Unclassified

POLICY STAFF COMMENTARY No. 13

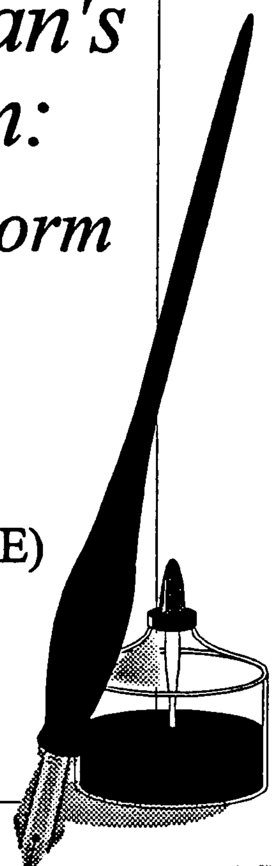
Restructuring Japan's Financial System:

Looking Beyond the Storm

Julie K. Fujimura
Economist

Economic and Trade Policy (CPE)
Policy Staff

(February 1996)



Policy Staff Commentaries are short papers on issues of interest to the foreign policy community.
The views expressed are not necessarily those of the Government of Canada.
Comments or enquiries on Commentaries should be addressed to the author.

Restructuring Japan's Financial System: Looking Beyond the Storm

Although it is undeniable that the Japanese financial system is experiencing a crisis, there is no reason to predict that it will be a fatal one. The Japanese government has made a public commitment to stand behind the major banks and those engaged in international business activities. With the Bank of Japan's backing, systemic risk can be controlled, and the government's commitment assumed credible. This is not to say that there are no serious problems within financial institutions. The post-war financial system in Japan has proven to be inherently weak. Lack of transparency has allowed poor management practices to go unnoticed and uncorrected. Although reform will be necessary for the system to regain its health, steps are finally being taken by regulators and financial institutions to ensure that this takes place.

Restructuring of a system which is home to many of the world's largest banks will inevitably have some bearing on the international financial system. Just what the results will be depends upon how the realignment progresses and upon the final structure of the Japanese banks. One change that is already taking effect is the "unbundling" of the major Japanese banks in terms of quality. The major banks used to be considered equals in terms of credit-worthiness. The differing degrees to which banks are expected to be able to weather the financial crisis will leave them with differentiated credit ratings and financial health. In addition, the crisis, including some small bank failures and the exposure of alleged corruption among bank employees and government officials, has eroded confidence in Japanese financial institutions. Foreign (including Canadian) banks could use these changes as an opportunity to expand their business in Japan, subject to deregulation. Foreign banks could have a slight advantage over the next several years because they will not be burdened by the large write-downs plaguing the Japanese banks.

Bursting of the Bubble Economy

The 1980s in Japan was a period of rapid economic growth and asset price appreciation commonly referred to as the "bubble economy". During this period, financial agents acted as if the pace of expansion would continue forever and forced up asset prices, particularly real estate, by speculation. The current financial crisis was precipitated by the cessation of this growth at the start of the 1990s. The inevitable bursting of the bubble exposed underlying weaknesses in the management and lending practices of Japanese financial institutions (JFIs) and the system as a whole.

During the boom years, the Japanese economy grew more rapidly than those of the other G-7 countries. From 1980 to 1989, Japan's average annual real GDP growth was 4.0 per cent, compared to 3.1 per cent for Canada and 2.6 per cent for the U.S.. The 1980s also saw a large asset price appreciation in Japan, particularly in the real estate market. Starting in the mid 1980s, real estate prices began to skyrocket, peaking at the beginning of the 1990s.[1] However, by 1992 Japan's real GDP growth had fallen to 1.1 per cent and 1993 recorded negative growth. Estimates of GDP growth for 1995 are only slightly positive and 1996 projections call for around 2 per cent growth.[2]

Japanese financial institutions suffered when asset prices started falling. The expectation, however, was of a readjustment which would bottom out with anticipated economic recovery. The banks' strategy was to wait out the depreciation and have the subsequent pick-up in prices resolve the non-performing loans problem. Unfortunately, the economy did not recover rapidly and real estate prices continued to decline. To date, official land prices have declined more than 30 per cent from their 1991 peak levels.[3] Although values seemed to have been stabilizing early in 1995, the year brought continued declines in land prices, residential real estate and the rental market. In addition, the real estate market is now stagnant at even the lowest of prices.

