

Policy Shifts and the Changing Role of Banks: A Comparison between Japan and Germany

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- I. Introduction
- II. Financial Systems and Global Challenges
 - 1. Bank-Based Economies
 - 2. Global Challenges
- III. Policy Developments toward Capital Market Expansion
 - 1. Financial Reforms in Japan and Germany between the 1980s and early 2000s
 - 2. Recent Policy Changes Impacting the Role of Banks
- IV. Market Changes in Corporate Shareholding and Securitization
 - 1. Declining Bank Corporate Shareholding
 - 2. Growth of Securitization
- V. Conclusion: Policy Implications

I. INTRODUCTION

This article overviews the changing roles of banks in what are generally considered to be bank-based economies, Japan and Germany. The analysis focuses on policy and market changes in the late 1990s and early 2000s, which were driven by a long-range policy initiative towards capital market expansion pursued from the 1980s to the early 2000s. Time-series statistical data is used to examine whether there has been a shift in the bank-based features of the two economies. The discussion includes possible policy lessons learned from the recent financial turmoil concerning the institutional designs of the financial and banking systems.

The collapse of the Bretton-Woods System in the 1970s led to an international regime change,¹ which furthered financial integration, global competition, technological advances, and the development of short-term money markets. These global shifts induced both policy and market shifts in individual countries. Policy shifts often

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1 Concerning changes and continuity in the international monetary regime before and after the collapse of the Bretton-Woods System, see R.O. KEOHANE, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton 1984) 184-87.

strengthened market shifts. To confront the new challenges of global finance, countries embarked on a series of financial reforms in order to make their financial sectors and markets more competitive globally. At the same time, the expansion in newly invented and newly authorized financial products and instruments often eroded the business bases of traditional bank lending, so that banks increased their involvement in the investment service business. In addition, technological advances, such as securitization, enabled banks to spin off the credit risk of their assets to general investors.

Global financial integration, financial reforms aimed at capital market expansion, and a surge in market-based financing and securitized products weakened the bank-based aspects of the Japanese and German economies. Statistical evidence of changes in bank shareholding and the growth of securitization markets, as will be shown in this article, signals the abatement of the practices and incentives that were typical in these bank-based economies.

The structure of this article is as follows. Section II explains the bank-based economies of Japan and Germany, and the global challenges that they confronted. Section III looks at the policy initiatives aimed at capital market reform which progressed either in discrete steps or incrementally from the 1980s to the early 2000s in both countries. In particular, it focuses on recent policy changes between the late 1990s and the early 2000s impacting the roles of banks. Section IV overviews the subsequent market changes in this period and examines whether there has been a shift in the features of these two bank-based economies and, if so, to what extent. The analysis indicates a change in bank corporate shareholding and a trend of securitization. Section V concludes with a discussion of policy directions in banking systems and regulations in the light of the policy agenda that has emerged from the 2007-2010 financial crisis.

II. FINANCIAL SYSTEMS AND GLOBAL CHALLENGES

1. *Bank-Based Economies*

The literature on political economy has paid serious attention to distinct differences in the structure of financial systems: between capital market-based systems and bank-based (or loan-based) ones. Alexander Gerschenkron attributes these structural differences to the historical period of countries' industrial development.² Industrial economies that developed relatively later than others had scarce and diffused capital, so that, in response to enormous pressures for business expansion and growth, they developed a greater role for banks in gathering a substantial amount of financial resources and using them for industrial ventures.³

2 A. GERSCHENKRON, *Economic Backwardness in Historical Perspective* (Cambridge 1962) 11-16.

3 *Ibid.*, 14.

Concerning the characteristics of bank-based economies, Gerschenkron states:

A German bank ... accompanied an industrial enterprise from the cradle to the grave, from establishment to liquidation [and] acquired a formidable degree of ascendancy over industrial enterprises, which extended far beyond the sphere of financial control into that of entrepreneurial and managerial decisions.⁴

As for the differences between the two types of financial systems, he notes:

Between the English bank essentially designed to serve as a source of short-term capital and a bank designed to finance the long-run investment needs of the economy there was a complete gulf.⁵

Similarly, John Zysman argues that companies that pursue a higher growth rate than they could obtain from retained earnings and issuing securities resort to bank financing. Thus, the bank-based system tended to develop in late- and rapid-growth countries such as Japan and Germany.⁶ Regarding its characteristics, Zysman continues:

Loan-based systems of corporate finance are of necessity premised on the exercise of influence by voice. Since such systems have more restricted capital markets and, in particular, a limited secondary capital market, it is harder for financial institutions to treat equity investments simply as a matter of financial portfolio balance. In a limited secondary market they may not be able to dispose of equity holdings without affecting the price of the stock. Exit is not easy and, as a result, these institutions are pressed into close monitoring of management and the exercise of voice. Limited secondary markets and the long-term loans characteristic of this system reinforce each other, militating toward intimacy between financial institutions and the companies whose equity they own and to whom they lend.⁷

Therefore, bank-based economies have two important features: relationship lending and a high ratio of bank corporate shareholding. Banks choose long-term over short-term financing and hold a large portion of corporate shares over the long term. To protect their profits, they intervene in the management of firms, constantly monitor firms' activities, and involve themselves in the financial restructuring of companies if necessary.

Economies featuring these bank-based and relationship-driven financial systems are called 'coordinated market economies (CMEs)' by Peter Hall and David Soskice in *Varieties of Capitalism*.

4 *Ibid.*, 14.

5 *Ibid.*, 13.

6 J. ZYSMAN, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change* (Ithaca 1983), 63. In contrast to the accounts of Gerschenkron and Zysman, Sigurt Vitols attributes diverse financial systems to the 1930s policy responses of states to the Great Depression. See S. VITOLS, *The Origins of Bank-Based and Market-Based Financial Systems: Germany, Japan, and the United States*, in: Streeck / Yamamura (eds.), *The Origins of Non-liberal Capitalism: Germany and Japan in Comparison* (Ithaca and London 2001) 171-91.

7 ZYSMAN, *supra* note 6, 64.

This financial system

typically provides companies with access to finance that is not entirely dependent on publicly available financial data on current returns. Access to this kind of 'patient capital' makes it possible for firms to retain a skilled workforce through economic downturns and to invest in projects generating returns only in the long run.⁸

However, when Japan and Germany confronted common challenges that were driven by a transformative change in the international finance regime and by global financial forces, they had to embark on a series of reforms to open up their markets to new financial instruments and products, and make financing through securities markets cheaper and easier. These changes impacted their financial markets and sectors, and attenuated the bank-based features of their economies.

2. *Global Challenges*

Global financial integration has resulted in an increasingly significant role for capital markets. In parallel, a change in corporate finance toward market-based financing, developments in money markets and financial technological advances have progressed at a global level, thus forcing countries to undertake financial reforms to make their financial markets and sectors more globally competitive and investor-friendly.

After the collapse of the Bretton-Woods System in the 1970s, cross-country capital flows rose through interest rate arbitrage activities, due to the liberalization of currency and interest rates. Financial market integration progressed through an increasing amount of cross-border (where companies raise funds from foreign investors in local markets) and cross-exchange trade (where companies raise funds on foreign stock exchanges), with intensifying global competition. In addition, the Euromarket also developed outside nationally regulated areas in search of less costly capital and financial transactions.

