of risk compared with a bank deposit. So if the firm issuing this stock does well, then this investor should earn a lot. And if the firm fails, then the investor should lose. In many situations, when the firm goes bankrupt, investors lose all the money. But in many cases, although the firm proves very successful, its investors cannot make as much as they should, because management steals money from the firm. I do not know to what extent that is true. The challenge is how to protect the interest of these shareholders. And as I have told you it is far more difficult to protect the interest of investors than to protect bank depositors. It requires a number of elements of infrastructure: good accounting principles, reliable audit firms, investment banks, and so forth. And it is very difficult to develop all these elements at once.

I want to make another point that relates to the government industrial policy. When a government wants to intervene in economic matters, it may be better for the government to rely on the system based on banks because it is far easier to influence a small number of banks than to influence the capital market. The capital market itself is not amenable to guidance from the government. When the government is prepared to give up the power over the allocation of financial resources, they can move to a capital market-based system.

Prof. Yoshino:

As Dr. Chung pointed out, I think many countries start from postal savings or micro-credit or local financial institutions. They are receiving small depositors' money and then they make loans in the region. But once it develops, many companies want to raise a huge amount of money, then the capital market has to be developed. As Prof. Kim pointed out with shareholders' protection, I think there are two meanings of protection. Shareholders should be protected based on information, accounting and so on, but the risks associated with the profitability of the company, they have to take those risks. So that is a difference between depositor's protection and shareholder's protection. Prof. Tong was talking about how many Chinese people have lost money in the capital market and stock market. There are two or three papers by Japanese scholars and they found out the people who gained most in the Japanese stock market were foreign investors. They gained the most profits. And the worst performance was individual investors in the past. But in these recent couple of months, since the stock market is going up, all individual investors are also gaining, but in the long run, many small investors had minimum gains compared to foreign investors.

So if you have more. Yes, please.

Mr. Chung:

Sorry, just supplementing my question on banking. In the case of Korea, since I have been out of the country for now 22 years, I am not up to date. Would this rapid development of the capital market and basically financial flows shifting to the capital market and not as much to the banking sector, does small and medium industry, for example companies and even individuals today get enough loans when they need it? Or do they have to resort to some other means? That is my question to Prof. Kim. One comment I have related to this capital market theme is related to that of Dr. Tong. With the capital market and also with globalization taking place together, with institutional investors particularly from the international capital market coming in big numbers, they engage in programming trading and others making the market more volatile than ordinary individuals can handle…In the capital or stock market in Korea, most people are not able to participate in a meaningful way and enjoy directly because the risk is so much because it is so volatile. So I think as a result they depend on it more in an indirect way by depending on mutual funds and others which are very popular these days. But my comment is that with globalization and with big money coming in and out, volatility even on the foreign exchange market has affected the capital market very much. So the regulators' job is certainly much more daunting and more difficult to manage these things. That is my comment.

Prof. Yoshino:

As for your comment about small and medium-sized enterprises, today we have discussed that we have to develop the capital market. And the banking market is sometimes not very well functioning. But whether the capital market can cover small and medium sized businesses or banks are the main source of growth for that market, in Japanese experience during crisis periods, there are two policies. One is creative guarantee by government or city government organizations. They provide full or 100% guarantees. And the second one is Japan has government banks. There are two government banks for small and medium-sized businesses. They are relatively expanding their loans to those businesses. And the third one is that in Japan the securitization of SME loans has started. In the past, it was very difficult to securitize SME loans because of a lack of credit information. But Japan created the Credit Risk Database (CRD) and also each small bank has also started to collect its own data. And somehow they could utilize that information, and then it became easier to securitize. So I think changes in technological development will be slightly different. Are there any other comments? Prof. Rhodes, would you like to give any?

Prof. James Rhodes, Professor, National Graduate Institute for Policy Studies Japan:
Well, sitting here listening to you all talk about the difficulties of developing capital markets calls to mind a book I read many years ago by Prof. John Hicks, a Nobel Laureate. It had a rather unusual title and I do not remember it exactly, but it was something like *A Theory of Economic History*. Because of this title, I do not think it got quite the attention that it probably deserved, because in my recollection, really what it was about was the difficulty of creating capital markets in the West. Before capital markets in the West could be created, you had to break down all these feudal, medieval-type guild systems. You had to create a basis for this cross-sectional system that you are talking about developing here. So I think while many Western economists are very puzzled about why it is taking so long in Asia to develop these capital markets and why they are very impatient for you to move down the road, I think we tend to forget that it took hundreds of years to develop the same type of capital markets in the West.

