

General

1 Necessity to consider a shift to function-based, cross-sectoral financial regulations

1.1 History of socioeconomic conditions and financial regulations in Japan

- The strict postwar entity-based, sector-specific regulatory framework began to be relaxed in 1992 to allow entities (i.e. banking, securities and insurance sectors) to engage in services of other sectors through their group companies
- A cross-sectoral, flexible regulatory framework was put in place for investment-type financial products (*Financial Instruments and Exchange Act*, enacted in 2006)

1.2 Changes in the circumstances surrounding the financial system

- Development of information technology (IT) has encouraged unbundling and rebundling of services

1.3 Landscape of financial services a decade from now

- Adoption of cutting-edge technologies would bring about efficiency in fields such as payment and settlement, further advancement of unbundling and rebuilding, and changes in the structure of financial networks
- A drastic change in the financial system, financial services, and financial institutions may result

1.4 Features of current financial regulations and points to consider

- Currently, most financial regulations have been based on the type of the entity. If the sectors of the entities in question are different, applicable rules will be different even if the functions and risks associated with their activities are similar
- In light of the advancement of unbundling and rebundling driven by the development of IT and endeavors to enhance user convenience, it is critical to incorporate **function-based, cross-sectoral** elements more to the regulatory framework and to **apply the same rules to activities with the same functions and risks**

- ✓ Promote innovation and enhance user convenience: Players choose their business models and services in a flexible manner, with applicable rules being determined in accordance with their functions and risks
- ✓ Ensure protection for users and a level-playing field: Players are not allowed to enjoy regulatory arbitrage

(Greater flexibility in financial regulations)

- Apply the same rules to activities with the same functions and risks
- Adjust rules in accordance with differences in the nature and risks of each service in each function

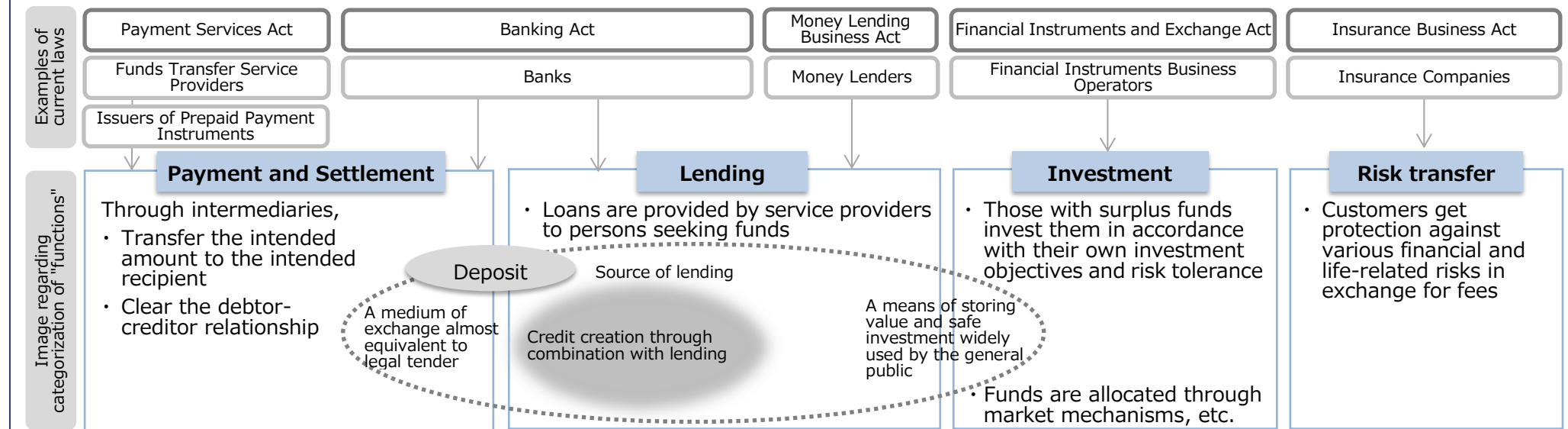
(Harmonization of rules in different functions)

- Harmonize rules as appropriate in different functions where regulatory objectives are common

- In exploring the function-based, cross-sectoral financial regulations, it is necessary to consider the fact that the boundaries between financial services and non-financial services are being blurred

Specific

2 Categorization of financial "functions"



3 Benefits that should be attained in each financial "function" and rules to attain such benefits

- Items of benefits that should be attained in each "function":
 - Reliable provision of each "function"
 - Provision of information to users
 - Protection of user assets
 - Protection of user information
 - Anti-money laundering and combating the financing of terrorism
 - Prevention of the realization of systemic risk

Note: For financial markets, fairness and transparency are important

- Even when the items of benefits to be attained in each "function" are the same, required levels of attainment for each benefit will be different; tailored measures for each "function" are required

4 Approach to entity-based regulations (i.e. regulations on scope of permissible business, safety nets, etc.) under the function-based, cross-sectoral financial regulations

- Amid blurring boundaries between financial services and non-financial services, banks and banking groups are subject to strict entity-based regulations (i.e. regulations on scope of permissible business, prudential regulations, safety nets, etc.)
 - There is room to reconsider the focus placed on regulations on scope of permissible business of banks and banking groups
 - Regulations on scope of permissible business should be reviewed so that groups with the top-tier company being bank holding companies (i.e. value of shares of subsidiaries accounts for more than 50% of total assets), banks, and other business companies can compete on an equal footing basis, with attention to the differences in the effectiveness of avoiding risk in other business to the basic lines of business of banks
 - Considering possible changes in the scope of business that conventional banking groups are expected to engage in, broad-ranging studies will be necessary to update prudential regulations which accommodate risks of new types of business
 - It will be necessary to consider whether objectives and coverage of safety nets may change, and effective methods will need to be considered accordingly

5 Approach to rules for the process of providing products and services

- Harmonization of rules for the process of providing products/services such as intermediary and agency services will be important so as not to hinder the cross-sector, cross-function provision of products / services which meets user needs
- Considering possible changes in the structure of financial networks, it will be important to consider appropriate rules for platform providers (those that match parties to contracts in financial transactions), rather than regulating platform users (parties to the contracts), for effective implementation

6 Issues for future considerations

- It will be necessary to devise a workable regulatory framework which encompasses ways to recognize and measure differences in the nature and risks of each service in each "function" and which adjust rules accordingly
- Note: Depending on the future discussions, concepts in this *Interim Note* may need to be modified
- Consistency should be considered with the mission of the financial regulator
 - Attention should be paid to creation of an environment in which players can properly utilize a wide range of information as well as proper protection of user information
 - In deepening discussions on aforementioned issues, following topics should also be considered:
 - Ways to deal with global activities, achieving international harmonization and avoiding global regulatory arbitrage
 - Right combination of laws and self-regulations
 - Consistency with discussions from a private law perspective (i.e. how crypto-assets are recognized there)
 - Adoption of cross-sectoral common fundamental concepts and rules in the financial field
 - Cross-sectoral authorization process in which requirements are adjusted in accordance with differences in the nature and risks of each function / service could be an issue to consider