A large number of profitable companies started to embark on financing through the issuance of stocks and bonds – a typical case of market-based financing – in overseas capital markets at cheaper costs than those of financing in their domestic markets and through bank borrowing.⁹ A number of stock exchanges were in competition with each other to attract the listing of stocks and a significant pool of investors' money. Moreover, large multinational firms increasingly engaged in financial activities through their treasury departments, the so-called corporate banks. This phenomenon led to a relative

8 P.A. HALL / D. SOSKICE (eds.), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford 2001) 22.

9 For example, Daimler-Benz AG listed on the US's New York Stock Exchange (NYSE) on October 5, 1993, despite the fact that a listing at the NYSE required a 1.8-billion-Deutsche-mark adjustment to its reported earnings under the U.S.'s Generally Accepted Accounting Principles (GAAP). See E. NOWAK, *Recent Developments in German Capital Markets and Corporate Governance*, in: *Journal of Applied Corporate Finance* 14, no. 3 (2001) 40.

increase in the ratio of internal funding in corporate finance.¹⁰ These changes often resulted in the decline of traditional banking businesses.

In addition, the worldwide development of short-term money markets pressured each country to develop its own markets and lift restrictions on money market transactions. Money markets were developed through the introduction of permission to issue Commercial Papers (CPs) and Negotiable Certificates of Deposit (CDs). These markets were funded by a growing number of Money Market Funds (MMFs) and Money Market Mutual Funds (MMMMFs), which provided customers with similar benefits to bank deposits, such as clearing functions and the possibility of withdrawal upon request, thus starting to erode the banking businesses. In particular, in Japan, where a universal banking system had not been put in place, the government gave permission for banks to engage in money market transactions to compensate for their losses in traditional lending businesses.

Furthermore, major developments in financial technology followed the transition from the fixed exchange rate system to the post-Bretton Woods floating exchange rate system in the 1970s. Market players started to develop hedging instruments, such as currency futures and options, in order to hedge the currency risk that emerged from the shift to a floating exchange rate system. Technological financial development made various risks tradable, and risks and costs associated with financial transactions spread beyond national borders.

In the 1990s new financial innovations, such as securitization, became distinctly popular among financial institutions and corporations. Securitization enabled banks to bundle and sell credit risks to general investors, and the invention of such techniques boosted bank engagement in capital market investments. As will be discussed later, the way in which such products were used and developed increased financial instability, thus partly contributing to the 2007-10 financial crisis.

Against the background of global financial integration, a change in corporate financing structure, developments in money markets and technological advances, each country undertook financial reforms to strengthen its financial markets and sectors. For Japan and Germany, where the capital markets were underdeveloped, policy developments towards capital market expansion and integration between the 1980s and early 2000s played a significant role. In addition, both countries incorporated technological advances into their financial markets and policy frameworks, and allowed new financial instruments and products to grow rapidly.

Although this article mainly addresses empirical questions regarding the changing role of banks in the two economies, it also has some modest normative implications for the discussion on regulatory reforms. Section III shows how countries faced and re-

10 In a German context, see R. DEEG, *Finance Capitalism Unveiled: Banks and the German Political Economy* (Ann Arbor 1999) 80-87, and J. EDWARDS/K. FISCHER, *Banks, finance and investment in Germany* (Cambridge 1994) 54-55.

sponded to global challenges to enhance the competitiveness of their financial markets and sectors. Section IV focuses on the market changes which resulted from the above-mentioned financial reforms, and their potential contribution to the losses stemming from the 2007-2010 financial crisis. Finally, Section V addresses the question of the directions in which the countries' financial and banking systems should next be guided.

III. POLICY DEVELOPMENTS TOWARD CAPITAL MARKET EXPANSION

1. *Financial Reforms in Japan and Germany between the 1980s and early 2000s*

As stated in the previous section, in response to common challenges each country started to expand its capital market and make its financial sector more competitive in order to attract a larger pool of investors and profitable firms. In Japan and Germany there were a series of regulatory changes in this direction starting in the 1980s. This section will examine the capital market reforms that aimed at a greater level of market-based financing, which in Japan took the form of a discrete step, leading to the so-called financial big bang in the late 1990s, while Germany took an incremental approach.

Japan

When the Japanese government faced the fiscal situation in which it had to issue an increasing amount of bonds, it needed to rethink its capital market policies. An initial major reform was undertaken in the early 1980s, after a surge in government bonds had necessitated the development of bond markets in the late 1970s. After World War II, the Japanese government had followed the U.S. Glass-Steagall Act and created legal barriers separating banking and securities activities. The amendment of the Banking Law and Article 65 of the Securities and Exchange Law in 1981 led to a partial liberalization of securities activities by banks, and allowed them to deal in and sell public bonds.¹¹

In response to the liberalization of interests rates and the foreign exchange market, which was implemented in accordance with the Yen-Dollar agreement in 1984, Japan had to take policy measures to strengthen its financial sector and make Japanese financial markets more investor-friendly to survive under global financial integration. This resulted in the enactment of financial system reforms in 1992, which permitted cross-sectoral business entries in different financial sectors through the creation of subsidiaries that engaged in only one category of activities.¹²

As financial integration progressed further and profitable companies started to raise more funds through overseas capital markets, the Japanese government undertook more

11 Concerning the process of deregulation in the early 1980s, see F. ROSENBLUTH, *Financial Politics in Contemporary Japan* (Ithaca 1989) 106-112.

12 For the process of financial system reform in the early 1990s, see S.K. VOGEL, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca 1996) 180-189.

drastic reforms to expand the capital markets and allow financial institutions to conduct their businesses at full capacity. Moreover, the burst of the Japanese asset bubble in the early 1990s and the necessity of disposing of non-performing loans in the financial sector prompted the government to launch a “Financial Big Bang,” leading to the enactment of the Financial System Reform Laws in 1998.¹³

To strengthen the functions of the capital markets, these laws introduced the following measures:¹⁴ a transition from a licensing system to a registration system for securities industries; the introduction of wrap accounts in the securities business; the introduction of Proprietary Trading Systems (PTS); the unfixing of commission rates; the expansion of corporate bond markets; the strengthening of over-the-counter markets; the abolition of the concentration principle in stock exchanges; a transition from a licensing system to an approval system for investment companies; the incorporation of registrable and non-listed shares into investment trust funds; the introduction of corporation type and privately placed investment funds; and other measures to liberalize asset management businesses. In parallel to the enactment of the Financial System Reform Laws, other asset-liquidation laws, such as the Specific Purpose Company (SPC) Law in 1998 and its revised version, the new SPC Law in 2000, were enacted, contributing to the further development of capital markets. The next subsection will explain these asset-liquidation laws in detail.

In addition, the Financial System Reform Laws included a fuller implementation of the repeal of cross-sectoral business-entry restrictions. As a result of the new rules, securities and trust bank subsidiaries were given access to all sectors by fiscal year 1999, although banks had to wait until 2001 to enter the insurance business.¹⁵ Cross-sectoral business entries were furthered by the amendment of the Antitrust Law and the enactment of the Financial Holding Companies Laws in 1997, which permitted the operation of financial holding companies.

