CHAPTER II

The History of the Japanese Securities Market

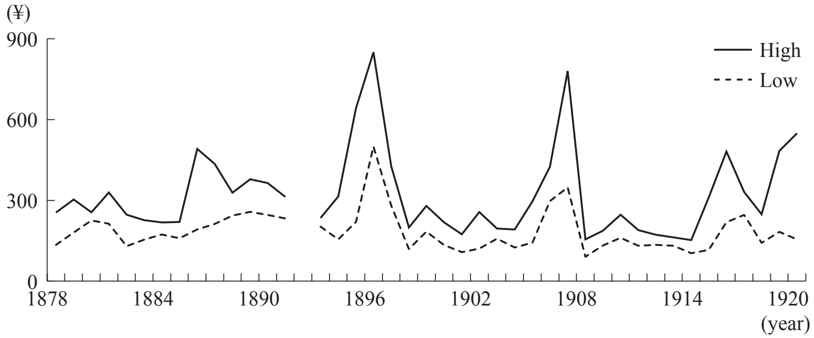
1. The Securities Market in the Prewar Period

If we take the point of origin of Japan's securities market to be the first issuance of securities, it occurred in 1870 with the issue of a foreign currency denominated government bond bearing 9% interest in London, England. If we consider the birth of a secondary market based on a legal ordinance, it happened in 1878 with the establishment of stock exchanges in Tokyo and Osaka. Whichever definition is used, Japan's securities market has been in existence for about 150 years. The stock exchanges started off as markets for trading in public debt, such as old and new public bonds and *Chitsuroku* bonds. Although the stocks of the exchanges and of banks were later listed, public debt accounted for most of the trading for some time. Around 1886, there was a period of rapidly emerging mainly railway and textile companies that ushered in more active trading in stocks.

The formation of corporations (*kabushiki kaisha*) in Japan was not related to the huge capital investments that are required to develop the heavy chemical industry. Instead, the corporation was introduced to deal with the low level of capital accumulation in the economy. In conjunction with that action, schemes were established to facilitate the paying in of capital, such as the stock installment payment system and stock collateral loans. As a result, the corporations set up in the Meiji era were mostly small companies primarily involved in light industry and they really could be considered corporations in name only in terms of their generally intended function of raising capital. The turning point for that function in Japan came with the shift in the composition of industry toward the heavy industry prompted by World War I. Only then did the country see a sharp increase in large albeit mainly financial combine (*zaibatsu*)-related companies with paid-in capital exceeding ¥5 million.

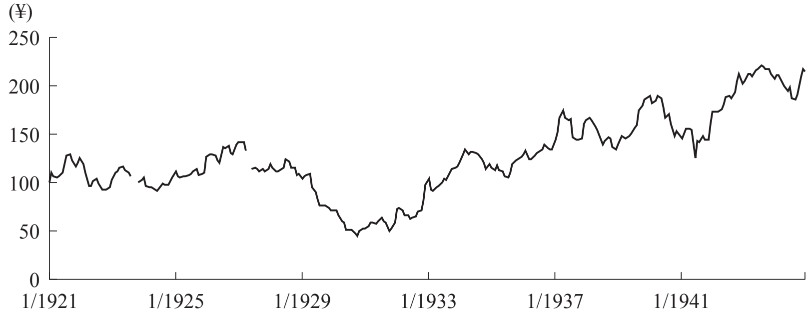
There were practically no shares of major companies listed on stock exchanges in the secondary market because the *zaibatsu* held exclusive ownership of their group companies. And as a result of the lack of investment capital and inadequate credit provision by banks before World War II, the secondary market developed mainly around future trading called settlement

Chart II-1. Changes in Stock Prices (Long-term margin transactions) (1878−1920)



Source: Complied from *Tokyo shoken torihikisho no nijyunen shi-kisoku to tokei* (A 20-year History of the Tokyo Stock Exchange-Regulations and Statistics).

Chart II-2. Stock Price Movement (Major Stock Price Index) (1921−1944)



Source: Complied from *Tokyo shoken torihikisho tokei nenpo* (Tokyo Stock Exchange Annual Statistics Reports) and *nisho tokei geppo* (Japan Securities Exchange Monthly Statistics Reports).

dealings and forward transactions. Even the main trading issues of exchanges' stocks were subject to speculative investment. For that reason, the prewar stock market can be characterized as being speculative. Another characteristic that can be pointed out in retrospect is the imposition of wartime regulations. Following the Showa depression, the government sought to achieve economic recovery by devaluing the currency to promote exports and by creating inflation through expansive government spending, principally on the military. After the outbreak of the Sino-Japanese War, the government implemented a wartime regime and imposed regulations on the securities market. The government restricted the issuance of securities for nonessential indus-

Table II-1. Issues Listed on the Tokyo Stock Exchange

(as of end of 1878)

Bonds:	New and old public bonds, *Chitsuroku* public bonds, *Kinroku* public, bonds, *Kigyo* public bonds
Stocks:	Tokyo Stock Exchange, Daiichi National Bank, Tokyo Kabutocho Rice Merchant Association, and Tokyo Kakigara-cho Rice Merchant Association

Source: Complied from *Tokyo shoken torihikisho no gojyunen shi* (A 50-year History of the Tokyo Stock Exchange).

Table II-2. Number of Issues Listed on the Japan Securities Exchange, by Industry

(as of May 31, 1945)

Subscription certificates, 2; banks, trust companies, and insurance companies, 64; investment companies, colonization companies, and securities companies, 28; stock exchanges, 2; railroad and electric railroad companies, 62; transportation and communication companies, 28; gas and electric utilities, 43; mining companies, 86; shipbuilding and machinery companies, 232; steel companies, metal companies, and smelting companies, 81; textile industrial companies, 58; sugar manufacturing and milling companies, 18; food processing companies and fisheries companies, 29; chemical companies, 65; ceramics companies, 25; paper and pulp, printing, and tanning companies, 26; other industrial companies, 31, rubber and tobacco companies, 23; land, building, and warehousing companies, 17; commercial companies, 46

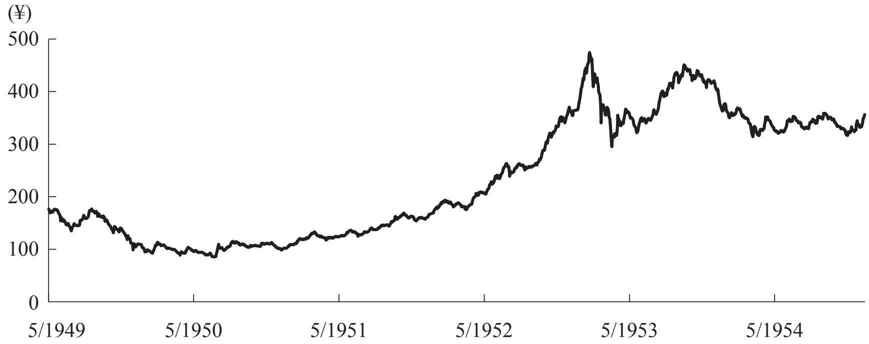
Source: Japan Securities Exchange.

tries, instituted planned corporate bond issuance, put controls on stock prices, and introduced a licensing system for securities companies. Japan's 11 stock exchanges, furthermore, were merged into the Japan Securities Exchange in 1943.

2. The Period of Postwar Economic Rehabilitation (1945−54)

After the war, Japan was placed under the control of the general headquarters (GHQ) of the supreme commander for the Allied powers. There was immediate movement within Japan's securities industry to reopen the market. At one point, in fact, the Ministry of Finance decided to restart the stock exchanges on October 1, 1945. However, the GHQ did not approve this, and the market was not reopened. The securities industry continued to enthusiastically lobby for a restart of market operations, but the GHQ rejected the idea as premature

Chart II-3. Stock Price Movements (1949−1954)



Source: Compiled from Nomura Securities' *Shoken tokei yoran* (Manual of Securities Statistics).

