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**OECD/ADBI 7th Round Table on  
Capital Market Reform in Asia**

**27-28 October 2005  
ADB Institute, Tokyo, Japan**

**SESSION 1: FINANCIAL POLICY LANDSCAPE**

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# **Global Financial Policy Landscape** **and Japan**

7<sup>th</sup> Tokyo Roundtable on Capital Market Reform in Asia  
(October 27, 2005)

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# I . Major Global Trends in Financial Policy

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## 1. Financial Conglomerates

Widening scope of financial businesses and establishing appropriate regulatory framework

[U.S.] Gramm - Leach - Bliley Act of 1999

⇒ Establishment of Financial Holding Company (FHC)

⇒ FRB as an umbrella supervisor

[EU] Financial Groups(Conglomerates) Directive (February 2003)

⇒ Establishment of the supplementary supervision of credit institutions, insurance undertakings and investment firms in financial conglomerates

[Japan] ⇒ Establishment of Guideline for Financial Conglomerates Supervision (June 2005)

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## 2. Investment Services

Widening scope of investment services and instruments

[U.S.] Securities Act of 1933 and Securities Exchange Act of 1934  
⇒ Definition of “security” including “investment contract”

[U.K.] Financial Services and Markets Act of 2000  
⇒ Concepts of “regulated activities” and “investments”

[EU] Directive on Markets in Financial Instruments (MiFID) (April 2004)  
⇒ Establishment of the legal framework encompassing the full range of investor-oriented activities  
⇒ Concepts of “investment services and activities” and “financial instruments”

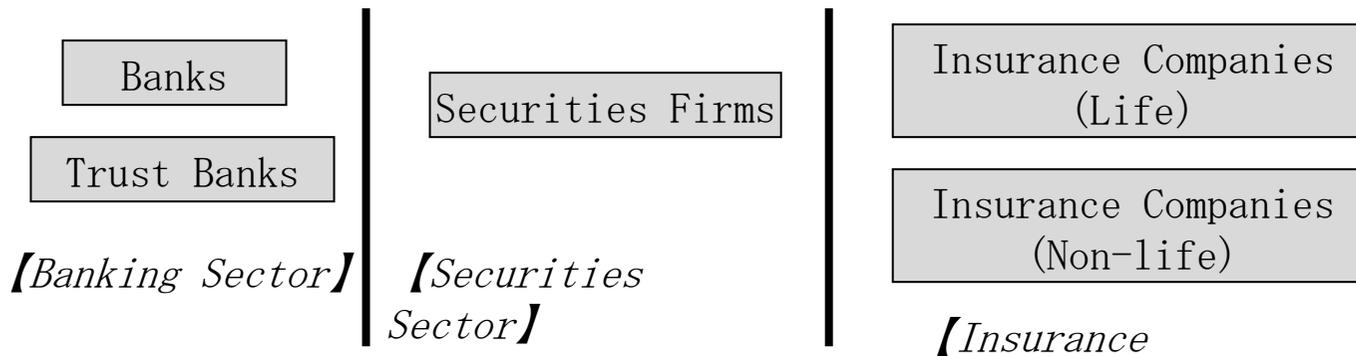
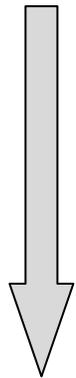
[Japan] ⇒ Preparing legislation for the “Investment Services Law (provisional title)”

