

Japanese Corporate Governance under the Revision of Corporation Law, and Financial Law Reform in Japan

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Table of Contents

Introduction

I Japanese Corporate System and Corporate Governance

- 1, Legal Features of the Japanese Corporation
- 2, Auditors system and Committee system
- 3, Mutual Holding of Corporate Stocks and Corporate Governance
- 4, Derivative Action and Bribes concerning the Exercise of Shareholder Rights
- 5, Public Enterprise and Japanese Corporations

II Japanese Financial Institutions

- 1, Features of Financial Institutions in Japan
- 2, The Administration of Financial Markets by the Ministry of Finance after World War II
- 3, Bursting of the Bubble Economy and background of Crime in the Financial Markets
- 4, Bad Debts of Banks and Bank Support Subsidy using Public Money (Tax)
- 5, Bankruptcy of Financial Institutions in Japan
- 6, Directors' duty of care and loyalty when Financial Institutions become insolvent

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III ASIAN CURRENCY CRISIS

- 1, Emergence of *Hot Money* –Who is the powerful man?–
 - 2, Task of the Law? to make New World order or rules
- Conclusion

Conclusion

- 1, Why is Japan suffering from such a long recession?
- 2, Is Japan a Socialist Country?

Introduction

In '80, Japan was an economic superpower. Many countries admired and emulated the Japanese company system. At the same time ,many Japanese Financial Institutions such as banks, securities companies², and insurance companies ranked among the world's biggest Financial Institutions.

But now we are in a long recession and as Japanese economic power decreases, no other countries even pay attention to Japan. The '80 were only ten years ago. What made Japan change? Why are the Japanese economy and Japanese company system now so weak?

It is said in some cases that an existing system will already have become old-fashioned, 50 years after it has been established. This can be shown when one considers the many distortions of the Japanese system, for example: scandals concerning company directors and illegal lobbyists³, or the credit risk of the whole Japanese Financial system.

2 In Japan, Securities Company deals with bonds and stocks of the companies. But they are prohibited to deal with deposit, loan, and to transfer money by Law.

3 They are called "Sohkaiya" in Japanese. Some of them have connections with the Japanese Mafia. Company directors took advantages them in order to hide some information in the shareholders meeting.

In recent years, the speed of Japanese corporate change is very rapid. The commercial law has been changed more than 10 times in 5 years, and it will be changed whole commercial Law and corporation Law will be established in 2005. How our corporation system should be changed?

In this paper, I will discuss the questions⁴ mentioned above, focusing on the Japanese Corporation system and Financial Institutions. I will try to explain the facts objectively, and answer those questions according to my opinion.

I The Japanese Corporate System and Corporate Governance

1, Legal Feature of the Japanese Corporation

Japanese Corporations find their legal basis in *the Law of Commerce*⁵. There are four kinds of corporations: Kabusikikaisha (the joint stock company), Yugenkaisha (the limited liability company), Gomeikaisha (the limited partnership), and Goshikaisha (the unlimited partnership). All corporations except a limited liability company are based on commercial law, but a limited liability company is based on *The Act of limited company*⁶. The Joint Stock Company is the most important type of business organization, and there are more than 1 million joint stock companies⁷ in Japan. But less than 3000 companies⁸ offer their shares to the public.

4 What made Japan change? Why do the Japanese economy and Japanese company system become so weak?

5 It is called as "*Shoho*" in Japanese and prescribes 3 kinds of corporation. Article 52 to 500 is called corporate law in Japan. In some other parts, it prescribes insurance and merchants. I will use the term *corporate law* as *Shoho* in this paper from now on. The Corporate Law will be revised completely in 2006.

6 *the Act of limited responsibility company* is called as *Yugenkaishaho*.

7 In this paper after this, I will use "*company*" as a joint stock company.

8 Cf. Masao Kishida "Kaishahounyumon" (nikkei-shinbun press, 1994) p23.ff.

In order to establish a company, promoters must collect at least ten million yen⁹ as capital. The issued shares have to be accepted or underwritten. A promoter or promoters must settle *Teikan* (the Articles of Association) at first. The Articles of Association comprises the constitution of the company later on. The Articles contain the name of the company, address of the company, and kind of business that is managed by the company etc. Then a promoter or promoters go to the registration office and register a company. After that, legally that union can be a company or legal person, so that the company itself may possess real estate or property in its name. At the same time, promoters have to organize the first shareholders' meeting, then in many cases, the promoters become the directors by election of shareholders.

In Japanese companies, the shareholders' meeting is the highest organization. It is like Congress or Parliament in the country. Shareholders gather and hold the meeting, and check the most important and basic things in the company. Shareholders meetings can select a member of the board directors, approve the settlement of account, and even fire directors and auditors in the middle of their term, if a quorum of more than half of the share attends the meeting, and two-thirds of share approves¹⁰. Usually, private companies are managed by shareholders who are also directors of the company. But in public companies¹¹, shareholders do not understand the management of the company in detail, so the principal of separation between management and possession works. In short, there are two kinds of companies in Japan: public companies and private companies.

Japanese companies must have a quorum of at least three directors in order to organize a meeting of the directors, or board of directors. Directors meetings select a representative of the directors or CEO. Directors meetings deal with important business transactions

9 About ten thousand US dollars.

10 Sec.257 paragraph 1, corporate law

11 "Public company" means that the company whose shares are open to the public.

such as issuing more shares to get more capital, and the other financing matters. Some companies have more than 60 directors as members of directors meeting. In this kind of case, they have an additional board of directors¹². A representative Director has very wide and great power in the company. A representative Director can deal with almost every kind of daily job. A representative Director can represent a company, when the company does business or undertakes legal action. Japanese CEO's¹³ deal with daily business. The CEO has very strong power in the company, although a representative of directors or CEO has to obey the decision of the directors' meeting.

Auditors audit company accounts. In the *big company*¹⁴, at least three auditors are needed in order to establish Kansayakukai (an auditors meeting). But in this case, each auditor still has the right to represent the company. In *the big and middle company*, an auditor can audit not only accounts, but also business transactions decided by the directors meeting. But in the small company, an auditor can only audit accounts. According to corporate law, auditors have a very strong power which is the same as directors, or even stronger. Big companies, in order to audit correctly, are required to ask CPA's to audit their accounts. In this way, Japanese companies have some important organizations to control the company. Those organizations exist to check and balance each other.

12 This board is called "*Jomukai* or *Juyozaisaniinkai*" (supreme business committee). Corporate law doesn't mention about it.

13 Japanese CEO is called "Shacho" or "Kaicho".

14 According to the corporate law, Japanese companies are divided into three kinds of companies. The big company is a company which has more than 500 million yen as a capital or more than 20 billion total debt. The small company is a company which has less than 100 million yen as a capital and less than 20 billion total debt. The middle company is a company which belongs neither the big company nor the small company.

2, Mutual Holding of Corporate Stocks and Corporate Governance

After the burst of the *bubble economy*¹⁵, a lot of scandals concerning companies have been happening. One of the reasons for this is that the limit of contemporary social and corporate system, which was built in 1940', has appeared in many situations. The contemporary system was established during World War II¹⁶. So in this paper, I want to focus on the question what the Japanese company is. In order to consider this problem, we must try to argue about *Kabushikimotiai* (Mutual Holding of Corporate Stocks) and Corporate Governance.

In Japan, till 1998, holding companies were prohibited by sec 9 of Japanese Anti-Trust Law. So Japanese companies invented another way has the same functions as holding companies. After Japan became a member of the OECD in 1964, Japanese companies had to open their shares to the foreign public. Many managers of the companies were afraid that their companies would be taken over or managers would be kicked out. After a short while, many companies purchased large mutual shares, and became groups. As a result, many company shares were held by very stable shareholders mutually: in other words whole industries were owned substantially by the companies which ran them but mutually and not directly.