Table II-3. Number of Members and Listed Companies of Each Exchange at Establishment

	Establishment	No. of members (at the time the fund was established)	Listings
Tokyo Stock Exchange	May 16, 1949	116 official members, 12 specialists	681
Osaka Securities Exchange	May 16, 1949	76 official members, 11 specialists	523
Nagoya Stock Exchange	May 16, 1949	50 official members, 8 specialists	268
Kyoto Stock Exchange	July 4, 1949	41 members	217
Kobe Stock Exchange	July 4, 1949	34 members	189
Hiroshima Stock Exchange	July 4, 1949	28 members	119
Fukuoka Stock Exchange	July 4, 1949	29 members	181
Niigata Stock Exchange	July 4, 1949	24 members	176
Sapporo Securities Exchange	April 1, 1950	17 members	103

Source: Complied from *shoken torihiki iinkai hokokusho* (a Securities and Exchange Commission Report).

and instead gave priority to economic reforms (land reform, dismantling of the *zaibatsu*, and labor reform) and political and social reforms. Consequently, it took nearly four years to reopen the stock exchanges, during which time the Japan Securities Exchange remained closed. This has been the only blank period in the operation of exchanges in the history of the securities market in

Table II-4. Member Securities Companies at the Establishment of Tokyo Stock Exchange (April 1, 1949)

Nikko Securities, Tamazuka Securities, Yamaichi Securities, Yachiyo Securities, Taguchi Securities, Maruhiro Securities, Nitto Securities, Yamazaki Securities, Kaneju Securities, Irimaru Securities, Yamayoshi Securities, Aizawa Securities, Kokusai Heiwa Securities, Marusui Securities, Toyama Securities, Meiwa Securities, Sekitani Securities, Daiwa Securities, Sekito Securities, Shinko Securities, Nomura Securities, Matsuya Securities, Tokuda Securities, Sanko Securities, Yamaka Securities, Kanaman Securities, Bokutoku Securities, Naruse Securities, Daifuku Securities, Rokushika Securities, Daito Securities, Oda Securities, Tokyo Daiichi Securities, Ninomiya Securities, Yamakanou Securities, Osawa Securities, Obuse Securities, Marusan Securities, Tabayashi Securities, Kakumaru Securities, Koyanagi Securities, Tsukuba Securities, Chiyoda Securities, Nippon Kangyo Securities, Tachibana Securities, Marusugi Securities, Mie Securities, Haratada Securities, Maruya Securities, Fukuyama Securities, Irinaka Securities, Ikko Securities, Rokko Securities, Nippon Sangyo Securities, Toyo Securities, Totan Securities, Toko Securities, Tokyo Showa Securities, Tokyo Shinei Securities, Tokyo Jiyu Securities, Chugai Securities, Marukuni Securities, Ikanagashira Securities, Kaga Securities, Kadoman Securities, Yoshikawa Securities, Yoshimura Securities, Taihei Securities, Taiyo Securities, Tanaka Securities, Takai Securities, Taishichi Securities, Taisei Securities, Naigai Securities, Nakahara Securities, Nakajima Securities, Hachisu Securities, Ueno Securities, Ono Securities, Osaka Shoji, Oda Securities, Yamani Securities, Yamawa Securities, Fukuri Securities, Yamamaru Securities, Yamafumi Securities, Yamasachi Securities, Yamasan Securities, Marutoyo Securities, Maruwa Securities, Marusan Securities, Maruju Securities, Matsui Securities, Fuso Securities, Koiei Securities, Ebisu Securities, Ando Securities, Yamata Securities, Sanshin Securities, Sansei Securities, Sakai Securities, Kyowa Securities, Kyodo Securities, Misawaya Securities, Miki Securities, Shimizu Securities, Shinei Securities, Jujiya Securities, Juzen Securities, Joichi Securities, Jonan Securities, Hinode Securities, Hiyama Securities, Hirahara Securities, Central Securities, Marugo Securities Specialists: Daiichi to Daijuni Jitsuei Securities

Source: Compiled from *Tokyo shoken torihikisho no jyunen shi* (A 10-year History of the Tokyo Stock Exchange).

Japan.

Despite trading being halted on the floors of the stock exchanges and official secondary market, the demand for securities trading persisted even in the confusion of postwar Japan. Securities trading naturally emerged at the offices of securities companies in the form of over-the-counter (OTC) trading. When it became clear, moreover, that the stock exchanges were not going to restart anytime soon, “group transactions,” which involved institutionalized OTC trading at fixed places and times in parallel with the OTC trading at individual securities companies, also got under way. By the end of 1945, group transactions, which first emerged in Tokyo and Osaka, had spread to exchanges in Nagoya, Niigata, Kyoto, Kobe, Hiroshima, and Fukuoka, among others.

It would, of course, have been difficult to reopen the stock exchanges merely by continuing the prewar exchange organization and securities legislation. To democratize the securities industry, the Japanese government commenced the formulation of a new legal framework. In 1947, it promulgated the Securities and Exchange Law, which drew on the Securities and Exchange Act of the United States. Initially, only those articles of the law dealing with the Securities and Exchange Commission, which was patterned after the U.S. Securities and Exchange Commission (SEC), were enforced. Then a full-scale revision of the law was promulgated in 1948. This amended law formed the legal framework for the new postwar securities market, replacing the licensing system for securities companies with a system of registration with the regulatory authority and putting in place such regulations as the separation of banking and securities businesses.

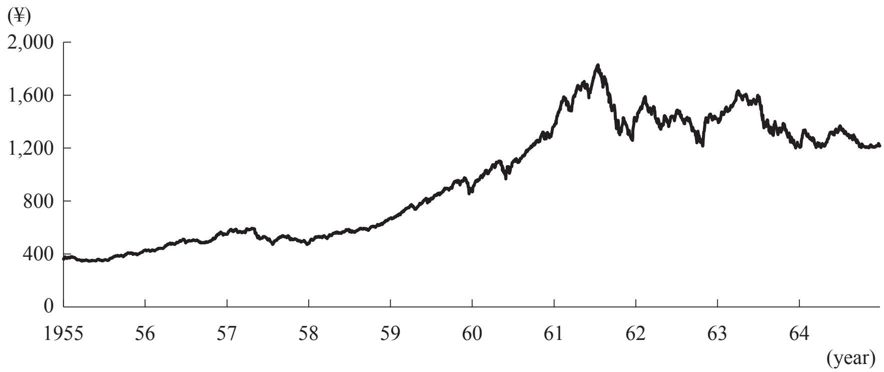
Stock exchanges were established in Tokyo, Osaka, Nagoya, and other cities from May 1949. The GHQ, however, instructed Japan's Securities and Exchange Commission to ensure the strict observance of its Three Principles of Market Operation: (1) recognize transactions in order of the occurrence, (2) concentrate trading on exchanges, and (3) prohibit futures trading. All exchanges pledged to strictly follow these principles, enabling the long-awaited reopening of stock exchanges (participants in group transactions and the issues they had traded moved en masse to these stock exchanges and restarted trading on a cash transaction basis only). Because, however, it was difficult to match buys and sells based only on actual demand, a movement got under way in the industry to push for the revival of prewar forward transactions for the purpose of introducing temporary demand. Since the management of the exchanges and the GHQ were against this proposal, a margin trading system modeled on the U.S. margin trading system was introduced in 1951.

3. The Securities Market during the First Period of Rapid Economic Growth (1955−64)

As made clear in the title of an economic white paper issued in 1956, The Post-War Period Is Over, in the first half of the 1950s Japan had finished with its postwar recovery and was heading into its first period of rapid economic growth. Japan's *Jinmu* and *Iwato* booms in the mid-1950s and from 1958 to 1961, respectively, were representative of the change. Against a backdrop of favorable growth in corporate performances, stock prices rose almost universally during the period from the latter half of 1955 to July 1961. An investment trust boom at the time also contributed to the rising securities market.

Japan had introduced a postwar securities investment trust system in 1951, but the market for these investment trusts struggled until 1955. From 1956 on, however, stock prices surged, and the outstanding principal of investment trusts expanded sharply. Investment trusts became such a force in the securities market that they were referred to as “the whale in the pond.” Another

Chart II-4. Stock Price Movements (TSE's Modified Stock Price Average) (1955−1964)



Source: Compiled from Nomura Securities' *Shoken tokei yoran* (Manual of Securities Statistics) and the Tosho tokei nenpo (TSE Annual Report).

