

Asia Business Conference 2014
Keynote Address by Masamichi Kono
(Financial Services Agency, Japan)
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1. Introduction

- It is my great honor and pleasure to be given this opportunity to speak before such a distinguished audience on the occasion of this Asia Business Conference 2014.
- This year's title, "The Future of Asian Financial Markets", is an extremely interesting and timely one, as the importance of Asian Financial Markets has been rising rapidly in recent years, and we look forward to further growth of those markets in the foreseeable future.
- In my speech to you today, I would first like to trace this development of rapid growth of Asian financial markets in the context of providing the necessary financing for Asian economic growth and development, in particular infrastructure development. I would also like to touch upon the G20 initiatives for international financial regulatory reform, and their possible impact on Asian financial markets. Then I would like to refer to the priority areas for further work in this area, and the challenges for regulators.

2. The Growth of Asian Financial Markets

- Even as the recent global financial crisis deepened, and subsequently developed into a sovereign debt crisis in Europe, Asian financial markets have demonstrated steady growth in proportion to global financial markets. Learning from the experiences of the Asian financial crisis in the late 1990's, Asia has weathered this most recent crisis well, and Asian financial institutions and markets have maintained their soundness and resilience in recent years, in spite of the rapid growth of credit and exposures.
- For example, the global share of Asian banks' assets has risen

from 27.8% in 2002 to 31.5%, and that of stock market capitalization increased from 17.8% in 2002 to 29.2%.

- The withdrawal of European banks from Asia has been particularly conspicuous, due to the need for deleveraging caused by the global financial crisis, and it is well-known that Asian banks have substituted for them, eventually preventing a credit crunch from occurring for a prolonged period. Portfolio investment into Asia coming from the EU reduced its share in the total of such investment into Asia from 42.8% to 33.9%, whereas that from within Asia to Asia increased its share from 9.2% to 12.3% after the global crisis. Such trends are also visible in the BIS statistics on international credit flows.
- Despite such developments, however, it is still true that a bulk of investment into Asia comes from outside the region. Asian savings are recycled through the markets of the EU and the US, and a large part of long-term financing for infrastructure development in Asia would still need to be financed through those markets outside the region.
- Such a system of “recycling” of funds can be vulnerable to financial crises and disruptions occurring in those financial systems and markets abroad. Recently, concerns over the tapering of the extraordinary monetary policies of the US Federal Reserve, in particular, caused large fluctuations in the capital inflows to Asia. Wide fluctuations in exchange rates were observed, in particular with regard to currencies of countries in Asia with large current account deficits and smaller foreign exchange reserves.
- Lately we have experienced more calm in the markets, but we cannot be complacent about the future. Deeper and more resilient financial markets for Asia would be a necessity, and would provide the means to sustain growth and development of the real economy in Asia.
- In order to encourage such developments, we need to foster confidence in the Asian financial markets, including through applying proper regulation and supervision over those markets.

The role of the regulator in developing sound and efficient financial markets might not always be obvious, but is certainly an integral part of such efforts in jurisdictions.

- In promoting financial market development in Asia, we need to be very clear about our priorities: to ensure there is sufficient funding for long-term investment in infrastructure needed for sustainable economic growth and development in the region.

3. Promoting financial market development in Asia

- Let me now introduce what we have been doing at the JFSA to assist financial market development in Asia. Recently, in the context of Japan's Growth Strategy, we have decided to substantially upgrade our efforts and apply a more strategic approach to our efforts.

(1) Strategy for technical assistance

- Asia is an extremely diverse region, and the needs of individual jurisdictions in developing financial markets differ quite substantially. In order to be effective, the technical assistance menu for each market will have to be tailored to the needs of the jurisdiction.
- We have categorized the technical assistance we could provide into three broad categories; (i) help build the regulatory framework of laws and regulations needed for proper regulation and supervision of financial markets; (ii) assist the development of financial infrastructure including payment and settlement systems, stock exchanges and other trading platforms, non-life insurance rating organizations etc.; and (iii) share knowhow and experience in onsite inspection and offsite supervision including the design of the organizational structure of the relevant authorities.

(2) Deregulation where appropriate, including removal of barriers to foreign entry

- When businesses operate abroad, they need to have access to

various financial services enabling them to fund their investments as well as to make the day-to-day payments and settlements. Such financial services are often provided by foreign banks and other foreign financial services providers that service the global markets or have established service arrangements in the home jurisdiction of the firm.

- In many jurisdictions, there are certain restrictions on the foreign banks and financial services providers in supplying such services. Examples can be found in limiting the establishment of branches/subsidiaries, limiting the number of licenses, restrictions on capital flows, limitations on foreign direct investment etc. There may be obligations to allocate a certain proportion of lending to specific sectors or limitations on the number of foreign nationals to be employed in local establishments.
- While the introduction of such restrictions may be necessary in the earlier stages of financial market development, they could become impediments to the development of sound and efficient financial markets in developing countries. Depending on the stages of development of the financial systems and markets in those countries, a progressive removal of such restrictions or deregulation may be called for, and advice on how to take a step-by-step approach could be provided as part of technical assistance to authorities in those market jurisdictions.

