Creating a Financial System Where Market Discipline Functions Properly

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The Program for Further Financial Reform and Pillar 3 of Basel II

When the Financial Services Agency announced its Program for Further Financial Reform in December 2004, one of the five headings under which it arranged its plans for reform was "the establishment of a reliable financial administration that complements market discipline." The Program also states that one of the "basic principles of the future financial administration" is "thorough implementation of playing a financial administration's role as judge that complements market discipline." In other words, it is "market discipline" that is to play the key role in ensuring the stability of the financial system and the soundness of financial institutions.

Preparations for implementing Basel II, one of the three pillars of which is "market discipline," are also nearing completion as part of the Program. In April 2005, the Agency established a unit within its Supervisory Coordination Division to coordinate implementation of Basel II, including acting as a source of information, responding to enquiries, discussing sophisticated methods of calculation with financial institutions planning to use them, preparing the implementation of Pillars 2 and 3 (see below), and liaising with regulators in other countries about matters such as the process of approving such methods of calculation.

The Program envisages: that Japan's capital adequacy rules will be amended in 2005; that regulatory guidelines and interpretations will be announced by March 2006; that the inspection manual will be revised to incorporate these changes; that integrated risk management systems will be inspected; and that current early warning systems (including those for monitoring the interest rate risk on banks' accounts) will be overhauled.

As part of the implementation of Basel II, Japan's leading banks will also be required to submit plans for upgrading their risk management systems by August 2005. Work on deciding what should be included in those plans began in March 2005 and is due to be completed by June 2005. A start has already been made on monitoring the

risk management systems of small local financial institutions (one of the subjects covered by the Agency's Action Program Concerning the Enhancement of Relationship Banking Functions as well as its general guidelines for these institutions). However, the Agency also wants to take the initiative with the country's leading banks rather than leave them to their own devices. Discussions are currently going on to decide whether the plans the leading banks will be required to submit should also include details of what they are doing to make use of syndication or securitization of loans and to ensure that they are able to make an early assessment of the possibility of business revitalization. Underlying this is the Agency's desire to encourage the development of new areas alongside traditional banking.

What is distinctive about Basel II is the fact that it consists of three pillars: Pillar 1 is the original requirement for a minimum ratio for regulatory capital but with a more sophisticated method of calculating risk sensitivity; Pillar 2 is the requirement that banks have a capital strategy and that this should be monitored by the regulators; and Pillar 3 is the requirement for greater disclosure as a means of improving market discipline (see above). The implementation of Basel II should ensure that the focus will no longer be exclusively on whether a bank's capital adequacy ratio is likely to fall below 8%.

The Reason Why the Need for Market Discipline Extends beyond Basel II

The reason for including market discipline in the Pillar 3 rules for financial soundness is to try to change the traditional tendency to think about commercial banking and the securities brokerage or underwriting business as being mutually exclusive by introducing the notion of using the securities markets as a way of making banks financially more sound. This approach is based on the view that, as banking becomes more sophisticated and complicated, and the resources available to the regulator for monitoring and inspecting banks are stretched to the limit, market discipline has a role to play in helping to ensure that the regulator's aims are achieved. This notion of three pillars (where the banks are basically left to decide how to manage risk; where the regulator plays an auxiliary role by checking this; and where the market carries out a further check by means of disclosure) was first incorporated in the Bank for International Settlements' capital adequacy rules in 1996 in the form of market risk rules.[1]

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[1] See Ryozo Himino, "Kensho BIS Kisei to Nihon" [Japan and the BIS Capital Adequacy Rules], Kin'yu Zaisei Jijo Kenkyukai [Kinzai Institute for Financial Affairs], 2003. In October 2003 the New York Federal Reserve Bank held a conference on the subject of Pillar 3 and market discipline. For further details, see "Beyond Pillar 3 in International Banking Regulation: Disclosure and Market Discipline of Financial Firms," *Economic Policy Review*, FRBNY September 2004.

As was mentioned in the introduction, the notion of market discipline forms an important part of the Program for Further Financial Reform. More generally, however, the notion of using the market mechanism to impose discipline can be traced to Adam Smith. In the broad sense, the free market economic system itself is subject to market discipline inasmuch as it encourages innovation and the efficient allocation of resources by means of the price mechanism and the principle of competition.

