# Shaping Global Financial Regulation

## - A View from Asia -

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** Any views expressed in this presentation are those of the speaker, and not necessarily identical to those of FSA Japan.*

# Contents

# 1. Introduction – About IOSCO

# Outline of the IOSCO（International Organization of Securities Commissions）

## IOSCO

- Composed of 118 ordinary members
- The international standard setting body responsible for securities regulation

**Presidents' Committee**

**Board**

Chair: Greg Medcraft (ASIC)

- Consists of 32 jurisdictions
- Responsible for standard-setting and IOSCO's governance, etc.

**Growth and Emerging Markets Committee**

**Policy Committees and Task Forces**

## *IOSCO's Main Activities*

- Participating in the discussions about key financial reforms at G20 and FSB (e.g. OTC Derivatives and Shadow Banking, etc.)
- Developing international standards and recommendations for securities regulations (e.g. Credit Rating Agencies and Hedge Funds, etc.)
- Developing the "Objectives and Principles of Securities Regulation (Principles)" and supporting implementation of the Principles especially for emerging markets jurisdictions
- Enhancing international cooperation for enforcement and supervision

# IOSCO's Recent Progresses and Future Challenges

## 1. Recent Progresses

① The final report on **"Principles for Financial Benchmarks"** (17 July, 2013)
② The final report on **"Margin requirements for non-centrally cleared derivatives"** (2 September 2013)

## 2. Future Challenges

① **New efforts**

- Cooperation with IFRS Foundation on the development and implementation of IFRS
- C8（Committee on Retail Investors）
- Task Force on Cross Border Regulation : aims to issue a Consultation Paper and hold industry Round Tables in the first quarter of 2014

② **IOSCO Foundation**

- Establishing a **Capacity Building Development Fund** for provision of technical assistance and education and training especially for emerging markets jurisdictions from public sector sources, etc..

③ **Dealing with new risks and challenges**

- The report on "Securities Markets Risk Outlook 2013-14"(13 October, 2013)
- Cybercrime
- Crowd funding
- Long-term financing for Investment

# 2. World – Market Integrity

# OTC Derivatives Market Reform

## - Background: G20 Pittsburgh Summit Communiqué -

## G20 Pittsburgh Summit (September 2009)

1. All standardized OTC derivative contracts:
   a) should be traded on exchanges or electronic trading platforms, where appropriate; and
   b) cleared through central counterparties.

2. OTC derivative contracts should be reported to trade repositories.

***Based on the G20 Summit Statement, regulatory reforms for OTC derivatives markets are being implemented.***

# Recent G20 Communiqué (Sep. 2013)

**Communiqué of Finance Ministers and Central Bank Governors Meeting (St Petersburg, 5-6 Sep. 2013)**

- We welcome the FSB's report on progress in over-the-counter (OTC) derivatives reforms, including members' confirmed actions and committed timetables to put the agreed OTC derivatives reforms into practice. **We also welcome the recent set of understandings by key regulators on cross-border issues related to OTC derivatives reforms, as a major constructive step forward for resolving remaining conflicts, inconsistencies, gaps and duplicative requirements globally, and look forward to speedy implementation of these understandings once regimes are in force and available for assessment. We agree that jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes.** We call on regulators in cooperation with the FSB and the OTC Derivatives Regulators Group to report on their timeline to settle the remaining issues related to overlapping cross-border regulatory regimes, and regulatory arbitrage.

# （Ref.）OTC Derivatives Market Reforms in Japan

## Amendments to the Financial Instruments and Exchange Act (FIEA)

<First stage: Approved by the Diet on 12 May 2010>

- Mandatory central clearing at CCPs
  - -(Products) Index-based CDSs and JPY-denominated IRSs with reference to Yen LIBOR
  - -(Covered Entities) Large domestic financial institutions who are members of licensed CCPs in Japan

⇒ Implemented as of *1 November 2012*

- Reporting requirements to TRs

⇒ Implemented as of *April 2013*

<Second stage: Approved by the Diet in September 2012>

- Mandatory use of electronic trading platforms

⇒ Implementation will be phased-in (up to three years:Sep.2015)

# (Ref.) OTC Derivatives Market Reforms in Japan

<Next Steps>

- Clearing Obligation
  - Expanding the scope of products and entities
- Mandatory use of electronic trading platforms
  - Currently considering the details of the domestic implementation
- Margin requirements for non-centrally cleared derivatives
  - Preparation for domestic implementation for December 2015
- JFSA Supervisory Guideline for FMIs
  - Currently under public consultation

# Further international coordination is needed

1. Differences in the timing of implementation of reforms from jurisdiction to jurisdiction

⇒Possible market disruption and fragmentation

⇒Sufficient transition period and measures needed for foreign entities

2. A flexible outcomes-based approach should form the basis of final assessments regarding equivalence or substituted compliance.