Germany

Similarly to the Japanese case, intensified global market competition forced the German government towards active capital market policies, the so-called *Finanzplatz Deutschland*. In response to an increasing number of foreign banks in Germany and a relative

13 For a comparison between the reforms of the early 1980s, early 1990s, and late 1990s, see T. TOYA, *Kin'yū bigu bangu no seiji keizai gaku: Kin'yū to kōkyō seisaku sakutei ni okeru seido henka* [The Political Economy of the Japanese Financial Big Bang: Institutional Change in Finance and Public Policy Making] (Tokyo 2003) 251-260.

14 SHŌJI HŌMU, *Zadan-kai nihon-ban bigu bangu to kin'yū sisutemu kaikaku-hō* [Symposium: The Japanese Version of Financial Big Bang and the Financial System Reform Law], in: Shōji Hōmu 1514 (1999) 17-23.

15 *Ibid.*, 21. For the political factors that determined the differing timing of removing cross-sectoral business-entry restrictions, see TOYA, *supra* note 13, 237-242.

decline in German banks,¹⁶ the German government aimed for financial market modernization in order to nurture its own financial sector. Financial reforms progressed in an incremental manner, as opposed to a big bang approach. Through the Financial Market Promotion Law (*Finanzmarktförderungsgesetz*) I-IV in 1990-2001 and other legislative changes, Germany opened up its capital markets to an increasing number of new financial products, such as CPs, MMFs and structured and securitized products. A series of legislative measures allowed a variety of financial products and services, as well as facilitating the functioning of the stock exchange markets.

The First Financial Market Promotion Law (FFG I) in 1990 abolished capital transfer tax and stock exchange turnover tax, and expanded business opportunities to trust companies and mutual funds.¹⁷ The turnover tax had previously required the purchaser to pay between 0.1% and 0.25% of the value of securities trading and had been criticized for diverting trade from Frankfurt to London and Luxembourg. These regulatory changes aimed to reverse the tendency of German firms to issue CPs in foreign currencies and markets. The tax reforms made CPs more attractive for trade in Germany.¹⁸ In addition, the Second Financial Market Promotion Law (FFG II) of 1994 legalized MMFs that invested in short-term corporate and government papers, including CPs, thus contributing to the expansion of short-term money markets.

At the same time, the German government undertook policy measures to tighten securities regulations and to coordinate the fragmented securities supervisory authorities, thus enforcing market integrity rules for national capital markets.¹⁹ As part of the FFG II, the Securities Trading Law (*Wertpapierhandelsgesetz: WpHG*) of 1994 was enacted and established the Federal Securities Supervisory Office (*Das Bundesaufsichtsamt für den Wertpapierhandel: BaWe*), which started its operation in 1995. The same law banned insider trading, extended disclosure requirements, and instituted other investor protection measures by implementing European directives, such as the Insider Directive, the Transparency Directive, and the Investment Services Directive (ISD).²⁰

In addition, reforms of trading platforms progressed incrementally. The 1989 amendment of the Stock Exchange Law (*Börsengesetz*) permitted the trading of options and futures contracts, and led to the opening of the German Options and Futures Exchange

16 See C.L. HOLTFRERICH, Frankfurt as a Financial Centre: From medieval trade fair to European banking centre, trans. J.A. Underwood et al. (Munich 1999) 271-76.

17 NOWAK, *supra* note 9, 40.

18 K. Campbell, Risks and rewards of change in Frankfurt, in: *Financial Times*, 7 January 1991, 13; K. Campbell, European Finance and Investment, Germany 4; Deutsche Bank's aggressive start – Commercial Paper, in: *Financial Times*, 17 July 1991, 14.

19 The segmentation of supervisory authority across states (*Länder*) and the self-regulation of each stock exchange in each state had resulted in less-developed and smaller capital markets, and had driven German companies out of domestic markets.

20 H. BAUM, Change of Governance in Historic Perspective: The German Experience, in: Hopt / Wymeersch / Kanda / Baum (eds.), *Corporate Governance in Context: Corporations, States, and Markets in Europe, Japan, and the US* (Oxford 2005) 20-21.

(*Deutsche Terminbörse*: DTB) in January 1990. The DTB was computerized, and thus furthered shifts towards a national basis of operations, undermining regional principles.²¹

Subsequently, in January 1993 the formerly mutual Frankfurt stock exchange was privatized and became part of the new German Exchange Company (*Deutsche Börse AG*: DBAG). The DBAG was owned by the banks, the regional stock exchanges, and the stock exchange brokers. It became the largest national stock exchange through its linkage with other regional exchanges, and provided an electronic trading system (*Xetra*) and later introduced a joint cross-border derivatives market, *Eurex*, in cooperation with the Swiss Stock Exchange (SWX).²²

To further improve the trading platforms, in 2001, the Fourth Financial Market Promotion Law (FFG IV) led to the amendment of the Stock Exchange Law, enabling stock exchanges to function with more flexibility. It required the unrestricted equality of floor and electronic trading and gave stock exchanges the freedom to choose whether trading and official price determination were set by broker-dealers or through the electronic system.²³

2. *Recent Policy Changes Impacting the Role of Banks*

As part of the policy initiatives towards capital market expansion, which were explained in the previous subsection, the following two banking sector policies were implemented and started to affect the role of banks in both economies. First, both governments started to encourage banks to reduce their corporate shareholding. Second, the governments gave banks easier access to new financial innovations, such as securitization.

A Decline in Bank Corporate Shareholding

Bank corporate shareholding was discouraged due to its inhibition of effective corporate governance and the necessity of improving banks' financial health. First, banks' internal corporate control through their shareholding and lending relationships started receiving criticism for its lack of transparency and its inhibition of sound corporate governance practices. Instead, corporate control by investors trading in capital markets, including the dispersed investors in the household sector, was increasingly considered to be important.

The development of more active capital markets and the improvement of corporate governance were essential motivations for the reforms in the late 1990s in Germany. As John Cioffi argues, both the 1998 Control and Transparency in Business Law (*Gesetz*

21 R. DEEG, *Finance Capitalism Unveiled: Banks and the German Political Economy* (Ann Arbor 1999) 87-90.

22 *Ibid.*, 89; NOWAK, *supra* note 9, 40.

23 H. BAUM, *Changes in Ownership, Governance and Regulation of Stock Exchanges in Germany: Path Dependent Progress and an Unfinished Agenda*, in: *European Business Organization Law Review* 5 (2004) 698-99.

zur Kontrolle und Transparenz im Unternehmensbereich: KonTraG) and Chancellor Schröder's tax reform (*Steuerreform*) in 2000 promoted shareholding among dispersed investors.²⁴ KonTraG imposed a "one share-one vote" rule, abolished voting caps,²⁵ and prohibited the voting of cross-shareholding stakes above 25% in supervisory board elections. These measures were intended to reduce the power of insider shareholders such as founding families, encourage diffused shareholding, increase the power of minority shareholders, and make takeovers easier. In addition, the tax reform in 2000 abolished capital gains taxes on the sale of cross-shareholdings, thus encouraging firms to sell off their blocks of shares, undergo economic restructuring through outsider control, and attract overseas investors.