Prof. Yoshino:
We all believe that Western markets developed a capital market in a few days. Yes, go ahead.

Prof. Mamiko Yokoi, Lecturer in Law, Queen Mary University of London:
As I was speaking, I just remembered that I read a paper recently about exactly this—banking and capital markets, whether it is bank or market. And I feel that the tendency is an evolution from a bank-dominated system toward capital markets in terms of evolution. However, there will always be a banking system, as we all probably know already. But one of the points I want to also point out was that in the Professor's

classification of small economy for banking and large economy for market, there are some exceptions. For example I have a student from Jamaica. Jamaica is an extremely small economy, however their capital market system is much more well developed than their banking system. Also, I think Singapore, which is a relatively large economy—I am not an economist, so please correct me if I am wrong—I think their capital market is extremely well developed as well. Also, I wanted to point out that because microfinance was raised, even though microfinance is something geared toward actually extremely small amounts of credit or insurance to the extremely poor people, actually some countries in Latin America, the microfinance industry has grown so much that they actually tap the capital market for their funding. So there are also these sorts of diversions between these two systems which I think are extremely important to know about. You probably do not want to rule out one or the other because they probably should be mutually reinforcing each other.

The other thing I also wanted to point out was that as you move toward a more capital market oriented system, there is also another slight dangerous aspect which we do not really want to think about because it has a very negative impact, but what happens when you are for example in Argentina and you are, because you have suddenly turned toward a capital market oriented system and you country has mainly used capital market financing for your physical debts and what happens when you cannot pay your debts—in a banking system it is much more straightforward to restructure any of your outstanding loans because the party you are dealing with is much more straightforward. You know your banks. They know you. And therefore is much easier to restructure any of your loans you have. However, in a capital market system, even if this is with a corporate, if there is any problem with the corporate, to restructure the debts, the outstanding debt that has been issued, becomes extremely difficult because obviously we have the issue of investors, very small retail investors, becoming involved instead of a large bank that you are dealing with and also the number, which becomes numerous once you become a capital market system. So I just wanted to point this aspect which might be of interest to some of you.

Prof. Yoshino:

Thank you very much. Since Professor Kanda is not present here, his wording of small and large may not be so appropriate that is why so many questions will come out. Ms. Takahashi, if you have any questions or comments, please.

Ms. Nobuko Takahashi, journalist:

Yes, please. If I may, I would like to introduce from a different perspective. So we are trying to protect the financial service and product users and consumers, not only in Japan but in the Asian countries. We want to offer an assurance so that individuals and retail customers can use the market, but still we have a lack in the infrastructure. Earlier Professor Yanagawa said that the financial instruments are very complicated, it is mixed, but at the same time it offers big opportunities. And my comment is related to that.

My comment is related to that. In Japan, the financial instrument is becoming complex and there is a large variety. It is a very accelerated process. Yes, it offers big opportunities and chances. That is fine, but when retail customers want to transact, want to invest, many problems are actually occurring. And one of those problems that are occurring is in Japan. Traditionally, for example, in the case of banks, banks would have taken on the risk, and we have always transacted as banks. We have held a deposit, but now you can buy investment trusts or you can go through transaction of securities even through the OTC banks. So in the past we tried to divide the production and the sales, but now the structuring and the developing and the selling, there are so many parties who are involved. And now the consumer has difficulty to understand which party is playing which role in the flow of service.

You might believe in the bank. You believe it is an indirect financing mechanism, and you place your money in the deposit account. But you are not aware about the commission. Maybe it was only an intermediary, and without knowledge, you might have been involved and you might have become an investor into a highly risky financial instrument without acknowledgement. So that is why we have tried to establish this new law, the so-called investment service law in Japan. Under this new legal framework, if there is a party who is an intermediary taking on a commission fee and offering service on behalf of another party, we are trying to strengthen the legal framework. We are emphasizing on that aspect, so that it would have a proper meaning to protect the users. In the capital markets, for our retail investors to participate, it is important to offer good, attractive financial instruments, but at the same time you have to offer an appropriate environment so that if the consumers are going to invest in risky instruments, they have to be aware that they are taking on that level of risk. That is my comment. I will be happy to hear other people's opinions.

