

Overview of the Medium-term Vision for the Future of the Japanese Financial System (Summary)

Part 1: The Vision for the Future

1. Need to Construct a Financial System harnessing Both Industrial Financing and Market Financing

(1) Changes in the Economic Environment surrounding the Financial System

- Risks that need to be addressed by the financial system are on the increase.
- It is necessary to share risks properly through the financial intermediation function.
- It is necessary to ensure confidence for the market. A wide range of financial products need to be offered and risks be taken widely.

(2) Need to Construct a Financial System harnessing Both Industrial Financing and Market Financing

It is necessary to reconstruct the Japanese financial system to harness both industrial financing and market financing, with market functions set at its core, in the sense that the industrial-financing model will remain viable but the role of the market-financing model will become more important.

Industrial Financing Model = Financing mainly through intermediation based on bank deposits and lending

Market Financing Model = Financing through market-based intermediation in which the pricing mechanism functions

2. Efforts to Construct a Financial System harnessing Both Industrial Financing and Market Financing

(1) Government's Efforts in the Past

The Government has implemented institutional reforms, including the reform of the financial system, and developed a broad legal framework.

(2) Basic Directions of Financial Intermediaries

Financial intermediaries should generally head towards the following three directions.

(i) Ensure Returns based on Proper Risk Assessment

- It is necessary to clarify the relationship between the risks and returns associated with financial intermediation, and ensure appropriate returns commensurate with costs and risks.

(ii) Disaggregation of and Specialization in Functions of Financial Intermediaries

- It is necessary to disaggregate and specialize in various functions to offer more advanced and specialized financial services and promote securitization.

(iii) Diversification of Financial Products and Improvement in Access

- It is necessary to offer a wide range of different and attractive financial products according to the risk preferences, etc. of individuals. It is also important to improve access to financial products, in view of improving user convenience.
- Financial intermediaries need to properly fulfill their accountability in light of user protection.

(3) Involvement of Companies and Individuals

- **Companies:** Various means of financing need to be offered according to their growth stages, etc. and the market be further utilized.
- **Individuals:** It is important to be able to freely choose from various financial products. It is important to improve the environment so that individuals can engage in transactions with trust, in view of user protection.

(4) Government's Efforts

- The Government is to improve the environment to promote competition and implement function-oriented policies according to the progress in the disaggregation of functions of financial intermediaries.
- It is necessary to improve the market to ensure confidence and improve efficiency in the market. It is vital to promote consumer education and user protection, and tackle systemic risks.
- It is necessary to reform public financing in consistent with the financial system with market functions set as its core.

3. The Financial System harnessing Both Industrial Financing and Market Financing

(1) Supply of Funds in Financial System harnessing Both Industrial Financing and Market Financing

- **Wholesale Financing:** Further shift to the market-financing model. Progress in financing from the market and securitization of loan assets.
- **Retail Financing:** Industrial-financing model will remain effective but enhancement in risk management techniques and abilities will be required. Improvements in risk management abilities will help expand the scope of lending.
- **Venture Companies, etc.:** It is important to properly fulfill funding and functions to provide information, etc. by banks, venture capital, etc. to foster venture companies.

(2) Role of Indirect Market Financing in a Financial System harnessing Both Industrial Financing and Market Financing

- It will be effective for a service to specialize in facilitating financial intermediation between the market and individuals, and between the market and companies. The role of institutional investors will become more important. They are expected to fulfill responsibilities as agents of the final beneficiaries and demonstrate governance functions with respect to the object of investment.

(3) Ensuring International Competitiveness of the Japanese Financial System: Cooperation with Other Asian Countries

- It is necessary to restructure the Japanese financial system into a highly efficient one in light of international competitiveness. The financial system should play a pivotal role in the integration of the Asian region in both financial and real economic aspects.

Part 2: Challenges to be Addressed as a Bridge to the Envisioned Future

1. Basic Approach

(1) Conversion of Financial Intermediaries' Business Models

- Financial intermediaries themselves need first to convert their business models to properly demonstrate their functions.

(2) Promotion of Reform of Securities Market

- It is necessary to continuously promote reform of the securities market, which will play a more important part in the financial system harnessing both industrial financing and market financing utilized with the market function, by boosting confidence in the players (issuing companies, market intermediaries, market operators, etc.) and improving the accuracy and timeliness of disclosure, so that the market mechanism itself gains sufficient public confidence.