## II . Financial Conglomerates in Japan

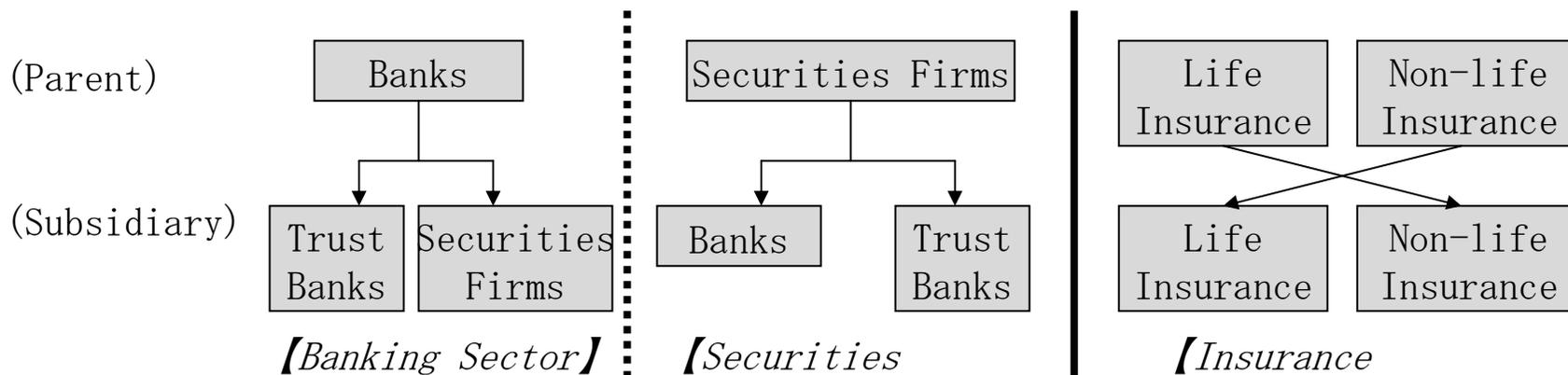
### 1. Overview and Changes of Japanese Financial Structure

Previous Structure (~1992)	Current Structure (1993~present)
<p style="text-align: center;"><i>Specialized Financial Institutions</i></p> <p>Each financial institution can conduct its</p>	<p style="text-align: center;"><i>Financial Groups (U.S. type)</i></p> <p>Each financial institution can conduct various businesses via a holding company</p>
<p><i>Emphasis on the stability of the financial system to support rapid economic growth</i></p> <ul style="list-style-type: none"> <li>➤ Ensuring soundness of each financial institution (blocking of risk transfer)</li> <li>➤ Preventing conflict of interest</li> <li>➤ Elimination of concentration of economic power</li> </ul>	<p><i>Producing various financial services in response to the needs of users</i></p> <ul style="list-style-type: none"> <li>➤ Compatibility between merit of economy of scale and effective management</li> <li>➤ Easiness of establishing appropriate firewalls compared with universal banking system</li> </ul>
<ul style="list-style-type: none"> <li>➤ Avoiding over-competition</li> </ul>	

Phase I --- Specialized / Divided Financial System (~1992)