Prof. Yoshino:

We were discussing about privatization of postal savings, one of our proposals was the post office should handle mutual funds or investment trusts. They we have discussed the same issue as Ms. Takahashi pointed out. And I was joking. Banks should distinguish several kinds of deposit accounts: green booklet, yellow booklet and red booklet. Green booklet is deposits. Yellow booklet is mutual funds. And red booklet is risky booklet. Then consumers can easily understand there are three kinds of booklets by post offices or banks. So that was my joke. But consumers have to know what product is protect, which one is medium risk and which one is high risk. So that is also related to a consumer’s education. Are there any other things that you would like to mention?

Mr. Chung:

Yes. On that I would like to share my personal sense, how I feel when I get nothing as an interest from my bank account in Japan. Being a commercial banker, before I joined ADB, I certainly appreciate the time value of money, and if you deposit your money to your banks, then your banks should use that money for productive purposes and then earn some, and you have to get some interest on your deposit. But in Japan, I have been depositing quite a sizable amount in yen here, but I have not received any interest here. So it is an injustice in a way. There is no time value of money here. So with that background, coming up with these new products available to consumers and depositors, this is certainly a welcome phenomenon. Depositors, I mean, consumers should have an alternative asset which can give them some return at least, not a zero interest rate.

Prof. Yoshino:

Professor Yanagawa’s name has been referred to. Can you offer some comments?

Prof. Yanagawa:

Ms. Takahashi is very much related to the argument about the banking system versus the capital market system. I think as Professor Yoshino has pointed out, in Japan the consumer protection, the depositors protection is very strong, so it is much different from the investor protection in the security market, because there is deposit insurance. We do not have to think about the risk of the deposit. We do not have any information about that. So this is something—there is a big Japanese bank, so I do not think anything about the risk. So just deposit.

So think kind of regulation of the system is a very easy way for us. So I do not have to get information. This is one reason I think that the Japanese banking system is very much growing and the Japanese banking system is dominant compared to the stock market and capital market. Yes, I think there are many other reasons that you pointed out, the banking versus the capital market, but I think this kind of special consumer protection policy is one reason, I think. So that is where we should go. Then the one drastic way is to take out the deposit insurance, but I think that that is so good a way. And the second way is as Ms. Takahashi mentioned that we should make a much better system for protecting the investors in the capital markets. So that is not just like deposit insurance, of course, just the main point is that more reducing asymmetric information problems and making a very good accounting system and make a better legal enforcement system. So we should make more investor protection in the capital market, which will be better for the Japanese economy, and increase the capital market system.

Prof. Yoshino:

As you pointed out, there is asymmetry between the protection of depositors and investors in the capital market, too much gap that has been making it much narrower. I would like to ask Ms. Hara.

Ms. Sanae Hara, Lecturer, Saitama University:

Thank you very much for giving me the floor. I have joined this conference since noon, and I have been very much interested in all the comments and questions that have been made by a lot of you. There was a mentioning of interest rates in Japan by banks. I was participating in a meeting this morning, and 17 yen is the total annual interest that we were able to earn for the amount of 6 million yen. And 7,000 yen we had to pay for the production of the certificate of deposited amount. There has been a diversification of business operations of banks in Japan. Banks and capital of raising in capital markets have been contrasted in our discussion, but looking at the Japanese situation, it seems there are a lot of overlaps between banks and capital markets, so it is not a one or the other kind of situation that we have in Japan. There are many overlaps between banks and capital markets in Japan, so infrastructure has to be improved and strengthened both for banks and capital markets, or capital markets inclusive for banks, I would say.

There are three requests I would like to make. In the morning session, I believe there was a presentation by Korea, I apologize if I missed some of the points that you mentioned in the presentation because I was absent in the morning. Capital market rules have been improved in South Korea. There was a need in South Korea to improve and develop infrastructure, be it banks, insurance companies, or securities firms. Walls had to be removed so that cross-sector, comprehensive legislation is now being implemented in South Korea. That is the information that I have gathered. Speaking of Japan, as was responded by the representatives of FSA, we are perhaps moving toward the same direction. However, in the case of Japan, insurance companies may want to be outside of the scope of this legislation. Banks may be outside of this legislation, so we have not seen much progress in terms of establishing comprehensive legislation in Japan, but it seems that South Korea is much more advanced in terms of coming up with comprehensive legislation to cover different sectors in the financial services industry.

It seems that the government of South Korea has much leadership initiatives and has the government of Korea decided that this is the way to go forward to establish a comprehensive legislation, be it China, South Korea or Thailand—mortgage loans, credit, consumer credit has seen much growth. Speaking of Japan, legislation in the area of consumer credit has lagged behind, and there is an urgent need for Japan to develop adequate and appropriate legislation for consumer credit, so I would very much appreciate if you could share with us the particular situation concerning consumer credit in your particular countries.

