Section 2　Monetary and Financial Policy

1　The First and Second Oil Crisis and Monetary Policy

Monetary Policy before and after the First Oil Crisis. This section is about macro monetary policy operation. Table 1-2-1 shows the change in the official discount rate in this period. It shows monetary easing until spring 1973. It was because of the domestic demand expansion policy under the condition of current account surplus, in order to maintain the fixed exchange rate system (policies for avoiding yen appreciation) and concern about recession due to the yen appreciation in August 1971.

However, as the money supply increased rapidly, it advanced price hikes and land speculation, then the first Oil Crisis occurred, and the economic scene was described as "galloping inflation". Then the Bank of Japan (BOJ) raised the official discount rate from 0.75% in April 1973 to 5.0%, took one monetary tightening measure after another, and finally the official discount rate was raised to 9.0% in December. The Ministry of Finance implemented its financing regulations. Following the restraining of real estate related loans in 1972 ("qualitative credit control"), "selective lending" was conducted at the end of 1973, upon the occurrence of the Oil Crisis. This was a guideline for financial institution loans to prioritize the emergency funds required for stabilization of public lifestyles and restrain funds suspected for use in speculation, such as for land acquisition, those buying up land and those reluctant to sell, etc. With the notification in December 1974, the regulations of large loans (for ordinary banks, a loan for one debtor should not exceed 20% of the net worth of the bank) was implemented.

In 1974, growth in productive activities turned out to be below zero and fell into stagflation. The Bank of Japan then took measures, while watching prices, to carefully shift the policy to an easy one, by cutting the official discount rate from April 1975. From 1977, because of the drastic yen appreciation, the official discount rate was further cut, and it reached 3.5% in March 1978. At the same time, the government made efforts to stop the yen's rise in value by selling yen and buying dollars.

Monetary Policy before and after the Second Oil Crisis. The official discount rate remained low at 3.5% from March 1978, but the price of crude oil started to significantly rise again, after the resolution of the OPEC meeting conducted in the end of same year (the second Oil Crisis).

From the lessons of the first Oil Crisis, the Bank of Japan was prepared to avoid inflation and promptly went on alert. It restricted the increase of bank loans from the

Table 1-2-1 Change in Official Discount Rate (FY1970～1979)

Year/Month/Date	%	Year/Month/Date	%	Year/Month/Date	%
1970. 5.15	6.25	1973. 5.30	5.50	1977. 3.12	6.00
10.28	6.00	7. 2	6.00	4.19	5.00
1971. 1.20	5.75	8.29	7.00	9. 5	4.25
5. 8	5.50	12.22	9.00	1978. 3.16	3.50
7.28	5.25	1975. 4.16	8.50	1979. 4.17	4.25
12.29	4.75	6. 7	8.00	7.24	5.25
1972. 6.24	4.25	8.13	7.50	11. 2	6.25
1973. 4. 2	5.00	10.24	6.50	1980. 2.19	7.25

Source: Bank of Japan, *Nihon Ginko Hyakunenshi*
[One-Hundred-Years History of the Bank of Japan] (1986)

first quarter of 1979, which was followed by more restraining measures such as gradually raising the official discount rate from April 1979, as shown in Table 1-2-1 (the official discount rate was later raised by 9.0% in March 1980). Reserve requirement ratios were also raised.

Because of this prompt and bold restraining policy, the price hike was successfully controlled for finished products, while import prices and raw material prices rose considerably. In other words, home-made inflation was successfully controlled to some extent.

Change in the Financial Structure. From the end of the period of high economic growth, an historic change in the financial structure began to take place.

Firstly, the fund flow changed. With the decline in the growth rate and the end of the period of investment boost, the era of the fund shortage ended. This can be seen by the drastic reduction in fund shortages in the corporate sector. In turn, the government and overseas sectors became main fund shortage (deficit) sectors. The fund shortage of overseas sector meant the stable current account surplus of Japan. (Capital is the net flow.) The government expanded its fiscal deficit by balancing the shortage in overall demand resulting from the shrinking of business investment (increase in fiscal expenditures and sluggish growth of tax revenues).

As the growth rate decreased, the level of the increase rate of money supply also decreased. The market equilibrium interest rate, which was once raised thanks to high growth and investment, declined as well.

Fiscal deficits increased the issuance of government bonds and accumulated the outstanding amount. This brought big changes to the financial system. The large amount of government bonds was absorbed by financial institutions but holding these turned out to be a burden and there was demand to ease the restrictions on transfer. Trading the bonds held by financial institutions in the market started in 1977. This resulted in the rapid expansion of the government bond circulation market, in and after 1977. This market was the core of the unregulated rate market, which further resulted in a chain reaction. If the free financial market were to be extended, the fund supply would be shifted to it from the regulated market, when interest is high, for instance (disintermediation). In order to avoid such an occurrence, the liberalization of interest rates was required.

Monetary Policy was also affected. Major policy instruments and measures in the high growth period were operating the official discount rate, the shift in the regulated rate system which was interlinked with the rate, credit rationing to control the sufficiency level of the excess demand to the BOJ lending, whose rate was below the market interest rate, and bank loan restriction, which was a kind of moral persuasion (to show the guidelines for the increase in bank loans per quarter). The quantitative control of bank loans was important.

In connection with the government bonds circulation market, the unregulated rate market expanded. Once each market was further linked (arbitrage), the monetary policy was also shifted to one based on the interest rate fluctuation mechanism.

2 The Basic Concept of Financial Regulation and Administrative Management

The Basic Concept of Financial Administration. The Ministry of Finance recognized that the economic and financial environment was changing, from a long term perspective, and that financial institutions and administration needed to move towards a new direction.

The basic direction was stated in the speech by the Minister of Finance, Hideo Bo, in July 1977, as follows: high growth of the economy is no longer expected, but we must cope with a new economic structure. Financial institutions are required to promote efficiency with self-responsibility, under the principles of fair competition, to accomplish a public mission and meet the needs of society. The administrative bodies must abolish their overprotective policies and illogical equality.