Although the term "market discipline" is normally used in a slightly narrower sense (namely, with reference to organizations or systems), it can be argued that considerable benefit would be derived from harnessing market discipline to a much wider range of purposes than just Basel II.[2]

Government bond markets, for example, impose fiscal discipline on governments by means of the impact they have on interest and foreign exchange rates. Stock and corporate bond markets impose discipline on companies by means of the impact they have on securities prices. Investors from industrialized nations impose discipline on the policies of developing nations by participating in sovereign debt markets and local stock markets.

This is not to deny that countries have parliaments that debate fiscal policies or that companies have shareholder meetings and boards of directors that monitor the actions of management. However, history tells us that this is not enough to guarantee sound fiscal policies or good company management. Before government bond markets, stock markets and corporate bond markets existed, goods markets and labor markets would ultimately impose a destructive market discipline in the form of a flight of goods or labor from countries or companies.

However, securities markets (a mechanism whereby a large number of participants use a vast amount of information to form expectations and update the prices of claims on organizations) can impose this discipline on organizations more quickly and induce changes in those organizations before problems become unmanageable.

The Limits of Market Discipline

Critics of market discipline have often argued that markets are imperfect, while advocates have responded that governments are also imperfect. The inclusion of market discipline as one of the pillars of Basel II has led to renewed interest in this

[2] For a view on market discipline applied to insurance, business and nation states as well as banks, see Claudio Borio et al. (ed.), *Market Discipline Across Countries and Industries, MIT Press*, 2004.

issue in recent years, with a growing number of commentators pointing out the limits of market discipline.

For example, some groups of academics have long argued that banks should be required to use subordinated debt markets as one means of imposing market discipline on them (i.e., the banks),[3] and some have argued that banks should even be required to issue subordinated debt. However, regulators are still cautious about adopting this across the board because of their concern that a market in subordinated bank debt might not be liquid enough for its pricing mechanism to send the right signals. It has also been argued that, in those cases where some of the leading banks have issued subordinated debt, it has been not the banks themselves but their holding companies that have been the issuers and that this is not necessarily an effective way of imposing discipline on the banks themselves.[4]

The Asian currency crisis left regulators in many countries with the impression that speculative money flows in and out of markets can increase economic volatility. This has made it difficult to argue strongly in favor of imposing market discipline on developing economies. Even in the United States (the country with the most developed securities markets), the corporate scandals that followed the bursting of the dotcom bubble and the collapse of Enron have raised doubts about the validity of the stock market's price signals and valuations.

As originally drafted, the section of Basel II dealing with market discipline contained detailed disclosure requirements. However, these were largely omitted from the final version—partly as a result of objections from the banks to disclosing information solely for the sake of Basel II.

Making the Most of Market Discipline

Nevertheless, public discipline (i.e., legislation) or government monitoring and intervention will not in themselves ensure that organizations (be they banks, governments or ordinary companies) are managed properly. There is therefore general agreement that some degree of market discipline is necessary.

Markets are not, of course, perfect. Nevertheless, instead of finding fault with their imperfections, we should try to make the most of the benefits that market discipline offers.

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3 Compare, for example, the views of the US Shadow Regulatory Committee.

4 See Simon Kwan, "The Promise and Limits of Market Discipline in Banking," *FRBSF Economic Letter*, 13 December 2002.

But, as Andrew Crockett, ex-General Manager of the Bank for International Settlements, has pointed out, for market discipline to be fully effective, four prerequisites have to be met.[5]

(1) Market participants need to have sufficient information to reach informed judgments. Conflicts of interest abound between users and suppliers of funds, and they are especially important in "bad states," when bad news needs to be communicated.

(2) They need to have the ability to process it correctly.

(3) They need to have the right incentives.

(4) They need to have the right mechanisms to exercise discipline.

Bearing these points in mind, let us now consider in more detail what needs to be done to make the most of market discipline.

1. Disclosure of financial and non-financial information

As Andrew Crockett points out, market discipline will not function properly if market participants do not have sufficient information. "Sufficient information" means the information investors want, which may be not just the information that companies are required to disclose or just financial information. Companies therefore need to adopt a positive approach to investor relations if they want investors to be able to value them properly.