The true valuation of real estate is complicated by the way in which "official" land prices are calculated. Embodied within the official price is a "theoretical price of land" which includes some factors that must be predicted for the future, such as interest rates. Such estimates are subject to "error" and some analysts believe that official land prices do not fully reflect the extent of the fall of market prices because the National Land Agency, although supposedly independent, has a vested interest in softening the decline.[4]

The bursting of the bubble need not have resulted in a crisis were it not for the collective irresponsibility of many financial institutions and inherent weakness in the system. Management and accounting practices at institutions which have failed have

---

[1]For details of trends in official land prices, see OECD, *OECD Economic Surveys: Japan,* November 1995, p. 53.

[2]OECD, *OECD Economic Outlook,* December 1995, p. A4.

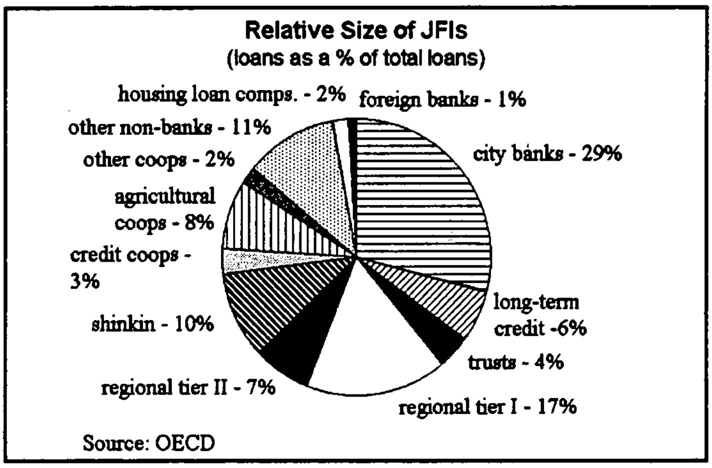
[3]I. Weberpals, *Recent Evolution of Consumer and Corporate Balance Sheets in Japan: Issues for Discussion,* Bank of Canada, September 1995, p.1.

[4]*Real* land prices have been estimated to be as low as 17 per cent of their 1991 levels. (Y. Kudo, "No Bottom in Sight", in *Tokyo Business Today,* November 1995, p. 14.)

been revealed to be anything but prudential; they were unconventional at best, corrupt and, sometimes, illegal.[5] An opaque reporting regime delayed the discovery of the weakness of failing institutions as well as of fraudulent activities. In addition, the preoccupation with size and market share exhibited by Japanese companies was not confined to non-financial firms; it extended to financial institutions, leaving less room for concern for more conservative (and real) measures of success, such as return on assets.[6]

Not All Banks Are Created Equal

First, it must be understood that not all JFIs are equal or in an equal amount of financial trouble. There are different types of JFIs and, although all have been affected by the bursting of the bubble economy and falling real estate prices, only some are in danger of failing. In general, the smaller and more specialized institutions are the most vulnerable, but even the larger banks are not without their problems, financial and legal.



The largest of the JFIs are the <u>city banks</u> (or major banks) which account for 29 per cent of total loans made by private financial institutions. Although the ratio of

[5]See *The Economist,* January 27th-February 1st, pp. 63-4 for general problems of poor management and regulatory practices.

[6]Loans are *assets* to banks, so to increase loans was to increase the prestigious size and market share of the financial institution. In addition, many JFIs extended loans which exceeded 100 per cent of the underlying value of the collateral, based on the assumption that real estate prices would continue to increase. (H. Asai, S.Tazaki, et al, "The End of the Post War Banking System?", in *Tokyo Business Today,* November 1995, p.9.)

non-performing and restructured loans to total loans at the major banks in Japan is around 5.9 per cent,[7] the major banks have managed to reduce their officially declared non-performing loans by writing off bad loans and increasing loan loss provisions. The OECD estimates that, given the current level of profits, the major banks could completely write off non-performing loans in three years, without further reducing their capital base.[8]

The measures taken to reduce exposure to bad loans have led the banks to revalue some of their long-held equity at a profit, which, combined with the more recent declines in the stock market, reduced the banks' unrealized capital gains by over half in the year ending March 1995.[9] This affected the banks' capitalization and lowered their average capital ratios to 8.9 per cent in March 1995 from 9.7 per cent a year earlier.[10] However, one benefit is that the major banks' overall capital position is now much less dependent upon unrealized gains than in the 1980s.