Second, the banks' corporate shareholding started to be perceived as problematic to maintaining their financial health. This was true especially in the Japanese context, where corporate share prices plummeted in the middle of the financial and economic crisis in the late 1990s-2000s and the government encouraged banks to dispose of shares in order to restore a sound balance sheet structure. In 2001, the Japanese government enacted a new law to put an upper limit on the amount of corporate shareholding by banks. Under this law, banks were not allowed to hold a total value of corporate shares which was greater than their capital.²⁶ At the same time, a new government-run special agency, named the Banks Shareholding Acquisition Corporation, was established to encourage banks to offload corporate shares by acquiring them at a higher price than otherwise would have been the case. Government share acquisition was intended to avoid the drop in share prices which could result from banks' sales of corporate shares.²⁷

In addition, bank shareholding became costly due to a change in international financial regulatory standards. At an international level, Basel II incorporated market risks, including share price volatility, in order to promote sound risk management in banks.²⁸

24 J.W. CIOFFI, Restructuring 'Germany Inc.': The Politics of Company and Takeover Law Reform in Germany and the European Union, in: *Law & Policy* 24, no. 4 (2002) 370-71, 379-80. See also C.M. HARLEN, Schröder's Economic Reforms: The End of Reformstau?, in: *German Politics* 11, no. 1 (2002) 71-72.

25 Voting caps had limited the maximum number of votes by one shareholder, so they prevented changes in control through the accumulation of shares.

26 See MINISTRY OF INTERNAL AFFAIRS AND COMMUNICATIONS, "Act on Limitation on Shareholding by Banks and Other Financial Institutions (in Japanese)," *Laws and Ordinances*; available from <http://law.e-gov.go.jp/htmldata/H13/H13HO131.html> (last accessed on 20 May 2010).

27 M.J.B. HALL, Banking regulation and supervision in Japan: Some issues and concerns, in: *Journal of Financial Regulation and Compliance* 11, no. 1 (2002) 50.

28 The Value-at-Risk (VaR) model that was adopted to measure the risk of banks' trading books was later criticized for its pro-cyclicality. See THE DE LAROSIÈRE GROUP, *The High-Level Group on Financial Supervision in the EU*, 25 February 2009, 17, available from http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (last accessed on 20 May 2010)

This incorporation of market risk into risk calculation had the effect of imposing costs on bank shareholding, thus reducing the incentives to banks to hold corporate shares.

Securitization Trends

Furthermore, both governments started to relax restrictions on financial institutions, including banks, engaging in securitization business, in order to exploit the benefits of this new financial instrument for their economies. The development of securitization became possible because of technological developments to unbundle risk. Through securitization, banks convert non-marketable loans into marketable instruments. The securitization of corporate loans and collateralized assets provides alternative sources of financing to corporations. Banks can ease lending requirements and covenants, since the securitized products often receive higher investment grades than the underlying assets, due to diversification. On the other hand, securitization can bring alternative income flows to banks. Underwriting, managing, and investing in securitized products could compensate a loss of business opportunities in traditional lending.

The easy growth of securitization in Japan and Germany had long been inhibited by legal barriers.²⁹ For example, these barriers included the requirement to notify debtors of the transfer of their debt to a third party and the practical difficulty or high costs involved in using bankruptcy-remote vehicles for underlying assets in both countries. Against this background, a series of reforms were undertaken from the late 1990s to the early 2000s to promote securitization in both countries.

In Japan, the definition of 'security' in the Securities and Exchange Law (SEL) had excluded most securitized products, thus prohibiting them from being sold and traded in domestic markets. Moreover, although Japanese banks had been allowed to sell portions of commercial loans since 1992, bank involvement in domestic securitization markets was limited, due to requirements for banks to notify debtors of the transfer of their debt to a third party and a prohibition on investors reselling the interest on loans.

To facilitate the restructuring of non-performing loans through sales of the assets used as collateral, asset liquidation went onto the policy agenda in the Japanese Financial Big Bang, thus leading to the enactment of the 1998 SPC Law. This law permitted the easy establishment of a special purpose company (SPC) to issue tradable asset-backed securities and included these securities in the definition of 'security' in the SEL. In addition, related amendments to the Civil Law Code exempted the originator from the requirement to notify the debtors of transferred assets as long as registration require-

29 Concerning legal obstacles in Germany, see L. ALEKNAITĖ, Why the fruits of capital markets are less accessible in civil law jurisdictions or how France and Germany try to benefit from asset securitization, in: *DePaul Business & Commercial Law Journal* 5 (2007) 191-236. As for the legal and political obstacles in Japan, see E.J. PARK, Comment: Allowing Japanese Banks to Engage in Securitization: Potential Benefits, Regulatory Obstacles, and Theories for Reform, in: *University of Pennsylvania Journal of International Economic Law* 17, Summer (1996) 723-752.

ments were met. Moreover, in 2000, the SPC Law was amended to abolish restrictions on the range of assets which qualified for liquidation, further relax the requirements for the establishment of an SPC, and expand the range of types of asset-backed securities permitted.³⁰

Similarly in Germany, a series of policy changes were made to facilitate the growth of securitization. In 1997, the federal banking supervisory office (*Bundesaufsichtsamt für das Kreditwesen*: BAKred) issued a “Circular Regarding the Sale of Customer Receivables by Credit Institutions in Connection with Asset-Backed Securities (ABS) Transactions,” which specified the conditions under which the originating bank could avoid the application of an 8% capital requirement for true-sale securitized products. It also provided exceptions to the ban on the originating bank giving assurances regarding the subsequent quality of receivables and on financing Special Purpose Vehicles (SPVs) – entities which issue tradable asset-backed securities.

Moreover, Germany passed the Refinance Register Law to create refinance registers (*Refinanzierungsregister*) in order to ease the registration requirements for SPVs to gain the full protection of their assets from the bankrupt estate of an originator bank. In addition, the Trade Tax Law was amended in 2003 to abolish the tax on the purchase of securitized products originated by banks.³¹ The reform of the Trade Tax Law eventually led to a surge in securitization in Germany in 2006 (see *Figure 3* in the next section), as Standard & Poor’s reported.³² Such legal developments were made possible by the political push of the True Sale Initiative (TSI) on the part of thirteen leading German banks to promote the improvement of infrastructure for securitization.

Policy Impact

As capital market expansion led to a surge in market-based financing, and expanded the variety of financial products and instruments, the traditional role of banks in the bank-based economies and their business scope started to shift. These shifts included a reduction in bank corporate shareholding and a surge in securitization transactions. The next

30 M. KINOSHITA, Tokutei saiken hô no haishi ni kan suru oboegaki [Memorandum on the Abolition of the Specified Claims Law], in: Hiroshima Law Review 1 (2005) 10-14. The Special Claims Law (SCL) of 1992 was abolished as other laws opened easy legal channels for securitization, although investor protection issues were not fully addressed.

31 V. KOTHARI, Securitization: The Financial Instrument of the Future (Singapore 2006) 120-125. See BAFIN, “Sale of Customer Receivables in Connection with Asset-Backed Securities Transactions by German Credit Institutions (English translation)” Publications, 19 March 1997, available from http://www.bafin.de/nr_720784/SharedDocs/Veroeffentlichungen/EN/Service/Circulars/anrs04_97en.html (last accessed on 20 May 2010).

