IV.-3 Financial Services

Overview

Financial institutions are critical to the healthy functioning of the global economy. The industry drives economic activity by providing credit and liquidity and protects households and businesses through risk management solutions. The Councils support the majority of post-crisis regulatory reforms adopted by most of the major economies, including the United States and Japan. The reforms generally have effectively and efficiently strengthened the global financial system and promoted more sustainable economic growth. At this juncture, 10 years after the financial crisis, we are encouraged by recent initiatives to assess prost-crisis reforms against their intended objectives, and urge a continued active process by governments to reexamine reforms that have produced unintended effects on growth and to be alert to new and emerging risks. At a time of increasingly rapid technology-driven change in the production and delivery of financial products and services, a growing shared interest in achieving sustainable development globally, and demographic shifts with far-reaching implications, the Councils believe it is more vital than ever for industry and governments to collaborate in creating an environment that encourages innovation, growth and appropriate consumer protections while ensuring systemic soundness.

Responding to a New Era of Innovation

1. Innovation has brought the latest technologies to market and a new vitality to the global economy. At the same time, it has presented new risks. The challenge is to ensure that regulatory policies and financial institution behavior maximize the opportunities while containing excessive risk taking. The Councils urge both governments to pursue policies that address this important challenge.

2. **Establishing a Framework for Effective Financial Supervision and Regulation in the New Era:** The Councils believe it is essential to maintain a level playing field between new entrants, including FinTech/BigTech, and conventional financial services companies. An appropriate balance should be struck between regulations that support innovation and economic growth and enhance customer convenience, while maintaining robust customer protections. The Councils endorse, and regard as a key priority, the principle of "same activity/same risk/same rules/same supervision." The U.S. and Japan should collaborate to take the lead in proposing rules at the global level by entities such as the Financial Stability Board (FSB). U.S. and Japanese financial institutions stand ready to work constructively with our respective governments to achieve this objective.
   - The Councils believe it is critical to conduct a fundamental review of "business scope" banking regulations in Japan and the U.S. to create the foundation for free and fair competition.
   - Considering the cross-border nature of digitalization, the U.S and Japanese governments should jointly lead the establishment of a globally harmonized regulatory framework and encourage coordination and dialogue among new market entrants, existing companies and regulators — for example via initiation of a formal dialogue between the U.S. and Japan and coordination on a bilateral "regulatory sandbox".
   - To facilitate innovation and growth, regulations designed for legacy industry practices should be reviewed and updated, including cloud services and data sharing by financial institutions through application programming interfaces.

3. **Level Playing Field:** Maintaining a level playing field – that is, like regulation for like products and service providers – has been a key regulatory principle for strengthening financial and capital markets and avoiding market inefficiencies and distortions since the pre-digitalization era. In the spirit of this principle, the Councils urge both governments to avoid market distortions such as, in the case of Japan, mutual aid cooperatives (*kyosai*), non-Financial Services Agency (FSA)-regulated private sector financial service providers, and between Japan Post Holdings and the private sector. The Councils look forward to further steady progress by the Japanese government on postal privatization and stand ready to play a constructive role as the Government continues to take steps to create a level playing field between postal financial institutions and the private sector.

4. **Free Flow of Cross-Border Data:** The free flow of data generates innovation and contributes to job creation and economic growth. The Councils strongly oppose the trend in some jurisdictions to force localization of data processing and storage and to monopolize de facto standards of data utilization. The two governments must work toward more open data architectures in Asia and other markets.

The U.S., Japan, and Global Social Challenges

5. The Councils recognize the significant impact that the financial services industry has on virtually every aspect of society. In this spirit, the U.S. and Japanese financial industries embrace their responsibility to contribute innovation and leadership regarding the future role of finance in supporting prosperity. In Japan, this effort has the potential for especially potent results in the government's "Society5.0" initiative.

6. **Aging Population:** As the nation confronts significant challenges related to an aging and declining population, Japan is well-positioned to serve as a global role model on the development of innovative financial services to address rapidly shifting demographics and the emergence of artificial intelligence (AI). In the U.S., the success of defined contribution plans as a wealth creator similarly can provide Japanese policy makers with a highly useful framework for further initiatives to reduce the burden on an increasingly stretched public pension system. The Councils therefore urge regulators and elected officials of both countries to engage with industry to establish policy priorities, and requisite regulatory frameworks, to drive innovation and product development geared to the needs of the elderly, and to cultivate conditions to promote wealth formation among younger generations.

7. **Infrastructure Investment and Support from a Financial Perspective:** Financing infrastructure is a priority of the G20 and U.S. and Japanese financial institutions stand ready to advance this agenda. The Councils support U.S.-Japan cooperation for developing national infrastructure projects. The Councils seek a supportive environment that includes: a suitable regulatory framework (see below), an appropriate level of public-private risk sharing, and a reliable pipeline of bankable projects.

8. **Cost/Growth Balance and Financial Standards for the SDGs and ESG:** Consideration for sustainable development goals (SDGs) and Environmental, Social and Governance (ESG) is important for social infrastructure financing. The Councils discourage a "negative list"

approach in the evaluation of specific projects, as it can inappropriately reject suitable technologies, for example super-high efficiency coal-fired power generation.

- The governments of the U.S. and Japan are encouraged to take the lead in pursuing a balance between economic growth and sustainability goals. The Councils urge the establishment of financial market standards conducive to this end.