Table II-5. Changes in Assets of Stock Investment Trusts and Bond Investment Trusts (Principal basis)

(millions of yen)

	Stock Investment Trusts					Bond Investment Trusts				
	Sales (A)	Cancellation (B)	Redemption (C)	Year-end Principal	Net asset change (D=A–(B+C))	Sales (A)	Cancellation (B)	Redemption (C)	Year-end Principal	Net asset change (D=A–(B+C))
1955	26,381	31,792	13,640	59,519	−19,051					
1956	51,431	27,163	16,039	67,748	8,229					
1957	92,544	16,178	7,199	136,915	69,166					
1958	106,412	25,741	7,890	209,695	72,780					
1959	182,480	58,876	3,219	330,081	120,385					
1960	362,066	87,945	–	604,202	274,120					
1961	588,205	155,751	9,810	1,026,845	422,643	244,490	88,470	–	156,020	156,020
1962	347,116	229,174	14,161	1,130,627	103,781	83,819	107,160	–	132,679	−23,341
1963	331,873	274,226	17,884	1,170,388	39,761	109,857	71,021	–	171,515	38,836
1964	330,158	293,573	45,415	1,161,558	−8,829	122,332	84,811	–	209,036	37,521
1965	196,829	349,502	42,556	966,328	−195,229	120,665	110,132	–	219,569	10,533

Source: Compiled from *Shokenshintaku sanjyugonen shi* (35-year History of Securities Investment Trusts).

Table II-6. Categories of Investible Custody Securities and Investment Uses

(millions of yen)

	Total Assets Under Management	Category			Investment Area	
		Special debt		Corporate bonds	Deposited collateral	Others
			Of above, bank debentures			
Sept. 1958	62,701	61,984	61,384	568	53,812	5,283
Sept. 1959	108,347	107,602	105,381	673	88,793	19,420
Sept. 1960	146,076	144,875	141,666	969	116,061	30,015
Sept. 1961	139,833	138,552	134,794	1,239	116,988	22,845
Sept. 1962	154,284	152,127	143,946	2,005	129,030	25,254
Sept. 1963	209,197	205,337	196,967	3,386	156,319	52,877
Sept. 1964	249,079	244,685	235,557	3,714	195,891	53,189

Source: Compiled from the Securities Bureau of the Ministry of Finance, *Nenpo* (Annual Report).

factor in the bull market was the system of “investable custody.” Under that system, securities companies borrowed bank debentures (primarily discount bank debentures) that they had sold in the market on a commission basis from unspecified multiple customers for a predetermined fee through a custody system. The securities companies then raised capital from small and medium-sized financial institutions or in the call money market by using the bank debentures as collateral and invested it in stocks or bonds through their own proprietary trading accounts. In this manner, against the backdrop of an expanding economy and bullish securities market, OTC trading value rose sharply, and the number of companies approved to sell their securities OTC grew rapidly, concentrated mainly on start-up and growth companies. To deal with the rapid expansion in the OTC market, the Tokyo, Osaka, and Nagoya stock exchanges each established Second Sections.

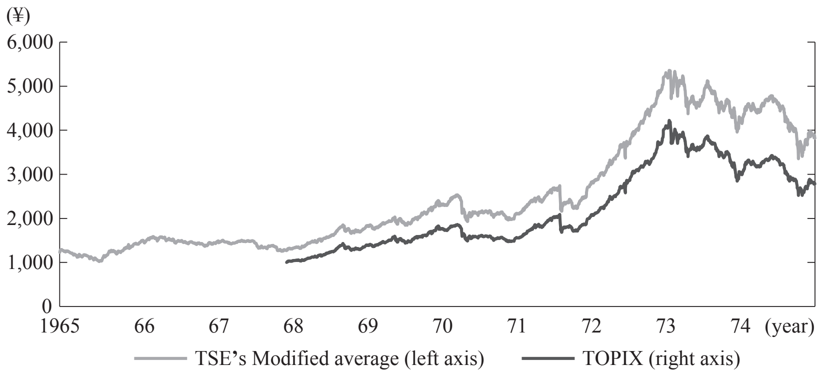
Japan, though, was striving to balance its current account, and when the balance of payments fell into the red it tightened the money supply. When the interest rate was raised in July 1961 to improve the balance of international payments, Japanese companies began liquidating their stockholdings. In combination with corporations’ focus on increasing capital, this trend caused a worsening in the demand-supply balance for stocks. The resultant drop in stock prices forced an end to the investment trust boom, as the mechanism that had been driving up stock prices reversed and caused further declines in stock prices. The increase in the official discount rate also produced a rise in the number of redemptions of bond investment trusts, especially by companies. This action placed a great financial burden on the securities companies, which were forced to buy bonds that were being removed from the pool of investment trust assets. These factors became a cause of panic in the securities market.

For that reason, the market took such steps as urging business corporations to rearrange their financing plans (cutting back or postponing their planned increase of capital) and persuading commercial banks to make loans secured by bonds to four bond investment trusts. Despite these efforts, stock prices kept declining, partially because of the market reaction to the assassination of U.S. President Kennedy. To deal with the issues, the industry formed stock purchasing organizations. In January 1964, banks and securities companies contributed capital to create the Japan Joint Securities Co., Ltd., while in January 1965 a group of securities companies jointly established the Japan Securities Holding Association. Both of these organizations carried out share purchasing operations in the market and assumed ownership of shares held by investment trusts with the aim of improving the demand and supply balance in the stock market. In the latter part of May 1965, however, the news that Yamaichi Securities Co., Ltd., was on the verge of bankruptcy hit the market, plunging it into a state of panic.

4. The Securities Market during the Second Period of Rapid Economic Growth (1965–74)

The curtain opened on the 10-year period from 1965 onward with a securities panic. At the end of the first half of fiscal 1964 (September 30, 1964), the cumulative earnings of securities companies in Japan amounted to a loss of ¥26.4 billion. And Yamaichi Securities' performance had deteriorated particularly badly; by March 31, 1965, the company had racked up a loss of ¥28.2 billion, compared with total capital of only ¥8 billion. On May 21, 1965, it finally was revealed that Yamaichi Securities was on the brink of failure. To avoid a loss of confidence in the market, a move was made to bail the company out. In the late night on May 28, the government invoked Article 25 of the Bank of Japan Act and announced that Yamaichi Securities would receive a special loan from the Bank of Japan without any required collateral and for an unlimited amount (in actual fact some collateral was secured). Stock prices continued to fall for some time following the announcement but staged a rally when the government made clear that it intended to issue deficit-covering bonds for the first time since the war. Meanwhile, the panic in the securities market also served as the basis for a reorganization of the securities industry. The government amended the Securities and Exchange Act, introducing a licensing system for securities companies. This forced many

Chart II-5. Stock Price Movement (TSE's Modified Average, TOPIX) (1965−1974)



Source: Compiled from data the *Shoken tokei yoran* (Manual of Securities Statistics), the *Nihon Keizai Shimbun*, and the *Tosho tokei nenpo* (TSE Annual Report).

securities companies to combine their operations, or merge, to prepare for the new system. In combination with the securities companies that had their registration revoked around the time of the securities panic and those that dissolved their operations, the number of securities companies at the time of the conversion to the new licensing system declined to 277 companies, compared with 593 companies at the end of 1963.

During the decade from 1965 to 1974, progress was made in internationalizing Japan's securities market. In 1964, Japan became an Article 8 country member of the International Monetary Fund (IMF), joined the Organization for Economic Cooperation and Development (OECD), and publicly promised to liberalize capital transactions. Consequently the government implemented measures to liberalize the capital market in five stages beginning in July 1967. This process steadily eased the restrictions on ownership of Japanese stock by foreigners, and they were finally fully lifted with the exception of certain stock categories. The liberalization of capital transactions was not limited to foreign investors; foreign issuers and intermediates were also able to operate in Japan's securities market. In 1970, the Asian Development Bank started issuing yen-denominated foreign bonds in Japan. Foreign shares were made available to buy in Japan in 1972. The Tokyo Stock Exchange established a Foreign Section in 1973. Around the same time, foreign securities companies commenced setting up operations in Japan. Merrill Lynch opened a Tokyo branch in 1972, becoming the first foreign securities company to receive a securities business license in Japan.