32 STANDARD & POOR’S, Germany Securitization Outlook 2007 – Continuing Diversification to Advance Market Maturity, available from <http://www2.standardandpoors.com/portal/site/sp/en/eu/page.article/2,1,1,0,1148414593977.html?vregion=eu&vlang=en> (last accessed on 20 May 2010).

section examines these market changes in the late 1990s and early 2000s, driven by the policy changes discussed in this section.

IV. MARKET CHANGES IN CORPORATE SHAREHOLDING AND SECURITIZATION

This section examines two aspects of the change in the structure of banks' investment businesses: 1) the reduced role of banks in corporate shareholding and 2) their increased engagement in securitization markets. Whereas banks started to unwind their investments in their corporate lending customers, they began using risk-shifting strategies through securitization. Although this article does not examine the shifts in relationship lending as such, or other traditional control instruments used by banks over corporations, such as German bank representation on supervisory boards, a decreasing amount of bank corporate shareholding may have lessened their interest in corporate control. Rather, they chose a risk-shifting strategy of spinning off credit risk from their balance sheets through securitization. A comparison of the banking sector's activities in the capital markets of the two countries shows more prominent shifts in corporate shareholding in Japan, and the expansion of securitization in both countries, although with more significant exposure to the 2007-2010 financial crisis on the part of German banks.

1. *Declining Bank Corporate Shareholding*

Time series data on stock ownership structure in Japan is available from the 2008 Shareownership Survey, released by all the domestic stock exchanges in Japan, including Tokyo, Osaka, Nagoya, Fukuoka, and Sapporo on June 19, 2009. According to this survey, the percentage distribution by market value of shares owned by type of shareholder shows a low level of household shareholder ownership, a continuing high level of corporate shareholding, a decreasing holding by banks and insurance companies, an increasing holding by investment trusts and pension funds, and a remarkable increase in shareholding by foreign investors. The percentage figures calculated on a market-value basis for the years 1992, 1996, 2000, 2004, and 2008 are shown in *Table 1* and *Figure 1*³³ (please see p. 94).

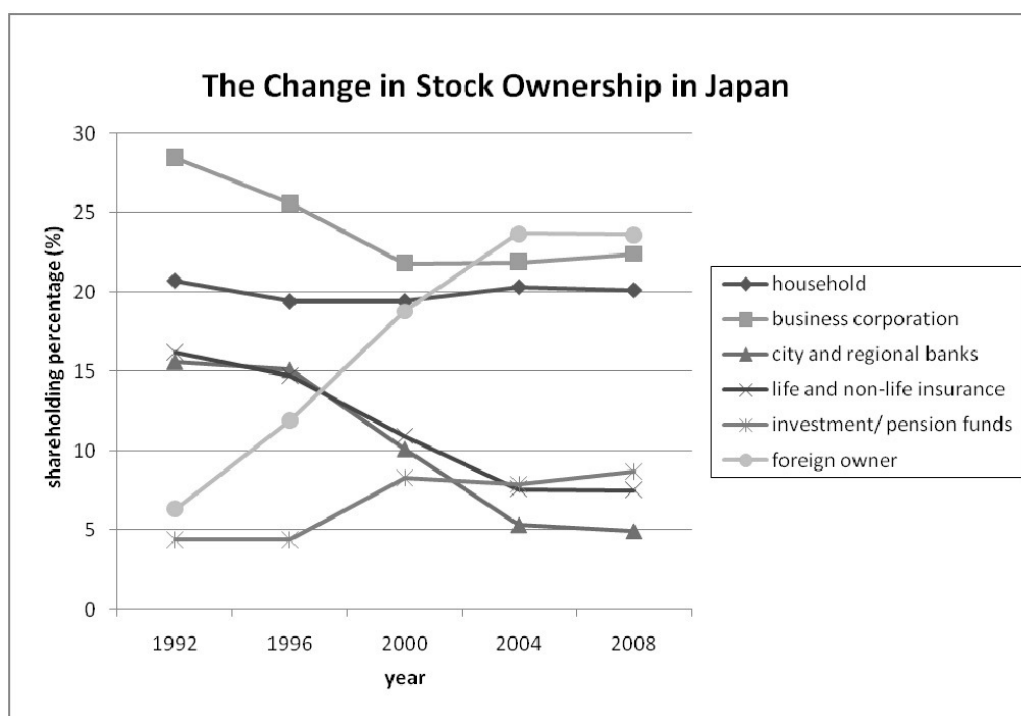
33 See TOKYO STOCK EXCHANGE, 2008 Shareownership Survey, 19 June 2009, 5, Table 3, available from <http://www.tse.or.jp/english/market/data/shareownership/index.html> (last accessed on 20 May 2010).

Table 1: The Change in Stock Ownership in Japan

Year	Household	Business corporation	City and regional banks	Life and non-life insurance	Investment / pension funds	Foreign owner
1992	20.7	28.5	15.6	16.2	4.4	6.3
1996	19.4	25.6	15.1	14.7	4.4	11.9
2000	19.4	21.8	10.1	10.9	8.3	18.8
2004	20.3	21.9	5.3	7.6	7.9	23.7
2008	20.1	22.4	4.9	7.5	8.7	23.6

Data Source: Tokyo Stock Exchange

Figure 1



Data Source: Tokyo Stock Exchange

As for Germany, historical share ownership structure data is available from Deutsches Aktieninstitut (DAI)-Factbook 03.03.2009. This database is based on Deutsche Bundesbank's Financial Accounts for Germany and its monthly reports on capital market statistics. According to the data, the percentage distribution by market value of shares owned by type of shareholder shows a low level for household shareholders, a constant high

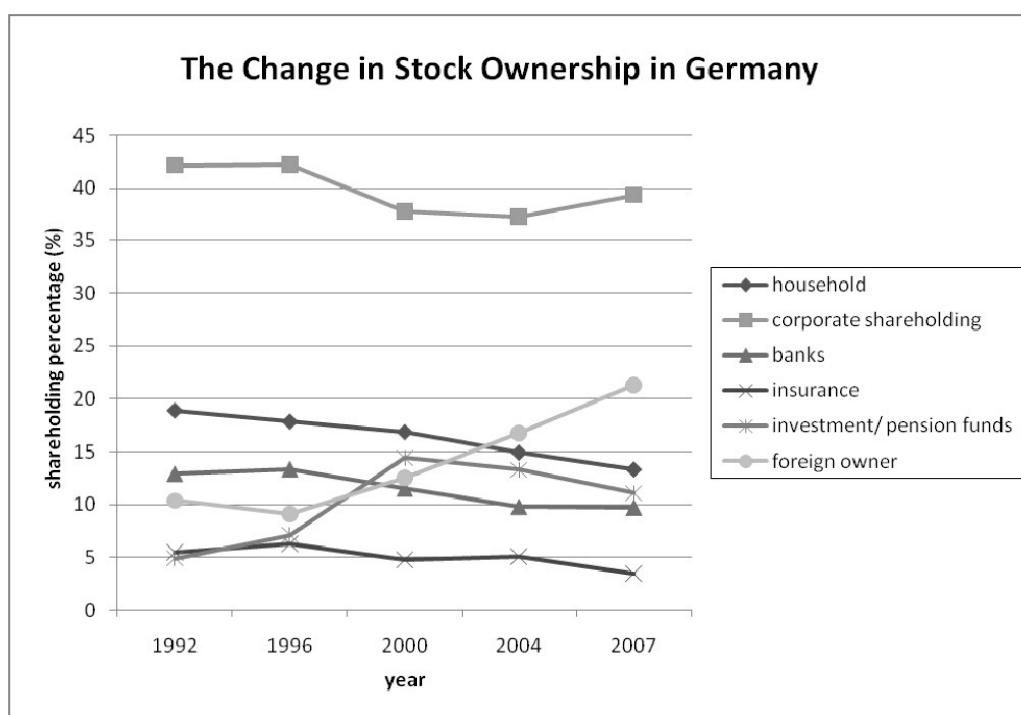
level of corporate shareholding, a modest decrease for banks and insurance, an increasing holding by investment trusts and pension funds, and an increasing holding by foreign shareholders. The percentage figures calculated on a market-value basis for the years 1992, 1996, 2000, 2004, and 2007, are shown in *Table 2* and *Figure 2*.³⁴