Other types of JFIs include regional banks and credit cooperatives. Regional banks can be separated into Tier I, which are generally financially sound and account for approximately 17 per cent of total loans, and the much weaker and less well-managed Tier II regional banks, accounting for 7 per cent of total private institution loans. Credit cooperatives are mutual institutions which take deposits and lend mostly to their members. They account for only 3 per cent of total loans by Japanese financial institutions but have experienced some severe financial problems, resulting

[7]OECD, *OECD Economic Surveys: Japan,* November 1995, p. 44. The most easily comparable figure for Canada is net non-performing loans as a percentage of total loans and bankers acceptances for the Big Six Canadian banks. This ratio was 1.1 per cent in fiscal 1995 and only went as high as 3.1 per cent in 1992, following the recession and Canadian banks' problems with commercial real estate loans.

[8]However, the process of writing off bad loans has been extremely slow and many analysts believe this to be an overly optimistic scenario.

[9]OECD, *OECD Economic Surveys: Japan*, November 1995, p. 45.

[10]Minimum capitalization ratios were established by the Basle Supervisor's Committee to promote stability and quality control within the international financial system. The ratio of capital to risk-weighted credit exposure is set to be no less than 8 per cent. Capital consists of two types: core or "Tier 1" capital; and supplementary, or "Tier 2" capital. Tier 2 capital is generally poorer quality and can include the unrealized capital gains on bank equity holdings. Japanese banks have traditionally relied on unrealized gains as an important part of their capital bases but these depend upon the value of the stock market, which can be volatile. (For implications of bank equity holdings within the *keiretsu* system, see J. McCormack, *The Japanese Way: The Relationship Between Financial Institutions and Non-Financial Firms*, Department of Foreign Affairs Policy Staff Paper No. 94/16, July 1994).

in failures and mergers with larger institutions. Agricultural cooperatives, which account for 8 per cent of total loans, also face severe problems.

Non-bank institutions, active in real estate, leasing and consumer finance, have been the most negatively affected by the financial crisis. The most visible problems have occurred with the seven housing loan companies (HLCs), which account for 2 per cent of total loans by private credit institutions.[11] *On average, bad loans represent 74 per cent of their total lending.*[12] Although these institutions make up only a small portion of total loans within the financial system, they have borrowed extensively from the banks because regulations virtually denied them access to open financial markets and they do not take deposits.[13] This has, in effect, increased the major banks' exposure to bad commercial real estate loans.

Bank Failures

In total, five JFIs have failed in the wake of the current crisis.[14] Although all of the institutions that failed were local in business focus and none was a major bank, confidence in the system was shaken. In addition to these local problems, the New York branch of Daiwa Bank, which *is* one of Japan's 21 major banks, was implicated in illegal business activities.[15] Corruption has been evident not only within the banks but also, allegedly, among government officials. In addition, even Japan's largest

[11]The HLCs were formed by the major banks in the 1970s to meet a growing need for housing loans and to bypass regulations against bank lending in these areas. As the major banks entered the residential loans market themselves in 1980s, the HLCs increased their more risky business loans to real estate and construction companies.

[12]OECD, *OECD Economic Surveys: Japan,* November 1995, p. 50. Other estimates have put this ratio as high as 90 per cent.

[13]T. Masahiko and P. Turner, *The Liberalisation of Japan's Financial Markets: Some Major Themes,* BIS Working Papers No. 34 - November 1992, Bank for International Settlements, p. 61.

[14]Two Tokyo-area credit cooperatives failed in December 1994. Cosmo Credit Corporation and Kizu Credit Cooperative both failed in the summer of 1995. One regional bank, the Hyogo Bank Ltd., needed to be bailed out in 1995 as well. It was a Tier II regional bank that operated in the Kobe area and was adversely affected by the earthquake of January 1995.

