Recent JFSA’s initiatives in financial and capital markets

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Introduction

Thank you very much for your kind introduction. Good morning, distinguished guests, ladies and gentlemen. I am very much honored to have this opportunity to speak at Global Compliance and Japanese Financial Regulatory Summit.

Today, I would like to share with you recent several challenges which the Financial Services Agency of Japan (JFSA) faces in the area of financial and capital market, and our directions or efforts to address these challenges.

1. Reforms underway at the JFSA

First, let me start with the ongoing reforms on organizational culture and structure of the JFSA. We believe, prior to addressing any challenges, it would be important that the JFSA itself should make our missions clear and put in place the appropriate structure to achieve the goals.

Since 2015, the JFSA has annually published the “Strategic Directions and Priorities” to set out our policy goals. To continue enhancing the quality of regulation and supervision, we continuously evaluate the process and progress during the previous year and
publish a report on progress and assessment of our strategic directions and priorities. The findings and observations will be reflected in the next year’s strategic directions and priorities. This is how we keep the ball rolling, with the PDCA cycle in mind.

We believe that the ultimate mission of the JFSA is to contribute to the national welfare by securing sustainable growth of national economy and wealth. To this end, we are currently making reforms of the JFSA’s organizational culture, structure and governance, as well as making transformation to our new supervisory approaches.

In light of our organizational culture, we consider it crucial to establish a culture that each one of the JFSA staff will make proactive contribution to the maximization of national welfare, and thereby enjoying the sense of fulfillment. The various measures to this end are currently under implementation or consideration.

As for the organizational structure of the JFSA, to be more responsive to the new challenges and tasks, we plan to move to the new organizational structure, as from this summer, to enhance our strategic and planning capability, strengthen expert skills needed across the sectors, and enhance functions for Fintech innovation and effective supervision/surveillance capability.

As regards the JFSA’s governance side, it is vital for us to be open to any suggestions and criticism from the outside. In this regard, we have put in place mechanisms, by which we can listen to the experts’ views as needed, as well as opinions from the outside on our policies and governance more broadly.

With respect to the JFSA’s supervisory approach, we are currently working toward developing new supervisory approaches, taking into account the proposals from the advisory group of March 2017. New approaches have the focus on substance rather than form,
forward-looking rather than backward-looking analysis, together with forming holistic views rather than looking at individual elements. We are also working to integrate on-sight inspections and off-site supervision into seamless on-sight/off-sight monitoring.

Based on these ideas, we issued for public consultation a draft report on the JFSA's supervisory approaches last December.

Furthermore, the JFSA and our Local Finance Bureaus are pursuing a more efficient, speedy, and transparent registration processes, to be responsive to the needs of market participants.

2. Realization of vibrant capital markets and stable financial asset building of the Japanese households

In order to revitalize the Japanese capital markets and realize stable asset building of the households, one fundamental issue that needs to be addressed as a nation as a whole would be how we can realize an optimal matching between the demand and supply of capital and fund.

Looking back at the financial and real economy cycle for the past 20 years, bank deposits have accumulated under deflation. As a result, demand for capital shrank, as companies avoided taking risks and reduced leverage. As such, banks had no other way to utilize their deposits but holding them as Bank of Japan deposits or purchasing government bonds. This has in fact resulted in insufficient flow of funds available in capital markets.

To address this challenge, the JFSA has been continuing to make efforts on several fronts. For example, we have been putting in place policy frameworks, by which households can diversify their financial assets and receive benefits of economic growth in a longer term. We have also encouraged institutional investors to take measures to enhance their investment management and governance.
Corporations are expected to increase corporate value over the mid-to long-term under the Corporate Governance Code, while institutional investors are expected to improve the values of investee corporations through constructive dialogue in accordance with the Stewardship Code.

Now, I would like to turn to our policy initiatives to revitalize capital markets and make stable financial asset building of households.

The growth rate in the financial assets of the Japanese household has stayed lower than that of the United States. Looking back over the past 20 years from 1995 to 2016, household financial assets in the US increased 3.3 times, while that of Japan increased only 1.5 times.

One reason behind this is a large discrepancy in the composition of household financial assets between Japan and the United States. However, about 30 years ago, the household portfolios in the US situation in United States was more or less in the same circumstances as our country. Subsequent shift to defined contribution pension plans, 401(k) and IRA raised the share of stocks and investment trust funds in the United States. As a result of this, the portion of stocks and investment trust funds has grown substantially in the United States.

In Japan, on the other hand, the size of funds invested through defined contributions remains small. Looking at sales practices of investment trust funds, one will notice that so-called “theme-based” funds, which primarily invest in a certain eye-catching investment field, have been widely sold. Generally, distributors had incentives to sell such funds that would not be suitable for long-term investment, as they can receive more commissions if investors trade these funds more frequently. For investors, however, it would be difficult to estimate the right timing to trade such “theme-based” funds.

