Financial System Stability and Competition

Japan Financial Services Agency
Tokio MORITA

January 27, 2014

The views expressed in this presentation are not necessarily the official views of the FSA Japan.
JFSA Mission Statement

1. Ensuring stability of the financial system

2. Protection of users and improvement of convenience

3. Establishing fair and transparent market
Pillar

I: Rules-based and principles-based supervisory approaches

II: Prompt and effective responses to high-priority issues (risk-focused, forward-looking approach)

III: Encouraging voluntary efforts by financial institutions, and placing greater emphasis on incentives for them

IV: Improving and predictability of regulatory actions
New Supervisory Approach and Tools

1. Countercyclical capital buffer under Basel III

2. Macroprudential supervision

3. Stress testing

4. Global cooperation (Supervisory college)

5. Ending too-big-to-fail
   - Crisis management group for each G-SIB
   - Operational resolution plan for each G-SIB
   - Gone concern loss absorbing capacity (bail-in)
   - Resolvability assessment
1. Corporate Governance
   (1) Engagement of the Board
   (2) Commitment of firm’s senior management
   (3) CRO and internal audit functions
   (4) Succession planning

2. Risk appetite and culture

3. Operational risk

4. Sustainable business model

5. Remuneration policy
Shadow Banking (Credit intermediation which occurs outside of banking system)

Firms
Financial Institutions

Banks

Depositors
Investors

Lending / Investment

Deposit

Flow of funds might shift towards more loosely regulated sector.

Hedge Funds, Etc.

Holdings of shares

Investment in Securities

Shadow Banking System
Shadow Banking (Credit intermediation which occurs outside of banking system)

- After the financial crisis, it has been recognized that entities which conduct credit intermediation like banks, and such activities themselves, are not subject to capital / liquidity regulation and prudential supervision, and hence regulation and supervision on shadow banking need to be strengthened.

- At the G20 Cannes Summit (November 2011), Financial Stability Board (FSB) was asked to build recommendations for regulation and oversight of shadow banking system in the course of 2012.

- Regulation and oversight of following areas are being examined by the FSB etc.
  (i) The indirect regulation of shadow banking through banking entities
  (ii) Money Market Fund (MMF)
  (iii) Securitization
  (iv) Securities lendings and repos
  (v) Other shadow banking entities
Share of assets of non-bank financial intermediaries

20 jurisdictions and euro area

At end-2011

- US: 35%
- Euro area: 33%
- Australia: 1%
- Brazil: 2%
- Canada: 2%
- China: 2%
- UK: 14%
- Switzerland: 2%
- Korea: 2%
- Japan: 6%
- Hong Kong: 1%

At end-2012

- US: 37%
- Euro area: 31%
- Australia: 1%
- Brazil: 2%
- Canada: 2%
- China: 3%
- UK: 12%
- Switzerland: 2%
- Korea: 2%
- Japan: 5%
- Hong Kong: 1%

Sources: National flow of funds data; other national sources.
1. To strike a balance between the competition and stability is a challenge. The nature of the regulations is changing, and the role of the supervision and self-discipline of the bank management is coming to the fore.

2. However, the effectiveness of the new approach has not been well tested yet. Another full-scale financial crisis may not be avoidable. Adequate deposit guarantee scheme and resolution fund are needed as a backstop.

3. Healthy competition between banks and non-banks may contribute to the financial stability on the whole. The difference of the size and nature of the shadow banking sector between Asia and US/Europe should not be overlooked, and we should pay attention to the differences in the discussion of the standard setting bodies.
Feature of Asia Banks’ Business Strategy / Model

1. Traditional commercial banking model

2. Strong capital position

3. Not high level of leverage

4. High quality assets
   - High loans to assets ratio
   - Healthy net interest margin
   - Low NPL ratio

5. Enhancement of fee business

6. Simple business segment

7. Selective Focus on geography - Asia market