[15]In September 1995, U.S. prosecutors accused an employee of falsifying records to conceal losses totalling more than US $1.1 billion over an 11 year period. The bank was subsequently implicated in a cover-up. (For a description and analysis of Daiwa's illegal activities and the U.S. response, see *Financial Times,* November 6, 1995, p. 17.)

banks have experienced balance sheet problems, which are being reflected in their credit ratings.[16]

Currently, the official estimate of bad loans for JFIs is about 40 trillion yen (approximately US $395 billion). Even using these official figures, which are considered to be underestimated, the percentage of bad loans to total lending is higher now than during the worst part of the savings and loans crisis in the U.S..[17] Moreover, calculations based on the disclosure of specific institutions yield figures for total bad loans as somewhere between *60 and 100 trillion yen*, much higher than the 40 trillion yen official estimate.

...And Problems in the Insurance Industry

In addition to the problems in the banking industry, the extent of problems in the life insurance industry has recently come to light. The return on assets (ROA) within the insurance industry has fallen below that which had been guaranteed on life and annuity policies. The financial state of this industry, however, is even less transparent than that of the banking industry since companies are almost exclusively mutually owned (not publicly traded) and independent audits are, therefore, unavailable. Although problems with the insurance industry are less well-publicized than those with banks, the likelihood that the Japanese government will have to spend public funds to bail out these companies is thought to be higher. Because of their ownership structure, weak insurance companies cannot simply be merged with stronger ones, as has been done with the failing Japanese banks.

There is a real danger that insurance companies will sustain substantial losses on existing policies which would jeopardize their capital bases. Although insurance companies could avoid this by lowering the return on new policies and using profits to cover the losses on existing policies, deregulation of the insurance industry has increased competition from new entrants who do not need to cover previous losses

[16]In August, Moody's Investors Service ranked two major banks, judged on their ability to survive without outside assistance, in its lowest category, and a number of other Japanese banks in its second-lowest category. (See D. Ostrom, *Japan's Bad-Loan Problem: The Search For An Exit,* Japan Economic Institute Report No. 44A, p. 7.) Recently, Moody's announced that it had lowered the long-term senior debt ratings of two different large Japanese banks because they were carrying high volumes of problem assets and would require several more years to restore their balance sheets. (See *Financial Times,* January 24, 1996, p. 19.)

[17]D. Ostrom, *op. cit.*, p. 5.

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.)

According to the new plan, the main banks associated with the HLCs would write-off their loans, totalling 3.5 trillion yen. The party most exposed to the HLCs, the agricultural cooperatives, got off lightly, presumably because of their political influence with the Liberal Democratic Party. To cover initial losses, it is expected that the agricultural cooperatives will make a contribution of only 530 billion yen. The use of *public* funds will be higher, at 685 billion yen. The report noted that it was justified that tax-payers should be asked to bear some of the burden because they are the indirect beneficiaries of a stable financial system. However, popular opposition to the use of public funds has been strong and is undermining the credibility of the government.[21] In January 1996, it was disclosed that covering secondary losses of the HLCs will likely require *at least* another 600 billion yen[22] of government funds, a revelation that further angered the Japanese public. The current plan has not yet received parliamentary approval and the possibility of amendment remains.

Another major, and better-received, recommendation of the report was the establishment of a "Jusen Resolution Corporation" (JRC) similar in structure to the Resolution Trust Corporation that was set up in the U.S. to deal with that country's savings and loan crisis. It will be a temporary institution that will deal mainly with the disposal of the failing HLCs. The JRC is to be charged with collecting loans "rigorously and promptly" and is to have close cooperation with prosecutors and police.

From a political standpoint, the Japanese government's decision to use public funds has been problematic. There are also some economic arguments against this, particularly with regards to allowing the agricultural cooperatives not to assume their fair part of the burden. Although the Committee's report argues that society as a whole benefits from a stable financial system, and therefore using public funds is justified, there is a moral hazard involved with guaranteeing the rescue of failing financial institutions. When an institution believes that it will not be allowed to go bankrupt, prudential management can suffer. The bailout of the HLCs indicates that creditors of failing financial institutions, if politically influential, can escape the negative consequences of their bad investments *at public expense.*

---

[21]Political and popular opposition to the bail-out has been cited as a factor in the former PM's resignation and has even sparked the government to consider breaking up the powerful Ministry of Finance. (D. Iwaasa, Canadian Embassy, Tokyo, "The Jusen, Politics and MOF", unclassified report, February 9, 1996).