New entries, exits and mergers of financial institutions. The following describes the actual administration. First, is the management of new entries and exits. Following the high growth period, the industrial organizations of financial institutions were stable, as shown in Table 1-2-2.

Table 1-2-2 Number of Financial Institutions

Year end	1974	1975	1976	1977	1978	1979
City bank	12	12	12	12	12	12
Foreign exchange bank	1	1	1	1	1	1
Long-term credit bank	3	3	3	3	3	3
Trust company	7	7	7	7	7	7
Regional bank	63	63	63	63	63	63
Mutual bank (Sōgo Bank)	72	72	71	71	71	71
Cooperative bank (Shinkin Bank)	476	471	470	468	466	462
Credit cooperative	491	489	488	487	486	483

Source: Research and Statistics Department, Bank of Japan, *Keizai Tōkei Nenpō* [Economic Statistics Annual] 1980

For major commercial banks, there was no change in the 12 city banks after the merger of Taiyo and Kobe Banks in 1973, including Mitsui, Mitsubishi, Sumitomo, Fuji, Dai-ichi Kangyo, Sanwa, Tokai, Daiwa, Taiyokobe, Kyowa, Hokkaido Takushoku and Saitama. The only specialized foreign exchange bank was the Bank of Tokyo. The long-term credit banks included three banks: Industrial Bank of Japan, Long-Term Credit Bank of Japan and Nippon Credit Bank. There were seven trust banks, including Mitsubishi, Sumitomo, Mitsui, Yasuda, Toyo, Chuo, and Nihon. There was no change.

Regarding regional financial institutions, the number of regional banks remained unchanged at 63. In terms of mutual banks, Hirosaki Sogo Bank and Aomori Bank merged to become Michinoku Bank in 1976, so the number of banks was reduced from 72 to 71. This gained public attention as a merger of financial institutions from different fields, as the first merger of regional bank and mutual bank. The authorities welcomed the merger as it would bring a positive effect on the regional economy. The small number of cooperative banks (Shinkin Banks) and credit cooperatives (Shinyō Kumiai) declined annually due to merger.

Regulations on Branching. At the beginning of this term, the Notification in February 1973 was the basic policy regarding regulations on branching, as follows: (1) two branches should open per bank in a year for the convenience of users; (2) the unofficial announcement of new branches should be made for 2 fiscal years at a time (e.g. 4 branches in 2 fiscal years); (3) branches in housing complexes should be accepted as extra; and (4) no change of location is accepted, except for the reorganization of excess branches. (4) was specified to cope with cases where there might be struggles and frictions with the local community, due to withdrawal from under-populated areas.

However, branch authorization in 1974 to 1976 was restrained, as an emergency measure to prevent land speculation and land price hikes.

Unofficial announcements were less restrained in FY1977/FY1978. However, administrative guidance was given that large branches in busy areas, such as in front of stations, were almost saturated, and so new branches should be located in other regions as small branches or ATMs.

This was clearly stated in a notification in FY 1979/1980. This notification said that branches should be prioritized in the category of "non-competitive", that is, with no other competitors within a distance of 500m, such as branches in non-competitive areas but with potential for a rapid increase in users, small/ATM branches or branches in housing complexes.

Managerial Indicators Regulations. Managerial indicators regulations (balance sheet regulations) were applied to the following five items:

(1) Current account ratio regulations

Current account ratio (current expenditure /current revenue) regulations are to save costs and improve the stability of financial institutions, which was particularly important in the early stages after World War II, but was abolished in 1968. However, administrative guidance was provided for the gradual decrease in expense ratios and in restraining stock dividends.

(2) Loan-deposit ratio regulations

The amount of loans was restrained to within 80% of deposits, but the amount kept exceeding this standard, in major commercial banks, in particular.

(3) Real estate ratio regulations

Commercial real estate/net worth (in a narrow sense) was controlled to within 50% as a standard, and aimed for within 40%, but the standard ratio was exceeded in major commercial banks.

(4) Liquid assets ratio regulations

Aimed for 30% or more for liquid assets/deposits, but it was unable to achieve this target until the end of the 1970s. Liquid Assets were defined as assets other than those for lending - mainly securities - but shareholding was not encouraged.

(5) Capital Requirements

Net worth (in a wide sense) /deposits aimed at more than 10% (the denominator was deposits because the net worth was assumed to be reserve requirements for the deposits) but was never accomplished, so lowered even more.

As shown above, most of the cases could not achieve the regulation target. Even despite this, no strict penalty was specified. Therefore, these may have been measures to encourage the practical improvement of the existing conditions towards the target, and not measures which strictly required the accomplishment of the standard.

Bank Inspections. The following briefly describes bank inspections in the postwar era.

Japanese financial administrations have supervision executed by administrative divisions such as the Commercial Banks Division, the Small Banks Division, etc., of the Banking Bureau and inspections executed by the Banking Inspection Department as two separate wheels. That is, the Banking Inspection Department conducts inspections in accordance with important policies, specified by the administrative divisions as required, and in turn prepares the administrative divisions policies, taking into account the facts revealed in the inspections. In terms of personnel management, different from the system in the United States where inspectors are regarded as specialists, both sections encourage personnel transfers between sections, for the development of personnel who are well-versed in both administrations. Inspections are conducted by 80 inspectors from the Banking Inspection Department and in 200-240 Local Finance Bureaus, which is far less when compared to the United States.

The Banking Inspection Department of the MOF conducted inspections, as follows.

The Inspector’s Team comprises 5-10 members. It may be more than ten members, when including those for asset assessment for the inspection of major banks. First, the team prepares for about one week. This mainly includes reviewing materials from the previous inspection, and various financial data (for the past 3-5 years) of financial institutions in the same category, area and scale. This is followed by a meeting with an administrative division to specify the conditions of the target institutions, especially issues that need to be considered, and points of focus for the inspection.