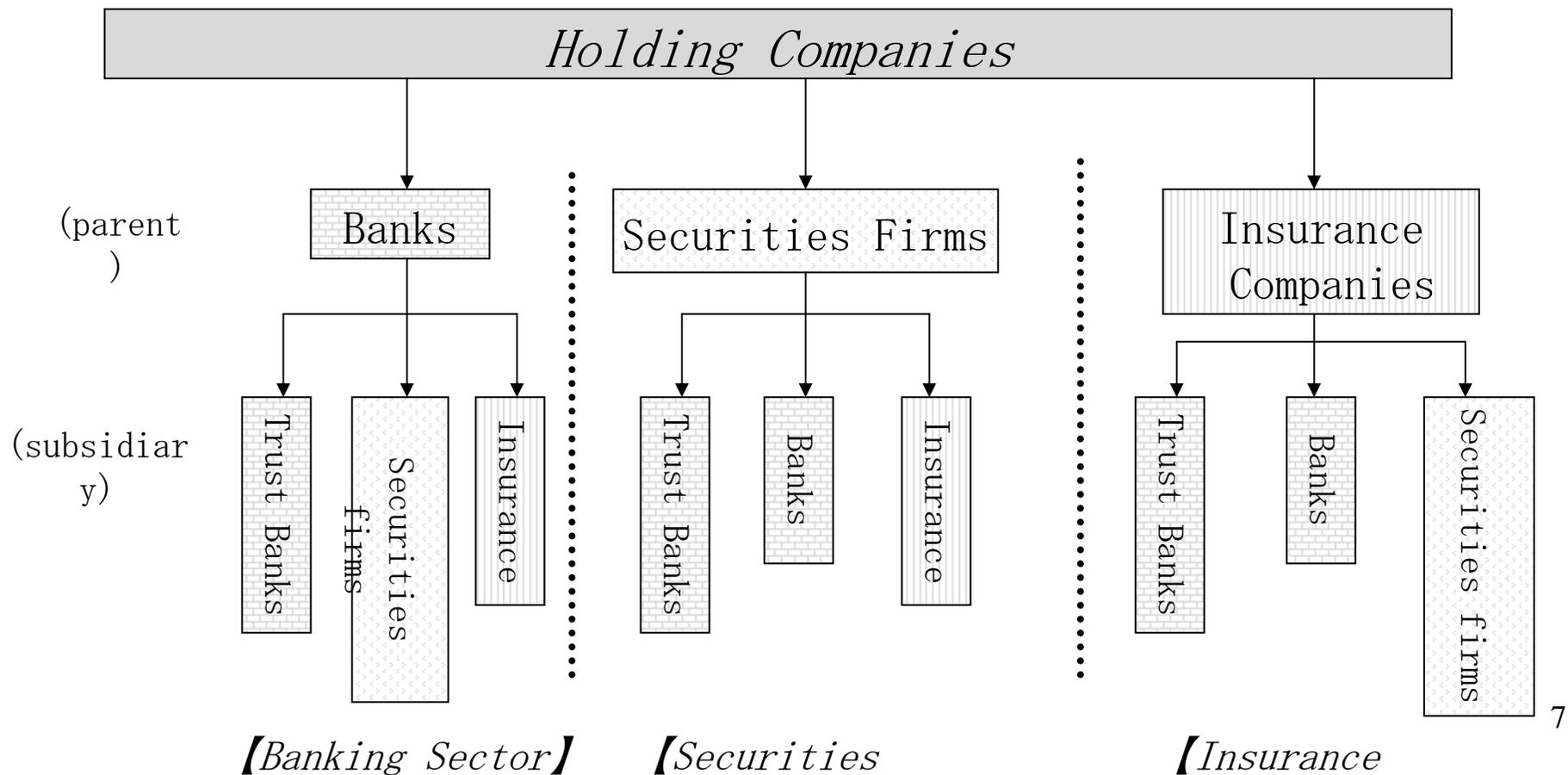


Phase II --- Entry of banks and securities firms into another sector owned subsidiaries (1993~97)



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Phase III --- Introduction of the system of financial holding companies  
(1998~present)



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## Phase IV --- Recent Measures towards “One-Stop Shopping”

- Start of the sale of investment trusts by financial institutions (1998)
- Removal of ban on a securities introducing agent service for financial institutions (December 2004)
- Enlargement of the scope of insurance products to be sold by depository financial institutions (December 2005) and possible selling of all types of insurance products by them (December 2007)

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## 2. Guideline for Financial Conglomerates Supervision

### (1) Definition of Financial Conglomerate

- ① Financial Holding Company Group
- ② De-facto Holding Company Group
- ③ Financial Institution Parent Company Group
- ④ Foreign Holding Company, etc. Group

### (2) Evaluation Points for Financial Conglomerates Supervision (Viewpoints)

- ① Management
- ② Financial Soundness
  - Capital Adequacy
  - Risk Management System
- ③ Operational Appropriateness
  - Compliance System
  - Appropriateness of Intra-group Transactions
  - Operational Risk Management System
  - System Risk Management System
  - Crisis Management System
  - Capital Increase
  - Protection of Customer Information

### III. Investment Services Law (provisional title) in Japan

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#### 1. What is “the Investment Services Law (provisional title)”?

A) What is “the Investment Services Law (provisional title)”?

- “The Investment Services Law (provisional title)” will establish a framework of comprehensive and cross-sectional protection of users of a wide range of financial products, including new financial instruments which are not under the regulatory framework of existing laws for user protection, in addition to the traditional securities such as stocks and bonds.
- According to “the Basic Policies for Economic and Fiscal management and Structural Reform 2005” (Cabinet Decision / June 21, 2005), it is stated that “the government will make efforts to promptly legislate `the Investment Services Law (provisional title)` as a cross-sectional legal system on financial(investment) services based on the Interim Report of the First Subcommittee of Financial System Council”.