By the way, at that time, share prices were very cheap; the shares were valued very cheaply in the balance sheet. In Japan they do not have to book assets contemporary value. So according to the Balance Sheet, very expensive shares appear to be very cheap. Companies could take advantage of this. These types of assets are called *hidden assets*. At the bubble era, share prices were very high.

15 In Japan, the late 80's is called Bubble economy era. The Japanese Stock Market was overheated. Many people invested their money in Stock market and bought very luxurious goods etc. Japanese financial institutions were among top ten in the world. Cf. II.3. in this paper.

16 Cf. Yukio Noguchi "*Saraba 1940 Taisei*" (Good Bye 1940 System) (Toyokeizaisinpou, 1995) ISBN4492392041 p.4ff. In this paper, I will mention about ISBN of the Japanese book in order to search easier.

So companies could use this **hidden asset** value to attract financing from the Financial Institutions. But it helped a lot to promote bubble economy. This was one of the secrets of economic power which Japanese companies once had.

One of the bad effects of mutual share holding is that shareholders meetings become merely ceremonies. According to the corporate law, shareholders meetings should be a supreme organization in the company. But, because of mutual holdings, shareholders meetings exist only to follow directors' decisions. One company doesn't harm an other company's business. It is considered that the shorter shareholders meeting lasts, the better company people judge. As a result, decision making should be held at directors meeting.

But in Japan many people, even now, continue to work in the same company which the person got position after graduation from school. And this is considered to be a good tendency widely. So the position of a director is an ideal goal for every employee. This system is the origin of Japanese big company and employees' loyalty toward the company. Even if the employee can't be a director, still company guarantees the lifetime employment¹⁷. They say that *lifetime employment*, *individual labor union*, and *raising salary every year* are the three biggest secrets. This is the Japanese management that was admired ten years ago throughout the world. But they are criticized after bubble economy crashed.

Among the board of directors, a representative of directors or CEO is the oldest and the earliest to become an employee. The other directors are behind him. At the same time, a representative of directors or CEO has his coalition in the board. So he can control the board of directors. Because every other directors are usually his junior in the company. As I mentioned before, the shareholders meeting is just a ceremony, so if the company suggests some

17 If an employee continued to work in one company 25 years, he could get company pension besides public pension. In this way a retired business man (called salary man in Japanese) can lead a better life than non-business man.

proceeding, everything will be approved. Because big companies' shares are held mutually, almost all the share will approve the company's decision. This is how a representative of directors or CEO can control or dictate to the company¹⁸. Usually, CEO's successor is chosen by current CEO's own decision in Japan.

I will give you an example of how Japanese companies are different from others. There is a labor union in Japan. In many big companies, union shop system is chosen. So every one becomes a union member. In Japan, to be a leader of the union is the one of the quickest way to be directors. Many directors are chosen from union leaders. There have been not so many severe labor dispute in Japan after world War II. In Japan labor unions work for the company, but in other countries they work against the company. By this example you can understand that the Japanese companies are an unity.

According to company law, directors meetings should decide the business matters. But a representative of directors or CEO can control the company, not directors meeting or shareholders meeting. Mutual holding of shares allows this situation to happen. In this way, companies are managed by one president alone in Japan.

Of course, auditors can check business judgments and book keeping. And they are given very strong power. But usually, auditors were once directors of the company or employees who did not have the opportunity to be directors of the company. They are juniors of the company presidents or CEO. They believe that the best way to manage the company is to obey the company or CEO's decision. If they don't follow the CEO's decision, they might be kicked out of the company in the next shareholders meeting.

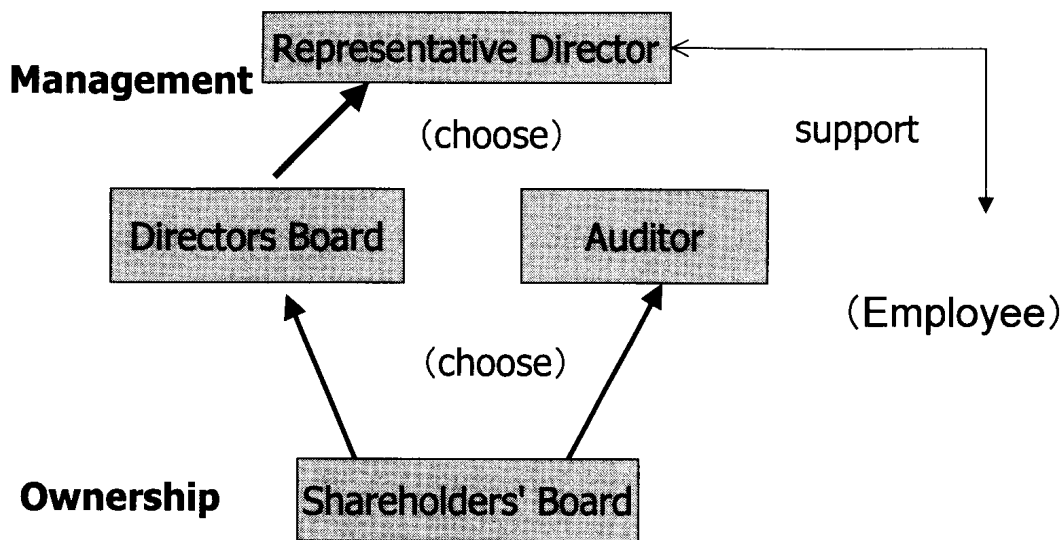
In this way, many Japanese companies are controlled by a president or CEO, not shareholders, or board of directors, or auditors.

As we have seen, our traditional types of corporation are that

18 Cf. Yasuhiro Kojima "Kaishahoukaiseisagyonokakushin (The point of revision of the corporate law)" 'Hogakuseminaru:ISSN0439-3235' Dec.1997 p.44-46.

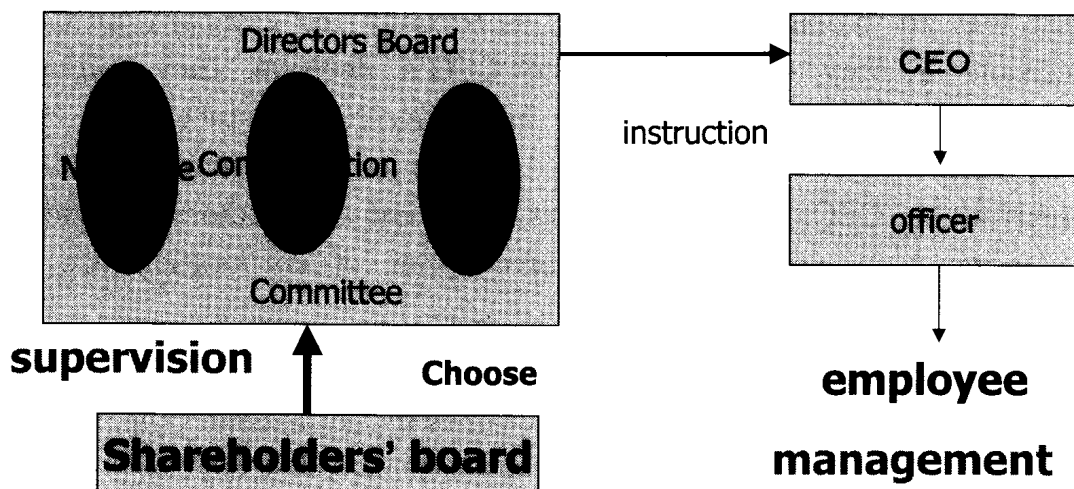
with auditors. It is said that auditors didn't work enough, so Japanese companies could not prevent from corporate scandals. In 2003, the committee system has been adopted. In this types of corporation, auditors have been eliminated and adopted many outside directors. At the same time the role of directors board has changed into supervision from management.