(3) AFPAC - A hub for Asian partnership

- The JFSA established the Asian Financial Partnership Center (AFPAC) last April, to establish a “knowledge hub” for supporting financial market development in Asia. Officials of Asian financial regulators are invited as visiting fellows to conduct research work on the region’s financial systems and markets, pay visits to relevant authorities and agencies as well as private sector institutions and markets, receive on-the-job training. The primary objective is to share and develop knowledge useful for financial market development in Asia. The visiting fellow will bring home his/her experiences and acquired knowledge in order to contribute to financial system/market development back home.

- These initiatives are firmly embedded in our Growth Strategy, as we are quite aware that Japan cannot grow without being part of the growing dynamic economies of Asia. Only sound and efficient financial systems and markets in Asia could provide the stable and sufficient funds necessary for growth and development in Asia, particularly in fulfilling its needs for long-term investment in infrastructure.

4. Challenges for International Financial Regulatory Reform

(1) International financial regulatory reform and Asia's role

- Today, I do not have the time to explain the current status of the multiple strands of financial regulatory reform measures agreed and implemented by the G20. But I would like to make an appeal that Asia deserves an even more important role in the entire process of rule-making and implementation of those reforms.
- As you are well aware, the G20 has been working on international financial regulatory reform as one of its core agenda items, taking leadership in building a more resilient financial system which would support sustainable growth and development.
- We should remember that, here in Seoul, the G20 leaders recognized in 2010 the importance of addressing the root causes of the global financial crisis, and committed to delivering regulatory measures to prevent the recurrence of such crises and ensuring the integrity and stability of the global financial system and markets.
- The four core pillars of international financial regulatory reform are: (i) building more resilient financial institutions, (ii) ending too-big-to-fail, (iii) transforming shadow banking, and (iv) making derivatives markets safer. We have made progress on all of those core pillars of work, but challenges remain.

(2) The challenges for regulators

- First, we need to continue to closely monitor the impact of such reform on Asian financial systems and markets, and take action to review the measures taken when and where necessary. The effects on trade finance of Basel III, for example, has been addressed, but require continuous monitoring. In developing appropriate regulatory responses to the risks of shadow banking, we need to be mindful that some types of shadow banking play important roles in promoting financial inclusion and supporting growth in Asia.
- In this regard, we must admit that we do not necessarily have a holistic view of the cumulative impact on the markets of the G20 regulatory reform measures taken together. The possibility of inviting unintended consequences of reform has been raised, but not sufficiently analyzed. If such unintended consequences become significant, we should be able to make adjustments, if and where necessary.
- As a matter of principle, therefore, developing new regulatory standards that have the potential of affecting financial markets materially and globally would require a careful thought process and a feedback mechanism. Ideally, in developing new standards, care should be taken in first assessing the expected macroeconomic and financial market impacts of such measures. Differences of regulatory frameworks and business models of financial institutions need to be fully taken account in developing such standards. Those arguments would apply in developing new standards regarding a framework for GLAC (gone-concern loss absorbing capacity), for example.
- Another challenge is to ensure close coordination and cooperation between regulators of different jurisdictions. In regulatory reform of OTC derivatives markets, there are problems of inconsistencies and duplications of jurisdictions' rules as they

apply to cross border transactions and activities of market participants. The content and timing of implementation have diverged across jurisdictions, and deference to other regulators has become a necessity to avoid unnecessary burdens on businesses and to prevent market fragmentation.

- Since the content and timing of implementation has diverged substantially across jurisdictions, we have yet to understand fully what market impacts are being caused by such divergence. As a result, we cannot deny the fact that huge uncertainty has been created over the divergent treatments by authorities of cross-border activities of firms and cross-border transactions in the implementation phase.
- In this regard, it is important to make quick and substantial progress in establishing comparability/equivalence between regulation and supervision across jurisdictions to enable maximum deference to each other. Such efforts are being made between the major Asian jurisdictions and European/US authorities for some time now. The authorities should establish comparability/equivalence on the basis of similar regulatory outcomes, not on a line-by-line comparison of rules. Asian regulators could work in a concerted manner in the course of such an exercise, and develop a common Asian view on many of the questions.
- In my capacity as co-chair of the Regional Consultative Group for Asia (RCGA) of the FSB, I would like to promote closer involvement of Asian jurisdictions in the FSB policy development process. In the RCGA Meeting held last April, we had fruitful discussions in exchanging views among FSB members and non-FSB members on such areas as OTC derivatives reform, the resolution of financial institutions, and contingency planning and operational challenges during and after severe natural disasters.
- Through various channels like this one, we are determined to make efforts to have Asia's voices heard in the global discussions

over regulatory reform, and promote the development and ensure the integrity and stability of Asian financial systems and markets.

5. Conclusion

- In closing, let me reiterate the importance of discussing and agreeing on a financial market development strategy for Asia among Asian regulators, and further strengthening our cooperation. Asia has a much larger role to play at the bilateral, regional, and global levels of international discussion on regulatory reform. Despite our differences, we have a lot to learn from each other.
- In this vein, I am sure today's Asia Business Conference will be a great success, and would like to wish you a fruitful and enjoyable discussion. Thank you so much for your attention.

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