

Exit strategy and financial regulatory reform

- Japan's perspective -



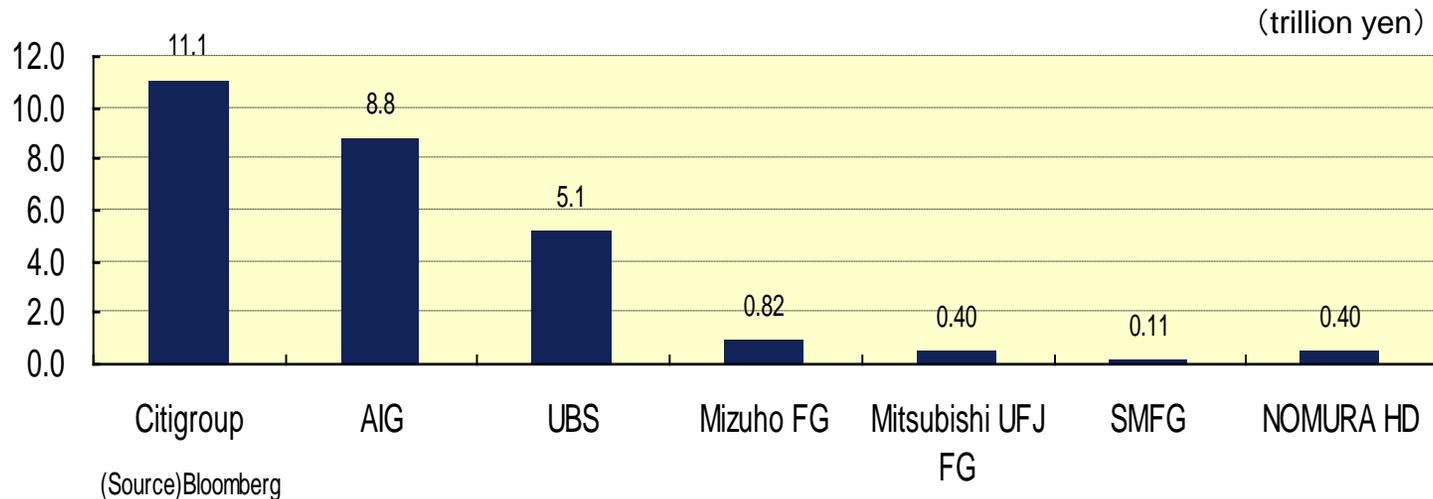
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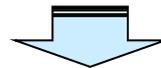
Current situation of Japan's financial sector

1. Losses incurred from securitized products including subprime loan products were relatively small.

Figure. Losses incurred from securitized products (as of December 2009)



