CFTC Global Markets Advisory Committee Meeting (2019.4.15)

"Overview of Financial System Issues for the 2019 G20 Japan Presidency "

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Thank you very much for inviting me to the Global Markets Advisory Committee of the CFTC. It is my great pleasure and honor to be here to talk about our priorities on financial sector issues for the G20 Japan Presidency of this year.

regulatory reform

- Let me start my presentation by looking at where we are in the history of the G20. G20 leaders met here in Washington in November 2008 to enhance cooperation and work together to restore global growth and to begin much-needed reforms of the world's financial systems.

- At the third G20 summit in Pittsburgh in 2009, leaders provided a blueprint for the post-crisis reform program. It had four pillars:
  - ✓ First, stronger prudential regulations to make banks more resilient by holding more capital and liquidity.
  - ✓ Second, an effective resolution framework to allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure to loss.
  - ✓ Third, making the derivatives market safer by introducing central clearing for standardized contracts, as well as higher capital standards and minimum margining requirements for non-centrally cleared contracts.
  - ✓ Fourth, strengthening the oversight and regulation of shadow banking, a cause of the financial crisis. The goal of these reforms was to address financial stability risks and transform shadow financing into resilient market-based finance.

- More than 10 years have passed since the crisis, and core reforms were largely in place by the end of 2017. Now, regulatory focus is shifting from new policy developments to evaluating past reforms, and assessing new and emerging vulnerabilities.

Japan priorities

- So at this critical juncture, what are the goals of Japan's G20 presidency? As agreed to by G20 Leaders in Buenos Aires, we remain committed to the full, timely, consistent implementation and finalization of the agreed upon financial reform agenda. And we remain committed to the evaluation of its effects.
- On the evaluation of the effects of reforms, the FSB has, using its framework for the evaluation of reforms, begun to analyze whether they are achieving their intended outcomes, and to help identify any material unintended consequences. During our Presidency, this evaluation work is focusing on SME financing.
- As part of our efforts to monitor and address new and emerging financial system vulnerabilities, Japan proposed three priorities under its Presidency; (i) fragmentation, (ii) innovation, and (iii) aging.

roadmap

- Before using the rest of my presentation to explain these three priorities, let me briefly touch upon our roadmap.
- As you may well be aware, a G20 Deputies' meeting as well as a Ministers' and Governors' meeting was held last week here in Washington. The standard-setting bodies, or SSBs, and other relevant organizations reported on the progress made since the Deputies' meeting in January, and were provided with guidance on the way forward. A roundtable on AML/CFT issues was also held the week before, as part of our efforts on financial innovation.
- Japan will also host a symposium and a seminar on aging and financial inclusion, two of our priorities, in Tokyo and Fukuoka, respectively, in early June. We will then host the Ministers' and Governors' meeting on June 8th and 9th in Fukuoka, where most of the financial system deliverables will be submitted. The Leaders' summit will follow later that month in Osaka.

market fragmentation

- Returning to our three priorities. First, market fragmentation.
- The G20 has long been committed to implementing financial reforms in a way that supports an integrated global financial system. When G20 Leaders set out the global reform agenda at Pittsburgh in 2009, they said: “We are committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets.” At the latest Summit Meeting in Buenos Aires last December, they again stressed that they would address fragmentation through continued regulatory and supervisory cooperation.
- Thanks to almost 10 years of effort by the G20, the FSB and other SSBs, we have largely put in place reforms to enhance the resiliency of the global financial system. These include Basel III, OTC derivatives reforms and resolution frameworks. On the other hand, our progress has been unremarkable with respect to promoting an open and integrated global financial system, despite the individual efforts of G20 members.
- Regulations and supervisory practices that are inconsistent, overlapped, or incompatible across jurisdictions are putting an excess burden on some financial institutions. This could give rise to market fragmentation along national lines. Against this backdrop, we proposed market fragmentation as one of the priorities of Japan’s G20 presidency. The FSB and IOSCO have launched an initiative to identify the sources of harmful market fragmentation and to explore ways to address any financial stability risks.
- The FSB discussion highlighted that some types of market fragmentation may, however, be intentional and can have a positive effect on financial stability. Such fragmentation may reflect differences in domestic policy mandates and responsibilities.
- Other types of market fragmentation, on the other hand, are often unintended and may reduce financial system resilience both domestically and globally. This could be the case if fragmentation limits cross-border diversification and risk management, impairs market

liquidity, or prevents the cross-border flow of capital and liquidity during times of stress.