1 , Auditors System



2 , Committee System

- Ex. Sony or Nomura



3, Derivative Action and Bribes concerning the Exercise of Shareholder Rights

In Japan, as I mentioned before, the shareholders meeting is only a ceremony in many cases. Directors of the company hope shareholders meeting ends in peace and quite. They are sometimes too afraid that shareholders meetings will last long. So some Japanese *professional shareholders* take advantage of this situation. When they find some important information, but if it not important information, such as small rumor or even scandals about the director, it still works, and they threaten company. Although they only have a small amount of shares, they attend shareholders meeting, and pose many questions to obstruct the proceedings. Sometimes the company overreacts and give extortionists money or goods. It is clearly prohibited to give shareholders money and goods relating to the exercise of shareholder rights¹⁹. If somebody breaks the law, that person can be sued, and might be sent to jail, bribers and bribe takers alike.

Even very famous Japanese companies have been continuing their relationship with special shareholders. Recently these kinds of scandals have been make public. Only one middle aged professional shareholder threatened many famous financial institutions, such as Nomura · Securities, Nikko-Securities, Daiichi-Kangyou-bank, etc. This relationship remained top secret among executive directors. Some former directors were arrested and were found guilty in 1997.

At the same time, directors who did this kind of crime have to take civil responsibility too. Sec 266 paragraph 1-2, Corporate Law regulates this. If a director or directors give money or goods to professional shareholders, that director has to compensate the company with that the same amounts money. If the director doesn't pay the damage voluntarily, the company can sue this director. In this case, the representative director, who is usually CEO of the company, becomes the plaintiff representing company. But many

19 Sec.294-2 paragraph 1, corporate law.

times, directors don't sue the other directors. Instead auditors will represent the company in such cases, but this doesn't work. Because they are also members of the company. In this way, shareholders ultimately sue the offending director and represent the company.

Formerly this system didn't work well. Because shareholders had to pay some amount of money to sue. According to the former civil procedure act, shareholders had to pay a sum in proportion to how much they ask for compensation. This means that if the company had big losses, and the directors were responsible for it, shareholders would have to pay a lot of money. But in 1993 a radical change occurred. The Civil Procedure Act²⁰ was revised, so that the court fee for a lawsuit, or derivative action had become ¥8200 in any shareholder representing lawsuit cases. Now the numbers of shareholders lawsuit is increasing rapidly.

This tendency has influenced the Japanese Company System greatly. Especially, among directors this influence is very severe. In many cases, Japanese businessmen worked so hard being loyal to the company, in order to be a director. Sometimes businessmen believe that they have to hide something in order to maintain this business situation. They thought they worked hard for the company; suddenly they became a defendant in a civil suit where they have never been in their lives.

In some lawsuits²¹, directors were ordered to pay over 2 billion-yen by the court. The problem is that a regular Japanese businessman, who becomes director, earns less than 500 million yen²² in his whole life. How could they have paid that much money? In Japan a CEO's income is only 20 times more than company freshmen, but in the U.S., 400 times. Directors are considered the professionals of management in the States. But in Japan directors are, people think, almost the same as employees, and the goal of businessmen, that is how most businessmen think.

20 Special Law concerning the fare of Civil Procedure, Sec3

21 This case is known as "*Nihondenshikougyou (Japan Electronic Industry) case*".
Ruled at Tokyo District Court in 20.6.1996.

22 About 4.5 million US-dollars

Tokyo Mitsubishi bank²³ has more than 60 directors, although corporate law requires only three. It is impossible to make every important business decision by 60 directors who are all over the world. Many big companies have established a supreme management board to make top business judgments. Normal directors board meetings are only ceremonies just like shareholders meetings.

Formerly Sony had over 50 directors, but they lost a lawsuit in the States. They reduced the numbers of directors. They have ten directors now, the others have become *Shikkoyakuin* (executive employee)²⁴. It is also impossible, as I mentioned before, for normal directors to make compensation for damages in law suits, because of the total income level of Japanese business men.

These days, several companies have reduced the numbers of directors²⁵. I think this tendency will continue. Directors must be the professionals of management. They should be able to earn more money than now in proportion to their duty. If present directors make a wrong business decision, they must resign or be sued by shareholders.

Company shareholders must pay attention toward dividends which comes from the possessed stocks. If they don't understand the policy of the company, they must attend shareholders meetings and pressure the company which has issued the stocks. In order to work this system in Japan, every open public company should disclose their information. Both individual and institutional investors have to pressure or monitor the company, if they have inefficient securities, investors have to pressure and monitor the company more. To carry out this purpose, I think we must enact more severe corporate law to disclose precisely or be punished, and to give duties for corporate

23 The biggest bank in Japan and second largest bank in the world in 1997

24 They are called 'a director' in Japanese. But legally they are not member of directors board meeting. They are not registered in the registry book.

25 For example, *Nihon Choki Shinyou Bank* (Nihon Long Term Credit Bank) has reduced from 26 to 5. You can find some examples.

investors including institutional investors, to report their vote.

At the same time, company directors must obey the law and if a bad custom continues, they must change. They must realize that if they do not, they can be sued and have the duty to pay compensation. We have to change this Japanese company system.

4, Public Enterprise and Japanese Corporations

Now Japan is suffering from much debt. There are 330 trillion yen in Government Bonds²⁶ still on the Market. This is equal to 66.2% of Japanese GDP. At the same time, local governments have issued a lot of bonds, too. Totally, the financial deficit of local and the central government remained 630.3 trillion-yen, it is equal to 120% of Japanese GDP.

Every year the central government issues more than 25 trillion yen in government bonds, which is equal to 4.7% of Japanese GDP. In order to be a member of the European Union, a country must not issue government bonds exceeding 3% of its GDP. So Japan could not be a member, but France, Germany and even Italy have cleared this hurdle. Now Japan is in the most dangerous situation in the world and we can't avoid this problem.

If you go to the countryside in Japan far from Tokyo where very famous politician once appeared, you may be surprised by what you see the sight. You will find very big gymnasium in which more than ten thousand people can gather small towns. You will also find wide highways and Bullet train (*Shinkansen*²⁷) many places. Every year in the winter representatives from each town or city come to Tokyo to lobby members of the Diet or government employee of Ministry of Finance to ask them to make more Institutions. After the Nagano Olympic Games was over, Nagano Shinkansen and a lot of deficit remained in Nagano.

Now the Japanese Stock Market has sunk to a low level;

26 About 1. 20 trillion U.S dollar in 2000.4.1. Government bond means Japanese Treasury Bond

27 Very fast special train, like a TGV in France.

especially Financial Institutions and Construction Companies. It is said that there are too many construction companies in Japan. They rely mainly on the government's contracts. And they say that the tender system has been not fair, companies and government employer discussed their bids in advance. Several governors, politicians and businessmen were arrested in 1997.

In Japan, recession has been the most important issue in the Economy. When the economy doesn't go well, every business leader requires a Supplementary Budget to promote public enterprise to the government easily. At the same time, the Bank of Japan was not neutral, and many politicians pressured them to make the Koteibuai (official discount rate) lower.

There are also many corporations or foundations²⁸ which have a special status. Some of their employees are from government offices. They are using very much government money every year, and having lots of deficit to compensate. But still they have their positions and salary and expensive retirement's money and pension. Nobody can change this flow of money and system. Many politicians tried to change it, but no one succeed. If the Japanese economy had continued to make progress forever, these kinds of problems would never have appeared.

II Japanese Financial Institutions

1, Features of Financial Institutions in Japan

The legal feature of Japanese Financial Institutions is, in one phrase, that of a separated business area by each institutional group. We can divide Financial Institutions into banks, securities, life

28 They are called *Tokushuhoujin* in Japanese. There are nearly 100 Tokushuhoujin in Japan. And there are nearly one thousand foundations which need permission of the government to establish. Ministries, Toshuhoujin and foundations form the pyramid of the rights and interests.

insurance, and damage insurance²⁹. At the same time, there are very big Financial Institutions in Japan. Those are managed by government. The biggest one is the Post Office³⁰. I will explain the legal features of each financial institutional group as follows.