Table 2: The Change in Stock Ownership in Germany

Year	Household	Business corporation	Banks	Insurance	Investment / pension funds	Foreign owner
1992	18.84	42.15	12.9	5.48	4.92	10.36
1996	17.8	42.21	13.35	6.29	7.15	9.09
2000	16.81	37.76	11.51	4.73	14.4	12.52
2004	14.87	37.26	9.76	5.05	13.32	16.71
2007	13.28	39.33	9.68	3.43	11.08	21.27

Data Source: Deutsches Aktieninstitut (DAI)-Factbook 03.03.2009

Figure 2



Data Source: Deutsches Aktieninstitut (DAI)-Factbook 03.03.2009

34 DEUTSCHES AKTIENINSTITUT, (DAI)-Factbook 03.03.2009, 08. 1-3.

The increase in the ratio of shareholding by foreign investors was more prominent in Japan, whereas an increasing ratio of investment fund shareholding was more notable in Germany. Although a decline in shareholding by banks and insurance companies was seen in both countries, the degree of the decline in their shareholding was more significant in Japan. This was due to political pressure on financial institutions to unwind their shareholdings to recover their financial health after the 1990s Japanese financial crisis. There was no significant change in corporate shareholding or household shareholding. Business corporations still held a high level of shares in both countries, especially in Germany, and shareholding by households did not increase in either country, despite government efforts to increase the number of dispersed investors, and played a limited role compared to in the United States (Deutsches Aktieninstitut (DAI)-Factbook 2009: 08. 6-3).

A study by Patrick McGuire (2009) unveils the detailed picture of the decline in corporate shareholding by financial institutions in Japan.³⁵ His research is based on the “Kaigin financial database” from the Development Bank of Japan (DBJ). The amount of corporate shareholding by financial institutions decreased from 35 trillion yen in the fiscal year (FY) 2000 to 15 trillion yen in FY 2005. In terms of number of shares, in FY 2000 city banks held 20% fewer shares than in FY 1996 (in firms for which these banks were amongst the top ten shareholders). The drop in number of shares was even more significant in FY 2004, with more than a 60% decrease from the level of FY 1996. A similar decrease in equity shareholding is shown by trust banks and life insurance companies.

In McGuire’s paper, the declining trend in financial institution corporate shareholding is shown for each major banking group.³⁶ For example, the number of firms that listed the Bank of Tokyo-Mitsubishi UFJ (or financial institutions that were merged into this bank) amongst their top ten shareholders decreased from 1390 firms in FY 1996 to 741 firms in FY 2004. The declining trend in corporate shareholding applies to the four major banking groups in different degrees. The decrease in corporate shareholding is also confirmed by the decrease in the estimated market value of these banking groups’ equity portfolios, calculated by multiplying the estimated number of shares held in each firm by the firm’s end-of-period stock price.³⁷

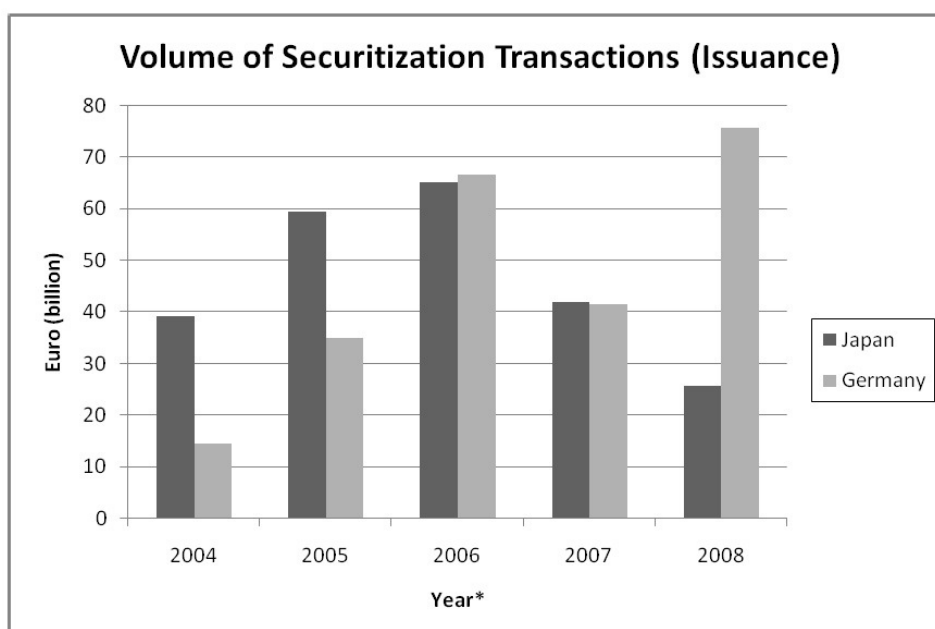
35 P. MCGUIRE, Bank ties and firm performance in Japan: Some evidence since FY2002, BIS Working Papers 272 (2009) 1, 6-8, 36, available from <http://www.bis.org/publ/work272.htm> (last accessed on 20 May 2010).

36 There were a series of major bank mergers in 2001, 2002, and 2005, leading to a decrease in the number of major banking groups from eight to four, which comprise three mega-banking groups.

37 MCGUIRE, *supra* note 35, 8-9, 37-40.

2. Growth of Securitization

The volume of issuance of securitized products in Japan increased in the early 2000s, but plummeted after the 2007 subprime loan crisis started to unfold: 5.3 trillion yen (€39.2 billion) in FY 2004, 8.2 trillion yen (€59.5 billion) in FY 2005, and 9.8 trillion yen (€65.3 billion) in FY 2006, 6.8 trillion yen (€42.1 billion) in FY 2007, and 3.7 trillion yen (€25.8 billion) in FY 2008 (Japan Securities Dealers Association).³⁸ In Germany, the volume of issuance of securitized products increased in the early 2000s and continued to grow even in the middle of the financial crisis. The volume of securitization transactions (issuance) reported in Germany is as follows: €14.5 billion in 2004, €35.0 billion in 2005, €66.7 billion in 2006, €41.6 billion in 2007, and €75.7 billion in 2008 (KfW).³⁹ Figure 3 shows the surge in securitization transactions both in Japan and Germany:



Japanese data: Japan Securities Dealers Association; German data: KfW

* Measured by fiscal year in Japan and by calendar year in Germany

38 JAPAN SECURITIES DEALERS ASSOCIATION, *Shôken-ka shijô no dôkô chôsa* [Research on the Securitization Market Trends: the Trend of Issuance in FY 2008] released on May 29, 2009, available from <http://www.jsda.or.jp/html/youkenka/2/2008doukou2.pdf> (last accessed on 20 May 2010). The exchange rate used was taken from the European Central Bank Statistical Data Warehouse, available at <http://sdw.ecb.europa.eu> (last accessed on 20 May 2010).