- In other words, it is important for authorities, when developing and implementing regulatory and supervisory frameworks, to consider the trade-offs between the benefits of increased cross-border activity and a need to tailor them to local conditions.
- In that case, what should we expect by discussing market fragmentation? We are not intending to re-open agreed upon international standards. Rather, we would like to discuss practical and pragmatic solutions for addressing market fragmentation. Our focus will be on market fragmentation driven by regulatory and supervisory measures which negatively impact financial stability or market efficiency.
- Potential sources of market fragmentation driven by regulatory and supervisory measures can be broadly classified into three categories. The first category is inconsistencies in the implementation of international standards, either in timing or substance. The second category is extraterritorial application of market regulation, or location policies requiring certain activities to be conducted in a specific jurisdiction. The third category is incompatibilities between home and host regulatory or supervisory requirements.
- In order to seek valuable input from stakeholders, including market participants and academia, the FSB and IOSCO hosted workshops in January and March of this year. Stakeholders took the opportunity to highlight examples where supervisory and regulatory policies may give rise to market fragmentation.
- The first area identified was cross-border trading and the clearing of OTC derivatives, which are sometimes segmented along geographic lines. The second area was banks’ cross-border management of capital and liquidity, which can be affected by local ring-fencing or prepositioning measures. The third area was barriers to information sharing across borders, including differences in data reporting requirements.

Now, how can we address market fragmentation? This is a challenging task because we need to tackle this global issue mainly through the collective actions of national authorities. To come up with practical, concrete solutions, it can help to look at the various phases of regulation: the development of international standards, national rule making, deference and/or recognition of foreign regulatory framework; and daily supervisory activities. It may be useful to design processes and approaches fitted to each of these phases.

- For example, when developing international standards, the FSB and SSBs could put additional focus on implementation and operational challenges to help prevent inconsistencies in implementation. More attention should also be paid to the burden on firms facing similar, but different requirements in multiple jurisdictions.

- National authorities may be able to prevent unintended regulatory conflicts through the meaningful exchange of information on national rule-making processes. Timely input from foreign stakeholders on the potential impact on cross-border activities could help pre-empt regulatory conflicts.

- With regards to recognition or more broadly, deference, authorities need comparability assessments of foreign regulatory frameworks. For such assessments, they tend to conduct line-by-line comparisons of domestic rules on a bilateral basis, which often result in duplicative and inefficient processes. Against this backdrop, IOSCO is going to consider whether there are ways to further improve the process of comparability assessments, based on its previous work on a toolkit for cross-border regulation. We appreciate that the CFTC is leading IOSCO's work in this area.

- Last but not least, we need to explore how supervisory cooperation could be improved for mitigating fragmentation. Insufficient cooperation often leads to excessive conservatism in comparability assessments of foreign regulatory frameworks, or excessive prepositioning of capital and liquidity. We should discuss cross-border supervisory cooperation more so that we can enhance mutual trust among authorities.

- Sometimes, small and practical steps can make a difference. We look forward to discussing practical ways to address market fragmentation at the FSB and IOSCO, and to presenting something tangible at the June G20 meetings.

