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Speech for Tsunehiro Nakayama, Deputy President
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At 25th Anniversary and 23rd General Meeting of the Asian Bankers Association

Thank you Mr. Edeza for the kind introduction. Please allow me first to say that it is a pleasure for me to be here and have this opportunity to speak on the occasion of the 25th anniversary of the ABA.

In light of the ever-increasing pace of economic and financial integration of Asia, I would like to focus today on the potential for further development of the financial markets in Asia and the possibilities for enhanced cooperation among the financial institutions within the region, with reference to some of the lessons that Japanese banks learned in dealing with their post-bubble financial difficulties.

Nine years ago, in 1997, Asia underwent a very traumatic experience: the Asian Currency Crisis. Since then, the economies of Asia have shown steady and stable recovery, and at the same time, they have become more integrated and interconnected.

In terms of their economies, inter-dependence among the countries of Asia is swiftly growing, due to increasing trade within the region – the result of shifts in comparative advantage and increasing division of labor. And it appears that this trend will only intensify. In order to support the growth and development of this economic integration within the region, it is my view that banks in Asia will need to work in closer cooperation.

On the one hand, we are seeing new developments in the bond markets in Asia, such as the Asian Bond Market Initiative led by the Asian Development Bank and the Asian Bond Fund established through the joint efforts of the central banks of Asia. These developments are important and necessary, given that one of the underlying causes of the Asian currency crisis was the fundamental structure of financing in Asia, namely an over-reliance on indirect financing and the under-development of a direct finance infrastructure.

The further development of the bond markets in Asia is also meaningful in that it will bring back to the region “expatriated capital.” There is an immense pool of savings in Asia, but because the markets in Asia have not been sufficiently developed to utilize a majority of those funds, they are being channeled into more attractive investment opportunities in Europe and America. The development and enhancement of the bond markets in Asia will help repatriate those funds.

As such, the further development of the Asian bond market will also contribute to the creation of a sound financial system in Asia. However, the development of direct financing cannot be done quickly enough to adequately keep pace with the financial needs of the growth in Asia, and it is my opinion that banks will need to play a key role in meeting the financing needs of the region, through enhancement of loans and other forms of indirect finance. I would like to expand on this point, with reference to the experience of Japanese banks.

As you all know, Japan’s bubble collapsed in the early 90s, starting a long and arduous process of non-performing loan disposal. The aggregate amount of loan disposals came to the equivalent of just under 1 trillion U.S. dollars, a full 20% of Japan’s GDP. Behind Japan’s non-performing loan problem was a financial system with two important characteristics: one, the main-bank system, where typically one borrower would heavily depend on its so-called “main bank”; and two, a significant reliance on real estate collateral.

Under the main-bank structure, Japanese banks had close relationships with their core customers, and bilateral transactions were the standard. This resulted in a significant amount of credit concentration with the main banks, and in the days of the bubble economy, these banks lent largely on the value of real estate collateral, rather than the objective business performance of the borrower.

However, when the bubble collapsed and real estate prices fell, the non-performing loans placed a tremendous burden on the main banks, which seriously deteriorated their balance sheets. As a result, a number of drastic measures had to be taken, including the injection of public funds into major Japanese banks. Inevitably, through this process, the credit market in Japan shrank dramatically.

The lessons that Japanese banks learned from their experience with the non-performing loan problem was that it is critically important to mitigate credit concentration risk and share the borrower risk among various financial institutions. And this can be done through the introduction of market mechanisms to indirect financing, which will increase transparency in pricing and diversify risk through the participation of multiple financial institutions. Syndicated loans are a prime example of these principles at work.

Syndicated loans will not only eliminate concentration risk at each bank; the risk-sharing characteristic will also enhance the risk-taking capability of the financial system as a whole and invigorate the corporate finance market. This is what is starting to happen in Japan now. Today, syndicated loans are utilized in the area of M&A financing, LBO and MBO, corporate revitalization, and project development, where mega-debt financing is required. Also, the borrowers are not only the large corporates; we are seeing activity among small-and-medium-sized enterprises and the public sector as well. Cross-border syndicated loans for foreign companies, so-called "Ninja loans," are also gaining popularity, with a widening range of structures available. The total amount of syndicated loans arranged in Japan in 2005 was approximately 200 billion U.S. dollars, about 3 times the amount of corporate bonds issued. The amount has doubled in the last five years, and the market is showing remarkable expansion.

Also, the asset securitization market in Japan has been rapidly expanding in recent years, with the amount of asset-backed securities issued showing an annual growth rate just under 30%. With asset securitization, the investors are taking on asset-risk, not corporate-risk. This helps to improve the company's balance sheet, while allowing the financial institution to efficiently and effectively manage their portfolio, as well as create additional opportunities to enhance fee business.

In Asia, where indirect financing has been the primary form of finance, I believe that it is important, as well as practical, to develop the infrastructure to support an indirect finance system which incorporates market mechanisms, given that direct financing cannot immediately take over as the primary form of financing. I feel we must make a strong and concerted effort to expand and enhance the market, by combining and fully utilizing the experience of the financial institutions of the various countries in Asia.

For example, the technology for syndicated loan origination has already been introduced in the countries of Asia, but the borrowers are still primarily large corporates that have high credit ratings. It seems that the mid-sized corporates and small-and-medium-sized enterprises are not enjoying the benefits of this diversified method of financing. I strongly believe that banks should take advantage of the risk-sharing characteristic of syndicated loans to provide financing to such corporates. Moreover, promotion of asset securitization will be effective. In many cases, these corporates have good assets, such as receivables, suitable for securitization. Also, banks themselves can extend loans to such corporates on the premise that they will ultimately securitize the loan assets and effectively distribute the risk exposure to investors inside the region. In order to expand these technologies, it will be necessary to enhance the accurate disclosure of borrowers' financial information and to foster the development of investors who understand Asia and are willing to take on local credit risks.

Earlier, I mentioned "Ninja" loans. Ninja loans are syndicated loans for non-Japanese corporate borrowers, where the syndicate participants are domestic Japanese investors, such as regional Japanese banks. Ninja loans enable borrowers to diversify their funding sources and eliminate exchange rate risk, while at the same time allowing lenders to avoid credit concentration risk. I believe that similar types of syndicated loans could be arranged across the borders of Asian countries, where the investors and borrowers would be entities from different countries.

If, in this way, the leading financial institutions of the countries in Asia can work together to develop market-oriented indirect financing, we can create new methods of fund-raising that cross borders and generate more investment opportunities. This will also enable financial institutions to diversify their portfolio and, I believe, will lead to the creation of a more efficient and integrated financial system in Asia.

In order to do this, however, it will be necessary to carefully analyze and identify the financing requirements of borrowers, cultivate a new breed of investors, and further develop market infrastructure. It is essential that we, the financial institutions of the countries of Asia, share our experience and know-how, and work together in close cooperation toward these goals.

It is often said that finance is the lifeblood of economic growth. For the future development of the Asian economy, it is essential that we further enhance the financial markets, so that this lifeblood can flow freely and reach everyone.

I am confident that the continuing cooperation among the members of the Asian Bankers Association will lead to the integration of finance within the region, contributing to the further development of the Asian economy.

Thank you.