First of all, I will focus on the separation between bank and securities firms³¹. Securities business contains brokerage, underwriting, selling and dealing³² of securities such as bonds, stocks, CB, etc. But banks can't deal with this kind of business. Art. 65 Sec. 1 *Shokentorihikiho* (Securities Regulation Act) prohibits banks to deal with securities business. This law was revised after World War II. The Glass-Steagall Act³³ in the U.S. gave big influence upon Japanese Securities Regulation Act. But there is a big difference between the two Acts. There are some exceptions in Japanese Securities Regulation Act, such as brokering Japanese Governmental Bonds and selling by its own account. Furthermore, banks can buy and hold shares of the companies³⁴. Banks deal with corporate bonds whose holders are less than 50 people. If there are more than 50 holders of corporate bonds, this business becomes securities business. If we judged from this situation, it has been often said that Art. 65 Sec. 1 Securities Regulation Act is a Japanese Glass-Steagall Act, but the purpose of the Japanese Securities Regulation Act is not only to

29 It is called "Sonpo" in Japanese. It includes fire damage ,accident and traffic insurance.

30 It has more than 22 trillion yen as a deposit. It is 3 times bigger than Tokyo Mitsubishi Bank, which is the biggest bank in Japan.

31 In Japan, securities firms deal with bonds and stocks like in U.S.

32 Art 2 Sec 2 Sentence 8 *Shokentorihikiho* (Securities Regulation Act). This Act regulates securities business.

33 After Great Depression in 1929, many banks failed. American government enacted new law named after senator Glass and Steagall. It prohibited banks to deal securities business. Because they believed that securities business are risky and banks mustn't do. This law still have effects, but it is considered as a symbol of Anti-Free financial business now.

34 Art11of Anti-Trust Act prohibits banks to hold the issued shares more than 5% of whole shares which that company has issued.

keep banks away from risky securities business like the Glass-Steagall Act, but also to keep banks from securities business in order to encourage securities firms. In this way, Japanese securities companies, such as Nomura, Daiwa or Nikko, had become the biggest in the world before the bubble economy crashed. To be frank, securities firms exist to get fees from customers.

Secondly, Banks deal with an ①ordinary and a fixed deposit, ② money transfer, and ③loan to both individuals and companies. In Japan the direct capital market doesn't work well, so companies rely on banks ,that is, indirect finance works better than direct finance. So banks play a big role in business in one side, the cost of corporate finance is higher, and companies can't get risk money which aren't needed to pay back. The business which bank can deal is regulated by *Ginkoho* (Banking Act). The three businesses which I mentioned before are central business of the bank, but banks can deal with other business, such as dealing in governmental bonds, foreign currency exchange, dealing in certain area of derivatives, even renting safety deposit boxes for a fee. Roughly speaking, banks get profit from loan profit minus deposit interest, plus fees.

Among merchant banks, we can sort banks into four groups, City Banks, Regional Banks, Credit Associations, and Credit Cooperatives. The former two kinds of banks are based on the Banking Act. Credit Associations, and Credit Cooperatives are based on Special Acts: the *Shinyoukinkohou* (Credit Associations Act) and the *Shinyokumiaihou* (Credit Cooperative Act). There are no legal and functional distinctions between these banks. But the scale of business is very different. City banks are based on very big cities like Tokyo, or Osaka. They do business with big companies. There are one or two Regional banks in one prefecture, which do business with local companies. Regional banks have some branches outside their own prefecture, but very few. Some regional banks have or had branches overseas as an accessory during bubble era. But they have to suffer a heavy burden to obey harder BIS regulations³⁵. They are trying to

35 If some banks deal with international business, they have to obey 8% of the ratio of owner's equity, but if they deal with only domestic

withdraw branches overseas now.

Credit Associations are specialized Financial Institutions that service medium and small companies, which are mainly based on the member system. They collect deposits from members and the general public, and provide loans for members. Credit Cooperatives are specialized financial institutions for small companies, and mainly for individual members. They are licensed by the Prefecture, not the ex. *Zaimusho* (Ministry of Finance: MOF). Both have the same problem: the number of members is decreasing in recent years.

Thirdly, there is a category of Trust Banks only in Japan, which is permitted to engage in trust business. Trust Banks are considered long term Financial Institutions³⁶, which deal with loan trusts, money trusts, investment trusts, land trusts, and pension trusts. Other major business activities include stock transfer agency services, custodial service for assets etc. Loan trusts and money trusts are almost same as deposit and loan for customers. Land trusts include real estate brokerage, so Trust Banks have been much damaged by bad debts from bubble crash. But many financial institutions, including foreign institutions, pay attention to pension business, because the amount of pension is becoming bigger, as the Japanese society is growing older rapidly, and pension business has been opened to other Financial Institutions.

There are three exceptional banks, called Chokishinyouginko (Long - Term Credit Bank) which can issue bank interest-bearing and discount debenture. They can loan money to big companies such as Toshiba, Hitachi, and Sony etc on very long term, sometimes over 10 years. Formerly these kinds of banks were considered high position bank, but if companies can finance money from the capital market, there is no special reason to exist. Now they have a small number of branches³⁷, they must find ways to survive after Japanese

business, 4%.

³⁶ Long term means over one year in financial society, short term less than a year.

³⁷ Among this category, Industrial Bank of Japan (IBJ) is the biggest, but it has only 25 branches in Japan, on the other hand, city banks have ten

Big Bang.

Except for banks, there is another Financial Institution to loan money, called a *Non Bank*. Legally Non Bank is a Financial Institution which loans to both companies and individuals, but can't collect money by deposit or debenture. They therefore have to borrow money from other Financial Institutions. The outstanding balance of all Financial Institutions' loan in 1996 was about 500 trillion-yen in Japan. The outstanding loan balance of City Banks is 220 trillion yen, Regional Banks 140 trillion, Long Term Credit Bank 50 trillion, Non Bank 90 trillion. You can understand how big Non Bank is in Japan. Among Non Banks, there is a variety of Financial Institutions. Non Banks called *Shohishakinyu* (Consumer Loans) work very well these days, so even City Banks shift their main works into individual business.

The Japanese Central Bank is *Nihonginko* (Bank of Japan: BOJ). It is a joint stock Corporation based on Bank of Japan Act, you can buy the stocks of the BOJ. The BOJ issues Japanese Yen. BOJ can control the official discount rate, and decide monetary policy such as open market operation and reserved account control. Formerly independence of the BOJ was not so strong, so BOJ was interfered by politicians, or the Ministry of Finance which is governing authority of the BOJ. But in 1997, Bank of Japan Act was revised to make it independent.

We must not forget to mention the Post Office among Financial Institutions. The Post Office is the biggest Financial Institution which deals with individual deposits and loans, postal life insurance, and the mail service. Its workers are government employees, and more than half of postal offices is special Post Offices, which are managed by civil managers. Managers of Special Post Office have a very strong political power. The deposits³⁸ which are collected by the Post Office

times more branches.

38 It is said that Japanese individual have 1200 trillion yen as an asset. Post Office have more than 220 trillion yen as a deposit. Many foreign Financial Institutions eager to participate Japanese market to target individual asset.

are kept at Ministry of Finance, and invested managing division of Ministry of Finance. They make an investing strategy³⁹, which must be approved by the diet. Most severe critics say that Japanese Banks bad debts are 20%, but it is considered this investment has more than 30% of bad debts. The Institutions which have invested in this fiscal investment and loan program are, in many cases, corporations having special status, public corporations⁴⁰. They can't function, without this money, these kinds of Institutions are bankrupt. We must reform this system to invest and manage our 120 trillion asset better, but Managers of Postal Offices have a very strong political power and can control many politicians.