2. Impact of liquidity shortage and rapid deleveraging triggered by the collapse of Lehman Brothers was limited.

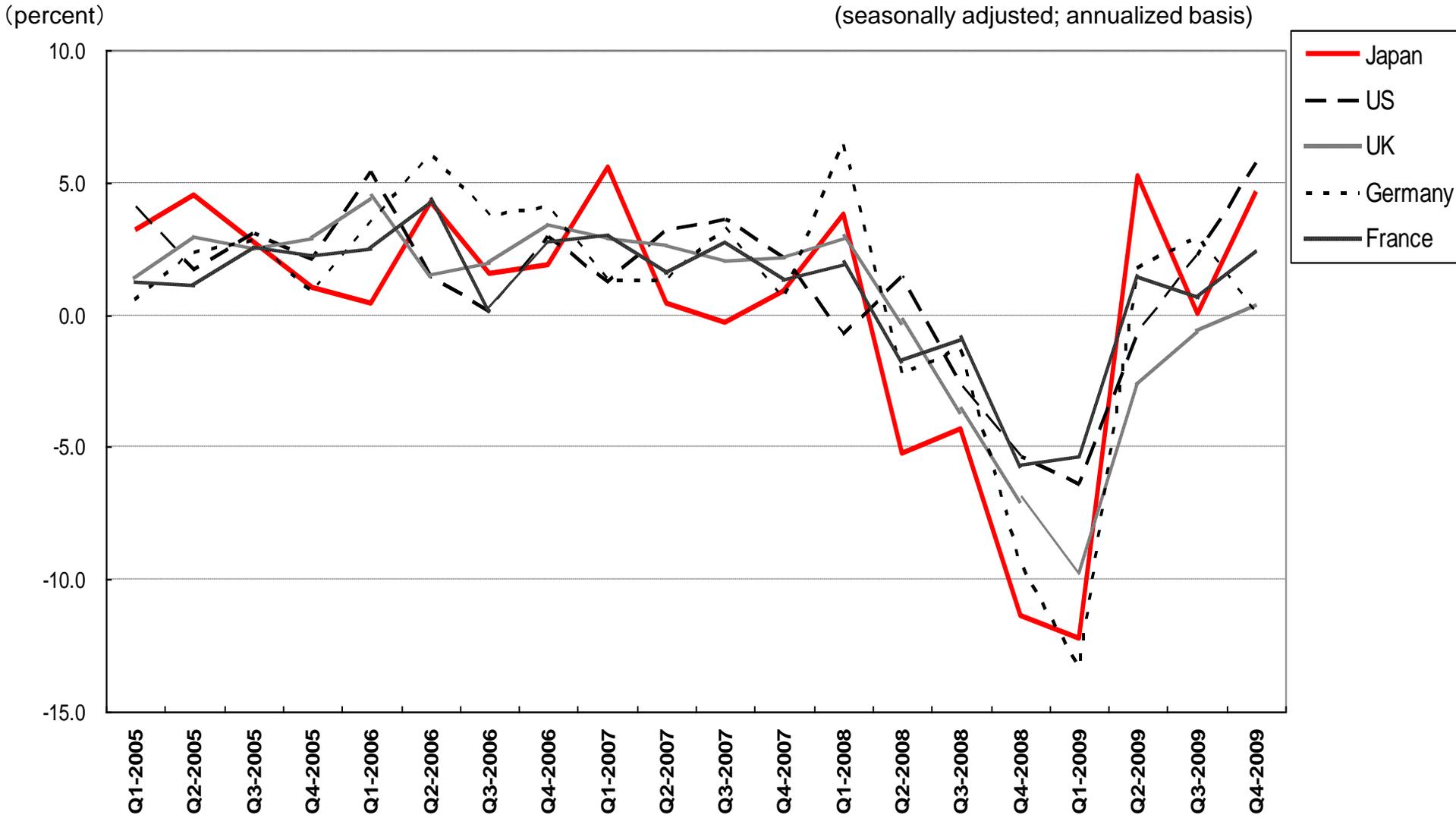


The financial system has been relatively sound compared with US and Europe

Reasons for relative soundness

- 1. Japanese firms: not strongly innovation-oriented**
- 2. Final stage of resolving NPL problems coincided with spread of “originate-to-distribute” model**
- 3. Improvement in firms’ risk management, early implementation of Basel II**

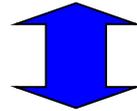
Real GDP growth of advanced economies



(Source) OECD

US/Europe: extraordinary actions with massive public support

- Large-scale capital injection
- Temporary bank nationalisation
- Bank debt guarantee by governments...



Japan: more focused on maintaining financial intermediary functions

because of :

- relative soundness of financial system
- severe weakening of real economy

Stabilisation measures in Japan

The measures taken are mainly aimed at:

1. Preserving the soundness of the financial sector

- Cross-sectoral stress testing
- Efforts to identify potential spillover of overseas events
- Communicate concerns to firms and urge remedial actions

2. Maintaining the functioning of markets

- Ban on naked short selling and enhanced disclosure
- Close coordination with the Bank of Japan *et al.* on CP/bond purchases to provide liquidity

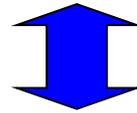
3. Sustaining bank lending

- Revision of capital injection scheme
- Intensive supervisory review of lending practices
- Temporary measures to request revision of terms of loans to SMEs, homeowners on a best effort basis

Exit strategy: Need for well-balanced judgment

Side effects of prolonged public support

- Could harm pricing functions of the markets
- Could cause serious moral hazard



Possible adverse effects of too early withdrawal

- Could impede market normalisation
- Could have adverse effects on economic recovery

Therefore, authorities need to carry out:

- ✓ Careful analysis of economic/financial situation of the country
- ✓ Evaluation of effectiveness of individual measures
- ✓ Consistency check with international developments

“Re-design” of regulatory framework

Medium-term reforms to prevent recurrence of crisis

➤ **Capital adequacy and liquidity**

Public consultation by BCBS; impact study forthcoming

➤ **Addressing procyclicality in financial system**

Countercyclical capital buffers, provisioning rules...

➤ **Market integrity/transparency**

Strengthened disclosure, robust market infrastructure, regulation of CRAs, hedge funds, OTC derivatives...

➤ **Addressing misaligned incentives**

Bank remuneration practices, trading book capital...