Thirdly, I am a member of the financial systems council representing consumers. It is a unique position that I serve on the council. So I am not an academic. I am not a legal expert. I am not an economist. Someone mentioned about the roles to be played by consumer organizations, consumer advocates. To give you an example, Citibank, I think it was two years ago in Japan was involved in a series of scandals. And this has become a major problem in Japan, and this has also been true in India as well. This has become an issue in India as well, I understand. Partnership, partnering with consumer organizations, consumer advocates in different countries could be a way for us consumer organizations to move along. So I would like to hear from you the roles that have been played by these consumer advocacy organizations in your countries. Thank you.

Prof. Yoshino:

Three questions. The first question was specifically targeted to Korea. Thank you. Professor Kim.

Prof. Kim:

Yes. I am only marginally qualified to answer your first question. As I have told you in the morning about our government's attempt to consolidate financial services laws. In the year 2003, the government tried to consolidate all these laws related to the financial market. But the government gave up that plan and they have decided to consolidate only those laws related to the capital market. So now I think the insurance companies and banks are outside the scope of this new law, which has been just announced by the government, and not been enacted. Three years ago, banks, insurance companies and securities companies were not that enthusiastic about the idea of consolidating all these financial market-related laws. But now that the government has announced that they are going to consolidate all these laws only related to the capital market, the banks are now becoming more anxious. It is because under the new law, securities companies will be free to create new financial products, while banks still need to get a license beforehand whenever they want to deal with a new product. I am afraid they may make a move against this new law.

And let me make some remarks on the points raised during the discussion. In Korea, banks still enjoy a dominant status in the financial market. The capital market is much smaller. And as I have shown you in the morning session, the percentage of equity securities of the household financial assets accounts for less than 8%, which is quite low. True, the stock market is now booming, but it is primarily foreign investors who benefit most from this boom. Foreign investors are much more optimistic about our capital market than domestic investors who shy away from the capital market. Now we are all talking about the bipolarization of our economy. Big firms have no difficulty finding funds. Banks are eager to provide loans to big firms. But banks are avoiding medium and small-sized companies. And these poor medium-sized companies cannot get funding from the capital market either because no one wants to believe the information produced by these firms. So the capital market is beyond their reach. I think it is very important for us to develop the capital market-related laws so that these medium-sized companies can enjoy the benefits of the capital market.

Prof. Yoshino:

Thank you very much. The second point from Ms. Hara was about consumer protection of credit cards and credit loans from the consumers. The Thailand case, I think there is a lot of development recently in Thailand.

Mr. Suwanaporn:

Let me give the background of the consumer protection measures in Thailand. In the past, as the consumers and people in general are not that well-educated or the economy was not that developed, the consumer awareness was not that great, but as of now people are more aware of their rights. So coupling with the growing business in terms of credit card consumer loans the government has stepped in and tried to strengthen the consumer protection as well as the prudential requirements that need to be put in place.

In the past, the consumer loans business was conducted by only banks who take deposits, so they are under the direct regulation of the government—both the Ministry of Finance and the central bank. So that was no problem. But later on as the non-bank companies, the credit companies, are coming in and they are giving out credits and given the big margins of profit that they can enjoy so there is a very fast growing industry in Thailand. Since they do not take deposits from the public, they do not come under direct supervision or scrutiny by the government. In the last five years the government has issued new regulations concerning credit card businesses and the consumer loan businesses.

What we did was to try to improve consumer protection as well as to ensure that the businesses are not going to jeopardize the prudential stability of the whole financial system. What we do is we control in terms of who are legible to have credit cards or consumer loans, the price or interest rate that can be applied on the consumers, and thirdly the reporting requirements that they are subject to, because in this way we can keep track of what they are doing and also to improve transparency to the public, to the society, and to the consumers as a whole. These are the three measures that we have imposed on them.

Just recently at the Ministry of Finance level we have conducted a comprehensive study on the so-called non-bank creditors. Unfortunately I have not given it out to you, because the report is quite thick. It was only finished last week and I need to make sure that the content is correct, but if you are interested I can share with you some of the information here. This report contains non-bank creditors in terms of consumer loans, credit cards, leasing, hire purchases—which means auto leasing and also the factoring businesses. This is the report that we have done. That I am willing to share if you are interested. This is the development in Thailand.

Prof. Yoshino:
Thank you very much. Is there any comment from China? Professor Dong or Professor Tong, if you have any. If you do not have any specific ones, that is fine.