(3) Active Efforts in Measures to Promptly Construct a Financial System harnessing Both Industrial Financing and Market Financing

- The Government need to actively take measures to promptly construct a financial system harnessing both industrial financing and market financing.

2. Conversion of Financial Intermediaries' Business Models

(1) Conversion of Financial Intermediaries' Business Models

(i) Deposit-taking Financial Institutions

- It is necessary to further strengthen management bases through enhanced profitability. It is important to promote functional disaggregation and specialization and the securitization of loan assets, and enhance retail financing when converting the business model.

(ii) Securities Companies

- It is important for each securities company to build various business models taking advantage of its characteristics. Securities companies themselves need to make further efforts to gain customers' confidence.

(iii) Insurance Companies

- It is necessary to enhance their security functions against various risks, in line with changes in needs.
- Insurance companies need to construct a new business model as key players in the new financial system, amid the intensification of intrasectoral competition, competition between life and non-life insurance sectors, and competition with other financial sectors. It is important to enhance the risk management ability and confidence in the management base of securities companies under the current circumstances.

(iv) Institutional Investors such as Investment Trusts

- Their role as a player in indirect market financing will become more important. For example, investment trusts need to offer attractive products effectively making use of the new framework. Institutional investors must improve their know-how on asset management, and fulfill their responsibilities as agents of their respective final beneficiaries.

(2) Measures to Promote Mergers and other forms of consolidation

- Considering the vision for the future, especially in regard to regional financial institutions, the effective injection of management resources into their own competitive fields, and reorganization through merger and other forms of

consolidation are strong options. It is important to take measures to support mergers and consolidations, to overcome barriers including administrative procedures.

(3) Removal of the Blanket Deposits Insurance (Restarting the ‘Pay-off’ Scheme) and Ensuring the Stability of the Payment and Settlement Functions

- It would be appropriate for the deposit insurance system to return to a partial coverage system to protect (i.e. restart of the “pay-off” system), based on the view that it is desirable to improve the efficiency of the financial system as a whole. On the other hand, it is indispensable to ensure the stability of the payment and settlement functions considering their public nature. Therefore, it is necessary to prepare a scheme that protects deposits in full amount when a financial institution fails (“payment and settlement deposits”) and take measures to definitely complete transactions in the course of payment and settlement.

(4) Disposal of Non-Performing Loans (NPLs)

(i) Various Aspects of NPL Problem

- Each bank needs to promptly dispose of NPLs utilizing the market mechanism. NPLs are partly attributable to companies’ overborrowing. Also, it is important to overcome deflation.
- It is important that banks convert their business models to improve their profitability and promote the securitization of loan, in light of overcoming the NPL problem as well.

(ii) Government Supervision of Banks for the Foreseeable Future

- It is necessary to continue strictly conducting inspection and supervision to ensure the soundness of bank management.
- Basic rule for the Government supervision of banks is to ensure the soundness of bank management, which should be assessed as a whole in a comprehensive manner.

3. Efforts to Promote the Reform of the Securities Market, etc.

It is necessary to implement speedily the *Program for Promoting Securities Markets Reform* and constantly examine the system in the future.

(1) Ensuring Fairness and Transparency in the Market: Ensuring Confidence in the Market

- It is indispensable to make the market fairer and more transparent, and gain public confidence for the securities market to become a truly solid market.
- It is necessary to enhance and reinforce accounting and auditing for these reasons.

(2) Improving the Stability and Efficiency of the Market

- It is necessary to construct a highly convenient, stable and efficient market for investors.

(3) Widely Promoting Japanese People's Participation in the Market

(i) Improvement in the Market Access

- It is necessary to promote diversification of sales channels and improve the environment so that individuals can easily access a wide range of attractive financial products, etc. in order to realize a truly solid market in which Japanese people widely participate.

(ii) User Protection and Changing Individual Investors' Mentality

- It is important to improve user convenience and protect users.
- It is important to promote consumer education and change individual investors' mentality.

4. Aggressive Efforts in Alternative Measures that help the Prompt Construction of a Financial System harnessing Both Industrial Financing and Market Financing

(1) Reform of Public Financing

- **Postal Savings and Postal Life Insurance:** Need to ensure an equal footing with private financial institutions.
- **Government-affiliated financial institutions:** Securitization of loan assets must be promoted by government-affiliated financial institutions.

(2) Tax System for Financial Products

- The tax system must be simple and easy to understand in consideration of the actual status of transactions, etc.
- The tax system must promote the trend to shift the object of preferential treatment from savings to investments.