Next is the inspection at the object institution. Inspections are classified into each of comprehensive or partial inspections, and ordinary (regular) or special inspections. Comprehensive and ordinary inspections are conducted normally. Partial inspections are for specific items, such as asset assessment or corporate management checks, etc. Special inspections are not conducted regularly and are for a special purpose.

Firstly, the inspection of actual things and the site investigation are conducted. The inspection of actual things comprises 3 kinds of inspections: inspectors stay in a branch selected for the checking/cross-referencing of books for 2 days (to check ledgers/daily journals and cash balance, contacts and actuals, etc.); then there is the common items check (target industries, purpose of use of loans, terms of repayment and credit investigation for lending; presence of illegal deposits and management of bookkeeping); and the specific item check (for specific business items). On the other hand, site investigation is also to check issues picked up in the advance investigation. These inspections are also completed, with comments.

Next is the main inspection, which takes 1 week to 10 days, based on the materials provided by the financial institution or documents collected in the field inspection. It is mainly for asset assessment, especially research on loans. In particular, suspected assets and large-scale lending issues are carefully checked. The inspection is completed upon hearing from individuals who are in charge of specific items, as well as comments from the bank president and board of directors.

The inspection team holds a reflection meeting, to report to headquarters. The result of inspections is summarized in the report for circulation in the Banking Bureau.

The most important lending asset assessments are:

- Category I…… Sound assets (Unclassified assets)
- Category II……Suspect assets (with potential uncollectibles in the future)
- Category III……Where loss is suspected but the amount is not specified (50% is regarded as a loss based on the net worth assessment)
- Category VI…… Assets which are deemed uncollectible or with no value.

Category II and onward are called “Classified Assets”, and the ratio of these is called the “Classification Ratio”. The classification ratio is almost 1% for major banks, 2% for regional banks, 3-4% for mutual banks and double for cooperative banks.

Discussions in the Financial System Research Council “On Ordinary banks”. In May 1975, the Financial System Research Council was consulted by the Minister of Finance about laws and systems, such as the Banking Law. After 4 years of discussions, the council submitted a report “On Ordinary Banks”, after many assessments, in July 1979. It became the basis of the amendment of the Banking Law.

The discussions took a certain time to investigate basic and initial issues, including “Japan’s economic and financial structure in the future”, the “Roles of banks”, the “Scope of bank activities” and “Principles of the business operation of banks”. One of the reasons for doing this process was the criticism and public opinion that had been voiced against big companies and banks since the “galloping inflation”. It was said that these issues should be carefully considered after a certain time. The other was the need to review the structural change in the fundamentals of Japanese economy from the basics.

The report stated:

○ With the shift from high growth to stable growth, the financial environment is also changing, such as the shrinking in demand for funds from the corporate sector. It now requires efficiency, or making use of market mechanisms and competitive principles. At the same time, banks have social liability and a public role.

○ Therefore, financial institutions should take measures to secure their soundness to maintain the financial order and protect depositors, as well as using the interest rate function (liberalization/relaxation), relaxation of business activities, efficiency of management, specialties of each kind of institution, and conducting flexible management of administration.

○ Based on the above, a comprehensive revision of the Banking Law is appropriate. More concretely, objectives to show the basic principles, standards of license and authorization, principles for maintaining soundness (enough capital, liquidity of assets and regulation on large-size loans), disclosure regulations and stipulation on supervision and command, should be provided.

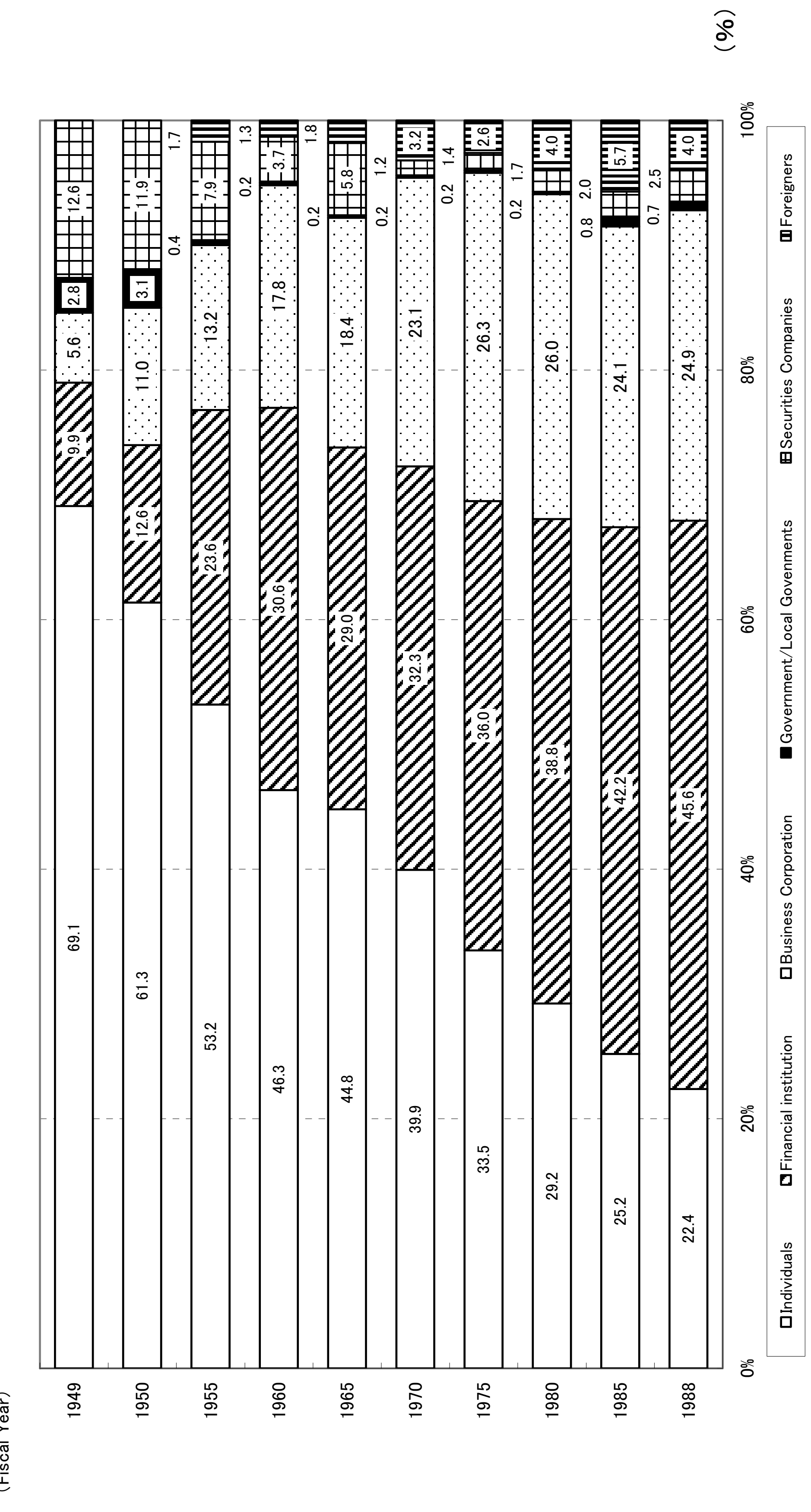
In addition, banks' activities related to securities, that is, the over-the-counter selling of newly issued government bonds and dealing (buying/selling of outstanding bonds) became a problem, as a borderline business between banks and securities companies ("*Gyosai Mondai*"). This problem was left to the Ministry of Finance for resolution.

