

**International Conference on Strengthening the Asian Financial Sector
toward Sustainable and Inclusive Growth
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Keynote Speech

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**Toward Stronger Financial System:
Challenges facing Financial Environment in Japan and Asia**

Good morning ladies and gentlemen.

I would like to thank all of you for participating in this international conference.

The Financial Services Agency (FSA) is currently attaching importance to “Financial measures to overcome deflation,” which is one of the main policy agenda of the new Abe Administration stipulated in its growth strategy. The FSA is also giving priority to revitalizing financial and capital markets. In this context, I am pleased to find it very timely that this Conference is to discuss “Strengthening the Asian Financial Sector toward Sustainable and Inclusive Growth.” I would like to take this opportunity to explain our basic thoughts on the important policy issues, in light of the current financial environment in Japan and Asia.

1. Financial Institutions Growing Hand-in-Hand with Regional SMEs

First, I would like to explain measures to facilitate regional small and medium-sized enterprises (SMEs) financing. Asian countries are facing a challenge of responding to the financing needs of SMEs and individuals. In Japan, regional financial institutions have developed a business model called relationship banking: they have been maintaining hand-in-hand relationships with regional SMEs for a long period of time by committing to the long-term growth of SMEs and provide support even when those SMEs’ short-term profits fall; this relationship leads to the growth of those regional financial institutions themselves. In recent years, these financial institutions have been supporting the entry and expansion of the business of Japanese SMEs in Asia.

During the Lehman Crisis, Japan enacted the SME Financing Facilitation Act. This law was designed to facilitate the revision of terms of lending to SMEs in line with their business conditions and to ensure the smooth supply of funds to SMEs. While these initiatives have been taking root, the SME Financing Facilitation Act will expire at the end of March this year. Thereafter, we will encourage financial institutions to provide smooth financing for SMEs through inspection and supervision. However, ensuring smooth financing does not suffice. It is extremely important for financial institutions to become involved in the business improvement of client enterprises. With this in mind, the government will implement comprehensive measures that aim to achieve the business improvement of these client enterprises.

To support business improvement and turnaround, regional networks of experts have been established in all prefectures throughout Japan. These networks consist of financial institutions, SME management consultants, tax accountants and others. Additionally, the Enterprise Turnaround Initiative Corporation of Japan (ETIC) will now be re-organized as the “Regional Economy Revitalization Support Corporation of Japan” to reinforce its functions. The new organization will support the frontlines of business turnaround and regional economic revitalization throughout Japan by dispatching experts and making investments. It is hoped that these activities will help develop robust business organizations and sound enterprise clusters.

2. Regime for Orderly Resolution of Financial Institutions

Next, I would like to briefly comment on the development of the regime for the orderly resolution of financial institutions.

The financial crisis experienced by Japan was attributable to the non-performing loan problem of banks. To protect against this conventional type of financial crisis, Japan has already developed and put in place the most robust safety net in the world.

However, the financial crisis spreading across markets following the Lehman Shock took a different path. Market participants rapidly lost confidence in their counterparties, and the loss of confidence spread throughout the market in a chain reaction. Finally, this resulted in global market dysfunction.

As in the case of other countries, Japan will develop a regime for the orderly resolution of financial institutions to cope with this type of crisis. The regime will cover the entire

financial services sector, including insurance and securities companies in addition to banks. The regime has been designed to reduce and settle market transactions by the resolved institutions, while providing them with liquidity, financial assistance and capital reinforcement. Needless to say, the purpose is not to actually activate this mechanism but to have a preventive regime in place, which boosts market confidence.

3. Financial Measures to Overcome Deflation

This brings me to my third topic: financial measures to overcome deflation. Japan has been in a deflationary environment for many years. As a result, there is a strong preference in Japan for “safe assets,” such as government bonds and bank deposits, because these assets do not depreciate even when in a low-yield market environment. Banks hold large volumes of government bonds, while households hold large amounts of bank deposits. Consequently, sufficient funds are not supplied to growth areas. This has become a structural problem in Japan. It is also pointed out that ample savings in Asian countries are not fully utilized in fostering businesses in the region.

One of the top priorities of the Abe Administration is to revitalize the economy and to overcome deflation. In this environment, banks would be accepting a certain level of risk to increase their forward-looking lending. At the same time, household financial assets would be invested in growth industries in both Japan and abroad. The two goals of increasing supply of growth capital while ensuring stable returns could be achieved in this way.

The following types of initiatives will be implemented in the area of indirect financing. Such institutions as the “Regional Economy Revitalization Support Corporation of Japan,” which I mentioned earlier, will provide nationwide support for business turnaround, new businesses creation, business conversion and regional revitalization. Diverse financing methods will be used to facilitate fund procurement of businesses.

In the area of direct financing, financial assets will be more effectively utilized. Japan’s household sector holds approximately 1,500 trillion yen in financial assets. The majority of this is held as bank deposits. Targeting these funds and to redirect them, we will introduce a Japanese version of the Individual Savings Account, also called “ISA”. Through the Japanese ISA, capital gains and dividend income on small-amount equity and other investments of up to 1 million yen per year will be tax exempt. This system will encourage the use of the enormous pool of household financial assets as growth capital and equity-type funds supporting Japan’s economic growth.