However, the kind of information that companies use to reach informed judgments is also of value to investors, and companies should disclose it along with a wide range of other information. It is 10 years since the Jenkins Committee recommended this in its report, but little progress has been made in putting this into practice. In the words of J. Frank Brown, Global Leader, Assurance and Business Advisory Services at PricewaterhouseCoopers, "…despite great strides in the development of internal performance measurement systems, the kinds of information that business executives report to the market—and the means by which they do so—have changed hardly at all in the past 100 years."[6]

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5 See Andrew Crockett, "Market discipline and financial stability," BIS Speeches, 23 May 2001.

6 Robert Eccles et al., "The ValueReporting Revolution: Moving Beyond the Earnings Game," John Wiley & Sons, 2001.

It may indeed be the case that companies will only provide investors with the kind of information they want if they are either required to do so or obliged to by public pressure. It is therefore significant that, in its Program for Further Financial Reform, the Financial Services Agency has called on financial institutions to carry out customer satisfaction surveys and publish both their findings and how they have used them to improve their service. Of similar significance is the fact that, in its Action Program Concerning the Enhancement of Relationship Banking Functions, the Agency has called on small local financial institutions to set themselves and publish numerical and other objective targets.

Although the former policy is intended to encourage financial institutions to pay more attention to customer satisfaction, such information is also an example of the kind of non-financial information that investors have often wanted them to disclose. Similarly, the latter policy, unlike direct pressure from the regulator (e.g., to reduce non-performing loans by 50%), is intended to impose discipline from markets and local communities by disclosing information. Although only financial institutions are currently subject to these measures, it would be a good thing if other sectors were also subjected to such discipline by being pressurized (rather than required) to publish non-financial information and targets.

2. Internal controls and governance

No matter how much a company discloses, markets will only be confused and market discipline fail to function properly if the information itself is unreliable. This is the big lesson that has been learnt since the collapse of Enron and the scandals that followed it. The response in the United States was to pass the Sarbanes-Oxley Act, improve internal controls and give company directors greater independence.

In Japan false disclosures in the annual reports (on the Japanese equivalent of Form 10-K) filed by a number of major companies led, on 24 December 2004, to the publication by the Financial System Council of a report ("Further Measures for Ensuring Confidence in the Disclosure System") recommending that the disclosure system be made more reliable by setting out clearer criteria for management to assess, and for auditors to check, how effective a company's internal financial controls are.

A subcommittee of the Business Accounting Council is currently studying what to do about internal controls. Similarly, the Financial System Council is discussing corporate governance as part of its discussions on the Investment Services Law, and it was proposed at its meeting of 15 April 2005 that stock exchange rules should require companies to have non-executive directors on their boards.

3. The role of financial gatekeeper

Between the stage where companies prepare information for disclosure and the stage where investors use that information to make investment decisions there is a need for agents who will intervene to check whether that information is appropriate and to relay it accurately, clearly and free of distortion.

Following the Enron scandal it became clear that the auditors, securities analysts, rating agencies and other financial gatekeepers that were supposed to check the appropriateness of such information before relaying it to investors were, in some cases, distorting it for their own benefit.

In response, an independent watchdog, the Public Company Accounting Oversight Board (PCAOB), was set up to monitor the work of auditors, and measures have been adopted to prevent collusion between auditors and their corporate clients; research departments have been made independent from investment banking divisions, and securities analysts have been encouraged to set up their own research companies; and, in April 2005, the Securities and Exchange Commission published draft rules on the definition of Nationally Recognized Statistical Rating Organizations (NRSROs), which are still being debated by the Congress.

In Japan, the Certified Public Accountants Law was amended in May 2003 in order to increase confidence in the auditing system, and, in response, efforts were made to make audit firms more independent from their corporate clients and to prevent collusion between them. In addition, in April 2004, the Financial Services Agency established the Certified Public Accountants and Auditing Oversight Board (CPAAOB) to check whether certified public accountants and auditors were doing their jobs properly. Similarly, the report "Further Measures for Ensuring Confidence in the Disclosure System" (see above) called for companies to improve their disclosure of a number of items, including the "names of auditors involved in external financial auditing, audit firms to which such auditors belong, and their consecutive periods of audits of issuers."

In March 2004 the Board of the Japan Securities Dealers Association amended its "Resolution on the Handling of Research Reports." The effect of this was to include a rule similar to the US rule forbidding sell-side analysts from taking part in the sales activities of their firms' underwriting and investment banking divisions.