To address this issue, the JFSA published principles of
customer-oriented business conduct in March 2017, which is targeting financial service providers. And, as of the end of December 2017, about 930 financial service providers adopted these principles and formulated relevant policies and action plans.

Through these principles, we are aiming to encourage financial service providers to consider what will be good for customers in terms of a longer-term asset building and at the same time to compete with each other and provide better financial products and services. We continue to make these efforts more visual by encouraging financial service providers to formulate and disclose their policies and key performance indicators (KPIs). We hope this would help promote customer-oriented business activities.

Furthermore, the JFSA has also taken other measures to promote long-term, regular and diversified investment among households. From January this year, the JFSA introduced a new tax-exemption scheme called “Dollar-Cost Averaging NISA”. In this scheme, tax exemption is only applicable to such funds that meet certain criteria, such as no-load funds and funds whose trust fees are low. We believe this scheme will also help promote long-term, regular and diversified investment, as is the case in the United States. Actually, the launch of “Dollar-Cost Averaging NISA” is already making a difference in the asset management industry. One year ago, only about 50 investment trust funds were qualified in the “Dollar-Cost Averaging NISA” scheme. At present, the number of eligible funds has nearly tripled to about 140. We hope that theme-based, short-term investment trust funds with high turnover ratio would gradually be replaced by quality products that would be suitable for long-term, regular and diversified investment.

Going forward, the JFSA would like to put more emphasis on workplace as an initial foothold for those who have not engaged in regular investment and we will promote this initiative to be widely
introduced by other public agencies and private enterprises as well. In this regard, we also think it important for financial education to be further enhanced. We also plan to utilize new information channels, such as internet blog and SNS, for example through exchanging views with individual bloggers and providing information to internet media.

3. Corporate Governance Reform

If we are to promote the Japanese households to shift their funds from bank deposit to investment and enjoy the resulting benefit, it will be important to ensure that corporations would enhance their corporate values. In this regard, corporate governance reform would be key, and we issued the Stewardship Code in 2014 and the Corporate Governance Code in 2015.

As a result, the percentage of listed companies with two or more outside directors has risen from 17% in 2012 to 88% in 2017 at the 1st section of the Tokyo Stock Exchange. As for asset managers and asset owners, progress has been seen in management of conflicts of interests and disclosure of voting records.

We can also see that corporations in Japan are steadily changing in tandem with the progress made in corporate governance reform. Corporate earnings in Japan have more than doubled from 230 billion dollars to 460 billion dollars over the five years under the Abe administration.

Nevertheless, it remains important to continue these reform initiatives by addressing remaining issues to keep this momentum. Going forward, the JFSA will formulate guidelines for dialogue between institutional investors and investee corporations and consider the revision of the Corporate Governance Code.
4. Fintech Innovation

Next, I would like to turn to Fintech innovation which is backed by rapid IT system development.

Amid technological innovation around the globe, it will be important to promote Fintech innovation and thereby raise convenience of users and corporate productivity, which would lead to sustainable economic and financial growth. The JFSA will take the initiatives in accelerating efforts to establish a business-friendly environment that will facilitate creation of innovative financial services through collaboration between financial institutions and Fintech companies.

More concretely, the JFSA will continue discussions to advance settlement capabilities with a view to achieving a seamless IT processing of finance and settlement of corporations. We will also make continued efforts to develop an environment which would help promote open API and strengthen assistance to the launch of new business services through JFSA Fintech support desk and Fintech Hub for Proof-of-Concept.

Furthermore, advances in IT technology in recent years have been bringing about significant changes in circumstances of financial system and services. This is actually fueling the trend in expansion of unbundling of financial services into individual functions, as well as rebundling of multiple services at a package. In order to keep up with these changes, the JFSA has formulated Study Group on Financial System under our Financial System Council. The Study Group currently discusses approaches to shift from a segment-based legal regime to a function-based and cross-sectorial framework, based on the concept that the same rules should be applied to the same functions and risks, while striking a balance between financial innovation and user protection.
As a somewhat related topic, let me now turn to issues of the virtual currencies broker-dealers and Initial Coin Offerings (ICOs).

As you may be aware, the JFSA introduced registration requirement for virtual currency broker dealers under the amended Payment Services Act as from April 2017, in response to the discussions at FATF and the MtGox incident. Currently, there are 16 virtual currency broker-dealers registered with the JFSA. In addition, there are also broker-dealers which are still under the registration vetting process.

At end-January this year, a Japanese virtual currency broker-dealer under registration vetting process suffered from illegal access and lost a huge amount of a virtual currency, affecting a large number of users. In this regard, the JFSA swiftly took a series of actions so far, including issuing a reporting order, business improvement order and conducting on-sight inspection. Beyond this particular incident, the JFSA will continue to take appropriate actions if needed to ensure adequate internal control systems to be put in place for all virtual currency broker-dealers, and we will see whether and how we could consider any lessons to draw.