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B) Why would “the Investment Services Law (provisional title)” be necessary?

- (i) **Emergence of new investment instruments that are not under the regulatory framework of existing laws for user protection.**

(Example)

• *Kumiai* (partnership) investment scheme

⇒ Amendment of the Securities and Exchange Law (entered into force in December 2004)

• FX ⇒ Amendment of the Financial Futures Trading Law (entered into force in July 2005)

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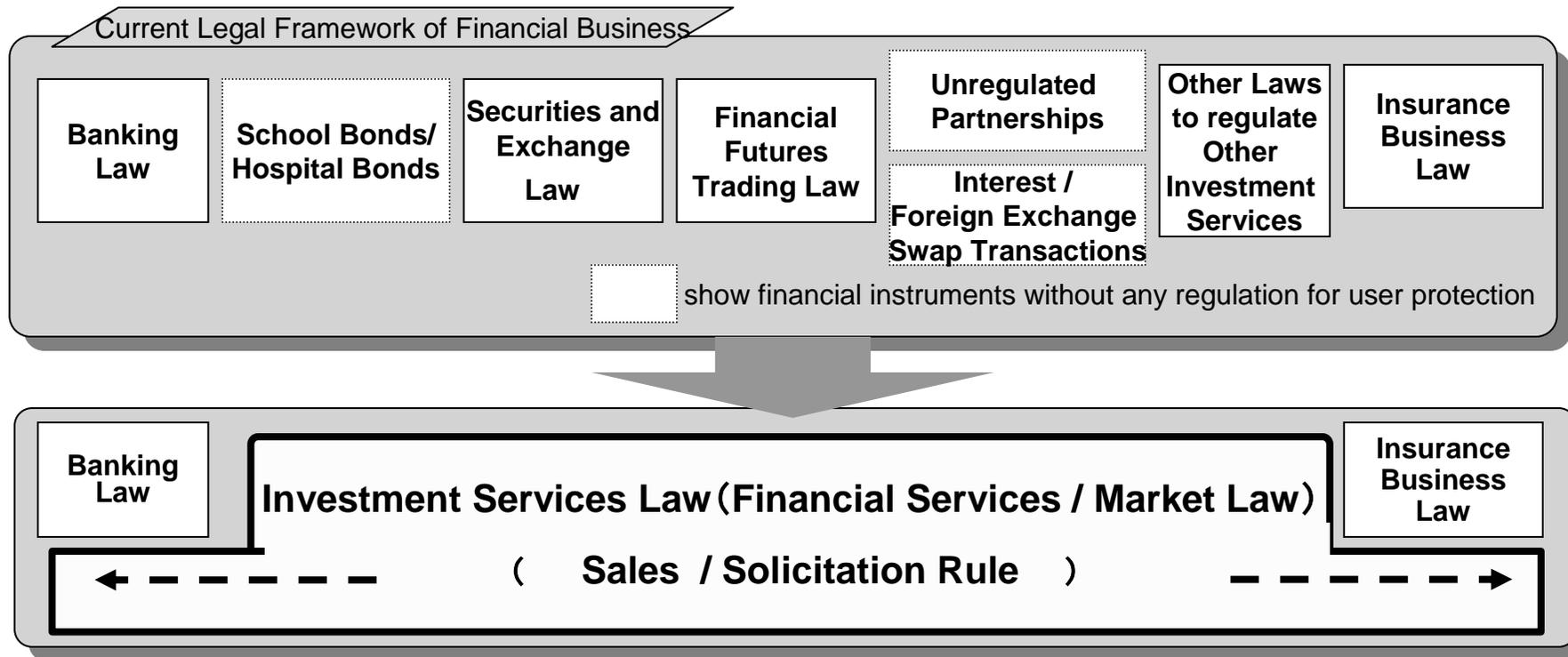
As there are still some loopholes where there is no user protection, a framework of comprehensive protection of users is necessary.