The liberalization of capital transactions also meant that it was then possible for foreign companies to take over Japanese companies. Japanese compa-

Table II-7. Changes in Number of Securities Companies

	Changes in the number of companies		Companies at financial year-end	Number of Business Offices	Total Capital (in ¥ mil.)	Per-Company Capital (¥ mil.)
	Increase	Decrease				
FY1948	959	11	948			
1949	292	113	1,127	1,889	3,014	2.7
1950	18	209	936	1,601	3,454	3.7
1951	11	109	838	1,642	3,767	4.5
1952	71	73	836	1,794	6,683	8.0
1953	52	52	836	2,105	10,115	12.1
1954	11	83	764	1,997	10,713	14.0
1955	2	66	700	1,901	10,826	15.5
1956	7	55	652	1,848	12,022	18.4
1957	7	77	582	1,904	18,062	31.0
1958	7	32	557	1,984	19,569	35.1
1959	15	26	546	2,233	29,221	53.5
1960	36	30	552	2,565	39,094	70.8
1961	48	10	590	2,841	74,991	127.1
1962	23	12	601	2,934	78,114	130.0
1963	8	16	593	2,893	100,573	169.6
1964	0	82	511	2,424	126,118	246.8
1965	0	86	425	2,109	125,599	295.5
1966	2	30	397	2,009	118,632	298.8
1967	0	113	284	1,869	119,955	422.4
1968	0	7	277	1,572	119,904	432.9

Note: Figures for "Number of Business Offices" and "Capital" for the years preceding 1959 are as of the end of the calendar year concerned.
Source: Compiled from the Securities Bureau of the Ministry of Finance, *Nenpo* (Annnual Report).

Table II-8. Changes in Stock Ownership Among Investor Categories

By Owner	FY	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
National and local government organizations		0.3%	0.2%	0.3%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%
Corporations	Financial institutions	26.8%	29.8%	30.6%	32.0%	31.9%	32.3%	33.9%	35.1%	35.1%	35.5%	36.0%
	Securities companies	5.4%	5.4%	4.4%	2.1%	1.4%	1.2%	1.5%	1.8%	1.5%	1.3%	1.4%
	Business corporation, etc.	21.0%	18.6%	20.5%	21.4%	22.0%	23.1%	23.6%	26.6%	27.5%	27.1%	26.3%
	Foreign corporations	1.9%	1.7%	1.7%	2.1%	3.1%	3.0%	3.4%	3.4%	2.8%	2.4%	2.5%
Corporate investor total		55.1%	55.5%	57.2%	57.6%	58.4%	59.6%	62.4%	66.9%	66.9%	66.3%	66.2%
Individual	Individuals and others	44.4%	44.1%	42.3%	41.9%	41.1%	39.9%	37.2%	32.7%	32.7%	33.4%	33.5%
	Foreign investors	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%
Individual investor total		44.6%	44.3%	42.5%	42.1%	41.3%	40.1%	37.4%	32.8%	32.8%	33.5%	33.6%

Note: Investment trust portion is included in financial institutions.
Source: Compiled from *Kabushiki bunpu jokyo chosa* (Survey of Stock Distribution Status).

nies countered this new possibility by focusing on building stable shareholder bases. If companies held shares with each other, this reduced the number of shares available in the market, making it easier to defend against takeover attempts. Cross-shareholdings were viewed from the perspective of takeover prevention. Later, after Japanese companies switched the form of their capital increases from making rights issues to existing shareholders at par value to making public offerings of stock at market prices, issuers pursued share crossholdings from the point of view of the desirability of high share prices in case of public offering. As a result, there was a change in the shareholding composition of the market, with the proportion of corporate shareholdings increasing and the proportion of individual investor shareholdings declining.

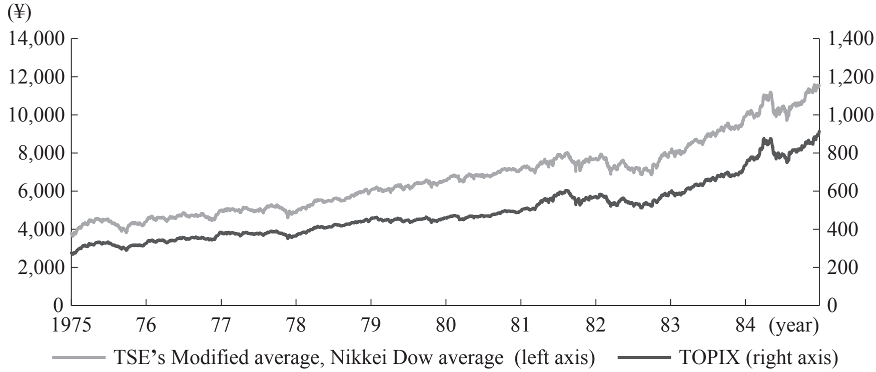
5. Measures Taken to Cope with the Oil Crisis (1975−84)

At the end of the previous 10-year period, there had been a succession of major events that shook the Japanese economy, including the Nixon Shock (1971), the introduction of a floating exchange rate system (1973), and the first oil shock (1973). The second oil shock occurred later, in 1979. With Japanese companies practicing energy conservation management in the face of back-to-back oil crises, the government seemed intent on getting through the crises using a fiscal expansion strategy. Underpinning that strategy was the massive issuance of deficit-covering Japanese government bonds (JGBs).

As previously mentioned, government bond issuance after the war got started in fiscal 1965. The main feature of those bonds was that they were issued at low interest rates without regard to market conditions and were forcibly allocated among financial institutions belonging to the underwriting syndicate according to their capital strength. Maintaining this artificially fixed, low interest rate market meant that financial institutions could not be permitted to sell the JGBs in the market freely. Since at the time the government was trying to keep JGB issuance within the scope of the growth in the money supply, the Bank of Japan purchased almost all JGBs that had been held by the financial institutions for one year (liquidity policy). The reason, in fact, that JGB issuance after the oil shocks was said to be massive was that JGB issuance after fiscal 1975 exceeded the growth in the money supply.

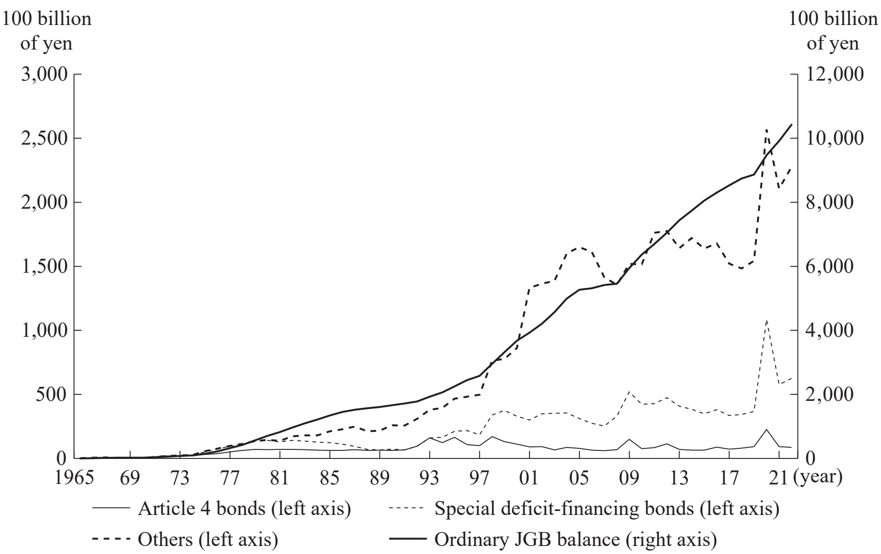
With the massive issuance of JGBs, the liquidity policy reached its limits, making it impossible to avoid issuing JGBs in the public market. Accordingly, the government approved, with some restrictions, JGB sales on the bond market in 1977. Following this change, the restrictions on sales were liberalized in stages, resulting in the deregulation of the JGB secondary market. The interest rate yields for JGB subscribers, on the other hand, were the base rates given by the regulated interest rate structure in Japan. To deregulate

Chart II-6. Stock Price Movement (TSE's Modified Average, Nikkei Dow Average and TOPIX) (1975−1984)



Source: Compiled from data from the *Nihon Keizai Shimbun*, the *Tosho tokei nenpo* (TSE Annual Report), and the *Shoken tokei nenpo* (Annual Securities Statistics).