10 Years Later - Addressing the Next Possible Crisis, Striking a Balance, and Avoiding Fragmentation

9. The U.S. and Japanese financial industries recognize that many pre-crisis business practices were contributing factors to the crisis itself as well as to the Interbank Offered Rate (IBOR) issue and others. In response, the industry has taken far-reaching steps to realign business practices, embed cultures that prioritize ethical conduct and anchor businesses in sustainable, customer-first practices. In Japan, for example, the 2017 "Principles for Customer-Oriented Business Conduct" released by the FSA created a model of long-term investment asset formation and produced a major new focus on appropriate fiduciary duties. Strong incentives to make fiduciary duty standards public practice in turn has led to an increase in public trust of financial institutions. Additionally, fraud prevention structures have been further strengthened through the conduct risk and compensation management principles provided by the Basel Committee on Banking Supervision.

10. **Examining Crisis Risk and Response:** The Councils believe that post-crisis financial regulatory reforms have been highly effective in fostering a far more sound and resilient global financial industry. However, 10 years after the last crisis, we also believe it is essential for industry and regulators to engage in an ongoing process of evaluation to assess whether the existing regulations are functioning effectively against emerging risks, and to identify regulations that may be inhibiting economic growth without enhancing safety and soundness.
    - New global risks have emerged, including increased external liabilities of developing economies and associated currency volatility; rising leverage at many companies with relatively weak credit ratings, and; rising global asset price volatility as monetary policy normalizes in several developed economies. While the Councils believe existing regulations provide adequate safeguards against these risks, we also believe vigilance is key to early detection of excessive risk-taking.
    - In Japan, the protracted low interest rate environment places significant pressure on the business models of financial institutions and could impede the financial intermediation function. This in turn could trigger excessive risk-taking, for example at regional financial institutions. The Councils urge policymakers to consider the multi-dimensional effects of continued ultra-low interest rates.
    - Additionally, digitalization has introduced new types of risks not covered by conventional prudential regulations, including cyber risk, crypto assets, and growth of non-traditional financial intermediaries. The Councils strongly recommend that, along with appropriately monitoring and responding to these issues, the Japanese and U.S. governments collaborate to drive the global agenda in establishing an appropriate regulatory framework.

11. **Setting Appropriate Regulations:** Post-crisis efforts toward international financial regulatory reform have delivered substantial progress. However, the Councils have concerns regarding the increasing costs accrued by financial institutions to conform to certain post-

crisis regulations, as well as possible unintended effects on the real economy. With implementation of the immediate post-crisis reform agenda now largely complete, the Councils support continued evaluation of the impact of the reforms and revisions to regulations determined to be overly restrictive or causing unintended negative consequences. The two governments should provide their full support for this effort and seek to collaborate with private sector financial institutions to ensure appropriate outcomes are achieved.

- In connection with supporting infrastructure finance, highly restrictive regulations applied to project finance under the Basel Accords should be reviewed and modified to produce a more appropriate balance between the risk-related concerns of regulatory authorities and actual risk posed.
- With regard to the **Insurance** Capital Standard (ICS) of the International Association of Insurance Supervisors (IAIS), the Councils urge the two governments to ensure the standard — and its market-based approach in particular — does not cause unwarranted volatility that is at odds with the characteristics of stable, long-term life insurance liabilities. Such unwarranted volatility could force companies to exit long-term insurance businesses that are essential to customers and result in negative effects on long-term funding necessary for infrastructure investment. The Councils urge both governments and their regulatory bodies to promote approaches to an ICS that would avoid such unintended consequences. Further, the Councils encourage both governments and their regulatory bodies to carefully assess the impacts implementing an ICS like framework in their respective market would have on the ability to address public policy objectives (e.g., aging societies, infrastructure needs, etc.) and competition (e.g., level playing field) before moving to do so.
- As JFSA modernizes its solvency requirements for insurance companies, the Councils urge JFSA to avoid valuation methodologies that result in non-economic volatility which could deteriorate long-term business. The long-term, illiquid liabilities of life insurers are ideally matched with long-term, illiquid assets such as infrastructure investments; solvency regulations should avoid the same negative effect on long-term funding as noted above.
- The Councils support IAIS' and FSB's efforts to develop an activities-based approach to address systemic risk. From a macro-prudential viewpoint, it is important for both governments to focus on the potential contributions to systemic risk from business activities of insurance companies and analyzing whether existing regulatory measures can sufficiently address potential risks. The Councils urge both governments to exercise sufficient care and avoid adopting unneeded regulations or those that may cause unintended effects. Additionally, due to the existence of issues that certain sectors cannot fully respond to independently, cross-sectoral discussions are necessary to establish appropriate regulatory frameworks for addressing systemic risk.
- The Councils also encourage proactive utilization of RegTech, SupTech and other advanced technologies to further accelerate the efficiency of regulatory compliance.

12. **Avoiding Market and Regulatory Fragmentation:** Market fragmentation should be avoided, as it impedes efficient and seamless global financial system. When regulators impose cross-border requirements on an extraterritorial basis that deviates widely from international norms, it contributes to an un-level playing field and to market fragmentation. The Councils urge the governments of the U.S. and Japan to set an example of appropriate regulatory deference, both

in banking and insurance, and make proactive efforts toward equivalency assessments across jurisdictions. This will enhance liquidity and efficiency in markets and limit fragmentation, while maintaining robust cross-border risk mitigation.

- **Reference: Cross-sectoral guiding principles:** In seeking to build a more effective regulatory framework, the Councils believe in the need for certain cross-sectoral guiding principles, including:
  - Regulatory reform must not place excessive emphasis on eliminating risk to the detriment of the appropriate risk-taking necessary to finance growth.
  - While consistency among different jurisdictions is an important consideration, regulators and global standard setting bodies must recognize that the application of uniform, one-size-fits-all regulations may not be appropriate in certain markets.
  - Regulation should be proportionate to relevant risks and effective and efficient in meeting their objectives.
  - Counter-cyclical macro-prudential regulation should be encouraged and pro-cyclical regulation avoided.