Prof. Tong:
I have no knowledge about consumer protection or consumer group activities in China. Sorry.

Prof. Yoshino:
Mr. Kozuka? Because we are approaching the final stage. Either in Japanese or in English, please.

Prof. Kozuka:
Thank you Professor Yoshino. I wanted to put all those discussions into a broader perspective, that is, consumer protection in general. I have been considering all the time—what is different or what is unique with financial transactions as compared with consumer transactions in general? My idea is, as I may have mentioned in my presentation, in the case of a financial transaction it is the risk itself that is the subject of the transaction, whereas in the case of a general consumer transaction it is rather the products or services and risk or safety is kind of one of the natures that that subject has. Put in another way, in the case of, for example, a bottle of water, it is better, the safer the bottle is. However in the case of financial products, it is not always better, the "safer" the financial product is. But maybe you may have various different opinions.

Also, another point to put all these questions in a broader perspective in a different way—what is unique to Asia in terms of financial transactions or regulations on financial transactions as compared with other parts of the world? Sometimes I go to a meeting of lawyers. Many academic lawyers have an interest in Asia and always they keep saying that Asia is different from, say, Europe. In the case of Europe it is a group of countries with more or less similar backgrounds, but in the case of Asia someone said that it is nothing but a geographical designation, so there is a variety rather than a consistency or similarity. But my impression is—after all these discussions we had today—I sense we have found some common factors or common similarities among Asian countries, among Asian markets, although we must admit that there is a great variety after all. So those are two very broad questions I have posed. I do not expect it to be answered immediately, but if anyone has any idea, I should be happy to hear that. Thank you.

Prof. Yoshino:

As Professor Kozuka pointed out, it is often characterized that Asia has some common phenomena. One is a high savings ratio. Of course the Japanese savings rate is declining, but a high savings ration is one. And number two is a bank-dominated economy, especially in the financial market. And number three is home country bias. Those are the three common factors. All the countries have to change those bank-oriented to capital markets, however we discussed today there are lots of things we have to prepare. Hopefully all the countries harmonize each other and globalization could also enhance our cross-border capital flows the more we stabilize the development of the region and also across the world. Dr. Jung?

Prof. Jung:

Yes. A question. On this risk question—this is very interesting and I have been thinking of this for some time and I would like to share this also. Asia is diverse certainly, but one missing factor in the ones you just mentioned is the risk attitude of Asian depositors or investors. Maybe there is some difference. It is hard to generalize. But for example, I can sense some difference in general. I can say that Korean depositors and investors are much more risk-takers in my view. Japanese are much more risk-averse. So there is that difference. Having said that, a more fundamental thing is many depositors and consumers, particularly those who are not so sophisticated, they do not know the differential of the risk return matrix of two types of assets—the equity and debt（bank's debt）. As you all know the text book says debt is certainly less risky, so you need less return on debt, but with equity there is a certain risk here and you need a higher return on equity, but in actual market practices I do not see that much of depreciation there. In the Korean market for example and also in the Chinese market, people do not seem to bother with putting the risk of equity. They all love equity very much actually. Perhaps that is one of the reasons why the equity market is booming compared to the debt market. This is very much related to attitude and perception of risk, but there is a difference and that has implications on the relative development of the different markets also. Thank you.

Prof. Yoshino:
Yes. Please.

Mr. Ron Foster, Minister-Counsellor, the Australian Embassy:
I have enjoyed it very much and it was very informative. Also all of the speakers, thank you very much for your contributions. The thing that has struck me—and you sort of touched on it in the things you just said—throughout all of this discussion, was the lack of focus on risk in relation to the banking system, and it seems to bias the discussion about whether or not it is risky to have a capital market or to develop a capital market, because it seems that we have almost eliminated the risk from the banking system. Professor Kanda made a comment which I found interesting that there is an over-borrowing problem and the banks will just keep lending and keep lending and keep lending until they grow broke. In my capacity as a borrower I would like to meet a bank like that. In my capacity as a depositor I would not give them any of my money at all. The issue it seems to me is that there is a lack of risk assessment being applied by the banks and that there is no discipline on them. So yes it is a very unrisky system because we guarantee the depositors and the banks can do what they like. That seems to me to add another dimension to this discussion in terms of how you think about the moving to a capital market and the sorts of protections you want to put in, and perhaps also to think about avoiding having too much protection so that you actually eliminate the risk which is actually the essence of the system because financial transaction is about risk. It seems to be that it would be useful to have a discussion around more discipline in terms of risk assessment.