3 Large-scale Japanese Government Bond Issuance and the Securities Market

Increase in Shareholding by Corporations and Institutions. In the stock market, the change in the shareholding structure (shareholder composition) was a big issue. As shown in Figure 1-2-1, the individual shareholding ratio, which was once no more than 70% in FY1949, after World War II, thanks to the postwar reform measures, such as the dissolution of *Zaibatsu* (family-owned conglomerates), gradually declined to 45% in FY1965, and declined to around 20% in FY1988. On the other hand, business corporations and financial institutions (institutional investor) increased instead.

Cross shareholdings between companies, especially, were raised as a topic, because these could hinder the function of stock market. The Securities and Exchange Council compiled a report in 1976 ("On the problem of change in Shareholder structure and what a securities market should be"). This report suggested that the cause of the increase in shareholdings by corporations (or institutions) was because of the following: (1) Business group formulation and stable stockholder measures; (2) Decline in yield due to an increase in issuance at the marketplace and the stable dividend scheme for

Figure 1-2-1 Shareholding Ratio Types of Holders

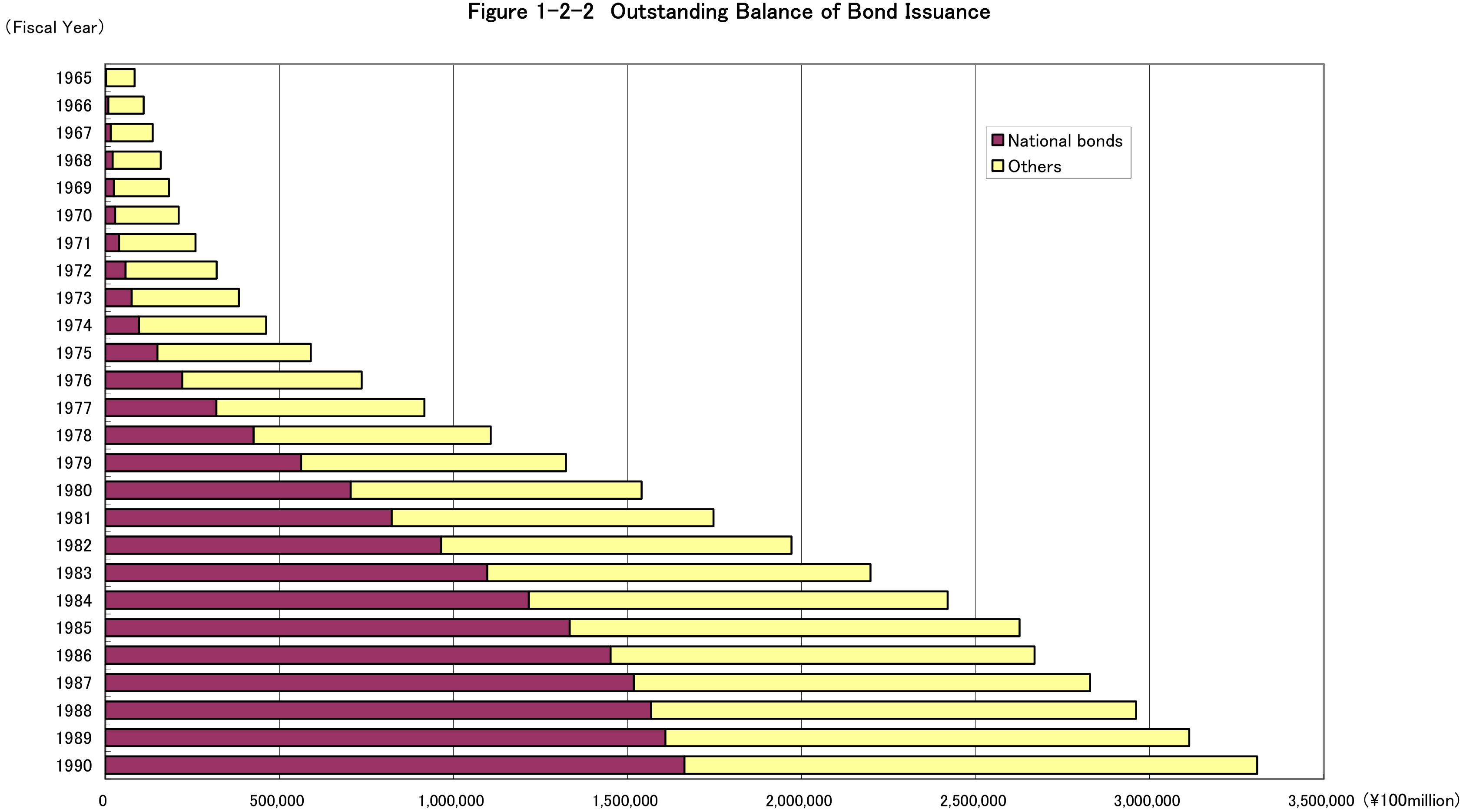


Source: National Stock Exchange, *Kabushiki Bunpu Jokyo Chosa* [A Survey of Share Ownership] stated value, which attracted fewer individual shareholders; (3) Disrespect of individual shareholders by companies and securities companies; and (4) Taxation disadvantages to individual shareholders. Therefore, the problem should be resolved by: (1) Correction of the excess shareholding of corporate organizations; (2) Restoration of the attractiveness of shareholding; (3) Improvement of the role of institutional investors; (4) Improvement of the sales attitude of securities companies; and (5) Protection of investors. Especially, importance was placed on aspect (2). In terms of (5), the fulfillment of disclosure measures and the avoidance of unfair trading were also prioritized.

Large-scale Issuance of Government Bonds and the Expansion of the Bond Market. The postwar bond market in Japan remained undeveloped in terms of both quality and quantity, including both the primary and secondary markets. In particular, the government bond market had no market rate to be referred to on issuance, so that bonds were issued by the financial authorities at a rate lower than the probable market rate. They would thus make a loss if sold on the market. In reality, however, there was an underwriting syndicate composed of financial institutions. They did not bear a great loss since the Bank of Japan conducted a buying operation for these bonds one year after issuance.

However, since the supplementary budget in FY1975, government bond issuance increased and outstanding bonds rapidly increased, as shown in Figure 1-2-2, which could not be handled by the buying operation as before. Trading Japanese Government Bonds in the market started in April 1977, and a secondary market was established in April 1979 (large-scale transactions conducted over-the-counter were brought into the stock exchange.) Since then, as shown in Table 1-2-3, the bond circulation market has been expanding rapidly, led by government bond transactions. After this large issuance of the government bonds, the bond market developed greatly and not only supplied liquidity but also became a large regulated rate market, which was a driving force for interest rate liberalization.

