and can price more attractively. Moreover, customers might prefer to invest elsewhere if returns on new insurance policies are reduced too drastically.[18]

The Japanese Response

Until recently, the Japanese government response to growing financial problems at JFIs was forbearance. Although this response might seem odd, it was assumed that economic recovery would solve the JFIs' problems. However, this has not occurred. With failures already experienced at five JFIs in the past year and economic growth forecast to be relatively slow in the near future, the Ministry of Finance has had to re-think its strategy and come up with a plan to restructure the system significantly.

In June 1995, the Ministry of Finance announced a five-year plan that dealt with the balance sheet problems of JFIs. It ensured that all deposits at banks would be honoured under the auspices of the Deposit Insurance Corporation. Moreover, the Bank of Japan stated in its annual review that it "...will continue to take appropriate actions to sustain the stability of the financial system by preventing systemic risk...".[19] The Bank of Japan has almost unlimited capacity as a lender of last resort to intervene to stabilize the system.

The June 1995 strategy, however, was generally considered inadequate[20] and, in December, a more detailed report was released. The most controversial section of the report dealt with bailing out the failing housing loan corporations (HLCs).

[18]For example, the Pension Welfare Service Public Corporation (Nempuku), the largest public pension fund in Japan, is considering cancelling its contracts with 18 life insurance companies, amounting to 5 trillion yen. The possible cancellation of contracts was precipitated by the life insurers lowering guaranteed yields on group pensions to 2.5 per cent (from 4.5 per cent) for the next fiscal year. (See *The Globe and Mail,* January 23, 1996, p. B10 and *Financial Times,* January 23, 1996, p. 1.)

[19]Bank of Japan, *Bank of Japan Annual Review 1995,* Tokyo, 1995, p. 25. In fact, The Bank of Japan can intervene at its discretion since it could argue that systemic risk is present with *any* failure.

[20]The inadequacy of the June plan was reflected in the subsequent emergence of a "Japan premium" in international markets, raising Japanese banks' cost of funds. The premium reportedly rose as high as 0.6 percentage points for the stronger banks and higher for some of the weaker ones. Recently, this premium has been disappearing due to a perception of increased strength within the Japanese financial system, largely stemming from the government's new plan to deal with the HLCs. However, as Japanese banks' demand for funds increases with the coming of their fiscal year-end in March, a premium might re-emerge. (*Financial Times,* February 3/4, 1996, p. 4.)