4. Regulation, supervision and enforcement

In markets where unfair and irregular trading activity is rife, there is a risk that price formation will be distorted and that liquidity may dry up as investors shun the market. It is too much to expect to be able to subject such markets to market discipline. For market discipline to be able to work in such markets, such trading activity needs to be rooted out so that investor confidence can be restored.

In order to maintain investor confidence, a regulatory framework is needed that includes disclosure rules, business conduct rules, self-regulatory rules, a safety net, market rules and rules governing irregular trading activity. At the same time, there needs to be a proper enforcement regime to ensure that these rules work.

In this regard, it is worth pointing out that the powers of the US Securities and Exchange Commission were extended significantly following the collapse of Enron and the number of its staff boosted by nearly 1,000 to 4,090 (as of fiscal 2004). Of these, 3,142 work in planning, regulation and surveillance related to investor services. The UK Financial Services Authority similarly has a staff of 2,115 (as of fiscal 2005).

In Japan, on the other hand, only 552 staff were involved in planning, regulation and surveillance related to investor services (as of March 2005), and this figure includes staff working for the securities regulation and surveillance divisions of the Ministry of Finance's local finance bureaus.

As well as increasing the number of regulatory staff, the system of administrative penalties (including administrative fines) needs to be improved, while more rapid action needs to be taken against market abuse of various kinds. Since the latest amendments to the Securities and Exchange Law came into effect on 1 April 2005, Japan now has a system of administrative fines. However, a number of issues remain, including the fact that the new system does not yet cover violations of the requirement for continuous disclosure (something the Diet is expected to legislate on during the current session by amending the Securities and Exchange Law) and the fact that the fines have little punitive effect, being largely limited in size to the economic gains involved.

In addition, serious consideration should be given to adopting a wide range of measures (such as class actions, a system of injunctions and correction orders, and regulatory support for civil actions) to give the regulatory authorities in Japan greater flexibility.

5. Distinguishing between professionals and amateurs

Not only does offering a wide range of products to cater for a wide range of needs help to make financial markets more efficient: it should also help to make market discipline more effective by imposing it via a wider range of channels.

One of the reasons why increasing hopes have been pinned on a market in subordinated bank debt is that it should send the banks signals that would be more in tune with depositor preferences than the discipline imposed by the stock market.

Furthermore, the messages sent by markets in which only highly trained professionals participate may be more effective as early warnings to both companies and regulatory authorities than those sent by markets in which the general investing public is a major participant. One of the reasons for the growing interest in book-building is that it is more likely to result in the valuation judgments of institutional investors being reflected in the prices of initial public offerings than auctions where anyone can participate.

It therefore makes sense—not only in terms of catering for investor needs but also in terms of making market discipline more effective—to have financial markets in which only professionals can participate. This will also help to avoid situations (such as a lack of liquidity) that result when a desire to ensure investor protection leads to overregulation.

In this regard, the development of the asset-backed securities market in the United States is instructive. Unlike traditional markets in corporate securities, this market's rules and conventions developed spontaneously among the originators, servicers, rating agencies and institutional investors that participate in it. The Securities and Exchange Commission has always been willing to support the market's development by responding to their initiatives in teleconferences, interviews and no-action letters.

On 15 December 2004 the Commission adopted a set of rules on asset-backed securities. However, these rules were drawn up after careful consultation with market participants on the basis of decisions made by the Commission in the course of the market's development. They are therefore market-driven. Because of the highly innovative nature of the market, the Commission has also been careful to ensure that the rules are principle-based as detailed rules could hamper innovation.

In Japan markets have often been established at the initiative of the government, and the starting point has often been detailed legislation. What tends to happen next is

that market professionals market products to the general public without sufficient regard to how complex or innovative they may be, with the result that problems occur and even more detailed legislation is introduced. This reliance on detailed legislation may also be the result of a tendency to follow the principle of legality rather than a principle-based approach where the principles are laid down and the rules are then worked out over the course of time from legal interpretations and court decisions. The fact that there have also been numerous cases (such as that of currency futures trading) where markets have been established without government involvement and the results have been more serious may also have played a part.

The debate on the Investment Services Law is proceeding in a favorable direction: namely, to re-examine the distinction between professionals and amateurs and reduce the regulatory burden on professional markets in order to encourage innovation. However, we need to remember the assumption underlying any granting of greater freedom to the professionals: namely, that careful monitoring by the authorities, shareholders and customers to ensure that the professionals do not overstep the mark needs to work properly on a daily basis.