Figure 1-2-2 Outstanding Balance of Bond Issuance



(Source) Bond Underwriting Association of Japan, *Gendai Nihon No Koshasai Shijo* [Bond Market in Modern Japan] (1986)
Koshasai Nenkan [Bond Almanac] 1991.

Table 1-2-3 Trading Volumes of Over-the-Counter Bonds

(¥100million, %)

Fiscal Year	Total	Government Bonds	Ratio of Government Bonds
1965	23,892	0	0.00
1966	28,321	411	1.45
1967	33,672	1,768	5.25
1968	51,349	2,433	4.74
1969	62,954	3,006	4.77
1970	90,981	4,343	4.77
1971	119,260	3,008	2.52
1972	168,610	5,196	3.08
1973	233,277	10,774	4.62
1974	384,290	17,112	4.45
1975	566,589	12,936	2.28
1976	725,367	32,677	4.50
1977	1,358,900	221,164	16.28
1978	2,014,573	697,383	34.62
1979	2,262,199	1,128,873	49.90
1980	2,854,593	1,663,681	58.28
1981	3,049,119	1,951,860	64.01
1982	3,415,085	2,332,934	68.31
1983	4,391,393	3,167,083	72.12
1984	8,380,231	7,235,556	86.34
1985	25,933,971	24,521,915	94.56
1986	36,138,530	34,125,643	94.43
1987	52,051,074	50,055,429	96.17
1988	41,820,500	39,797,076	95.16
1989	35,891,167	34,380,929	95.79
1990	33,512,145	31,957,578	95.36

Source:Bond Underwriting Association of Japan, *Gendai Nihon No Koshasai Shijo* [Bond Market in Modern Japan] (1986), *Koshasai Nenkan* [Bond Almanac] 1991

Administrative Guidance. Under the license system, since 1968, the establishment and location change of a sales office, and the promotion of smaller sales office (to a branch) was specified by the Minister of Finance. This restrained the uncontrolled increase of branches, especially by taking care to avoid excessive competition between large and small/mid businesses, so that local securities companies were prioritized.

As stated earlier, administrative guidance for balance sheet regulation was conducted, from the perspective that preventative administration - which takes measures before occurrence of problems - was desirable. In order to do this, it was necessary to standardize the account settlement rules (account titles/accounting treatment). In May 1971, the Japan Securities Dealers Association the industry group worked on achieving a standard by issuing a resolution of the board of directors meeting. The administrative bodies also issued the basic notification, the “Standard of Account Settlement of Securities Companies” in August 1972, to increase profit reserves and to achieve sound assets.

Table 1-2-4 shows the settlement of accounts of securities companies. Their business activity was expanded, especially in the bubble economy. Most of their revenue was commissions received, including brokerage fees, which often fluctuated. Profits on the sale of securities in share dealing fluctuated more. Losses and profits for such trading was not stable.

The sales attitude of securities companies was also criticized from time to time. The notification on an “Investor-Oriented Sales Attitude” issued in December 1974, pointed out that it is regrettable to see cases “with excessive competition and inducement with less emphasis on investor’s profit, and some securities companies lose their credibility to investors, due to a lack of investor-oriented attitude in sales”, and directed as below:

① Investor-oriented trading (according to an investor’s intention and condition): strictly refrain from providing an investment advisory or recommendation based on the security company’s decision.

② Refrain from excessive use of credit dealing.

③ Develop underwriting services.

④ Particular care should be taken for trading: enhancement of customer management system and the in-house assessment.