- (ii) **Emergence of new financial instruments that are provided beyond existing business lines.**

(Example) Wrap Accounts

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There is a limitation for regulating these instruments by respective laws. It is necessary to establish a framework of comprehensive and cross-sectional regulation in order to simplify and clarify regulations and encourage the provision of new financial instruments without undue restraints.



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C) What is the aim of “the Investment Services Law”?

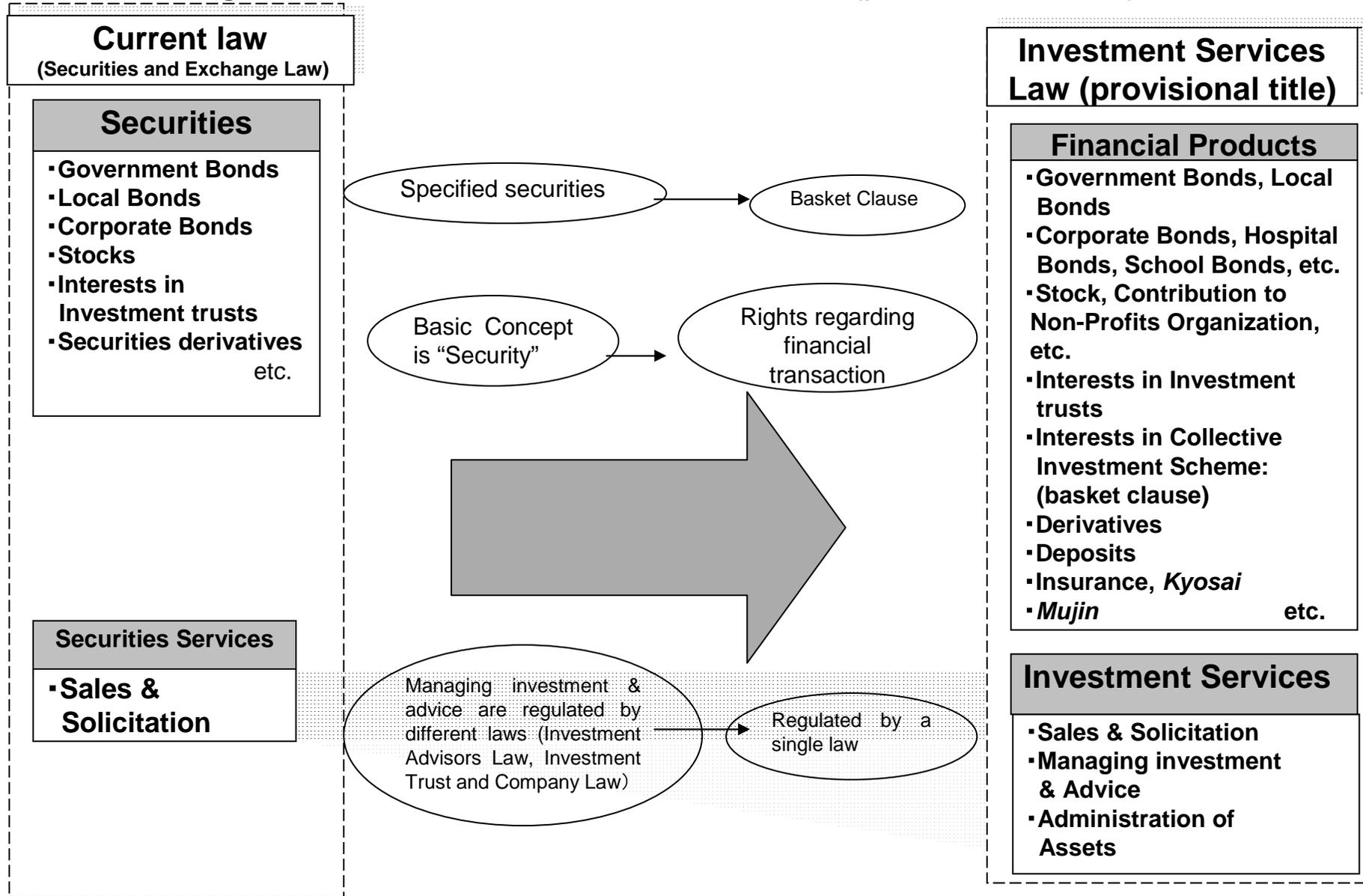
- Creation of “**Vitalized Financial System**” to allow “**market functions**” to work to the fullest potential based on the proper “**protection of users**”.
- ***Developing user protection for unregulated new financial instruments***
  - ⇒ Establishment of a framework of comprehensive and cross-sectional protection of users of a wide range of financial instruments.
- ***Enhancing benefits for users***
  - ⇒ Enabling the provision of various types of financial instruments and services responding to diversified needs of users
  - ⇒ Promoting financial innovation
- ***Enhancing market function and improving reliance on the market system toward the policy goal of encouraging funds from savings to investment***
- ***Responding to globalization of financial and capital markets***
  - ⇒ Development of market infrastructure to enhance the attractiveness of the Tokyo market as an international market.

