

***Financial Business Environment in Japan:  
Current Progress and Future Change***



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22 June 2009**

# Today's speech

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**I. Progress in Better Regulation and Better Market Initiative (BMI)**

**II. Broad directions of likely changes in financial regulation**

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## **I. Progress in Better Regulation and Better Market Initiative (BMI)**

## **II. Broad directions of likely changes in financial regulation**

## **Two categories of policies**

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### **Policy response to global financial market turmoil**

#### ➤ **Short-term crisis management**

- to stabilise financial markets
- to maintain functioning of financial intermediation

#### ➤ **Medium-term reforms of financial regulation**

- to “re-design” regulatory framework
- to prevent similar crises in future

## **Another category of policies in Japan**

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### **Proactive, medium-term policy initiatives characteristic of Japan's situation**

#### **➤ Better Regulation**

- Enhancing effectiveness, efficiency, consistency, and transparency

#### **➤ Better Market Initiative (BMI)**

- Concrete policy package to strengthen market competitiveness

# Four Pillars of Better Regulation

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## 1. Optimal combination of rules-based and principles-based supervision

- “The Principles in the Financial Services Industry”

## 2. Risk-focused, forward-looking approach

- Timely recognition of priority issues and effective response

## 3. Regulation aimed at incentivising private sector efforts

- Financial Inspection Rating System
- Early implementation of Basel II

## 4. Improved transparency and predictability of supervision

- Publication of guidelines and interpretation of rules

# Progress made in Better Regulation

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## 1. Better Regulation at financial inspections

- Focus on material issues
- Incentivise voluntary improvement
- Obtain a sense of acceptance and appreciation
- “Action Plan II for Better Regulation at Financial Inspections”

## 2. Risk-focused approach and international cooperation

- **Close monitoring of market developments**
  - Exogenous shock stemming from the collapse of the financial markets in other countries
- **Strengthened international cooperation**
  - Enhancing dialogue in terms of frequencies and substance
  - Establishment of supervisory colleges

# Better Market Initiative (BMI)— Four Pillars

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## **1. Reliable and attractive markets**

- Diversification of ETFs
- Exchange markets for professional investors
- Framework for alliance between stock and commodity exchanges

## **2. Enhanced business environment**

- Reform of firewall regulations
- Broadening the scope of business of banking and insurance groups (commodities, emissions trading, Islamic finance... )

## **3. Better Regulation**

## **4. Supportive market infrastructure**

- Human resource development
- Enhanced urban functions

# Progress made in Better Market Initiative (BMI)

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## **1. Reform of firewall regulations**

- Principle-based provision for proper management and control of conflicts of interest, and effective prevention of abuse of dominant positions

## **2. Exchange market for professional investors with streamlined disclosure requirements**

- TOKYO AIM starts operations

## **3. Alliance between stock exchanges and commodity exchanges**

- Bill including the provisions for such alliance passed by Diet

# Today's speech

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## **I. Progress in Better Regulation and Better Market Initiative (BMI)**

## **II. Broad directions of likely changes in financial regulation**

# Broad directions of likely changes in financial regulation (1)

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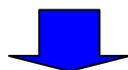
## 1. Enhancing risk management at financial firms

- Need upgrading and higher priority
- Strengthen risk capture
- Review amount and quality of capital
- Revise regulatory framework

## 2. Addressing misaligned incentives along securitisation chain

### **Moral hazard and conflicts of interest**

originators, arrangers, distributors, CRAs, investors...



### **Incentive structures/rules proposed**

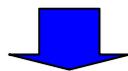
encouraging due diligence and transmission of information  
new regulation on CRAs

## **Broad directions of likely changes in financial regulation (2)**

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### **3. Enhancing integrity and transparency of the markets**

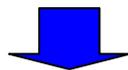
**Tremendous uncertainty and increased counterparty risk**  
inadequate appreciation of risks, lack of accurate information...



**Strengthening market integrity and transparency**  
transparency of securitised products, accounting standards...

### **4. Broadening the regulatory scope with a view to systemic risk**

**Significant systemic impact of non-bank financial firms**  
investment banks, insurance groups, investment funds...



**Broadening the scope of regulation**  
to all systemically important institutions, products, markets

## **Broad directions of likely changes in financial regulation (3)**

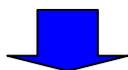
### **5. Strengthening international cooperation among regulators**

**Leading role played by G7, G20, FSF (FSB)...**

- Supervisory colleges to deal with global LCFIs
- FSF Principles for Cross-Border Cooperation on Crisis Management

### **6. Macroprudential perspectives for supervision**

- Macroeconomic/market developments bred crisis
- System-wide effect: counterparty risk, market illiquidity



**Need for macroprudential approaches**

- Identifying and analysing common risk factors
- Addressing macroeconomic impact of financial system/ financial regulation

## **Points to be kept in mind by regulators**

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- 1. Indispensable role of financial sector in supporting real economy**
- 2. Need to avoid impeding the vigour of financial sector by excessive regulation**
- 3. Right balance between short-term measures and medium-term reforms**

## **Implications for financial business in future**

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- **Reduced leverage in financial system**
- **Changes in financial firms' decision-making process**
- **Business models based on risk-adjusted profitability**
- **Enhanced market transparency**

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