➤ **Systemically important financial institutions**

Different treatment in capital, liquidity, crisis management? 7

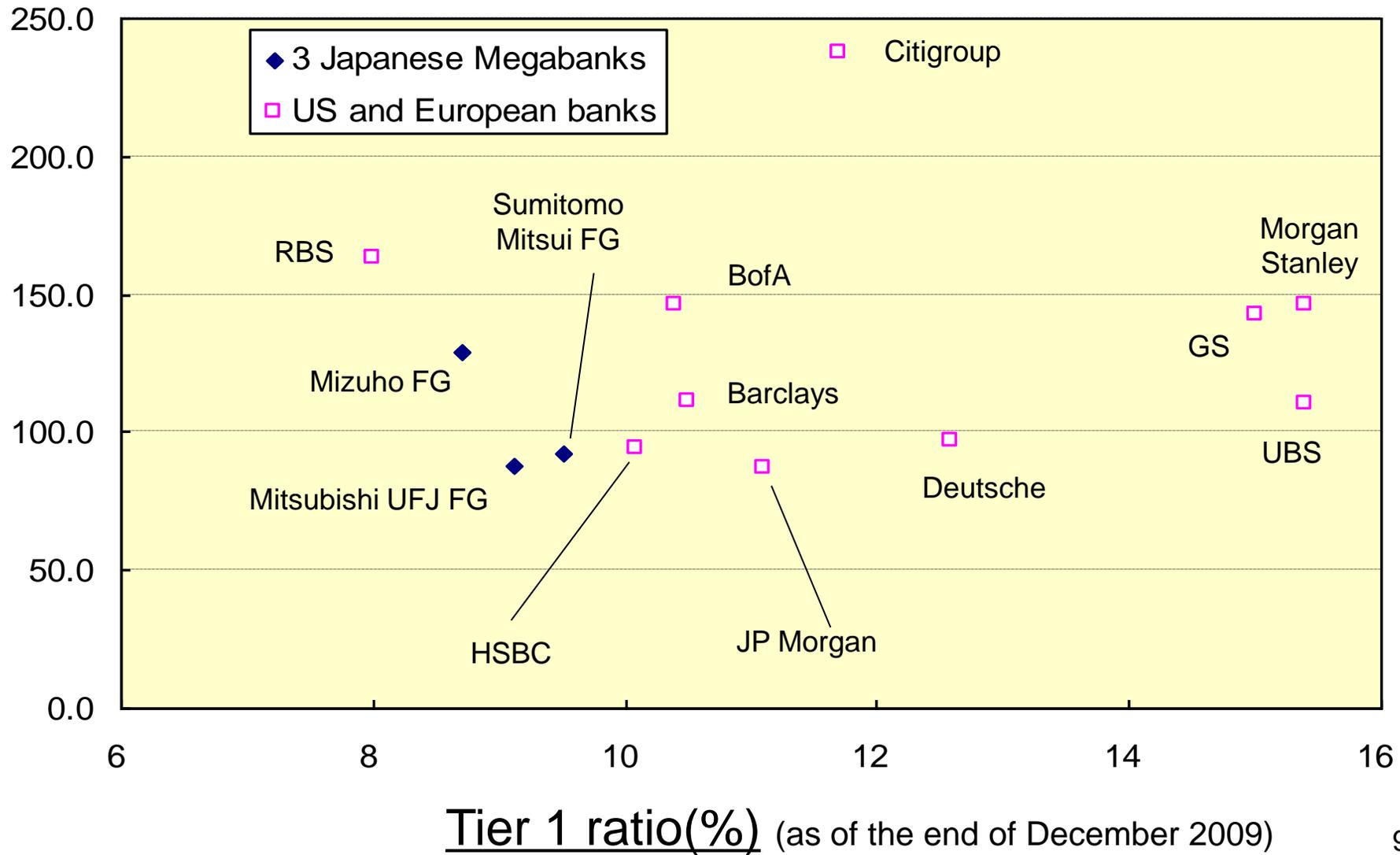
Points to be kept in mind on capital regulation

Some strengthening is certainly necessary, but...

- An important aim of the regulatory reform is to ensure that the financial system can fulfil its fundamental role of supporting the real economy
- Simply raising the minimum regardless of the risks associated with different kinds of business could impair the banks' lending capacity to ordinary borrowers
- The strength of the new capital regulation must be appropriately calibrated, while the timing of its implementation needs to be judged carefully in view of national circumstances

CDS spreads and Tier 1 ratio

CDS spreads (bps) (as of February 12, 2010)



Thank you.



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* The views expressed in this presentation are those of the presenter.
They do not necessarily reflect those of the Financial Services Agency.