⑤ Improve the sales performance evaluation: only turnover - commission is not desirable as an assessment standard, as it could lead to an improper sales attitude. Put more emphasis on other standards.

Table 1-2-4 Settlement of Securities Companies

(¥100 million, %)

Accounting term	Commission fees (a)	Brokerage Commission	Securities dealing profit	Financial account balance (b)	Marketing costs and Administration costs (c)	Ordinary profit and loss	Corporate tax , etc.	Profit and loss for this term	Sales account (a)−(c)=(d)	Current account (d)+(b)	Current account ratio
1974.9	3,711	2,440	2	582	3,993	342	210	268	−282	300	106
1975.9	4,257	2,695	554	630	4,572	892	546	396	−314	316	106
1976.9	5,760	3,875	785	667	5,609	1,623	761	732	151	818	113
1977.9	6,441	4,118	1,404	766	6,484	2,152	1,247	1,132	−43	723	110
1978.9	8,255	5,426	1,217	767	7,493	2,764	1,448	1,426	762	1,529	119
1979.9	8,830	6,181	247	879	7,765	2,229	1,034	1,157	1,066	1,945	123
1980.9	8,741	6,202	596	1,097	8,277	2,185	1,161	997	464	1,561	116
1981.9	10,442	7,765	767	1,235	9,512	2,947	1,640	1,329	930	2,165	119
1982.9	8,487	5,255	1,146	1,232	9,368	1,549	779	812	−881	351	103
1983.9	12,431	9,011	1,657	1,544	11,430	4,220	2,414	1,631	1,001	2,545	119
1984.9	15,227	10,802	2,086	1,792	13,518	5,612	2,894	2,469	1,739	3,501	123
1985.9	19,404	13,991	3,462	2,173	16,436	8,631	4,795	3,429	2,968	5,141	127
1986.9	30,552	23,840	4,533	2,439	21,685	15,783	8,873	6,350	8,867	11,306	146
1987.9	41,102	31,157	4,549	3,240	26,879	21,969	11,274	10,172	14,221	17,461	160
1988.9	38,430	27,436	2,277	3,701	27,381	16,812	8,211	8,249	11,049	14,750	148
1989.3	22,190	16,591	2,627	1,964	15,124	11,639	6,236	4,856	7,066	9,031	154
1990.3	45,085	31,143	3,365	5,247	31,693	21,675	11,130	10,039	13,392	18,639	152

Source: Ministry of Finance, *Okurasho Shokenkyoku Nenpo* [Annual Report of the Securities Bureau, Minisry of Finance] each year.

Securities Inspections. Annual security inspections were conducted under the Securities Exchange Law. The inspectors were 150 (full-time) and 68 (concurrent) in 1974, or 218 inspectors in total. The number of inspectors was quite small compared to the U.S.'s SEC. The inspection emphasized the soundness of assets, fiscal conditions and internal controls. There was a special monitoring system established in 1974 to monitor companies about whose corporate management there are concerns on a regular basis. This was to check small and mid-sized companies governed by Local Finance Bureaus and prevent financial difficulties and bankruptcy. In terms of companies needing to be monitored, some with potential were reconstructed under strict administrative guidance and, if this was difficult, merger was recommended.

4 Increased Popularization and the Insurance Business

The Postwar Insurance Business and Administration. The postwar insurance business was reconstructed after severe damage due to the war, but further developed thanks to the high economic growth of Japan. Insurance was rapidly popularized, in line with the improvements in income level. In terms of life insurance, Japan became the world's No. 1 country for the amount held to the national income, which exceeded the United States. Policyholders increased with popularization. The assets of insurance companies become huge so that insurance companies became an important shareholder/investor for stocks (they also became huge U.S. stock investors, afterwards).

At the same time, the insurance business was the most stable amongst those of all financial institutions under strict restrictions. The postwar Japanese financial system is often characterized as being a "convoy system". Insurance was the most typical business in this sense.

Under the policy of separating each financial business, life insurance and non-life insurance businesses were strictly separated from each other and from other financial institutions. There were almost no new entries, and the structure of these industries remained unchanged. In terms of life insurance, a "20-company system" was retained for years, but Ryukyu Life Insurance joined the category in 1972, with the reversion of Okinawa, and the system became known as the "21-company system". Other than that, there were a few new entries from overseas (including joint ventures). Non-life insurance has had a "22-company system" for a long time. In particular, two insurance business associations functioned strongly, due to the characteristics of insurance, such as the necessity of data-sharing of insurance accident data based on the "law of great numbers" and the required credibility and stability of companies for customers. Insurance contracts were set uniformly. Companies only competed with each other by offering slight differences in products. The premium, the price of insurance, was also mandated to be uniform under the permission of the authority, through the Fire & Marine Insurance Rating Association of Japan for non-life insurance. Even for life insurance companies, the rate was almost uniform. In other words, there was little price competition. Moreover, the rate was also determined, including the premium loading rate for a certain profit for insurance companies and the net premium rate in terms of non-life insurance, so that all insurance companies were guaranteed the stability of their businesses. Therefore, competition was only for quantitative expansion, the increase of sales, and saving costs.

This system, though, changed fundamentally after the drastic reform of the Insurance Business Law in 1995.

The basic law before 1995 was the 1939 Insurance Business Law. Therefore, the actual insurance administration guidance was made through notifications based on detailed reports by the Insurance Council. Therefore, it was just a notification-based administration, or a so-called “Council Administration”. The supervisory authority was the Insurance Department, of the Banking Bureau in the Ministry of Finance.

The Insurance Business in the Stable Growth Era. Even though the period of high growth ended, the trend of the insurance business was to keep growing at a high pace. It drastically increased in the bubble economy in the late 1980s. The postwar trend shift occurred in the mid to latter 1990s, after the collapse of bubble economy, as the insurance market ripened and it was nolonger natural to grow.

