International House of Japan

2023

26th Annual Japan - U.S. Symposium on Building the Financial System of the 21st Century

Banking Crisis of Spring 2023

Failure of SVB

- Causes
  - Concentration of risk
  - Deposit base: 97% uninsured
  - Poor risk management in face of rising interest rates
  - Severe asset-liability mismatch
- Regulatory/Supervisory Issues
  - Lack of prioritization and urgency (in identifying key risks and following up on them)
    - Interest rate risk should have been a high priority
  - Accounting of hold-to-maturity versus mark-to-market portfolio
  - Rapid rise in assets / change in business model should have triggered more scrutiny / special attention

Managing the SVB Failure

- Responses
  - Failure of the Lender of Last Resort Function
  - Systemic risk exception / unlimited deposit insurance
  - Bridge bank plus resale
- Dilemmas of deposit insurance
  - Was the systemic risk exception appropriate?
  - Moral hazard
  - Need for FSOC approval
- Lender of last resort function
  - Operational limitations
  - “Jurisdictional”: Fed’s choices for emergency lending
    - Discount window
    - Section13(3) emergency lending authority (Treasury approval / political considerations)
  - Need to coordinate with deposit insurance for rapid runs
  - Federal Home Loan Bank credit lines no substitute for LOLR

Japan's Regional Banks

- Could it happen in Japan?
  - Rapid SVB-like episode is unlikely
  - Slow bleed is more likely

- Risks to regional banks
  - Rising rates
  - Long duration of assets
  - Demographic contraction (reducing deposits) and weakening of regional economies (reducing lending opportunities)
  - New Risks:
    - Speed
    - Disintermediation (NISA, internet banking)
    - Borrower concentration (geographically, and therefore by industry)
  - Stabilizing features
    - Deposit base is diversified and insured
    - Strong supervision
    - Strong political support

- Rising rates: is the macroeconomy at risk from a currency crisis or downgrade of sovereign debt rating?

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The Role of Private and Public Markets in Japan and the U.S.

Public vs. Private Markets

- Public Markets
  - Price discovery
  - Liquidity, exit opportunities
  - Investor protection
  - Transparency and disclosure
  - Costs: compliance, agency problems, potential short-termism
- Private Markets
  - Funding for start-ups and growth companies
  - Value creation through restructuring of companies
  - Reduced regulatory scrutiny and greater flexibility
  - Higher returns
  - Long-term perspective
  - Incentive alignment between owners and managers
  - Risks: lack of liquidity, limited transparency, complex valuation
- Complementarities
  - Public plus private markets fulfill different roles and needs; different niches

Are Public Markets in Decline?

- United States
  - Still biggest public markets, but:
    - Decline in number of listed companies, rising concentration
    - Relative rise of private companies
  - Why?
    - Regulatory burden: disclosure, compliance obligations on the rise
    - Securities class action regime
    - ESG driving the shifts of certain types of assets into private markets
    - Alternatives to IPOs for funding – opportunities for private capital

- Japan
  - Cost of compliance is high
  - JPX is requiring firms to de-list if they do not meet JPX standards
  - Pressure from activists
  - METI push for consolidation in key sectors
  - Preference of family firms to stay private for control purposes

- But many firms want public listing to attract talent, good PR

Growth of Private Markets in Japan

- Starting from low base, but growing rapidly
  - Growing startup ecosystem in Japan
  - Companies with succession issues (family-owned SMEs that lack heirs)
  - Publicly-listed firms spinning off subsidiaries to focus on core businesses
    - For example, Hitachi and Olympus
- TSE demanding that publicly listed firms either absorb or spin off publicly listed subsidiaries
  - Governance concerns vis-à-vis minority shareholders
- Underperforming public firms are targets for activists
  - Can lead to forced sale to private equity firms

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Retail Access to Private Markets

- Is this is a good idea?
  - Yes: access to greater diversification and the higher returns (including those associated with earlier-stage high-growth companies); ability to match investment goals
  - No: unsophisticated investors may be unable to evaluate risk and pricing; higher return and higher risk
- Obstacles to retail access
  - Legal qualifications for private investors are strict in the U.S., stricter in Japan
  - Investor wariness, inexperience with startups
  - Japan: Regulators are mirroring risk-aversion of investors; value investor protection
- How could retail access be best offered?
  - Increase financial literacy
  - Public and corporate pension funds increasing allocation
  - Closed-end mutual funds (investing in private funds alongside institutional investors and on the same terms)
  - Secondary markets for private investments
    - Open-ended secondary funds
    - Platform-based trading
- How can retail investors determine appropriate price in absence of public information?
  - The price discovery process is far weaker in private markets

UPCOMING EVENTS

2024

Europe – U.S. Symposium

April 17-19

China – U.S. Symposium

June 5-7

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or to recommend your colleagues for participation, please contact:

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