

# To turn challenges into opportunities

Speech by Toshihide Endo

The commissioner of the Financial Services Agency of Japan

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Good evening, everyone. My name is Toshihide Endo. I am the commissioner of the Financial Services Agency of Japan, the JFSA. It is my great pleasure to speak in front of you today. Also, I would like to thank the International Banking Association of Japan for having me as a speaker for its 34<sup>th</sup> Annual General Meeting. I really appreciate this opportunity to present the JFSA's recent policy developments.

About two decades ago, the JFSA was established. At that time, our main focus was to tackle the non-performing loans problem, in other words, to secure financial stability on the verge of a financial crisis. With tremendous efforts over a long period of time, we were able to finally solve this problem. But now we face new risks and opportunities such as long-lasting low economic growth, aging, digitalization, globalization and issues like sustainable development. To deal with those, we must establish new forms of financial supervision to seek the best balance of financial stability and excellent financial intermediation while avoiding various risks. With such new supervision, by enhancing growth of the Japanese economy and by steadily expanding Japan's household assets, we will aim to maximize welfare of the Japanese people.

To achieve this goal, we are establishing a new strategy and organization of the JFSA. Let me explain about it.

This September, we released the JFSA's new annual strategic direction which is titled "For Providing Better Financial Services in the Era of Transition." In this strategy, we encourage financial institutions to provide best financial services to meet the needs of the Japanese people in facing various types of transition.

The "table of contents" of this slide shows the main priorities in the strategy.

## I Promoting long-term investment

First, I would like to talk about how we should tackle low economic growth and aging of the society by promoting long-term investment. Though Japan's households have about 1855 trillion yen, more than half is held as cash and bank deposits, and the ratio of investment such as corporate share and investment funds are still not high compared to the US and to the UK. Lower investments means that Japan's economy may not be provided with enough risk assets for its growth. Also, it means Japanese households are in a more difficult situation to benefit from the appreciation of stock prices. Stocks are theoretically supposed to increase more than deposits or fixed assets in the medium-to-long term though there are larger price fluctuations. For example, from 1997 to 2017, the household assets of the US have almost tripled (2.93 times). On the other hand, those of Japan have grown only by 44% (1.44 times). So, this makes it more difficult for Japanese households to prepare for rapid aging of the society. We must encourage the shift from bank deposits to investments.

To make this shift happen, we will take three policies. First, we will encourage "customer-oriented" business conduct in financial businesses. Though we have been encouraging long term investment by households, the average holding period of investment trusts has still shortened. Some of the distributors of investment trusts seem to be encouraging their customers to churn between funds in the short-term to gain profits from transaction fees. Such short-termism cannot be long-lasting since it does not create true value for customers. So, we encourage investment trust distributors to review their businesses to build long-term sustainable relationships with their customers utilizing the common Key Performance Indicators (KPIs) comparable across investment trust distributors. In the US, the asset management industry provides investment products at a lower cost for longer holding periods. But, since their market has been expanding, the industry has been profitable as have been the investors. We would like the members of the Japanese financial industry to build such a virtuous cycle to expand investment by providing long-term value for their customers as truly customer-oriented businesses.

Second, to enhance long-term and diversified investments, we introduced a new policy in January 2018, the Dollar-Cost Averaging NISA, which is epoch-making. It allows 20 year-long tax incentives to encourage long-term investment. It is applicable only for qualified investment products fit for long-term investment, too. Furthermore, to make sure people understand the importance of investment in their youth, we are trying to enhance financial literacy education.

Finally, we will address to another urgent issue, that is, to encourage the financial industry to review their services to make them appropriate for an aging society. As people live longer, planning and risk management for each life stage will become more important. We will enhance the visualization of such planning. We are considering the possibility of applying financial gerontology to improve financial services for people of advanced age.

## II Enhancing corporate governance

Let me turn to another topic, the Corporate Governance Reform. To enhance economic growth and to promote the shift from deposits to investments, strong corporate governance is indispensable since it secures steady increase of corporate value in the long-run. To enhance this reform, the Stewardship Code was introduced in 2014. It encourages engagement by institutional investors with the companies. Furthermore, the Corporate Governance Code for the listed companies was introduced in 2015. Although the introduction of those Codes is extremely important, we would like to make them more than just a formality. So, we have been trying to enhance the substance of corporate governance through continuous review and discussion. Based on this, two Codes were recently revised. Furthermore, the Council of Experts for the two Codes is reviewing cross-shareholdings, diversity in corporate boards and the publication of the results of proxy voting. Also, the JFSA is encouraging substantial dialogue between corporations and investors by publicizing best practices.