6. The need to re-examine investor education and excessive safety nets

However, greater efforts must also be made to raise the level of amateur investor education by avoiding excessive regulation and government intervention and ensuring that markets function properly at less cost. Society as a whole needs to do more to ensure that, as Andrew Crockett pointed out, market participants have the ability to process information correctly. One of the objectives of the Program for Further Financial Reform is "expansion of financial and economic education making use of familiar examples, responding to the user's life cycle…," and it was with this in mind that a study group on financial and economic education was set up in March 2005.

However, no matter how much investor education or financial and economic education is provided, investors will not participate in markets with a normal risk-return trade-off if they are protected by too many safety nets. The end of the blanket guarantee on demand deposits on 31 March 2005 was therefore a prerequisite for such education to take place. Moreover, the existence of too many safety nets may have been the reason for the lack of incentives for most market participants to exercise market discipline. The end of the guarantee is therefore to be welcomed in that respect, too.

However, the problem of excessive safety nets did not end on 31 March 2005. Market participants need to be convinced that the authorities will act swiftly to require prompt corrective action (rather than postpone any decision at their discretion) and, if necessary, begin the process of winding up an insolvent bank without any delay. To

take an extreme case, even if a bank had issued subordinated debt, there is no way that the holders of that debt would monitor the bank's risk properly and impose discipline on the bank via the subordinated debt market if they thought that the bank could be bailed out using taxpayers' money without further ado.

Not a Case of Freedom for Freedom's Sake

Since Japan's Big Bang program of reform, the country's financial markets have undergone a process of rapid deregulation, as a result of which market participants, be they issuers, financial professionals or investors, now enjoy a degree of freedom that is probably unsurpassed even in the West.

However, in many respects, we need to ask ourselves whether appropriate countermeasures have been taken to deal with the growing number of potential problems to which this rapid deregulation has given rise.[7]

1. The negative aspects of Big Bang

A number of transactions and products that came about as a result of Big Bang have since given rise to problems that have undermined confidence in the market. The following are some examples:

- Trading in stock options (on the Tokyo and Osaka stock exchanges) began on 18 July 1997. The then senior executive vice-president of the Osaka Securities Exchange, Takuo Noguchi, was later alleged to have manipulated the market (by colluding with others and initiating sham transactions, in which offsetting buy and sell orders in individual stock options were issued simultaneously). (On 17 February 2005 Noguchi was found not guilty by the Osaka District Court.)
- Trading in exchangeable bonds began in December 1998 following the deregulation of OTC trading in derivatives. There was a series of cases in which dealers were found to have manipulated the market on the day the redemption terms were fixed.
- Following the publication of a report on Big Bang by the Securities and Exchange Council in 1997 in which mention was made of a number of problems concerning the need to diversify the range of trading available on stock markets, the Tokyo Stock Exchange set up ToSTNet in 1998 to enable after-hours trading. In spite of the fact that trading on ToSTNet-1 is, to all intents and purposes, negotiated, it is

[7] This is a point long argued by Professor Tatsuo Uemura of Waseda University. See, for example, "Shijo Kanshi Kino/Taisei no Kyoka" [Improving the Way the Market Works], Jurist, 1 December 2004. Professor Uemura argues that deregulation of financial markets in Japan has gone even further than in the United States.

treated as "stock exchange trading" and exempted from the rules governing tender offers. This recently enabled Internet service provider Livedoor to acquire a large stake in Nippon Broadcasting without having to make a tender offer—a transaction whose legality was later questioned. As a result, a bill amending this and other sections of the Securities and Exchange Law was presented to the Diet in March 2005.

- Currency futures trading also began following the deregulation of foreign exchange dealing as part of Big Bang. With no single department clearly responsible for regulating this trading, a growing number of people became victims of mis-selling and fraud. Eventually the problem became so serious that it was decided to legislate, and the relevant amendments to the Financial Futures Law will come into force on 1 July 2005.

- Following the change in the system governing the status of securities companies from a licensing system to a registration system, many new companies entered the securities business. Although this in itself was a welcome development, some of the new companies began to market a range of funds to retail investors via the Internet that had previously been marketed solely to professionals on the basis of self-discipline. This sparked a debate on whether further regulation was needed. In addition, many of the initial public offerings arranged by some of these securities companies have involved companies that have since been found to have acted improperly (e.g., by cooking their books).