financial innovation

- The second priority under the Japanese Presidency is technological innovation in the financial sector.
- In Buenos Aires, leaders declared that they will step up efforts to realize the benefits of new technology while mitigating the risks. So, which efforts specifically should we step up?
- The more immediate needs are to mitigate the risks posed by crypto-assets. Since multilateral responses are needed given their borderless nature, standard-setting bodies have started working on addressing crypto-asset issues in line with their mandates.
  - ✓ On AML/CFT, the Financial Action Task Force (FATF) has been making progress in its work. Following the revision to the FATF Recommendation in October of last year, the FATF plenary agreed at its February meeting on a new Interpretive Note, part of which is now going through public consultation. The new Interpretive Note is expected to be submitted to the G20 in June.
  - ✓ The FSB compiled and published a directory of crypto-regulators, which is expected to form a basis for cross-border supervisory cooperation and policy dialogue. The FSB is also working to identify possible regulatory gaps in this area.
  - ✓ IOSCO is preparing a report for public consultation on regulatory approaches to crypto-asset trading platforms. It will include key considerations on issues such as consumer and investor protection, as well as market integrity. The report will also outline a toolkit of measures for regulatory authorities to consider.

- From a longer-term perspective, the FSB is exploring the use cases of the underlying decentralized financial technologies and their implications for financial stability, regulation and governance. Such technologies may reduce or eliminate the need for intermediaries or centralized process; this poses challenges as current financial regulations are based around these arrangements.

- In this regard, Japan will host a high-level seminar in Fukuoka on the margins of the Ministers' and Governors' June meeting. A panel discussion will be held to discuss the governance of the future financial landscape brought about by blockchain. It will include stakeholders from the regulatory community, academia, industry and the tech community.

aging

- The third topic is aging. In collaboration with the Ministry of Finance and Bank of Japan, we will comprehensively examine the implications of aging for fiscal and monetary policy, as well as for the financial sector. The JFSA's particular focus is on financial inclusion in an aging society.

- Aging is a global phenomenon. Both developed and developing countries are experiencing growth in the number and proportion of older people. The United Nations predicts that globally there will be over two billion people aged 60 and over in 2050. 80% of these are expected to live in low-and middle-income countries.

- Population aging is particularly challenging for less developed economies with limited financial infrastructure. It may be difficult for adults in such economies to access the financial products needed to plan for a long-life. They are less likely to be aware of how such products can help them navigate through the stages of life.

- Cognitive and physical decline are more likely later in life. The graph in the middle shows that there will be 130 million people with dementia globally in 2050. Others estimate that by 2030 around 200 trillion yen of Japanese financial wealth will in the hands of people with dementia.

- Financial decision-making becomes harder as cognitive skills decline, making it increasingly difficult for older people to choose and manage financial products or stick to financial plans. Physical decline also makes banks and other financial institutions less accessible. Travel becomes more difficult, and reading or hearing information or using digital tools can be problematic, leading to exclusion in later life.

- The more longevity people enjoy, the more financial needs they need to plan and manage. However, wealth formation is failing to keep pace with increased longevity. There will be an estimated retirement savings gap of US$400 trillion by 2050 for the eight advance economies shown in the right hand graph.
- As people age, medical expenses and other costs, like adapted housing and physical assistance, may grow significantly. Many will not be sufficiently prepared for, or even aware of, these expenses as they often arise unexpectedly.

- As such, we have a lot of issues to address to ensure financial inclusion in an aging society:
  - How should financial services be provided to those elderly with low cognitive or physical capacity?
  - How should financial products and services, including asset management services, be adapted for greater longevity?
  - Can emerging digital technologies facilitate financial inclusion, or does it raise the risk that the elderly will be excluded?
- Japan is a frontrunner in experiencing an aging society. During our Presidency, we will chair the Global Partnership for Financial Inclusion (GPFI) and identify emerging issues and potential policy responses. The GPFI will submit a report on the topic at the Ministers' and Governors' meeting in Fukuoka in June.
- To deepen the discussion, Japan will also host a high-level symposium in Tokyo in June. We will have leaders in financial services and regulation, gerontology and geriatrics, life planning, development economics and others.

Closing

To wrap up, Japan is focusing our priorities related to the financial sector on addressing the remaining issues of the global regulatory reforms proceeded in the past decade, and exploring new policy agendas looking towards the coming decade. We look forward to discussing and promoting these agendas with the US colleagues and other G20 members.

Thank you.

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