39 See KfW Bankengruppe, *Development of the securitisation volume and number of transactions in Germany since 2000*, available from http://www.kfw.de/EN/Home/Loan_Securitisation/European_Securitisation_Market/Pdf_documents_ESM/PowerPoint_-_Folie_2_German_Securitisation_Market_12_2009_ppt.pdf (last accessed on 20 May 2010).

As the 2007-2010 financial crisis deepened, securitization products were criticized for their contribution to it. This crisis hit German banks harder than Japanese banks. In 2009 the Financial Services Agency (FSA) reported⁴⁰ Japanese banks' exposure to subprime-related products as being 341 billion yen (€ 2.56 billion) at the end of September (book-value) and their losses from subprime-related products as being 1.070 trillion yen (€8.04 billion) from April 1, 2007 to September 30, 2009 (the sum of realized losses and valuation losses).⁴¹ Total exposures to securitized markets including those other than subprime-related products amounted to 16.919 trillion yen (€127.08 billion) (book-value) on September 30, 2009 and total losses amounted to 2.908 trillion yen (€21.84 billion) from April 1, 2007 to September 30, 2009.⁴²

Corresponding official data on German banks' exposure to subprime-related products and their total estimated losses are not yet publicly available from the German national financial authorities, the European Central Bank (ECB), the International Monetary Fund (IMF) or the Financial Stability Board (FSB). However, bank exposure to and losses from toxic assets seem to be more serious in Germany. On January 17, 2009, *Der Spiegel* reported the exposure of major German banks to toxic assets (presumably including collateralized debt obligations (CDOs) and subprime-related products amongst others) as being almost €300 billion with only one quarter having been written down, according to a survey conducted by German regulators and financial institutions.⁴³ In November 2009, the Bundesbank Financial Stability Review estimated a further €10 to €15 billion would be written down by the end of 2010, due to losses from securitization, almost exclusively resulting from banks' positions in CDOs.⁴⁴

In older figures, the Bloomberg report of March 14, 2008 showed larger losses at German banks than at Japanese ones.⁴⁵ Since the beginning of 2007, due to the collapse of the U.S. subprime mortgage market, large German banks had suffered \$23 billion

40 See FSA's website: <http://www.fsa.go.jp/en/regulated/subprime/index.html> (last accessed on 20 May 2010).

41 The figure includes exposures to/losses stemming from subprime-related products of Collateralized Debt Obligations (CDOs) and Residential Mortgage-Backed Securities (RMBS). For historical trends, see INTERNATIONAL MONETARY FUND, Japan: Selected Issues, IMF Country Report No. 08/254, July (2008) 4, available from <http://imf.org/external/pubs/ft/scr/2008/cr08254.pdf> (last accessed on 20 May 2010).

42 The figure includes exposures to/losses stemming from non-subprime parts of CDOs, Collateralized Loan Obligations (CLOs), RMBS, Commercial Mortgage-Backed Securities (CMBS), and leveraged loans. See also *supra* note 41, 10.

43 "Deutsche Banken sitzen auf Giftpapieren in Milliardenhöhe", *Der Spiegel*, 17 January 2009, available from <http://www.spiegel.de/wirtschaft/0,1518,601800,00.html> (last accessed on 20 May 2010).

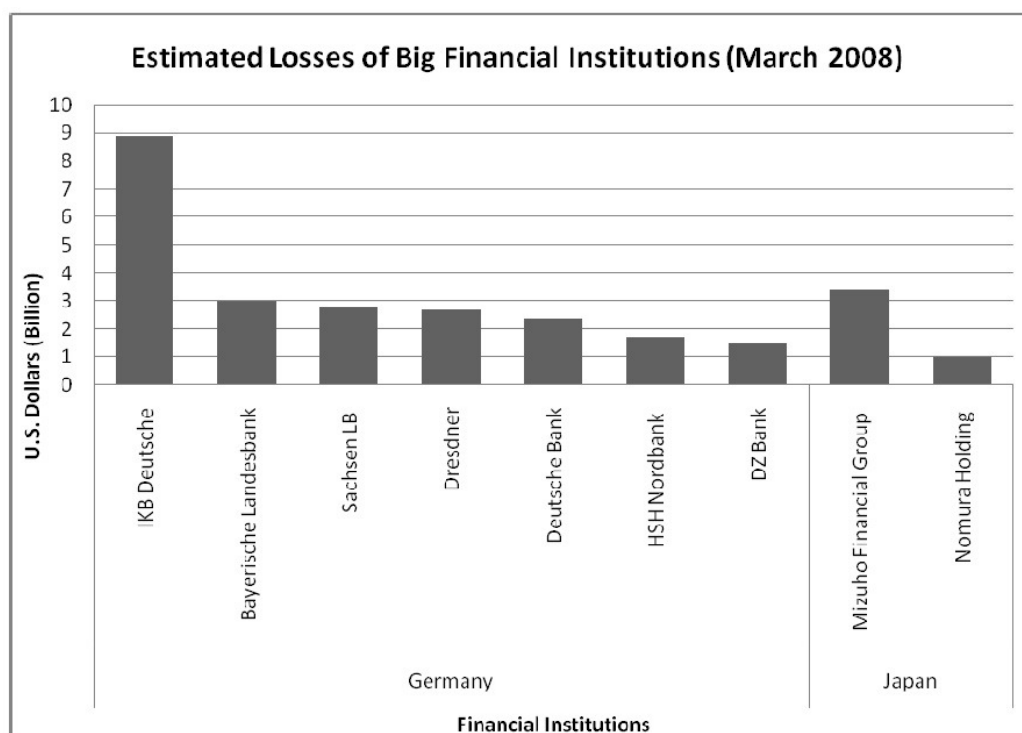
44 DEUTSCHE BUNDESBANK, Financial Stability Review 2009, November (2009) 11 [online], available from: http://www.bundesbank.de/finanzsystemstabilitaet/fs_dokumentation.en.php (last accessed on 20 May 2010).

45 Y. ONARAN, Subprime Losses Reach \$195 Billion; German Banks Get Hit: Table, in: Bloomberg, 14 March 2008 available from <http://www.bloomberg.com/apps/news?pid=20601208&refer=finance&sid=axW.W8dqt1xA> (last accessed on 20 May 2010).

losses (the sum of asset write-downs and credit losses), a large proportion of which was concentrated in public banks such as Bayerische Landesbank, Sachsen LB, and HSH Nordbank, whereas large Japanese banks had suffered only \$4.4 billion losses as of March 2008. The amounts are based on an examination of the bad assets of more than 45 big banks and securities firms in the world. These figures include some mortgage asset losses that are not subprime and reserves set aside for bad loans but do not include the charges stemming from leveraged-loan commitment. *Figure 4* summarizes losses reported for each financial institution by country.