At the end, we will mention insurance companies, which are divided into two categories. Those are *Seimeihoken* (life insurance) and *Songaihoken* (casualty, marine and fire insurance). Their business area had been divided by *Hokengyohou* (Insurance Act) and Commercial Law. At the same time, they are big and important Institutional Investors. They are expected to play the role of investigator of public companies, because they know how to investigate. They, especially life insurance companies, are buying many U.S. Treasury Bills. Without them, the U.S Government would have difficulty making a Budget. When we talk about casualty, marine and fire insurance, we must remember that they play an important role in traffic accidents, which kill more than 10,000 people every year. Compensation for traffic accidents is a very important problem in Japan too. As Japanese Big Bang goes, separations between life insurance and casualty, marine and fire insurance, or insurance companies and other Financial Institutions is lower.

39 This way of investing is called *Zaiseitoyuusikeikaku* (fiscal investment and loan program). It is called second budget, and it is easier to take advantage this money by politicians than make budget.

40 For example, *Juutakukinyuukouko* (Special bank for individual housing loan), or *Nihondourokoudan* (Public Road Service).

2, The Administration of Financial Market by the Ministry of Finance after World War II

Now we understand that the Japanese Financial System has been maintained by a kind of sectionalism of Financial Institutions. The separation system between ①banks and securities companies, ②long-term and short-term Banks, ③life and casualty, marine and fire insurance has worked well in order to finance especially important industries.

At the same time, after World War II, we had a special law to decide deposit and loan rates of all banks. It meant that there was no competition among Financial Institutions. This means banks did not have to make an effort to make profit ignoring depositors profit, if they could get deposit, so they can find company to loan easily till the 80's. But that law was abolished, there is such severe competition between Financial Institutions that they might become bankrupt.

The administration by the MOF made this system possible. All Financial Institutions are licensed by the MOF. The administration of the MOF is called *Gososendan System* (Flagship protection system or Convoy system) which aims to keep pace of all Financial Institutions business according to the weakest Financial Institutions, to avoid competition so that every Financial Institution can maintain its business. Almost no bankruptcies of Financial Institutions had happened before the bubble economy burst.

Regulation of deposit and loan interest and separation of business areas are two important regulations based on the Banking Act and other written laws, but when something happened, *Tsuutatsu* (Official Notice by MOF division chief) and *Gyoseishidou* (administrative guidance) were offered by MOF. All banks and securities, insurance companies obeyed every guidance voluntarily. This attitude is called and criticized *Yokonarabi* (exact same business actions done by all Financial Institutions). Some guidance were oral and unwritten, and not open, so foreign Financial Institutions don't understand this rule, for them Japanese Market and administration seemed very unclear and unfair.

The officers of MOF⁴¹ aren't specified in financing, they are also working on preparing national budget and tax problems. One Major interest of MOF officers is preparing the budget, so they don't know detailed financial business. They need to know this information in order to administer Financial Institutions, while at the same time Financial Institutions need MOF information, such as the date of investigating or permission to create new Financial goods. Financial Institutions establish special divisions to work only with MOF officers called MOF-tan (MOF co-working section). They go to MOF every day and try to get information, on the other hand, MOF officers can get information about real business. Sometimes Financial Institutions' MOF co-working sections entertain MOF officers to parties or golf to get a closer relationship. This is very important for the Financial Institutions, so the MOF co-working section in Financial Institutions is considered very important and where most able workers were collected. Many directors of Financial Institutions are from MOF co-working section. But this relationship can't be maintained in the coming Big Bang. In March of 1998, some MOF officers were arrested for bribery, and several MOF officers resigned on allegations of bribery being made.

For directors in Financial Institutions in Japan, the most important way to manage banks has been to know the MOF's decision, so they didn't have to make their own business decisions. But from now they have to make their own business decisions as other companies. If they failed to manage, the Shareholders Lawsuits would be waiting.

41 In Japan, to graduate from Law faculty of Tokyo University, to pass in a very difficult exam to be government employee, and to work in MOF is considered to be one of the best job. After becoming officers of MOF, severe survival competition goes on till one of the same generation members becomes an administrative vice minister. After retirement of MOF, all members who passed the most difficult exam can get a good job in Financial Institutions, and get good salary.

3, Bursting of the Bubble Economy and background of Crime in the Financial Markets

As the President of U.S. R. Reagan's economic policy, called *Reaganomix*, caused a lot of trade and budget Deficit, so they have had to change their policy in order to improve this situation. They were trying to make the U.S Dollar cheaper to promote U.S. Exports. The Secretary of U.S., James Baker held the G5 meeting at the Plaza Hotel in New York in 1985. They decided to intervene in the Foreign Exchange Market. One U.S dollar cost 240 yen in 1985, became 160 yen in 1986, 79 yen in 1995. Generally speaking, Japanese economy mainly has depended upon exports, so many people thought this was a very severe problem. At that time, this was called *Strong Yen Recession*. Many business people, especially exporting companies managers, requested a supplementary budget to overcome this recession. Though the U.S. dollar became weak, the trade deficit didn't decrease. So, in order to reduce the trade deficit, the U.S. Government pressured the Japanese government to take measures to expand domestic demand⁴². Japanese government couldn't say "No", because Japanese government wanted to stop the strong yen tendency. They had to ask the U.S. government to intervene in the Foreign Exchange together. Under domestic and international pressure, the Japanese government drew up the biggest ever supplementary budget. At the same time the BOJ lowered the official discount rate (2.5%), the lowest at that time. Though, according to official economic indicators, the recession had passed the bottom, and many Japanese exporting company had prepared countermeasures against a strong yen. This was how over floating capital or money appeared. These money headed for Stock Market and land.

42 U.S. government insisted that there were many unfair trade practices in Japan, which interfered free trade and U.S. export toward Japan as a trade barrier. They also pressured Japanese government to establish SII (structural impediments initiative), which is a bilateral conference to get rid of unfair trade practices in Japan in 1994.

The biggest problem of the bubble economy was skyrocketing of the land price, which became 300% more expensive than 8 years ago. The *Nikkei Average* (Japanese Dow Jones) of Tokyo stock market also jumped up. The stock of NTT⁴³ played a big part, and the Japanese Dow Jones average had become 38 thousand, which nearly tripled in 5 years. Many people believed this boom would continue for a long time and land price would go up forever.

But, after 1989, the Japanese government changed its policy toward the bubble economy. The BOJ raised the official discount rate three times. Solomon Brothers, which is a very big American securities company, dissolved very large arbitrage transaction. This caused a lot of selling, and a Stock Market crash, whose Japanese Dow Jones Average is 20 thousand (May '00), 14 thousand 2004.

During this process, various scandals of Financial Institutions appeared to the public. If bubble economy had continued, these scandals would never have appeared. I think these scandals show the characteristics of Japanese financial market and Financial Institutions well. Let's examine some examples as follows in order to understand Japanese problems in the financial market.

In 1991, incredible fraud cases happened. Bank officers forged certificates of deposit, and borrowed money from other Financial Institutions using those certificates of deposit as collateral. This kind of fraud happened in *Fuji Bank, Tokai Bank and IBJ*⁴⁴. In the case of

43 NTT is the biggest telephone and multimedia company in Japan, which was a former public corporation and became a private company. Japanese government was shareholder and sold its shares to finance. NTT shares became a boom and 1.19 million became 3.20 million in 6 months. Even no-experienced individual investors bought NTT shares, they believed Japanese assured NTT shares. But now it costs 1.1 million, many individual investors were, they felt, distrusted Stock Market and shares, and this makes more difficult for companies to finance through capital market.

44 Fuji Bank was a former top bank in Japan in '60. Tokai Bank is a top bank in Nagoya district, which is the third largest city in Japan. IBJ (Industrial Bank of Japan) is considered special bank to loan very good companies in Japan, and well known as IBJ in overseas Financial Market.