## III Strengthening capital market functions

To enhance economic growth and investment, we must enhance the function of the financial markets. Regarding this, I would like to say that the development of credit markets such as corporate bond markets, in which various players participate, is just as important as that of equities markets. It is essential to make the Japanese financial market more market-based and to diversify fund sources for corporations.

Furthermore, to provide the best financial services for the Japanese people, we must strengthen the competitiveness and convenience of the financial markets in Japan. To achieve this objective, the JFSA will aim for early establishment of the comprehensive exchange where various products such as commodities and derivatives are traded, cooperating with the related ministries.

#### IV Strategy for digitalization

Now, I would like to speak about how we are tackling the global wave of digitalization. This is severely affecting the players of the financial services industry internationally. Digitalization will enhance data processing. It will improve financial institutions' ability to meet their customer needs. In other words, it can make businesses more customer-oriented. Such technological change has great potential to improve the level of financial services. But it may also be accompanied with issues like personal data protection and cyber-security. Also, it may force incumbents of the financial industry to re-bundle or unbundle their businesses. It may facilitate new entrants for financial services industry.

Our policy-focus on digitalization is clear. Fully utilizing technological changes while avoiding associated risks, the JFSA will encourage players of the financial markets to provide best financial services for the Japanese people. To realize this goal, the JFSA has just formed the "Financial Digitalization Strategy" which is composed of four areas.

The first area is to make digital information more accessible. We will facilitate proper information usage in the financial industry, for example, with new inter-bank information system (Zengin EDI system). Also, to enhance information usage, customer protection issues should be properly addressed. In addition, we must enhance the digital literacy of customers. The second area is to build digital infrastructure both for the public sector itself and for the private sector. The third area is to encourage new innovative businesses. We will introduce regulatory sand boxes. We will encourage innovation based on enforcing Open API. The fourth area is to build a firm basis to cultivate such digital innovation. In this regard, international cooperation is important. Now the JFSA is enhancing cooperation in the Fintech and cybersecurity areas with other financial authorities. Also, the JFSA just held the "Fin-Sum week" (Fintech Summit) which is an international conference with many international participants, in which some of you may have participated.

To enhance innovation, we have decided to establish the FinTech Support Desk as a one-stop office for such Fintech businesses. Some of the innovative business models with new technology may not directly fit our existing regulatory framework and organizational structure in the JFSA. We are trying to solve this problem. As you can see in slide, in 345 cases treated by the Desk, one-third of rule clarifications are completed in only one day and another third is completed within just 1 week. We also clarified that the financial laws and rules are not applied for around 40% (41%) of them.

The FinTech Proof of Concept Hub is another policy to enhance digital innovation. We would like to encourage financial institutions and Fintech ventures to challenge themselves and take on innovative projects. Let me introduce one such project. Now, some financial institutions are working to make new common compliance procedures for a know-your-customer rule, applying blockchain technology. This may improve customer satisfaction and meet necessary regulatory requirements as well.

## V Approaches on crypto-assets

Also, let me briefly speak about our approaches on crypto-assets. Considering crypto-assets as a means of solution, the JFSA has introduced a registration system for crypto-asset exchanges in 2017 since it was necessary to respond to international AML requirements and there happened to be a collapse of one of the world's biggest crypto-assets exchanges in Japan. By doing so, we introduced a know-your-customer rule and certain customer protection measures for them.

But even after that, some crypto-asset exchanges had problems with their security systems and some of their customer assets were taken. Also, our inspection found problems of internal control in some exchanges. In addition, there are some opinions that customer protection for crypto-assets is still inadequate considering their price volatility. Furthermore, we may have to consider how we should deal with margin transactions and initial coin offerings.

So, this March, we established the Study Group on the Virtual Currency Exchange Services. And Extensive discussion is proceeding in the group now.

## VI The reform of the JFSA and its new supervisory approach

As the next topic, I would like to explain how the JFSA itself should be to best implement our new strategy.