[22]Private analysts have estimated the cost could be up to *three times higher* than the 600 billion yen estimate, although these costs will not have to be paid for 15 years. For a complete summary, see D. Iwaasa, Canadian Embassy, Tokyo, "Japanese Jusen Problem: Closer to the End", unclassified report, January 29, 1996.

To its credit, however, the Japanese government has stated a commitment to applying the principle of self responsibility to the management of financial institutions and to establish a transparent supervision system based on market discipline.[23] This involves introducing a system of "Prompt Corrective Action" in which authorities would take actions based on objective criteria such as the Basle capital adequacy ratios. These actions are intended to promote a level of "good tension" between the banking industry and its supervisory authorities. This "tension" is hoped to alleviate past problems of an overly cosy relationship between regulators and financial institutions.

International Implications of the Japanese Financial Crisis

Because of Japan's prominence, the crisis and subsequent restructuring of the financial system could impact on international financial markets and have spillover effects on foreign economies.

- The Japanese financial crisis has highlighted the relevance of systemic risk to the *international* financial system and the interdependence of financial markets and economies.

- The crisis has prompted reform of Japan's opaque regulatory system which should increase differentiation among the major Japanese banks and could provide increased opportunities for foreign banks in Japan.

- Mergers between Japanese banks could change the competitive dynamic of Japanese financial institutions, with attendant considerations for the international financial system.

<u>The prominence of Japanese banks in international markets gives rise to international systemic risk associated with a large Japanese bank failure.</u>[24] If a Japanese bank failed to meet its daily clearing obligations, this could damage foreign

---

[23] D. Iwaasa, Canadian Embassy, Tokyo, "Japan: Improved Banking Inspection and Supervision", unclassified report, January 20, 1996.

[24] According to the Bank for International Settlements, Japanese banks had US $723 billion in liabilities to foreign financial institutions in the BIS reporting area at the end of 1994. This represented 10 per cent of total international liabilities. On the asset side, Japanese banks' cross-border holdings totalled US $1 trillion at the end of 1994, second only to the UK, twice as large as the U.S., and representing 14 per cent of the total stock. (Bank for International Settlements, *65th Annual Report: 1st April 1994-31 March 1995,* 12 June 1995, p. 170.)

banks to which it owed money. Failure to receive a payment could lead to a "domino" effect rippling through the time zones in Europe and North America. However, considering the Japanese government's and Bank of Japan's assurances that banks with international dealings will not be allowed to renege on their major obligations, and with the problems at the major banks waning, this scenario presents little threat at present.

Weakness at Japanese banks affects their ability to borrow funds. Until recently, a "Japan premium" was being charged in international markets which would have a negative impact on profits. With increasing costs, Japanese banks could reduce projects dependent upon borrowed funds, adversely affecting Japanese firms located at home and abroad.[25] In addition, the financial crisis could dampen Japanese economic growth, limiting import demand.[26]

The fear that the Japanese financial crisis will significantly affect Japanese portfolio investment abroad is subject to debate. If the financial crisis exacerbates economic stagnation in Japan, this could reduce Japanese domestic investment. The gap between Japanese domestic savings and investment would increase. In the short run, this situation implies a larger, not a smaller, flow of funds abroad.[27] Lower interest rates in Japan, associated with expansionary monetary policy, would also increase the attractiveness of investing abroad. However, it is also believed that the long-term prospects for sustaining the amount of Japanese capital flows to Canada at their bubble-era levels are dim.[28]

The most visible result of the financial crisis will be reform of the Japanese financial system, including increased transparency and the decline of the "convoy"

---

[25]That is, assuming the *keiretsu* structure prevents the firms from raising capital directly in international markets or using other sources of funds.

[26]This could negatively affect Canada's exports to Japan, currently around 4.5 per cent of total Canadian exports. (See Statistics Canada Catalogue No. 65-001-XPB, Canadian International Merchandise Trade, November 1995.) However, it has also been noted that the post-bubble decline in real wages and job security have caused Japanese consumers to balk at paying inflated prices for domestically-produced goods. This "frugal" change in tastes could be an advantage for imported Canadian goods. (R. Wright, *op. cit.,* p. 48.)

[27]D. Ostrom, *op. cit.,* p. 13.