Fuji Bank, a very work eager branch section chief forged total 250 billion⁴⁵ certificates of deposit in his branch. He abused the bank operation system, and brought the certificates to Non Bank to borrow money. His aim was to increase his loan and deposit sales, but after a while he began to trade with a real estate swindler and got some kickback. In the Tokai Bank, the story was about same. In IBJ, a middle-aged woman played a main role. She managed a Japanese style luxurious restaurant. She invested a lot of money in the Stock Market without reasonable basis or theory. So she had difficulty in financing her investment. So branch chief of *Toyo Shinkin*⁴⁶ helped her and forged a total of 350 billion certificates of deposit of Toyo Shinkin. The IBJ accepted this certificate as collateral and guaranteed of her transaction, a kind of money laundering. Some people were arrested; the CEOs of these banks were fired and were summoned to the Diet. By these cases we can learn the lesson that during the bubble era, how powerless the internal checking system was, if there is a profit, everybody forgot the basic rule of Financial Institutions and society: to get collateral and behave legally.

The Next problem was the crime of all Japanese business society. From late '80 till 1991, almost all Securities companies compensated only the loss of corporate clients⁴⁷. At first this compensation was not illegal, but against the Japanese Securities Association's *Jishukisei* (Industries Moral Self-Imposed Rule). In 1991, the MOF issued authorities guidance, but after that many securities companies continued, so finally the Japanese Securities Regulation Act was revised to be illegal.

This compensation was to only corporate clients, not individual investors, which is unfair and nobody can understand. It harmed the

45 Cf. *Nihonkeizaisinbun* (Japan Economic Newspaper) 13. 9. 1991.

46 *Toyo Shinkin* (the credit association) was dissolved after this case. cf. *Japan Economic Newspaper* 14. 8. 1991

47 This was a scoop of *Japan Economic Newspaper*, after reported this news, many criticism attacked Securities Companies not only in Japan, but also all over the world

fair auto mechanism of establishing price. The fact that almost all securities companies compensated and many clients didn't feel guilty about this or didn't recognize the situation, shows this crime comes out of the Japanese societies traditional practice. It was a long year traditional business practice to maintain business relationship, many people took it for granted in the Japanese business world, which is never common sense outside Japan. What is most important about this case is that the impression of Japanese Financial Market is unfair is known to everywhere. Japanese Financial Market had lost many kinds of investors.

Furthermore, as I mentioned before⁴⁸, many Financial Institutions had continued to give bribes concerning the exercise of shareholders rights. These scandals show that Japanese long year traditional practice is far away from common sense in the World.

4, Bad Debts of the Banks and Bank Support Subsidy using Public Money (Tax)

Now Japanese Financial Institutions, especially banks, are suffering from very severe problem: Bad Debts⁴⁹. I will explain how this severe problem happened.

During the bubble era, almost all Banks and Non Banks loaned money to real estate broker companies. Usually, according to the loan textbook, when you hold a mortgage on land, you can borrow only 80% of land price at maximum. But Japanese Banks loaned over 100% or more, because many people believed that the land price would increase forever. And over-competition among banks for loans under MOF's authority helped this situation to worsen greatly. If a borrower has land, even if it's a small, distorted, steep, or plain land, Banks would loan at that time.

There was a terrible example, called *Jiage* (eviction using force). If they can buy vast square land facing a wide road, the land price

48 See, I, 3, in this paper.

49 It is said that among 500 trillion bank loan, officially 70 trillion is bad debts, but truly more than 100 trillion yen.

would be doubled or trebled easily. So some real estate brokers sometimes used *Yakuza* (Japanese Mafia) to do illegal evictions. Banks loaned real estate brokers much money. What is worth, banks, through Non Banks, loaned to the companies having connections with Japanese Mafia. So during bubble era, Financial Institutions, especially banks began to have relationship with Japanese Mafia, as Mafia becomes legal association on the surface. Financial Institutions tried to cut off this relationship, but this was not so easy. A Branch manager of Sumitomo Bank, which is one of the biggest banks in Japan, was shot. To collect loan from companies which have relationship with Japanese Mafia? In U.S. some critics say that this Japanese recession is called the "Yakuza Recession".

Though the bad debts of Japanese Financial Institutions were so large and risky, the MOF didn't try to solve out basically, tried to postpone them as long as possible. But when the Daiwa Bank case⁵⁰ happened, the MOF couldn't postpone any more. In 1995, *Jusen*⁵¹

(Non Bank of Individual Housing Loan) was a symbol of Japanese bad debts. So Japanese government and the MOF tried to deal with Non Bank of Individual Housing Loan first. Non Bank of Individual Housing Loan had nearly 15 trillion claim against debtors. But as much as 13.2 trillion, almost 90% of their loan was difficult to collect. The reason why they had become like that is not so difficult to understand. Their main customers were individual persons, as banks were trying to take its place, they had to find another customers.

50 Ex-employee was doing illegal transaction in New York branch of Daiwa Bank, which is a middle class city bank. To be worth, it is said that Daiwa bank didn't report to FRB within a month which was regulated by banking Act in U.S., because MOF officer told them not to report at that time. As Daiwa didn't report to FRB, they were deported from U.S. Further FRB pressured Japanese government to solve Bad Debts problem as soon as possible.

51 There were seven ex-Non Bank of Individual Housing Loan. Non Bank of Individual Housing Loan was established by all Financial Institutions including banks, insurance companies. Financial Institutions were shareholders of Non Bank of Individual Housing Loan. They borrowed money from banks and *Nokyo* (Agricultural Financial Associations).

Those were real estate broker. Though they didn't have special knowledge about real estate collateral loans, they soaked up this kind of loan. Sometimes shareholder banks introduced bad customers to collect bank's loan. This story was like Saving and Loan (S&L) in the U.S. Ultimately, they couldn't survive any longer. The problem was how to collect money to dissolve Non Banks of Individual Housing Loans. Among 13.2 trillion yen, 50% will be bought by ex-Jusenkarikiko (Housing Loan Collecting Association; but later unified to Japanese RTC) which was supposed to be established later. The other 6.2 trillion yen, banks as a shareholder gave up their claim as much as 5 trillion yen. But the Agricultural Financial Associations refused to abandon the rest. So 680 billion yen was lacking. The Japanese government had to compensate by using Budget (Tax). Many people got upset and said "Why do we have to pay the bad debts made by incompetent managers who made a lot of profit during the bubble era?" It was a very big confusion all over Japan. Agricultural groups have a very strong political power. This was the first time to use official money, when they would deal with bad debts of Financial Institutions.

5, Bankruptcy of Financial Institutions in Japan

Since 1994, several Financial Institutions have gone bankrupt⁵². Before that, we had a legend that Financial Institutions, especially Banks had never gone bankrupt. But that legend broke easily. I will classify a serious of Bankruptcy into three groups and explain.

In 1994, two Credit Cooperatives called *Tokyokyouwashinkumi* and *Anzenshinkumi* went bankrupt, because they had too much bad debts. They were dissolved and business property was transferred to Japanese RTC (Resolution Trust Corporation) which was established

52 In 1994, two Credit Cooperatives had gone bankrupt. In 1995 two Credit Cooperatives and one Regional Bank, in 1996 two Credit Cooperatives and two Regional Banks. In 1997, bigger scale of Financial institutions, one Life Insurance, two Securities companies, one Regional Bank and one City Bank went bankrupt.

from these two Credit Cooperatives by special Act. After that every Credit Cooperative which went bankrupt was dissolved and business property including bad debts was absorbed in to Japanese RTC. In order to deal with bankrupt Credit Cooperatives, governmental official money has been used through *Yokinhokenkikou* (Deposit Insurance).

In 1996, Regional Bank called *Hanwabank* went bankrupt. This time Hanwabank was ordered to stop business by MOF. So it would disappear after paying all its deposits off. After that, they claimed that this administration had no reason to the authority (Ministry of Finance), not to the court, but it wasn't admitted. I think this decision was reasonable, but it wasn't so clear why only Hanwabank was ordered to stop business. There is no standard to determine when such an order should be made. The most factor in ordering closure of banks is to stop as soon as possible, or the damage or loss may skyrocket. So we must make a clear standard, for example under 2% the ratio of owner's equity, they have to stop business.