Chart II-7. Change in JGB Issuance and Outstanding Balance (until the end of FY2022)



Notes: 1. JGB issuance amounts are calculated on a proceeds basis.
2. Special deficit-financing bonds include temporary-bridging, tax-reduction offset, and disaster-recovery special public bonds.
3. Others represents the total of pension plan funding special deficit-financing bonds, reconstruction bonds, FILP bonds, and refunding bonds.

Source: Compiled from the web site of the Ministry of Finance.

these rates would have forced the government to change its artificially regulated interest rate policy. For that reason, there was a great deal of resistance to the deregulation of the JGB primary market within the government, and deregulation proceeded at a snail's pace. When, however, the designated underwriting syndicate refused to underwrite the planned issuance of JGBs in June 1981, the issuance conditions for JGBs were deregulated, setting the stage for the deregulation of the different types of long-term interest rates.

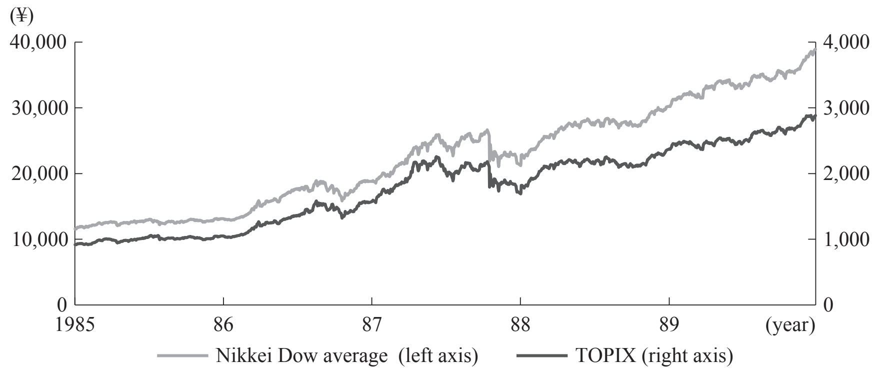
Internationalization proceeded at this time. During the period from 1975 to 1984, Japan's trade surplus with the United States ballooned, causing trade and economic friction between the two countries. Perceiving the reason for the problem to be the closed nature of Japan's financial, capital, and service markets, the United States demanded the overall reform of Japan's economic structure. As part of that process, the two countries formed the Japan-U.S. Yen/Dollar Committee. The United States argued that deregulated financial and capital markets driven by a market mechanism would enable the optimum allocation of capital in Japan. It therefore pushed strongly for the removal of various restrictions placed on those markets by the Japanese government that it considered obstructive to open markets. In this manner, internationalization formed the basis for financial deregulation in Japan.

6. Developments before and after the Economic Bubble (1985–89)

In a Japan-U.S. Yen/Dollar Committee Report released in 1984, the United States brought pressure on Japan to liberalize its financial and capital markets and to internationalize the yen. The Japanese government responded by liberalizing the domestic financial market through such actions as deregulating interest rates on bank deposits. It also moved to improve foreign financial institutions' access to the Japanese market through such measures as opening up membership on the Tokyo Stock Exchange (TSE). As the first step toward internationalizing the yen, the government liberalized the Euroyen market. The TSE, meanwhile, heeded the request of the government to open its membership by revising the fixed number of membership seats in its Articles of Incorporation in 1985 and accepting its first round of new members. A total of three rounds were eventually conducted, resulting in seats on the TSE for 25 foreign securities companies.

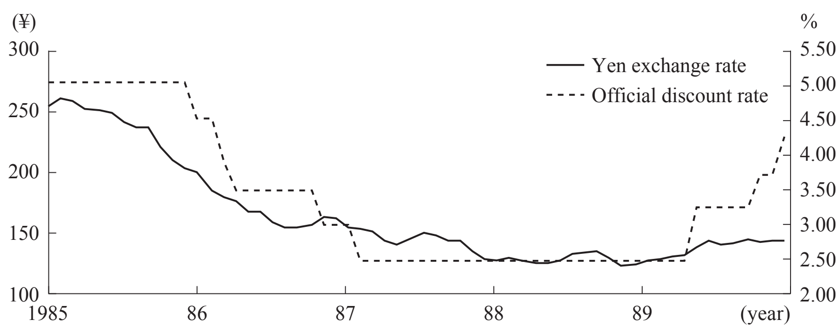
The deregulation of interest rates began in 1985 with the deregulation of interest rates on large deposits. After that, the deregulation of interest rates on deposits progressed rapidly. As a result, the Bank of Japan's open interest rate for fund raising jumped to 53% in 1989, from 7.5% at the end of 1984, greatly increasing fund procurement costs for banks. Major corporations concurrently shifted their financing from bank loans to security issuance, resulting

Chart II-8. Stock Price Movement (Nikkei Dow and TOPIX) (1985−1989)



Source: Compiled from data from the *Nihon Keizai Shimbun* and the *Shoken tokei nenpo* (Annual Securities Statistics).

Chart II-9. Yen to US$ Exchange Rate and Japan's Official Discount Rate



Source: Compiled from the web site of the Bank of Japan.

in a decline in the balance of loans being extended by major banks to their core customer base (heavy industry). To cope with the loss of business, the leading Japanese banks expanded the scope of their loan operations to include real estate, construction, and other industries and launched international operations. They also began planning to enter the securities business, creating friction between the banking and securities industries.

In 1985, the Plaza Accord was signed, after which the yen appreciated sharply against the U.S. dollar. The rate movement raised concerns about a strong yen-related economic recession in highly export-dependent Japan. The Bank of Japan's reaction was to implement successive reductions in the offi-

Table II-9. Stock Trading Composition by Investor Category

(100 million shares)

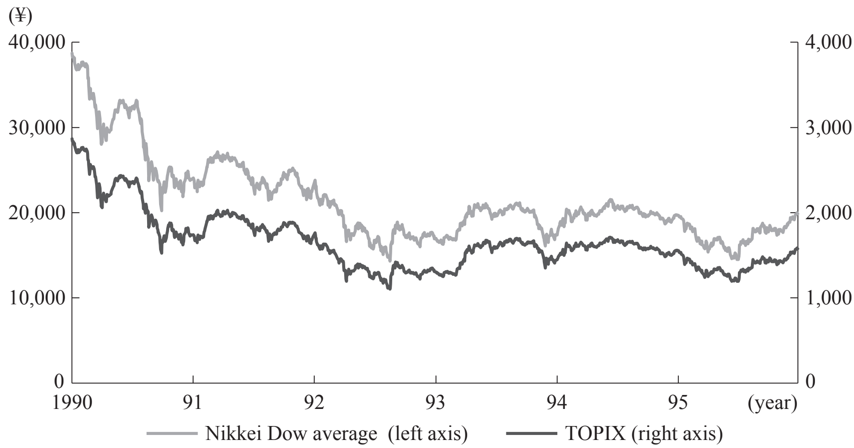
	Total Brokerage Trading	Individuals	Foreigners	Life and Non-Life Insurance Companies	Banks	Investment Trusts	Corpora-tions	Others
1983	1,250.7	59.5%	15.9%	1.3%	3.5%	4.4%	9.3%	6.1%
1984	1,344.5	54.6%	17.3%	1.2%	5.3%	4.4%	11.5%	5.7%
1985	1,615.6	49.5%	15.4%	1.2%	10.6%	5.0%	11.6%	6.6%
1986	2,772.0	41.7%	13.8%	1.1%	16.1%	5.4%	15.4%	6.5%
1987	3,683.4	36.8%	12.4%	1.0%	21.5%	5.6%	17.0%	5.8%
1988	3,979.2	34.8%	9.1%	1.2%	24.7%	6.8%	17.7%	5.7%
1989	3,395.1	32.3%	10.8%	1.2%	25.4%	10.0%	14.6%	5.7%

Note: Total brokerage trading equals the buying and selling of all securities companies on the first and second sections of the TSE, Osaka, and Nagoya exchanges.
Source: Compiled from the *Tosho yoran* (TSE Fact book).

cial discount rate from January 1986 onward, and the economy responded by entering a recovery phase. Amid this low interest rate climate, Black Monday rocked the U.S. market on October 19, 1987, causing nations around the world to initiate monetary easing to avert recessions. Japan, meanwhile, was still in an economic recovery phase, and its official discount rate remained at a low level. Consequently, the price of land and stocks continued to rise. Against this backdrop of asset inflation, corporations began taking advantage of their ability to raise capital through bank loans and securities, using financial engineering, or *zaitech*, to boost their financial income. Financial institutions, hurt by the decline in loan balances, also aggressively invested capital in securities. Heated investment in securities pushed the Nikkei Dow index up from ¥12,716.52 (September 30, 1985) before the Plaza Accord to a record high of ¥38,915.87 at the end of 1989.