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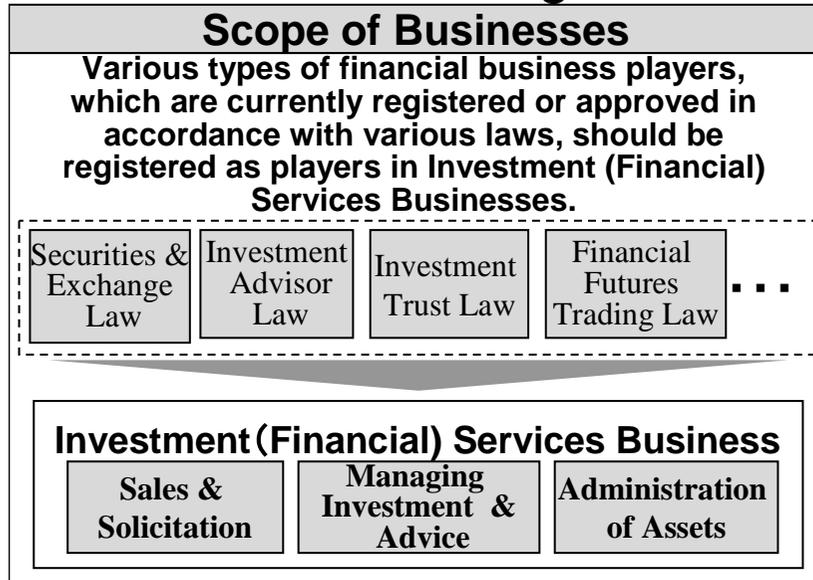
## 2. Outline of “the Investment Services Law (provisional title)”

- i) Review current vertically divided financial laws, and cover **a wide range of financial instruments**.
- ii) Investment services businesses include activities such as **sales & solicitation, managing investment and advice**, and **administration of assets** as their core businesses.
- iii) Regardless of the section of businesses, a rule of conduct under the Investment Services Law will be applied to sales & solicitation of investment products as a general law.
- iv) Review overall regulations of rules of conduct, and **restructure regulation with different criteria by type of customers**.
  - *Sales of investment products for professionals, typically institutional investors.*
    - ⇒ *Promoting deregulation*
  - *Sales of investment products for non-professionals, typically individual investors.*
    - ⇒ *Expanding investor protections*
- v) For entry to the market, a firm will be required to register in principle, but **different criteria for registration** will be applied depending on the nature of its businesses.
- vi) Minimum supervision of the **collective investment scheme** in a cross-sectional manner.
- vii) Consider different disclosure rules depending on characteristics of investment instruments.

### 3. Coverage of “the Investment Services Law (provisional title)”



## 4. Contents of Regulation



Regulation of Entry	
Regulation by types of businesses	
Players in the Investment Services Law	Regulation of entry
① Players engaging in sales, solicitation & custody service	Same level as current securities companies
② Players engaging in sales & solicitation of FP with low liquidity but not dealing with custody service	CAR regulation should not be applied
③ Players providing investment service based on entrustment of other investment service business players	Minimum regulation of financial conditions (same level as current sales agent for securities companies)

Regulation of Activities			
Reorganize current regulations by function			
Regulate by types of services and categories of businesses (sales or investment)			
Points of regulation Types of businesses	Fiduciary Duties		Regulation of activities by type of customers
	Basic Regulation	Specific Regulation	Pro ↔ Availability of choice ↔ Amateur
Sales & Solicitation	Suitability rule Advertisement regulation etc.	Prohibiting making up losses, etc.	Deregulation (under Pro)      Expansion of user protection (under Amateur)
Managing Investment (Advice)		Prohibiting investments which will raise conflicts of interest, etc.	