2. More recent problems

Many more problems involving new financial products and deregulation have occurred since Big Bang.

- In June 2001, following a package of emergency economic measures in March of that year, trading began in exchange-traded funds. However, in March 2003 Nikko Salomon was discovered to have manipulated stock prices in July 2002 in order to boost its profits on the creation of an exchange-traded fund.

- Stock splits have been promoted as a means of encouraging greater stock market participation by individual investors. In September 2001 the Tokyo Stock Exchange published its "Action Program to Promote Reduction in Minimum Trading Units," in which it called on companies to actively carry out stock splits. In the case of some companies that carried out splits with a high ratio, however, a shortage of stock developed before the new shares were issued, and some companies took advantage of the boost this gave to prices (e.g., by using the inflated value of their shares to acquire other companies in a paper deal). In response, on 7 March 2005, the Tokyo Stock Exchange called on listed companies (1) to carry out any stock splits that were in a ratio of more than 5-for-1 in several stages, (2) to refrain from carrying out stock splits where the

minimum investment amount would be less than ¥10,000, and (3) to refrain from carrying out stock splits in the six months following a convertible bond issue. In addition, on 10 March 2005, the Exchange called on investors to take sufficient account of any major changes in supply and demand when trading shares in companies that had carried out a stock split with a high split ratio.

- At one time, businesses wanted the authorities to make the compulsory tender offer system more flexible (e.g., to make it easier for them to restructure subsidiaries). More recently, however, the growth of hostile takeover bids has led them to call for the system to be made less flexible.

3. Relying solely on follow-up checks is not a realistic option

Even if the arguments in favor of deregulation or new regulations can each be justified in their own right, it is questionable whether each set of regulations or the regulatory framework as a whole has functioned well enough to prevent all sorts of problems and allegations.

Much has been made of the fact that, as a result of Big Bang, financial regulation in Japan has changed from a regime where anything that was not expressly allowed was assumed to be forbidden to one where anything that is not expressly forbidden is assumed to be allowed, and from one which relied mainly on discretion exercised in advance to one that relies mainly on follow-up checks. However, there is no denying the need for a system that minimizes the various problems that can occur as deregulation increases, that will detect problems quickly and systematically if they still occur, that will impose an appropriate penalty on those responsible, and that will help the victims as much as possible.

However, when it comes to putting this into practice while pursuing the same degree of deregulation as in Western countries but with, for example, much lower staffing numbers, it is clear that at the current rate of increase Japan will never catch up with the United States.

Whatever the shortcomings of the current system of follow-up checks, however, it would be a mistake to try to turn the clock back to the old system of discretion exercised in advance. Nevertheless, any deregulation should not be mainly for the benefit of some particular party, such as issuers, but to make the country's markets more efficient and fair. In order to achieve this, sufficient attention should be paid to potential irregularities and problems and more than usual care taken to ensure that a regulatory framework exists to prevent these from occurring. This should be done by having an open and public debate (e.g., in one of the government's advisory councils).

Other important preventive measures include improving governance, internal controls and the rules governing the fiduciary responsibility of market participants. Furthermore, provisions for penalties, user feedback and help for victims are poor compared with those in the United States and the United Kingdom, and urgent action is needed to remedy this.

The Program for Further Financial Reform envisages that a "Counseling Office for Financial Services Users" will be established by July 2005. Provided this is put to good use, the Financial Services Agency should be able to detect many of the kinds of problems that can be expected to occur in the country's financial markets and take prompt action to deal with them before they become social, political and criminal problems. As the decisive role played by the courts in the recent battle for control of Nippon Broadcasting has shown, a properly functioning legal system is also essential if financial markets are to function properly.

4. Discipline imposed on the market and by the market

The notion of market discipline has been advocated as an antidote to the problems that can occur as a result of overreliance on public discipline (i.e., direct control by means of legislation and administrative control). It is clear, however, that markets would not function and develop properly without legislation and administrative discipline—as experience in both the United States (e.g., the collapse of Enron) and Japan (e.g., the battle for control of Nippon Broadcasting) demonstrates.

Unless the markets themselves can be disciplined, there is little prospect of being able to use them to impose discipline on the financial system. This is one of the lessons to be learnt from the history of financial deregulation in Japan and the United States.

Figure Public Discipline and Market Discipline