New trading methods were also introduced during this period, commencing with bond futures trading in 1985. Stock index futures trading was introduced in 1987, and stock index options in 1989. Japan's securities market thus gained a full complement of cash, future, and options trading.

Chart II-10. Stock Price Movement (Nikkei Dow and TOPIX) (1990−1995)



Source: Compiled from data from the *Nihon Keizai Shimbun* and the *Shoken tokei nenpo* (Annual Securities Statistics).

7. The Reform of the Financial System after the Stock Market Scandals (1990−95)

The debate on financial system reform began in Japan in the mid-1980s. It arose in response to the global trend toward financial deregulation and to the change in the financing methods of Japanese corporations. The Financial System Research Council took the lead in the debate of revising in the specialized financial institution systems including the separation of long-term interest rates from short-term interest rates, commercial banks from trust banks, and the banking industry from the securities industry. These systems were the pillars of the postwar financial system in Japan. The Financial System Research Council, however, was positive about banks being allowed to enter the securities business and decided that the best approach would be to allow mutual entry into the banking, trust and securities businesses based on wholly owned subsidiaries. It requested the Securities and Exchange Council to revise the system separating the banking and securities industries. But the Securities and Exchange Council was wary of allowing banks into the securities business, recognizing that the securities industry overall was far less enthusiastic about this idea than the banking industry. The Securities and Exchange Council nevertheless decided to approve mutual entry through subsidiaries on the condition that firewalls were established between subsidiaries and parent companies. And for the time being bank subsidiaries, in-

Table II-10. Establishment of Securities Subsidiaries of Banking Institutions

Month/Year	Companies Starting New Securities Business
Jul. 1993	IBJ Securities (currently Mizuho Securities), LTCB Securities (currently UBS Securities), and Nochu Securities (currently Mizuho Securities)
Nov. 1993	Sumitomo Trust Securities (liquidated in 2000) and Mitsubishi Trust Securities (currently Mitsubishi UFJ Morgan Stanley Securities)
Jul. 1994	Asahi Securities (dissolved in 1999)
Aug. 1994	Yasuda Trust Securities (currently Mizuho Securities)
Nov. 1994	Sakura Securities (currently Daiwa Securities), Sanwa Securities (currently Mitsubishi UFJ Morgan Stanley Securities), Daiichi-Kangyo Securities (currently Mizuho Securities), Fuji Securities (currently Mizuho Securities), Mitsubishi Diamond Securities (currently Mitsubishi UFJ Morgan Stanley Securities), and Sumitomo Capital Securities (currently Daiwa Securities)
Mar. 1995	Tokai International Securities (currently Mitsubishi UFJ Morgan Stanley Securities)
Apr. 1995	Hokkaido Takushoku Securities (dissolved in 1998)
May 1995	Mitsui Trust Securities (terminated business in 1999)
Oct. 1995	Toyo Trust Securities (liquidated in 1999)
Nov. 1996	Shinkin Securities and Yokohama City Securities (both liquidated in 1999)
Aug. 1997	Tokyo Forex Securities (currently ICAP Totan Securities), and Nittan Brokers Securities (currently Central Totan Securities)
Nov. 1997	Ueda Tanshi Securities (dissolved in 2001)
Oct. 1998	Hitachi Credit Securities (currently DBJ Securities)

Source: Complied from data from the *Nihon Keizai Shimbun*, the Securities Bureau of the Ministry of Finance, Nenpo (Annual Report). "The First Year of the Financial Supervisory Agency", and "The First Year of the Financial Services Agency."

cluding indirectly owned subsidiaries, were prohibited from operating in the stock brokerage market. The Institutional Reform Law was enforced in June 1992 based on those conditions, and mutual entry into these financial sectors became a reality.

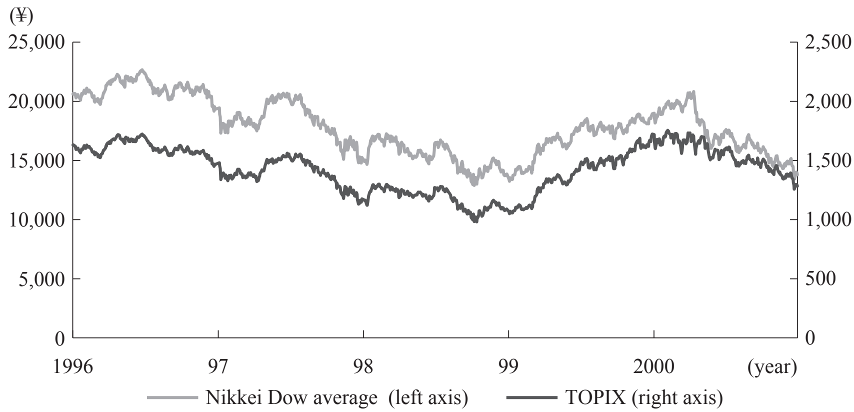
Around the time that the debate on financial system reform was dying down, the uncovering of major financial and securities scandals shook the banking and securities industries. For the securities industry it was unveiled by a tax audit that during the financial bubble major securities companies had been compensating their largest corporate clients for losses incurred (in August 1991, total compensation by the four major securities companies and 17 second-tier and medium-sized companies had reached approximately ¥172 billion). Dealings with members of known crime syndicates and market manipulation charges also surfaced, escalating the problems into a social issue. Most of the loss compensation was done to *eigyo tokkin* accounts (discretionary accounts managed by the securities company). The commonly used methods involved arranging to have the client earn a profit on transactions disguised as bond transactions or shifting losses between corporate clients with differing fiscal year-ends to avoid reporting the loss by temporarily transferring securities with losses at book value between their accounts in a process called *tobashi*.

Since under the then existing law loss compensation for trades after the fact was not illegal, the Securities and Exchange Act was immediately amended to ban securities trading under a discretionary account and loss compensation before or after the fact. Criticism mounted that "excessive profits of securities companies due to the regulator's protection, problematic administration, and fixed rate commissions had made loss compensation possible," and it was said that "what the solution requires is not the banning of loss compensation or the punishment of securities companies, but the implementation of financial system reform itself." In September 1991, the Provisional Council for the Promotion of Administrative Reform recommended the liberalization of brokerage commissions, the promotion of new market entries, and the separation of the market surveillance organization from the Ministry of Finance. In July 1992, the authorities established the Securities and Exchange Surveillance Commission. The rest of the Provisional Council's recommendations were included in the financial Big Bang reforms that came later, contributing to the formation of a new framework for Japan's financial and capital markets.

8. The Debate on, and Enforcement of, the Act on Revision, etc. of Related Acts for the Financial System Reform (1996−2000)

The bursting of the economic bubble left deep scars on the economy. The trauma from the collapse of stock prices emerged in the form of securities scandals, while that from the collapse of land and real estate prices emerged as the nonperforming loan problem in the financial industry. In particular, the nonperforming loan problem lingered on without the implementation of a fundamental solution. Subsequently, the banking industry struggled for close to 10 years to get out from under its bad debt. During this long process, foreign companies and investors and financial transactions flowed out of the Japanese market, making the hollowing out of the financial market real. Japan's way of addressing the issue was the financial Big Bang initiative proposed by then prime minister Ryutaro Hashimoto in 1996. The goals of the initiative were to wrap up the cleanup of nonperforming loans by 2001 and rebuild the Japanese financial market into an international market comparable to the New York and London markets based on the principles of "free,

Chart II-11. Stock Price Movement (Nikkei Dow and TOPIX) (1996−2000)



Source: Compiled from data from the *Nihon Keizai Shimbun* and the *Shoken tokei nenpo* (Annual Securities Statistics).

fair, and global."