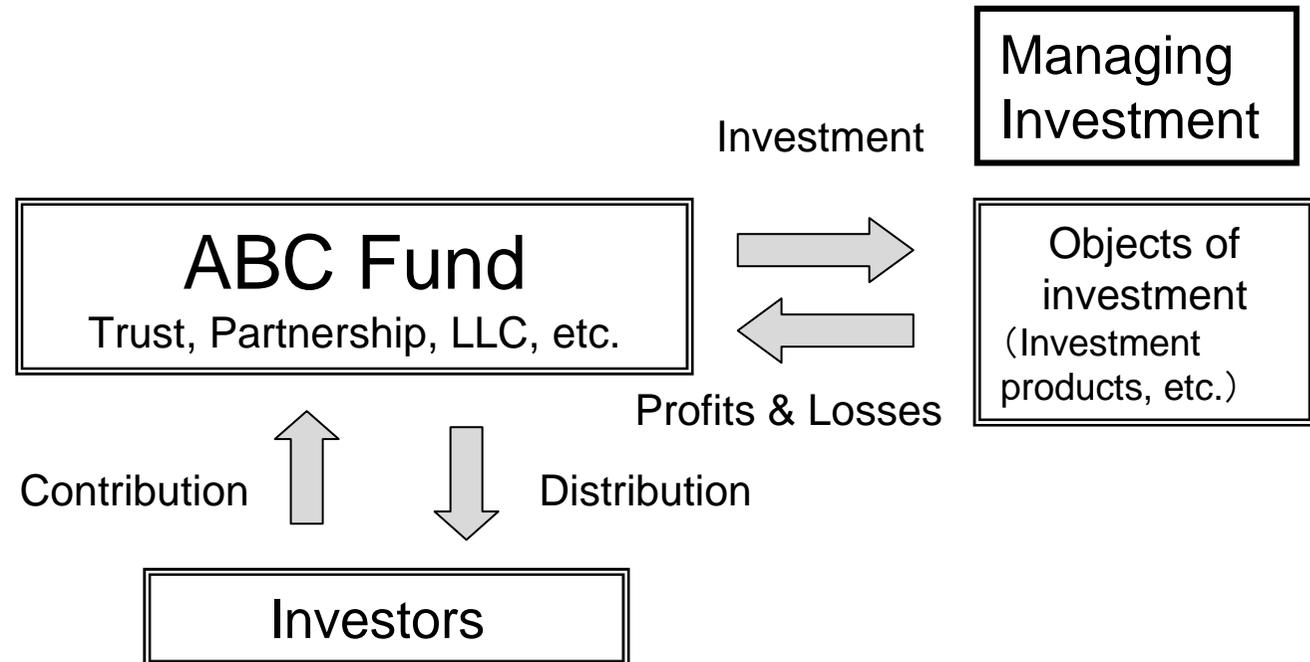
## 5. Collective Investment Scheme (Fund)

### ○ What is “Collective Investment Scheme”?

“Collective Investment Scheme” means a scheme to collect money or other properties, no matter how, from two or more persons, and invest in businesses to distribute profits originated from the businesses to investors.