Although the quantity of securitized products increased in both economies, exposure to toxic assets and subsequent losses was much higher in Germany. The German banks' exposure to toxic assets was partly encouraged by the country's high proportion of public banks, including Landesbanks, where extended government guarantees encouraged them to engage in more aggressive risk-taking investment overseas.⁴⁶

Figure 4



Data: Bloomberg, March 14 2008

46 S. THEIL, The Germans are toxic too: Claims of safer banks now ring false, in: *Newsweek*, 22 June 2009, 0; "Landesbanks' subprime exposure 80 bln eur-report", *Reuters*, 26 January 2008, available from <http://www.reuters.com/article/email/idUSL2651648120080126> (last accessed on 20 May 2010).

V. CONCLUSION: POLICY IMPLICATIONS

This article has shown some attenuation of the bank-based features of the Japanese and German economies and how these market changes were aided by a series of policy initiatives. The extent of the market changes and the consequences resulting from them varied between the two countries. First, in both countries, banks decreased the amount of their corporate shareholding, thus giving investors an enhanced role in corporate control. The declining trend in bank corporate shareholding was more prominent in Japan than in Germany due to Japan's experience of financial crisis in the 1990s. Second, banks in both countries increased their volume of service-oriented business such as originating and dealing in securitized products in capital markets, although the extent of exposure to and losses from toxic assets (among these newly invented financial products) was more serious in Germany than in Japan.

The next questions to be asked are thus: Was shifting away from bank-based features desirable for both economies? And in which directions should financial and banking systems now be guided? The 2007-2010 financial crisis highlighted the swollen systemic risk originating from complicated securitized businesses and derivatives markets that entailed unknown risk. Then, should banks focus on their traditional lending business while disengaging from these new businesses?

This comparative study has shown a different degree of exposure to toxic assets between two economies, despite similarities in their policy and market shifts in the recent decade. In both countries, securitization transactions were encouraged and cumbersome procedures and restrictions on these transactions were relaxed. However, Japanese banks were relatively less exposed to risky transactions than German ones. Thus, securitization itself may not have been the direct cause of the financial sector losses resulting from the 2007 subprime loan crisis.

The problems can be attributed to how these new instruments were used, rather than to securitization as such.⁴⁷ For example, although securitization aimed at risk diversification, this objective was not met since banks held a portion of the products they issued and hedged the risk through derivatives such as CDOs, whose market liquidity quickly dried up once investors' trust in the asset quality plummeted.

In addition, another major problem was found in the originate-to-distribute (OTD) chain of securitization transactions. Each securitization product entails a stream of contracts and transactions, called the OTD chain. The market players involved in this chain include originators, arrangers, distributors, and managers. Since too many actors were

47 This point comes from a suggestion by Charles Bean. Concerning his view on this crisis, see C. BEAN, *The Great Moderation, the Great Panic and the Great Contraction*, Schumpeter Lecture, Annual Congress of the European Economic Association, Barcelona, 25 August 2009, available from <http://www.bis.org/review/r090902d.pdf> (last accessed 20 May 2010).

involved in the OTD chain, the problem of information asymmetry arose and made the monitoring of the quality of assets and products difficult.⁴⁸

This suggests that the risk to which banks are exposed should be more carefully monitored. Brunnermeier, Crockett et al. (2009) stress the necessity of introducing macro-prudential regulations over systemically important financial institutions in order to address the risk of failures of wholesale financial markets and mitigate the impacts of a boom-and-bust cycle.⁴⁹ Moreover, the practice of micro-prudential (over the soundness of individual banks) and macro-prudential (over the soundness of wholesale financial markets) regulation should be more collaborative in order to monitor the impact of the financial behaviour of individual financial institutions or their behaviour as a group on overall financial market stability.

Closer collaboration in financial supervision based on micro- and macro-prudential regulation, combined with an improved legal platform for securitization transactions to ensure prudent practices, could help mitigate another future financial shock. This policy option provides an alternative to radical bans on banks engaging in securitization, which could damage a significant range of business activities including those without systemic risk for no obvious rationale. Banks have increased their exposures to capital market risk in regional and global markets, while newly-developed financial instruments such as securitization and derivatives have made short-term financing easier for banks and amplified the impacts of a boom-and-bust cycle. This changing role of banks therefore justifies the introduction of a strengthened financial supervisory structure which covers new types of risk. This policy option would seem attractive, since it can help find a proper balance between innovative and free market practices and overall financial stability.

48 See G. FRANKE/J.P. KRAHNEN, The Future of Securitization, Center for Financial Studies (CFS) Working Paper No. 2008/31, available from http://www.ifk-cfs.de/fileadmin/downloads/publications/wp/08_31.pdf (last accessed 20 May 2010).

49 M. BRUNNERMEIER/A. CROCKETT/C. GOODHART/A.D. PERSAUD/H. SHIN, The Fundamental Principles of Financial Regulation, Geneva Reports on the World Economy 11 (London 2009), 1-23.

ZUSAMMENFASSUNG

Diese Arbeit untersucht, ob es im Laufe der Zeit zu einer Änderung der Eigenschaften der bankbasierten Volkswirtschaften Japan und Deutschland gekommen ist. Die meisten Studien plädieren bisher für eine Konsistenz der bankbasierten Volkswirtschaften. Allerdings wurden im Zeitraum vom Ende der 1990er bis in die frühen 2000er Jahre einige Charakteristika in Japan und Deutschland in der Tat abgeschwächt. Diese Veränderungen des Marktes wurden durch politische Veränderungen in diesem Zeitraum angetrieben, die sich seit den 1980er Jahren als Teil einer langfristigen politischen Initiative in Richtung Expansion des Kapitalmarkts in Arbeit befinden.

Erstens gaben politische Veränderungen am Markt Investoren eine größere Rolle bei der Steuerung von Unternehmen, und die Verbesserung der finanziellen Gesundheit der Banken führten zu einem Rückgang der Aktienbeteiligungen von Banken an Unternehmen, wodurch sich die Beziehungen zwischen Banken und Unternehmen abschwächten. Dieser Effekt war besonders bedeutsam in Japan. Zur gleichen Zeit nahmen marktorientierte Akteure wie ausländische Investoren, Fondsgesellschaften und Pensionsfonds eine aktivere Rolle in beiden Ländern ein. Zweitens führten politische Veränderungen, die Banken durch Lockerung von Formvorschriften und Steuerbefreiungen einen erleichterten Zugang zu neuen Finanzinstrumenten verschafften, zu einem sprunghaften Anstieg an Verbriefungstransaktionen in beiden Ländern, die wiederum später für ihren Beitrag zur Finanzkrise von 2007-2010 kritisiert wurden. Obwohl in beiden Volkswirtschaften Banken erhebliche Verluste aus verbrieften Produkten erlitten, zeigt die Studie verschiedene Grade der Betroffenheit und des Verlusts aus faulen Vermögenswerten.

Vor dem Hintergrund des Beitrages politischer Veränderungen für die Weiterentwicklung des Bankgeschäftes beschreibt der Aufsatz die Richtungen, in die die Finanz- und Bank-Systeme beider Länder zukünftig gelenkt werden sollten, zeigt die Notwendigkeit sorgfältiger Aufmerksamkeit für die tatsächlichen Ursachen der Krise auf und schlägt einen Ausgleich zwischen den innovativen Praktiken des freien Marktes und allgemeiner finanzieller Stabilität vor.