Discussions on financial reform took place in the Securities and Exchange Council, the Financial System Research Council, the Insurance Council, the Council on Foreign Exchange and Other Transactions, and the Business Accounting Council. Those discussions resulted in recommendations to change Japan's established bank intermediation-based capital allocation system (indirect financing) to a market-based capital allocation system (direct financing). Passed in October 1998, the Act on Revision, etc. of Related Acts for the Financial System Reform, paved the way for services based on vigorous intermediation, set up a market system with special characteristics, and established a framework for trading that users could trust. Among its many revisions, the deregulation of stock brokerage commissions and the shift to the registration system of securities companies provided incentive for securities companies to reform their business models. Its elimination of the obligation to trade stocks only on exchanges, on the other hand, promoted competition between markets.

Almost at the same time as the financial Big Bang initiative was being proposed, major financial institutions experienced business and financial crises that led to bankruptcies. Among troubled banks were Hokkaido Takushoku Bank, Ltd., the Long-Term Credit Bank of Japan, Ltd., and the Nippon Credit Bank, Ltd. The list of securities companies included second-tier Sanyo Securities Co., Ltd., and one of the four major securities companies, Yamaichi Securities Co., Ltd. These companies previously would have been

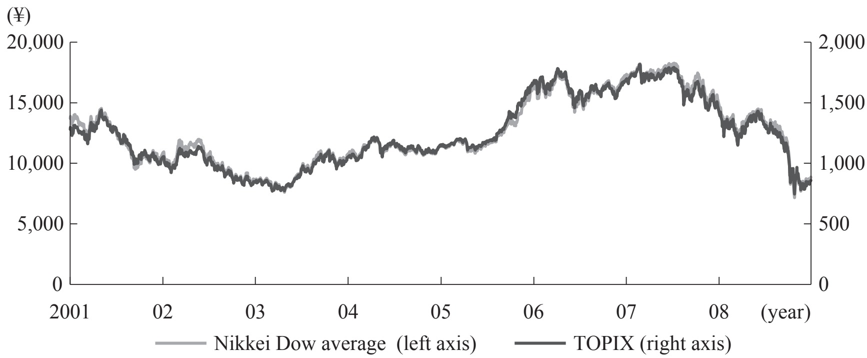
Table II-11. Schedule for Reforming the Securities Market During the Big Bang

	FY1997	FY1998	FY1999	FY2000	FY2001
I. Investment Vehicles (Attractive investment instruments)					
1. Diversity of the types of bonds					
2. Diversity of derivatives products					
3. Developing Investment Trust Products					
(1) Introduction of Cash Management Account (wrap account)					
(2) OTC sales of investment trusts products by banks					
(3) Private placement of investment trusts					
(4) Investment company type funds					
4. Review of the definition of securities					
5. Enhancement of corporate vitality and efficient use of capital					
II. Markets (An efficient and trust framework for transactions)					
1. Improvement of transaction system on stock exchanges					
2. Improvement of OTC (JASDAQ) market system					
3. Deregulation of sales solicitations by securities firms for unlisted, unregistered stock					
4. Improvement of share lending market					
5. Improvement of clearing and settlement system					
6. Strengthening inspection, surveillance and enforcement systems					
7. Strengthening disclosure					
III. Financial Intermediaries (Diverse investment services to meet client needs)					
1. Deregulating brokerage commissions					
2. Diverse activity by intermediaries					
3. Use of holding company structure					
4. Strengthening asset management					
5. Enhancing monitoring system for soundness of securities companies					
6. Entry regulations for securities companies					
(1) Licensing system reform					
(2) Enhancing mutual entry into banking, securities and trust businesses					
7. Investor protection related to exits of intermediaries from the market					
(1) Strict separation of client assets from securities companies' own assets					
(2) Enhancing the securities Deposit Compensation Fund scheme					
Review of the taxation related to securities					
Shift to the new administrative regime					

Source: Drawn from the Securities and Exchange Council's report "Comprehensive Reform of the Securities Market—For a Rich and Diverse 21st Century"

rescued by being absorbed by or merged with other major financial institutions. But there were no financial institutions with the financial strength to do so. The myth that banks could not fail was shattered, and the convoy system of securities companies came to an end. Forced into action by the crisis, the major financial institutions reorganized beyond traditional corporate lines, condensing into four major financial groups. The new groups also, furthermore, began reorganizing their affiliated securities companies from second-tier to small and medium-sized ones. Amid such major changes as the shift to a registration system and the deregulation of brokerage commissions, an information technology (IT) revolution occurred. This resulted in a rush into the market of securities companies with online brokerage businesses and other new business models, producing a change in key market players.

Chart II-12. Stock Price Movement (Nikkei Dow average and TOPIX) (2001−2008)



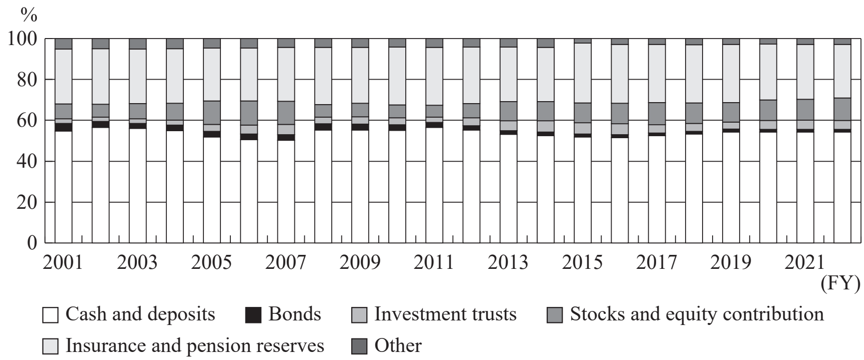
Source: Compiled from data the *Nihon Keizai Shimbun*, the *Tosho tokei geppo* (TSE Monthly Report), *Shoken tokei nenpo* (Annual Securities Statistics), and the web site of the Tokyo Stock Exchange.

9. Developments Since the Big Bang (2001−2008)

Entering the 2000s, the nonperforming loan problem reached a turning point. Prime Minister Junichiro Koizumi championed structural reform and oversaw the final clearing of this bad debt from the banking sector based on a Financial Revitalization Program in October 2002 that prioritized eliminating nonperforming loans. Because this approach threatened dangerously low levels of capital reserves at banks, a rise in bankruptcies in the corporate sector, and an increase in unemployment, the government took steps to control its adverse effects. It injected capital into banks to maintain the stability of the financial system and established restructuring mechanisms for corporations. These mechanisms included the enactment of the Civil Rehabilitation Act and of the function of the Resolution and Collection Corporation (RCC) and the setting up of the Industrial Revitalization Corporation of Japan (IRCJ).

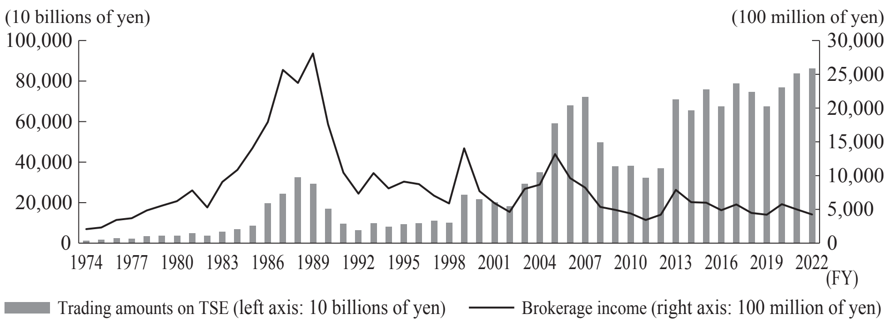
Under the slogan of "From Savings to Investment," Japan's government also implemented policies and programs to shift to a market-based financial system with a strongly rooted securities market at its core in which a diverse range of investors would participate. The policies and programs included the Basic Policies for Economic and Fiscal Management and Reform (June 2001), the Program for Structural Reform of Securities Markets (August 2001), and the Program for Promoting Securities Markets Reform (August 2002). These policies and programs put an emphasis on the expansion and improvement of sales channels (lifted a ban on banking and securities joint branch offices and introduced a securities intermediary system); the diversification of financial instruments and services (lifted a ban on wrap accounts,

Chart II-13. Changes in the Composition of Household Assets



Source: Compiled from the web site of the Bank of Japan.