In November 1997, a severe earthquake attacked the Japanese Credit System: This led to the Bankruptcy of Sanyo Securities Company, Hokkaido Industry Bank and Yamaichi Securities Company. When Sanyo Securities Company went bankrupt, default of obligation happened in the call market, where Financial Institutions borrow and loan very short-term money by phone. So the influence was very big, so that weak Financial Institutions according to the rumor can't borrow money from this market. So one day in November 1997, Hokkaido Industry Bank couldn't finance from the call market, it needed 200 or 300 billion yen to open a bank in a day. Finally, the board of directors decided not to open on 17th of November, if they opened the all branches, the money would go short easily. There would be a panic. They decided to give their main branches to *Hokuyobank*, which is small regional bank in Hokkaido-region. Hokkaido Industry bank was a City Bank, the 12th largest bank in Japan. Even now this affects the Japanese Economy substantially. Soon after the Hokkaido Industry Bank went bankrupt, Yamaichi Securities, which was one of the four biggest securities companies got into danger.

They were trying to hide illegal transactions, such as bribes concerning the exercise of shareholders rights, or illegal compensation of the loss in an offshore market. They didn't disclose the information. So investors distrusted Yamaichi Securities and sold a lot and lot of shares. So the price became as low as the standard price. At last, Yamaichi couldn't finance from the market. Yamaichi had to decide to close their business by themselves within a year. In these three categories, the reason why those Financial Institutions became bankrupt was clear: bad debts from the bubble economy. But they were gone to bankrupt by the power of the market.

Even after finishing Non Bank of Individual Housing Loan case, the risk of Japanese Financial System didn't go away. Many people said this is one of the causes of more severe recession. So the Japanese government had to get rid of the systemic risk to use more official money in 1998. The scheme was that government established a special account in Deposit Insurance to give money. The government prepared as much as 30 trillion yen from tax and borrowing from BOJ. The scheme was that banks apply for public help, not loan voluntarily, after checking their application, government would pay money. This time government has paid 1.2 trillion yen to make the ratio of owners equity stronger and to avoid a credit crunch. But I think this method doesn't work well. If you want to stabilize the financial system, to give public money equally and settle the loan and deposit rate works more, like in the U.S. in 1929. The most serious problem of this scheme is that this promotes moral hazards for bank directors. Even if they failed to manage banks, government would help them using public money. Every director thinks government will help banks next time without taking any responsibility. What is worth, according to the Asahi⁵³ newspaper, some politicians pressured even good banks to apply so those risky banks can apply easily. It is obviously against market rules. In this way, the crash of the bubble economy shows the weak and ugly

53 Asahi is one of the biggest newspapers in Japan. Asahi is considered rather liberal.

side of our corporate and financial system. I think today's recession comes, mainly from the risks of the Financial System and Credit crunch. At the end of this paper, I will try to show my opinion to solve these severe problems.

6, Directors' duty of care and loyalty when Financial Institutions become insolvent

Now I try to focus on the case known as '*Chukyo Bank case*'⁵⁴, in which there was a breach of directors' duty of care and loyalty, when they loaned to the questioned company, called GGS which dealt membership of golf course and real estate brokerage. GGS became insolvent on July of 1991, so the loan of Chukyo bank became bad loan or dishonored. The plaintiff pleaded that there was a breach of directors' duty of care and loyalty when they decided to loan GGS, they didn't check enough. The court ruled that the question whether there was a breach of directors duty or not should be decided on the fact that the decision made by directors was based on the duty of care as high as normal companies' directors. The problem is that not whether that loan become bad loan or not, but whether that decision was done based on the duty of care as high as normal companies' directors. The concrete reason why GGS became bankrupt was that bubble economy burst and nobody could expect that. So there was no responsibility for that bad loan. Finally, the Nagoya District Court dismissed the lawsuit. We must pay attention to the fact that the Nagoya District Court judged that there is no difference between Bank directors' duty of care and loyalty and other companies' directors'.

Let's move to the next case which is called '*Nomura Securities case*'⁵⁵, directors of Nomura Securities decided to compensate for the

54 It was ruled at Nagoya District Court, 20, January 1997 (p14. No.1012, '*Kinyushoujihanrei*'). Plaintiff was a shareholder of Chukyobank and defendant were directors of Chukyobank.

55 It was ruled at Tokyo District Court, 16, September 1993 (p16. No.928, '*Kinyushoujihanrei*'). Plaintiff was shareholder of Nomura Securities Co.

loss of the specific customer. That compensation to the specific customer was not prohibited by statute, but by public notification by MOF, and it harmed the reputation not only of the Nomura Securities but also of the all-Japanese market itself. The reason why they did was to continue the relationship between Nomura Securities and those specific customers, such as TV Company or Pension Funds. They expected to have commission from those customers. The court ruled as follows: the decision, which was made by Nomura Directors, to continue the relationship can give more profit to the Nomura than the compensation, was within *the business judgment* decision. So directors were not responsible for the compensation.

We can see similar case, '*Nikko Securities case*'⁵⁶ to deal with compensation for the loss of the specific customer. The court based on the condition that the breach of directors' duty of care and loyalty is under the category of commercial code Art. 266. Paragraph. 1 No. 5, 'violates any law or ordinance'. Then the court ruled, even when the defendant had already recognized, or had not recognized because of fault, that that compensation should be illegal, if the company could get more profit, that behavior could have caused no responsibility. If it were true in every situation, I think, companies can do everything as long as they earn profit.

In the U.S., after '80, there have been many bankruptcies of banks. After '90, many lawsuits against ex-directors of insolvent banks from trustees were brought. In the U.S., when banks or saving association become bankrupt, not federal bankruptcy law, but *Federal Deposit Insurance Act* : 12 U.S.C. § § 1811-1832) and *FIRREA* : Financial Institutions Reform, Recovery and Enforcement were applied to the cases. Art. 1811. paragraph. K of *FIRREA* provides that when the director of Financial Institution, which was available for Federal Deposit Insurance, have gross negligence, directors themselves would

and defendant were directors of Nomura Securities Co.

⁵⁶ It was ruled at Tokyo District Court, 13, March 1997 (p.116. No.1610, '*Hanreijihou*'). Plaintiff was shareholder of Nikko Securities Co. and defendant were also directors of Nikko Securities Co.

take responsibilities. But according to the case⁵⁷ in Colorado, where state law provides superior to Federal Law, the court declared not only that bank directors would take responsibilities when they have merely simple negligence, but also that normal companies' directors would not take responsibilities unless they have gross negligence about their business judgment. On the other hand, in the state of Texas or Missouri, for examples, in the case *RTC v. Gibson*,: 829 F. Supp. 1110., the court admitted the business judgment rule as long as directors of banks work for the companies in good faith and the best interest for the companies. But I some states there are some examples which don't belong to two categories, such as Delaware or Illinois. For examples, in the case of *RTC v. Platt*⁵⁸, decided about business judgement rule declaring that directors (of banks), who don't have unmoral motives and behave in good faith, don't have to take responsibilities of honest mistakes. In this way, in the U.S., there are some cases that admit to exit two standards of responsibilities of directors between bank and other countries.

As I explained before, there are bankruptcies of Financial Institutions, especially banks. There will be lawsuits filed by trustee of Financial Institutions in Japan in the near future.

Two standards of negligence for the directors should be admitted in Japan as same as in the U.S.

Let's consider about the illegal behavior such as false statement of financial statement. The problem is whether the directors should know the statute of securities of antitrust law.

The Japanese court said that securities directors don't have to know about antitrust⁵⁹, but directors of Financial Institutions should know basic statute such as Commercial Code, Civil Code or Antitrust Law, besides own business law such as Banking Act. The court should judge based on the standard of not normal businessman,

57 *RTC v. Heisermann*, 1993 U.S. Dist. Lexis 29122 (D.Colo., No.1, 1993)

58 *RTC v. Platt*, 1992 U.S. Dist. Lexis 21377 (S. D. Ill. 1992)

59 It was ruled at Tokyo District Court, 14, May 1998 (p.3. No.1043, 'Kinyushoujihanrei'). Plaintiff was shareholder of Nomura Securities Co. and defendant were also directors of Nomura Securities Co

but able financial businessman. Because they are directors of Banks which are needed public subsidies when they become bankrupt. Banks' directors should be judged as professionals as same as doctors or lawyers based the business tort.