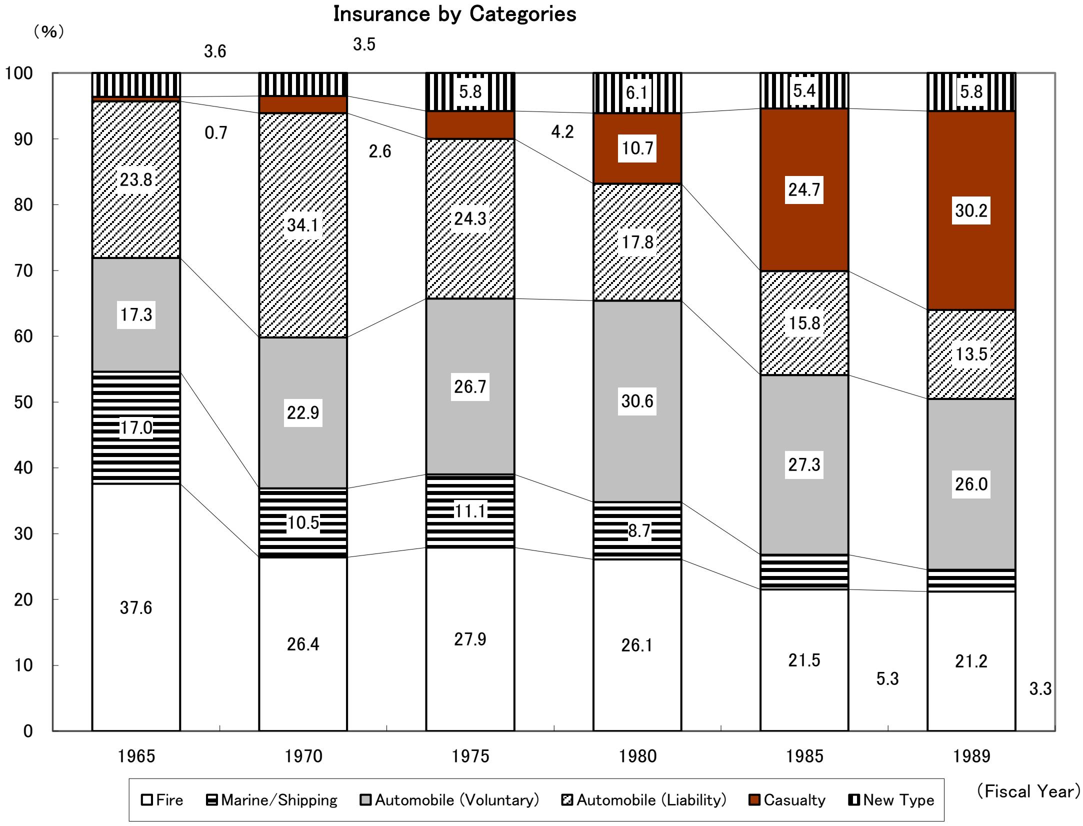
The number of contracts for life insurance gradually increased from 7.28 million at the end of FY1974 to 44.27 million at the end of FY1989, which was an increase of 6.1 times. The amounts of contracts also increased from ¥206 trillion to ¥1404 trillion, a large increase of 6.8 times. The total assets of life insurance companies also increased more than 10 times in the period, from ¥11 trillion to ¥116 trillion. This shows that the market expansion and popularization continued.

The number of contracts for non-life insurance increased from 100 million at the end of FY1974 to 310 million at the end of FY1989, an increase of 3.0 times, the amount going from ¥608 trillion to ¥4279 trillion, an increase of 7.0 times. The total assets of non-life insurance companies even increased from ¥3.3 trillion to ¥23.8 trillion, a large increase of 7.1 times. This also shows that market expansion and popularization continued.

Under the market expansion, popularization, and protection by regulations, insurance companies in this period still competed for quantitative expansion, i.e. expansion of their sales channel and network, as well as increase in market share.

The expansion of the insurance business during the bubble economy was remarkable and striking, but it was part of the boom in speculation. For instance, as shown in Figure 1-2-3, which shows the composition of the net premium for non-life insurance products, the proportion of fire, marine and automobile liability insurance, which were major products in the past, declined, but automobile insurance (voluntary insurance) became a major product. Casualty insurance also increased in the 1980s, which was outstanding in the bubble era. This was because the dramatic rise in funding type insurance with a special contract for a saving plan (repayment on maturity). This represents how the bubble economy affected insurance products, to cause them to seek a high yield return. The type of life insurance which increased in the bubble economy was ordinary endowment insurance, whole life insurance and individual annuity insurance. The major cause of this increase was the progression of the aging society but there was also an expectation of profitability, as single payment endowment insurance and variable insurance were popular. As Figure 1-2-4 shows, the assets of life insurance companies, the amount of loans which were popular in the past decreased, and cash and deposits (especially specified trust funds and foreign currency deposits) became popularized.