Chart II-14. Trading Amounts on TSE and Brokerage Income (as of the end of FY2022)



Source: Produced based on data from the *Tosho tokei geppo* (TSE Monthly Report), the *Tosho yoran* (TSE Fact Book), the *Shoken* and the website of the Tokyo Stock Exchange.

etc.); and the fairness and transparency of the financial business (thorough disclosure and the greater supervisory oversight of audit corporations, etc.). The authorities aimed at establishing a market that participants would have confidence in and that would attract a wide range of investors. Thanks to their reforms, the allocation of household financial assets into risk-class assets, such as equities, bonds, investment trusts, and other securities, trended upward until 2006. The reforms also, however, resulted in an increase in the number and volume of complex financial instruments and transactions that demanded a comprehensive set of regulations to ensure the thorough observance of investor protection rules and the coverage of an expanding and increasingly diversified range of investment instruments. In response, the government revised the Securities and Exchange Act, reintroducing it as the Financial Instruments and Exchange Act.

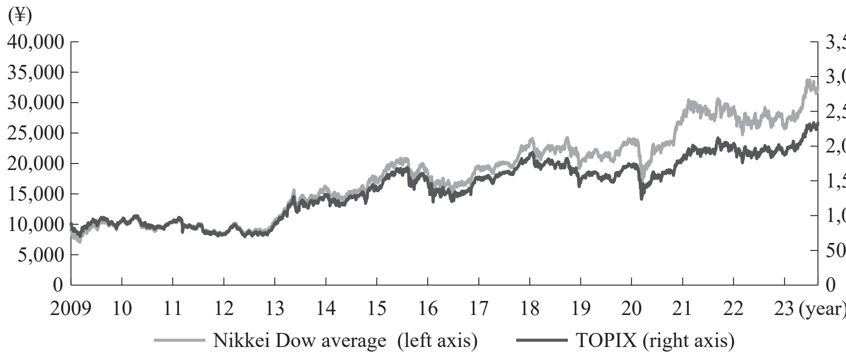
In the aftermath of the financial Big Bang, the retail securities business reform and the inter-market competition between exchanges got under way in earnest. In the retail securities business, ever since the liberalization of brokerage commissions, the level of commission income became sluggish. Therefore, leading securities companies that used to focus on the brokering business shifted their direction to adopting a marketing approach of paying greater attention to asset management in an effort to break away from being dependent on the market condition. Meanwhile, the inter-market competition was focused on attracting new listings and more transaction volume. The exchanges started targeting new listings around 2000, launching start-up company markets, and start-up companies and growth companies successively listed their shares on exchanges. In the battle for greater transaction volume, Tokyo Stock Exchange (TSE) quickly took the lead. The TSE introduced electronic stock trading and off-floor trading, strengthening its dominant position. The concentration of stock trading on the TSE, however, produced a notable decline in support for other regional stock exchanges, leading to successive reorganizations that began around 2000.

10. Changes after the Lehman Shock (2008 onwards)

Following the Lehman Shock, the outlook for global economy became increasingly uncertain, reflecting factors such as European sovereign debt crisis triggered by problems with Greek debt, trade friction between the U.S. and China, and the COVID-19 pandemic. In each of these crises, countries have implemented measures such as fiscal stimulus and monetary easing.

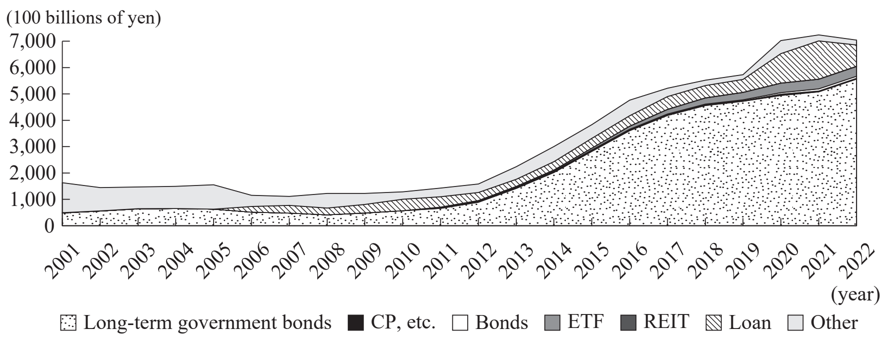
In addition, the Bank of Japan has had a policy of drastic monetary easing in place since 2013 to also combat deflation, purchasing not only government bonds but also ETFs and REITs. Accordingly, the Bank of Japan's assets have expanded rapidly, from ¥164 trillion at the end of March 2013 to ¥704 trillion at the end of 2022. Moreover, the assets purchased by the Bank of Japan include about ¥37 trillion in ETFs and REITs - measures still not used by central banks overseas. It has been reported that the number of companies in which the Bank of Japan is the de facto largest shareholder exceed 100 as of November 2020. Such large purchases of JGBs and ETFs raise concerns that the Bank of Japan's presence in the market is causing a deterioration in the proper functioning of the market. However, global monetary easing started to be scaled back from 2022, and Japan itself is beginning to consider the possibility of an exit from its 10-year monetary easing stance.

Chart II-15. Stock Price Movement (Nikkei Stock Average and TOPIX) (2010 onward)



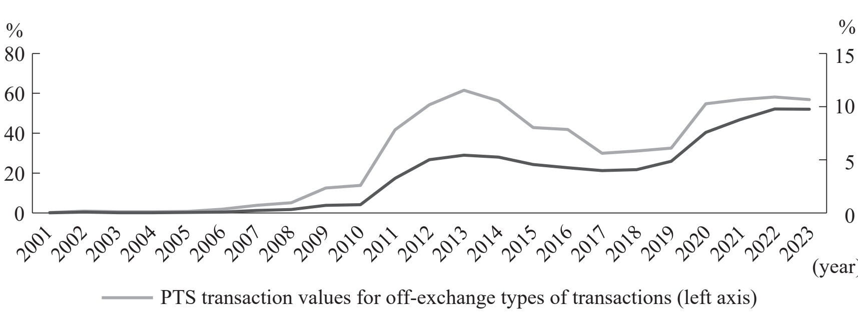
Source: Compiled from data the *Nihon Keizai Shimbun* and the web site of the Tokyo Stock Exchange.

Chart II-16. Changes in the Central Bank Assets (at the end of FY2022)



Source: Compiled from the data published on the web site of the Bank of Japan.

Chart II-17. Transactions on Proprietary Trading Systems (as of July 2023)



Source: Compiled from the data published on the website of the Japan Securities Dealers Association.

Corporate governance reforms have also been implemented in order to improve corporate profitability. These reforms include the introduction of the Corporate Governance Code, which outlines standards to be observed by listed companies, and the Japanese version of the Stewardship Code, which outlines the Principles for Responsible Institutional Investors, with the aim of improving corporate value and returns over the medium to long term. Since the introduction of these codes, institutional investors have publicly disclosed the results of their exercise of voting rights and engaged in dialog with investees. In addition, the number of companies appointing outside directors and female directors and dissolving cross-shareholdings is also increasing. In recent years, the importance of management awareness of the cost of capital has also been appreciated.

Another change has been the increasing use of IT in securities trading, typified, for example, by high-frequency trading (HFT) and robo-advisors. In 2010, the Tokyo Stock Exchange upgraded its trading system, leading to the introduction of HFT in earnest. According to the FSA, the number of orders placed via co-location had reached 80% by March 2021.

With the large-scale entry of HFT and the start of margin trading, use of proprietary trading systems (PTS) has also begun to increase in Japan. Their share of total trading value has grown to about 10%. Robo-advisor services, which use AI to automatically manage assets, were launched in Japan in 2016. The number of users has increased, mainly among those in their 20s and 30s, with assets under management for specialized firms alone in excess of ¥1.3 trillion at the end of fiscal 2022.