III ASIAN CURRENCY CRISIS

1, Emergence of *Hot Money* – Who is the powerful man? –

As you know, the currency market can give great influence upon the national economy. For example, Asian currencies were shaken in 1998. In Thailand, Malaysia, Korea and Indonesia, local currency was becoming very cheap. Especially, Indonesian Rupee became more than 30% cheaper in a day and more than 70% cheaper in a week. Indonesian can't import goods, food, medicine etc. as much as before. In Indonesia, people even caused riot.

We can find this influence on the campus too. Students from Asian countries are suffering from decreasing of income from overseas. I heard that in Texas University in the U.S. begun to financial aid for Asian students in CNN news the other day.

Two weeks ago, Japanese Yen was raised ¥21 (from 135 to 114) in a week against US\$. And C\$. It means I got loss myself, because you will pay me by C\$. This shows that currency problems make a great influence upon our life. These are caused mainly by what we call Hot Money or speculated money.

In 1987, a young American called Andrew Kruger made another history. He was introduced in a Newsweek as 'the man who made too much'. He noticed that New Zealand dollar, called KIWI, moved strangely one day. At that time the economy of New Zealand was not so good, but the exchange rate was maintained almost stable. He came to understand that this was an artificial exchange rate controlled by New Zealand government. He tried to lower the Kiwi's rate. He sold and sold Kiwi by using derivatives. He prepared 100 million US\$, but he could move 100 times more money, by using what is called leveraged effect.

Suddenly, Kiwi fell rapidly. New Zealand central bank couldn't control the rate any more. Kiwi fell 40% in a week. He got \$20 million in a week. New Zealand was beaten by a man. That was an epoch that the power of a man became bigger than the country.

Hot Money is speculated money by using derivatives controlled by a few people or institutional investors, like George Soros. It is wandering all over the world on line 24 hours in order to find next target. It is like hyenas or piranhas. When they find the target, the other hyenas come together and they eat victims up till they die or becoming bone. It is said that Mexican crisis or Russian crises were also caused by Hot Money.

Here is another example. In Japan there was a very big securities company called Yamaichi, which once belonged to Big Four. They had off balance loss which was equal to 220 billion yen. They went bankruptcy in 1997 by selling of forward and futures of the stocks by using kind of speculated money. The stock price of Yamaichi was 400 yen one time, but speculators sold its socks using futures. Yamaichi and other friendly companies couldn't resist this pressure. The stock price became 38 yen in two weeks and finally 2 yen. They couldn't manage their company any more. Nearly 50 thousand ex employee and family were left behind.

The financial market is controlled by greed. When Japanese Yen became more expensive than 80 yen in 1995, although Japanese economy didn't go well. It was said that Japanese export industries were not able to manage any more. I saw TV interview then and some bank trader answered to reporter and said that 'it is going to be a very big trouble to Japanese economy.' But on the other side, he bought yen to make profit desperately. This is the capitalism and the market.

Now the goods worth of US\$ 4 trillion is traded in a Year, but money flows US\$ 1 trillion in a day over the border. The power of a group of individual or institutional investors becomes much bigger than the power of the countries. The point is that we can control President or Prime Minister by any means directly or indirectly, but we can't control these speculators by today's system. Speculators or Hot money can change people's life, but we can't control them.

2, Task of the Law · to make New World order or rules

It is said that Asian countries and Russia move to the fixed rate currency system from floating exchange rate system. I don't think it goes well. The problem is not that simple. The black market of the currency may be established, and that system would be collapsed just same as what happened in the U.S. in 1973.

IBRD or IMF cannot solve these problems, because the purpose of these organization is to loan to already destroyed countries by war or hot money.

At the same time, we mustn't forget that money hates regulations. We can understand this easily to see what happened to Tokyo Market and London Market. The amount of dealing of Tokyo market has become one third in 1998, compared with in 1989. Tokyo market is very notorious about its many regulations. On the other hand, in 1985 the London market was worse at that time, so Margaret Thatcher made reforms called Big Bang in 1986. She liberalized and opened the financial market thoroughgoing. As a result almost all-English financial institutions were beaten and disappeared, but London market became very busy again. Just like a Wimbledon Tennis tournament, where almost no English player cannot be found, but it's the best tennis tournament.

Also we can find that there are many offshore market or Eurodollar market everywhere, now we understand money hates regulations and existing system doesn't work so much to solve hot money issue.

One of my colleagues asked me the other day 'Is there any the book of interpretation of the law of statute or case about international Financial Law?' As you know, in this field there is almost no statute or case. Now I understand this is a kind of the limit of the law or legal study. The most important thing for us is to read cases or statute and interpret and adapt that theory to some concrete case and reach result. But if we don't have any of cases or statute, what can we do? Do we have to wait till new case appears or new statute is enacted? No I don't think so. We need

rules to regulate speculation in order to make progress appropriately, not inappropriately like president somewhere else, for the whole world. I believe this is the very task of the law.

Conclusion

1, Why is Japan suffering from such a long recession?

I have to tell one thing before going to conclusion. After April 1997, Japanese economy got much worse. This year's rate of economic growth of GNP is -3%. This is obviously a human disaster, caused by ex-prime minister Hashimoto. He stopped reduction of income tax, raised the rate of consumption tax and medical public insurance from 10% to 20% altogether, although our economy didn't recover enough. He made the patient go on a diet. Since last year, Japanese economy became depression, not recession. I can tell you the causes of the Japanese recession very briefly on the consideration of this paper as follows.

- 1, Influence of the bubble crash.
- 2, Credit crunch of banks. Bad debts of the Financial Institutions. Yakuza (Mafia) recession
- 3, Influence of hot money or foreign currency exchange market.
- 4, Systematic problem of the Japanese Economy. No monitor against CEO's dictatorship. No self-responsibility management system. The Ministry of Finance had controlled everything in the financial market.
- 5, Japanese politicians are always, "Too late, too little."

2, Is Japan a Socialist Country?

As we have seen, the Japanese system was a kind of one nation system in which every Japanese person work for individual internal groups. During confusion or recovering from War, this system works very well and is effective. In this kind of society, there is not so much difference between employee and employer. Inside groups like

companies or associations, people don't need clear rules or judgment. Without clear rules, people can decide things by mutual agreement in advance. This is why this system is hard to understand for outsiders. They feel Japanese society unfair and unclear, not open. But Japan has become one of the developed countries, we make our rules clear and open to outsiders. Every company must disclose its information according to the law. Companies can do anything without prohibition by the law. Every business man has to obey only written law and administrative guidance, not oral or unwritten guidance.

In the Financial Markets, the Big Bang is waiting in front of us. Big Bang means a radical change in a the Financial Market, such as the revision of the Foreign Exchange Act, the abolition of the License system of Securities business, the abolition of the Concentration in Securities Exchange. But the biggest change, I think, is the method of administration by the MOF. The Japanese government, especially the MOF, has to change its policy: from preserving and raising industry, to checking and investigating industries according to the written law. Japanese government has to establish powerful checking Institutions like SEC in order to keep the market fair. MOF must not intervene in each Financial Institution's management or control all financial business. The Big Bang deregulates the business area and makes competition harder. This means many Financial Institutions would go bankrupt in hard competition. We must make a rule to remove the lost Financial Institutions from the market as soon as possible to reduce the cost. We must change the policy from bureaucracy to Market Rule. The Market must be competitive and fair. In a deregulated market, to take our own responsibility is the most difficult things to do. Energy from privatization and is the origin of Financial Market next century facing population decreasing and highly aging society. In this way, Japan's 1940 model of society has become tired and needs to be changed.

After all, not only the Financial Market, but also all Japanese society, including individuals need the Big Bang: in order to take their own responsibility for the market.

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