I also had the question which was related to that. I thought I heard you say earlier that deposit insurance had recently been extended to corporate depositors and I immediately wondered why. What market failure has occurred that they suddenly need protection from deposit insurance and what motivates that? And whether you think there are any possible downsides from that in terms of distortions for example. It might bias people’s choices in terms of where they put their money, it might bias interest rates in terms of you have put a zero interest rate on that. I just found it a really interesting comment just thrown into the conversation. It was just an observation and a couple of questions. Thank you.

Prof. Yoshino:

Thank you very much for summarizing some missing points. The last point I can answer as much as I can. During the introduction of limited deposit guarantee, there were huge criticisms from the corporate sector because they are transacting huge amounts of money and they are not used to the risk of the deposits. So I think it is a kind of transition to the perfect limited guarantee system. But interested rates on that transaction account are zero and banks can charge fees and commissions, so that means they have a negative interest rate. Superficially it looks like good deposits, but they can charge costs and so on. If the interest rate started to be a normal situation in the deposit market, then that transaction account is definitely an inferior product, so right now as you said there is a distortion. Many businesses are shifting their time deposit into a transaction account because almost all the interest is zero, so it does not matter whether they keep it. But once the interest rate will start to rise then they will think about it and it will become a normal situation. We think that is a transitional period, so that we want to calm down the turmoil of those deposit markets. That is my view. Thank you very much. Are there any specific comments and questions if you want?

Mr. Tapasanan:

Discussion about deposit insurance just as he mentioned and as you just explained it—that is the consumers' point of view that maybe consumer protection is weakened because only a number of depositors are protected. Well, that is the consumer advocate's point of view. As a regulator, there is some kind of another angle of point of view. I remember that my former governor gave a speech in London in the year 2000 regarding this issue. I would say that perhaps the limited guarantee by the debt insurance schemes also has an edge. It has a downside, it has an upside. It is pro and con. But from the regulator's perspective, I would say that a limited guarantee perhaps in another angle increases consumer protection. When we omit large depositors which mostly are corporations which we think are sophisticated, it means that bank managers or bank management will be in trouble because corporations will be breathing behind their neck. They are watching banks and how they manage. If you manage it wrong, they withdraw the money. Once the money is withdrawn, it is a signal that small depositors will be withdrawing money. Banks will collapse just because shareholders of the bank will not be happy with the bank management. So bank management will be disciplined. I will say that limited guarantee by debtors insurance is the way that people like us discipline banks.

Prof. Yoshino:

Yes, I agree. I completely agree. At the same time, how much amount of deposit should be guaranteed is also very important. In the Japanese case it starts at ten million yen, but each country may have a different size to protect. But as minimum protection I think it is definitely needed because banks are playing a very important role in the transaction business. It has to be protected. Thank you very much. We have already exceeded our closing time. I would like to thank all the participants and also the people from the three different countries: China, Korea, and Thailand. All of them have arrived yesterday. Are there any comments and questions? Specific questions and comments? Sorry there is one specific question if you can wait. Yes?

Dr. Yoko Shirasu, Research Fellow, Financial Research and Training Center, FSA, Japan:

I have a question about the roles to be played by the regulators. In the case of Thailand, it could be Bank of Thailand (BOT), could be the Ministry of Finance depending on which financial instrument you are talking about. BOT is positioned as the central bank of Thailand. MOF has to dispense laws as a government agency. But if they were to act as regulators, what is the role between the two? What is the position of BOT in regulating these financial instruments in Thailand? The distinction between BOT and the Ministry of Finance.

Mr. Tapasanan:

The BOT is a monetary regulator as well as the bank regulator. In short, Ministry of Finance is the policy maker. I think that the Ministry of Finance gives the policy and it is followed by BOT.

Mr. Suwanaporn:

I think what he said was correct but if you infer into some kind of how do we divide our responsibility and work as a team—yes, to some extent we work closely and we cooperate. But if you are referring or implying to whether we should have less regulators, then this is a very touchy, sensitive issue and one cannot assume that we have to follow some countries. There is a process. There are some ideas. We are working on this, trying to improve the regulation system regardless of whether there is a single regulator or a multiple system regulator type. Did I answer your question?

Prof. Yoshino:

So whether the multiple regulators will be better or a single regulator will be better is a discussion undergoing in Thailand. When I visit Thailand, when I talk to people at the Ministry of Finance then I talk to the central bank, their views are different. I think that is the best answer to her questions.