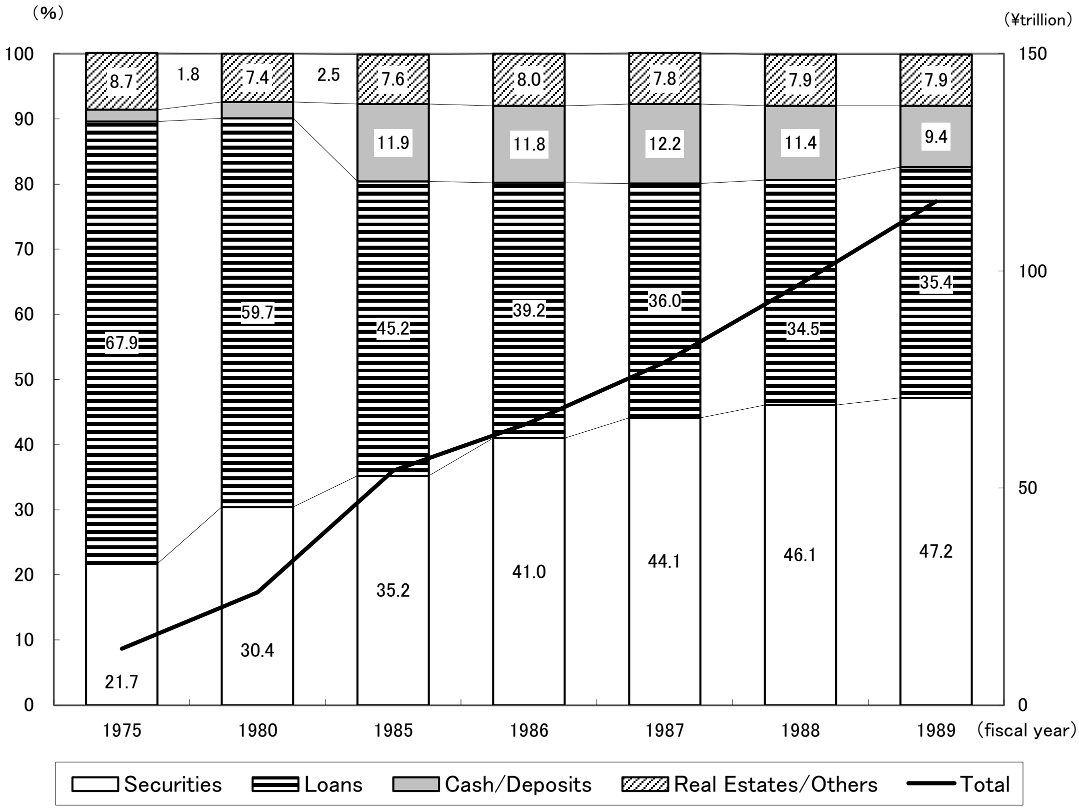
Figure 1-2-3 Distribution Ratios of Direct Net Premium of Non-Life Insurance by Categories



Source: Yoshio Maya "Insurance Business", The Society for Industrial Studies of Japan, *Sangyo Nihon Sangyo*shi [History of the Postwar Japanese Industries] (1995 Toyo Keizai Shinposha)

Securities investments (mainly in stock) also increased. In this way, the bubble economy affected the insurance business, so that it was damaged from the huge loss of stocks after the collapse of the bubble economy. Securities investments by non-life insurance companies also increased, but stock investments did not increase so much because this business is not so long-term as life insurance and investments were restricted by regulations. Therefore, the damage after the collapse of the bubble economy was less than that to other financial institutions.

Figure 1-2-4 Total Assets and Distribution Ratios of Life Insurance Companies



Source : Yoshio Maya "Hokengyo (Insurance Business)", The Society for Industrial Studies of Japan, Sengo Nihon Sangyoshi [History of the Post war Japanese Industries] (1995, Toyo Keizai Shinposha)
Note : Cash and Deposits include Call Loan and Cash Fund Trust.

Administration of the Life Insurance Business.

Emphasis on a Customer-Oriented Policy. With the improvement of living standards, customer's needs and the protection of their rights were emphasized. Moreover, because of the turmoil before and after the first Oil Crisis, people started to be keen on the protection of their lives. Therefore, the Social Policy Council's report in February 1973 also emphasized the viewpoint of customer protection for the insurance business. Under these circumstances, the Insurance Council also raised this issue and provided guidelines in the report issued in June 1975, "On the Desirable Form of the Insurance Business in the Future". Major items raised in this report were variations in insurance products and premium options, the provision of simple and accurate information, the improvement of the recruitment system (life insurance: agent; non-life insurance: agency), and the reflection of customer needs and complaints, especially in the case of mutual company type life insurance.

Improvements to the Agent System. The agent system, which was the major distribution channel for life insurance, was raised as an issue to be considered as its turnover (change of staff) occurred frequently, so there were problems of unskilled agents and “obligated and forced recruitment”.

Upon receipt of the Insurance Council report, the Ministry of Finance gave guidance to the companies by providing detailed instructions. In October 1975, the MOF requested that companies assign an executive to be in charge of the improvement of the recruitment system, as well as the review of the standard of sales pamphlets. In March 1976, a 3-year improvement plan was proposed. Companies received a memorandum from the MOF in August reminding them they needed to achieve the upgrading ratio of more than 15% of the field staff to key employees in the case of large companies, or more than 10% for small and mid-sized companies, by the end of FY1978, and to achieve a continuance rate for new contracts of more than 84% for large companies and more than 80% for small and mid-sized companies. Some insurance companies could not achieve these targets.

Administration of the Non-life Insurance Business

Customer-oriented Policy. For non-life insurance companies, the MOF provided guidance including on the early introduction of a premium increment system in the midterm against inflation, and the introduction or improvement of new products and services to meet customer needs.

Improvement of the Agent System. Regarding agents, the major sales channel of non-life insurance, there was an increase in new agents, especially automobile insurance agents, and an accompanying increase in their abolishment. Non-insurance companies implemented various measures, including enhancement of qualifications and training systems, in order to cope with the specific issues raised by the Ministry of Finance and the items pointed out in the Insurance Council report.

Improvement of Insurance Company Management. To improve corporate management systems of insurance companies, it was particularly necessary to reflect the intentions of members (customers) of the mutual life company type insurance companies. As of the end of FY1974, 6 out of 21 life insurance companies were mutual companies, which occupied nearly 95% of the amount of contracts and total assets. Mutual companies were intermediate corporations, neither public corporations nor business corporations. Their Members’ (equivalent to policyholders) general meeting was the best organization to make decisions. However, as it was practically difficult to hold a general meeting, a representative members meeting took place, instead. However, the selection of representatives was also criticized as it was formalized (most of them were important people). Therefore, the Insurance Council report proposed the selection of representatives from a wider range of members, the improvement of the councilors meeting in the same manner, and the fair operation of the representative members' meeting, such as by using an observation system for the meeting and having an informal gathering of policyholders. The Life Insurance Association of Japan also prohibited representatives from serving for over 3 terms and the double assignment of representatives for more than two companies.