[28]R. Wright, *Japanese Finance in Transformation: Implications for Canada,* The Canada-Japan Trade Council, 1994, p. 44.

system.[29] Reform should lead to increased differentiation among banks in terms of size and asset quality. One influential credit rating agency, the ICBA, has concluded that, because of changes in assumptions concerning the future level of systemic support to be given to the weaker banks by the Ministry of Finance, the credit ratings of major banks will be more differentiated in the future, with those of weaker banks more closely reflecting the impact on their financial condition of problematic loan losses.[30] Even the Japanese government has recognized the need to modify its convoy style regulation system into one that puts greater emphasis on market mechanisms.[31]

With the demise of the convoy system, the banks' traditional post-war role as "channellers" of individuals' saving into industrial investment might also diminish. The days of the bank being the centre of a cohesive industrial grouping and providing for most of the group's financing needs could be coming to an end. Given the advent of globalization and liberalization in financial markets and with the maturation of the Japanese economy, companies are relying less on their main banks and more on international financial markets.[32] Increasing transparency in the activities of the secretive Japanese banks and furthering market liberalization cannot but help level the playing field for foreign banks. The implications of this are positive for foreign banks which might be able to break through the invisible *keiretsu* barriers that have traditionally kept them out of the game in Japan.

Although highly unlikely, one interesting option open to the Japanese government in dealing with weak financial institutions would be to accept mergers with *foreign* banks. This could save public money because foreign banks might be willing to pay a premium to buy a failing institution in order to obtain the right to enter the market.[33] In addition, North American and European banks, which are more

[29]In the "convoy" system, the major banks reported remarkably similar results year after year. This system might be breaking down. For example, currently the strongest seven banks show an average of 3.9 per cent of problem loans to total loans, while the weakest seven show an average of 11.4 per cent. *(Financial Times,* December 7, 1995, p. 17.)

[30]D. Iwaasa, Canadian Embassy.Tokyo, "ICBA Note on Japanese Bank Failures", unclassified report, September 15, 1995.

[31]D. Iwaasa, Canadian Embassy, Tokyo, "Japan: Improved Banking Inspection and Supervision", unclassified report, January 20, 1996.

[32]*Financial Times* , December 7, 1995, p. 17.

[33]D. Ostrom, *op. cit.*, p. 14.

profitable (and efficient) than Japanese banks, might have more success than their Japanese competitors who will continue to face constraints due to loan losses.[34] Although the option of merging failing domestic with foreign banks is politically unlikely, it would present savings for the Japanese government at a time when its deficit to GDP ratio is expected to become the second highest in the G-7.[35]

In any case, domestic bank mergers precipitated by the financial difficulties are already changing the character of Japan's financial industry.[36] Previously, Japan's largest six banks were very similar in size when measured by total assets. The merger of Mitsubishi and Bank of Tokyo, and a rumoured merger of Sumitomo with Daiwa,[37] would increase these banks' size to such an extent that they would pull ahead of the pack. There is speculation that these mergers will precipitate others within the industry, leading to even bigger Japanese banks. The Japanese financial industry might become centred around several banking groups that are even larger than ones in evidence today. Without significantly increasing transparency in the regulatory system, increasing banks' size and range of activities could be damaging since they would be able to hide poor management practices even more effectively. If reforms get derailed, this could lead to further instability in the Japanese financial system with attendant considerations for the international system. As is evident from recent events, size is not insurance against crisis.

---

[34]The Japanese banks have the lowest profitability in the G-7. (OECD, *OECD Economic Surveys: Japan,* November 1995, p. 58.)

[35]The OECD projects that Japan's general government deficit as a percentage of GDP will reach 4.8 per cent in 1996, second only (in the G-7) to Italy's projected 6.0 per cent. Projections for Canada and the U.S. for 1996 are, respectively, 3.1 and 1.5 per cent. (OECD, *OECD Economic Outlook,* December 1995, p. A33.)

[36]The type of business activities Japanese banks can engage in has also changed with the advent of mergers, as the major banks have been able to maintain the business functions of their new "partners". For example, the separation between trust business and traditional banking activities has ended and banks are now allowed to engage in trust activities, such as fund management, through their trust subsidiaries. Historically, deregulation in the Japanese financial industry has been slow, conservative and measured. The current financial crisis might serve to quicken the pace.

[37]Sumitomo purchased Daiwa's U.S. assets after the latter bank was barred from the U.S.. The U.S. sale is rumoured to be a prelude to a merger between the two banks. (*Financial Times,* January 30, 1996, p.1.)