First, we are trying to improve the organizational culture of the JFSA. We are encouraging our staff to be more proactive to foresee and to adapt to fast changes in the financial sector. We have some developments. For example, by forming small groups in the offices and divisions of the JFSA, we are enhancing communication to improve the motivation of staff, for example, by introducing "1on1 meetings." Also, we are encouraging our staff to propose new innovative policies voluntarily

regardless of their current responsibilities. This initiative is called as the “Open Policy Laboratory.”

Second, to realize our strategy, we must change the nature of our supervision, too. To best balance financial stability and excellent financial intermediation, we must see the whole picture of each financial institution, not just a part of it. We must foresee how it can keep improving its business model in the future. To do so, we must not stick to formalities like checklists but must see the substance of financial institutions through extensive dialogues with them. Now, we are trying to strengthen this new supervisory framework. Following “JFSA’s supervisory approaches -Replacing checklists with engagement-” issued this June, we have just published the Draft Prudential Policy and Compliance Risk Management report to show some principles of our new supervision.

As for the supervision of foreign financial institutions, a similar thing can be said. We will try to see their whole picture, that is, their global strategy, in a forward looking manner in order to properly supervise their subsidiaries and branches in Japan. To realize it, we have decided to integrate the supervision of foreign banks and foreign securities businesses by setting up a new Office because some foreign financial institutions have business models different from banks and securities businesses in Japan. For example, sometimes, in their home countries, banking and securities businesses are integrated. Also, we have combined onsite monitoring, offsite monitoring and international supervisory cooperation in the Office to make them better-coordinated. Furthermore, through our supervision, we will collect information of their best practices. We will utilize them to improve our supervision and Japan’s financial system.

## VII The JFSA’s strategy for the Sustainable Development Goals

Now, let me explain our initiatives on the Sustainable Development Goals, globally shared goals for achieving sustainability. In our view, the SDGs fit very well with the JFSA’s ultimate goal, "enhancement of national welfare through the sustainable growth of business and the economy and steady increase of household wealth." So we are encouraging financial institutions, stock exchanges and other financial service providers to take strategic actions on this front.

Let me briefly touch upon the JFSA's strategy for the SDGs published in June this year. It covers two channels of financial flows. First, capital markets. In this regard, we revised the Corporate Governance Code to encourage corporate disclosure of ESG-related information, while revising the Stewardship Code to encourage asset owners/managers to look into risks and opportunities of

investee companies in terms of ESG. Second, financial intermediaries. The JFSA has been promoting the concept of creating shared value or CSV, particularly for regional banks. The JFSA sees positive interaction between the CSV and the SDGs. The value chain of regional banks depends critically on regional communities. By doing something good for communities, regional banks could enhance their productivity and profitability. The sustainable development goals or the SDGs will be a very good guide for identifying such good things.

#### VIII Contributing to global policy discussion and building global network

Lastly, I would like to emphasize the importance of international cooperation to realize financial stability and sustainable growth since financial markets are further globalizing and inter-connected.

There are global issues related to the sustainability of the economic and financial systems associated with digitalization and the aging society. Towards the Japanese G20 Presidency in 2019, the JFSA is to take initiatives for tackling a wide range of global policy agendas including evaluating the effects of regulatory reforms, addressing market fragmentation, considering multilateral responses in the area of crypto-assets, and promoting financial inclusion in an aging society.

With respect to cooperation frameworks with foreign authorities, the JFSA will promote cooperation contributing to the economic growth and financial stability of both countries. Regarding technical assistance to Asia and other emerging countries such as the Global Financial Partnership Center (GLOPAC), the JFSA will contribute to the capacity building of emerging countries through assistance programs in accordance with the needs of counterpart countries, taking into account the requests of Japanese financial institutions for their possible entry and business expansion.

Those are the main challenges we face and the strategies to tackle them.

In closing my speech, I would like to say a few more words. Though we are facing tough challenges, I am still optimistic. Japan's financial sector has faced so many challenges. However, overcoming them has achieved transformations that have led to successes that otherwise may not have occurred. If there are challenges, that means there need to be solutions. They may be either provided by the public sector from the JFSA, other financial authorities and international bodies or by the private sector from the financial industry. We should all do our best to provide excellent solutions for such challenges in our respective capacities.

The JFSA is ready to do our best to turn those challenges into precious opportunities for future success.

Thank you for listening.