Nearly 200 trillion yen of public and quasi-public funds are held in Japan's pension and mutual-aid systems. Traditionally, safety has been the first priority in managing these funds. However, as in the case of household financial assets, strenuous effort will be made to allocate these funds to growth areas both in Japan and abroad. Of course, such investment must be subject to appropriate risk management.

Japan will also promote private-public partnerships, also called "PPP". In this approach, public money will be used to facilitate the entry of private-sector funds and the utilization of know-how to promote social projects, such as the development of public infrastructures and projects in the field of social security, which generate user fees. Such approaches may also prove effective in social infrastructure development in Asia.

4. Modality of Financial Regulation to Attract More Long-term Funds

Next, from the perspective of ensuring economic growth in Asia, I would like to pose a question: How should financial regulations be designed in order to attract long-term funds? In many countries, ensuring a steady flow of foreign investment is the key to achieving sustained growth. This also applies to Asia. The Communiqué of the Meeting of G20 Finance Ministers and Central Bank Governors held in February this year contains a paragraph on "Long-term Financing for Investment." This paragraph also includes a reference to "country-specific factors affect access to long-term financing and there is therefore much that countries can do to attract long-term financing." This means that host countries are also requested to make further policy efforts. What are the obstacles to incoming foreign investment? Financial experts point to two possible factors: (1) first, excessive financial regulation, and (2) second, a lack of transparent and predictable enforcement of financial regulations.

Various types of financial regulations exist in Asian countries that act as obstacles to inward foreign investment. It is said that these regulations prevent foreign companies from making investment and undermine the prospect for sustained growth. For example, priority sector lending requirements obligate financial institutions to allocate a certain percentage of their total lending to designated sectors, such as agriculture and SMEs. In addition, there are caps for foreign bank branches and the loan-deposit ratio. These regulations often support such policy objectives as protecting domestic industries, maintaining domestic employment, and preventing rapid changes in the cross-border inflow and outflow of funds. However, these policy objectives must be balanced against other policies that

contribute to improving economic efficiency and raising growth potential. I think it would be a good idea for countries, including Japan, to conduct a comprehensive review of such financial regulations from this perspective.

Japan has adopted a policy of “Better Regulation.” Under this policy, we are working to enhance transparency and predictability of enforcement of financial regulations by publishing our guidelines on supervision and our inspection manuals. Above all, we emphasize the importance of good governance and self-discipline of financial institutions under this policy. The stability of the financial system is ultimately secured by the high level business ethics of the financial institutions and individual staff members as professionals. It is also secured by solid and unique corporate culture. Robust governance becomes possible only when this foundation for high-level self discipline is firmly in place.

5. Strengthening Financial Cooperation with Asian Countries

As my final topic, I will discuss the issue of strengthening financial cooperation between Japan and other Asian countries.

Countries in Asia are deepening their mutual economic relations. In this environment, Japan, both the public and private sector, will stand on the same footing as other Asian countries and contribute to their development.

For Japanese financial institutions, it will not be enough to merely increase their lending to Asia. They should discuss medium- to long-term growth strategies with their Asian customers and make a long-term commitment to building relations of trust that will allow mutual growth. I believe this is very important. We also hope that Japanese financial institutions will cooperate in building financial infrastructures in Asia, such as stock markets and local-currency denominated bond markets. Such markets are critically important in attracting sufficient domestic and international growth capital to Asia's growth sectors.

As part of the Japanese government, the FSA wishes to contribute to the development of financial systems and architecture in Asian countries. We will be happy to share our knowledge and experiences on Japan's financial system and financial infrastructures, as well as the FSA's specific methods for its supervision of financial institutions. We believe that we can contribute to building stable financial systems in Asia by sharing with you our frameworks and our experiences.

I would like to outline some of the technical knowledge and information we can provide: (1)first, Japan's legal structure and unique features of the banking, securities and insurance regulations, (2)second, ways to design various types of financial infrastructures, such as electronically-recorded monetary claims systems for supporting SMEs, and special institutions to calculate insurance premiums based upon transparent methodology, and, (3)third, the "Better Regulation" concept, which provides the principles and rules to the FSA in supervising, across sectors, the soundness and risk management of more than 11,000 financial institutions. We would like to share our knowledge and information, including the unique new steps taken, the lessons we learned, and a spectrum of our failures.

In any case, we will make our best efforts to respond to your requests for cooperation. Please feel free to let us know what you need at any time.

The FSA is now organizing the 15th Tokyo Seminar on Securities Market Regulations. I welcome participants in the Tokyo Seminar from 15 Asian countries who are here with us today. The FSA will also actively engage in staff exchange programs with other Asian countries one way or another. In particular, to strengthen Asia's financial infrastructure, we intend to further intensify our efforts for technical cooperation and staff exchange.

In closing, I would like to emphasize that we attach utmost importance to strengthening the cooperation with Asian countries in financial areas. Japan's authorities and the private sector are committed to working together with you to contribute to further development of the financial sector in Asia.

Thank you for your attention.