With respect to Initial Coin Offerings (ICOs), in view of a recent surge in ICOs worldwide, the JFSA issued a warning in October last year, targeting both users and business operators. The warning elaborates on risks associated with ICOs and the applicability of existing regulations to the ICOs. Similarly, a number of securities regulators around the globe also issued external communications, including statement and warning on ICOs. The JFSA would like to continue to make efforts to grasp an overview of the actual situations of ICOs.
6. Cyber security

In addition to Fintech innovation and virtual currencies/ICOs, I would like to touch upon another important issue which would arise from the rapid development of the IT technology. Cyber-security is obviously one of the growing threats to be managed in the financial industry.

In accordance with our “Policy Approaches to Strengthen Cyber Security in the Financial Sector” prepared in 2015, the JFSA has been calling upon financial institutions to strengthen their capabilities to cope with cyber-attacks, including conducting cyber security exercises throughout the financial industry. So far, the JFSA has been working to understand and analyze the status and measures taken by a total of 215 financial service providers in various financial sectors, including initiatives by the management, risk management frameworks and business contingency plans.

One of the trends or features which we have found through a series of the exercise was that financial institutions whose management exhibits strong leadership in taking preventive measures against cyber-attacks tend to make a rapid progress in developing risk management framework and technological measures. In contrast, those financial institutions with less involvement or weak leadership of the management tend to have more challenges which they will need to address.

The JFSA will continue to make efforts to enhance cyber security measures in close collaboration with public and private sectors, and would also like to contribute to discussions in the international fora, such as G7 and IOSCO.
I would now like to turn to the JFSA contribution to global initiatives.

We have actively been participating in discussions on financial and capital markets at various international fora, such as G20, Financial Stability Board (FSB) and IOSCO.

Since the 2008 global financial crisis, a number of major regulatory reform initiatives have been taken forward in those international fora and have been finalized by now. The present focus of discussion is now shifting to implementation of the regulatory measures currently in place, as well as the assessment of the impact of these measures if they are taken as a whole.

In the course of discussions on international regulatory reforms, the JFSA has emphasized several points to be duly taken into account: (i) first, the importance of achieving sustainable economic growth, while maintaining financial stability; (ii) second, the need for a timely, complete and consistent implementation of needed regulations, rather than continuing to endlessly produce new regulations; and (iii) third, the need to assess cumulative impacts of regulations taken as a whole, with identifying possible unintended consequences. We see that our approach has now become more or less a shared understanding at international fora, including G20 and FSB.

Also, within the JFSA, it would be important that both departments in charge of international and domestic matters collaborate with each other and express the JFSA’s views as a whole at international fora. To that end, we will continue to contribute to international discussions by ensuring seamless coordination between domestic and international departments within the JFSA, and we will share with foreign authorities any useful insight gained from our experience in supervisory activities.
Next, let me briefly touch upon the JFSA’s work of IOSCO which I am in charge of. I am currently the JFSA representative member at the IOSCO Board and concurrently serving as Chair of the Asia-Pacific Regional Committee of IOSCO. The IOSCO has eight policy committees, to all of which the JFSA sends our delegates and actively participates in the discussions. We also send a secondment staff to the IOSCO Secretariat at Madrid. I think that the JFSA has a strong presence at IOSCO and plays a proactive role, providing constructive input and useful contribution to the decision-making at IOSCO. Recently, IOSCO has taken a keen interest in policy areas, such as liquidity risk management for investment funds and virtual currencies and initial coin offering (ICO).

Furthermore, the JFSA also actively engages in initiatives to host international conferences and attract offices of international organizations in Japan. For example, as a result of the government-wide campaign, we have succeeded in hosting the permanent secretariat of the International Forum of Independent Audit Regulators (IFIAR) in Tokyo. In April last year, the IFIAR held its plenary meeting in Tokyo and the permanent secretariat of IFIAR was officially inaugurated. Actually, IFIAR is the first international organization in the financial sector, whose permanent secretariat is placed in Japan. The JFSA is ready to continue to support the operation of the IFIAR secretariat and contribute to international discussions at IFIAR.

Last but not least, I would like to mention the Global Financial Partnership Center (or GLOPAC). GLOPAC is an organization established within the JFSA in 2016, with the aim of strengthening cooperative relationships with foreign authorities by offering fellowship programs. To date, about 100 officials from financial authorities of 25 countries have completed the programs at GLOPAC.
Given the strategic importance of IFIAR and GLOPAC, both are referred to in the growth strategy of the Japanese government as important, strategic policy initiatives for Japan.

**Conclusion**

To sum up, I would like to conclude that, though there is still much to be done, it is important for the JFSA to keep addressing the remaining issues steadily and one by one, bearing firmly in mind that our mission is to contribute to the national welfare by ensuring sustainable growth of national economy and wealth.

Thank you very much for your attention.