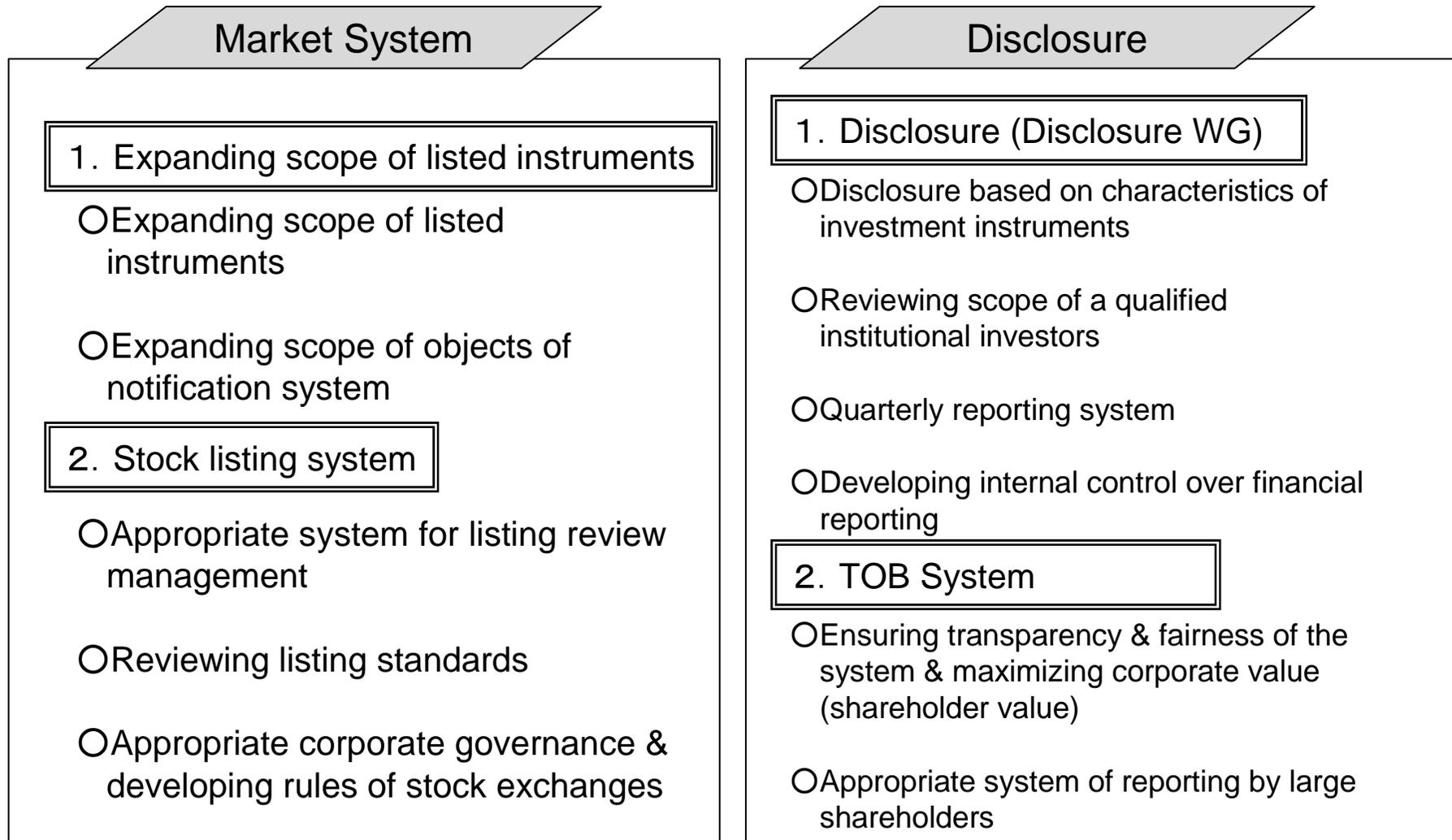
For the collective investment scheme, setting regulations, such as

- ① Notification & registration
- ② Administration of assets
- ③ Qualifications of asset managers
- ④ Fiduciary duties & measures for preventing conflict of interests
- ⑤ Investment reporting



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## 6. Desirable Market Framework



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## **7. Schedule of legislation for “the Investment Services Law (provisional title)”**

### **【First Subcommittee of the Financial System Council】**

- Continuously deliberate issues, including those indicated in “the Interim Report “of the Subcommittee. (Resumed session from October 5th)
- Reform of the TOB System has been discussed at the “Working Group for TOB System”.

### **【FSA】**

- Prepare legislation for the “Investment Services Law (provisional title) ”, to submit a bill to the Diet as soon as possible.