# Impact of Technological Changes on Market Integrity and Efficiency

*THE SEOUL SUMMIT DOCUMENT* (NOVEMBER 11 – 12, 2010)

Future work: Issues that warrant more attention

41. While we have made significant progress in a number of areas, there still remain some issues that warrant more attention:

Improving market integrity and efficiency: We called on IOSCO to develop by June 2011 and report to the FSB recommendations to promote markets' integrity and efficiency to mitigate the risks posed to the financial system by the latest technological developments.

IOSCO Final Report on *Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency (20 October 2011)*

# Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency (20 October 2011)

## Recommendations

*For Trading venue operators and trading participants*

(1) provide fair, transparent and non-discriminatory access

(2) have in place suitable trading control mechanisms (such as trading halts, volatility interruptions, limit-up-limit-down controls, etc.)

(3) subject to appropriate controls, including automated pre-trade controls on all order flow of trading participants

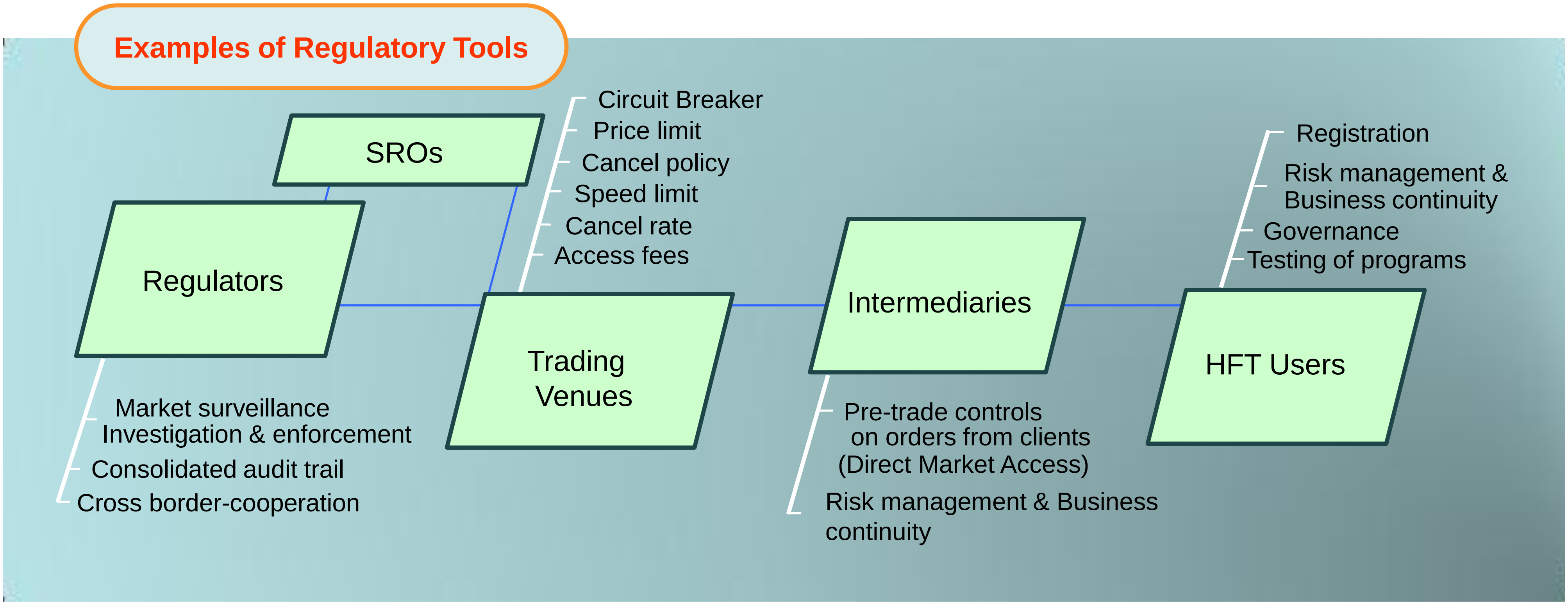
*For Regulators*

(4) seek to ensure that suitable measures are taken to mitigate any related risks to market integrity and efficiency

(5) monitor for novel forms or variations of market abuse that may arise as a result of technological developments

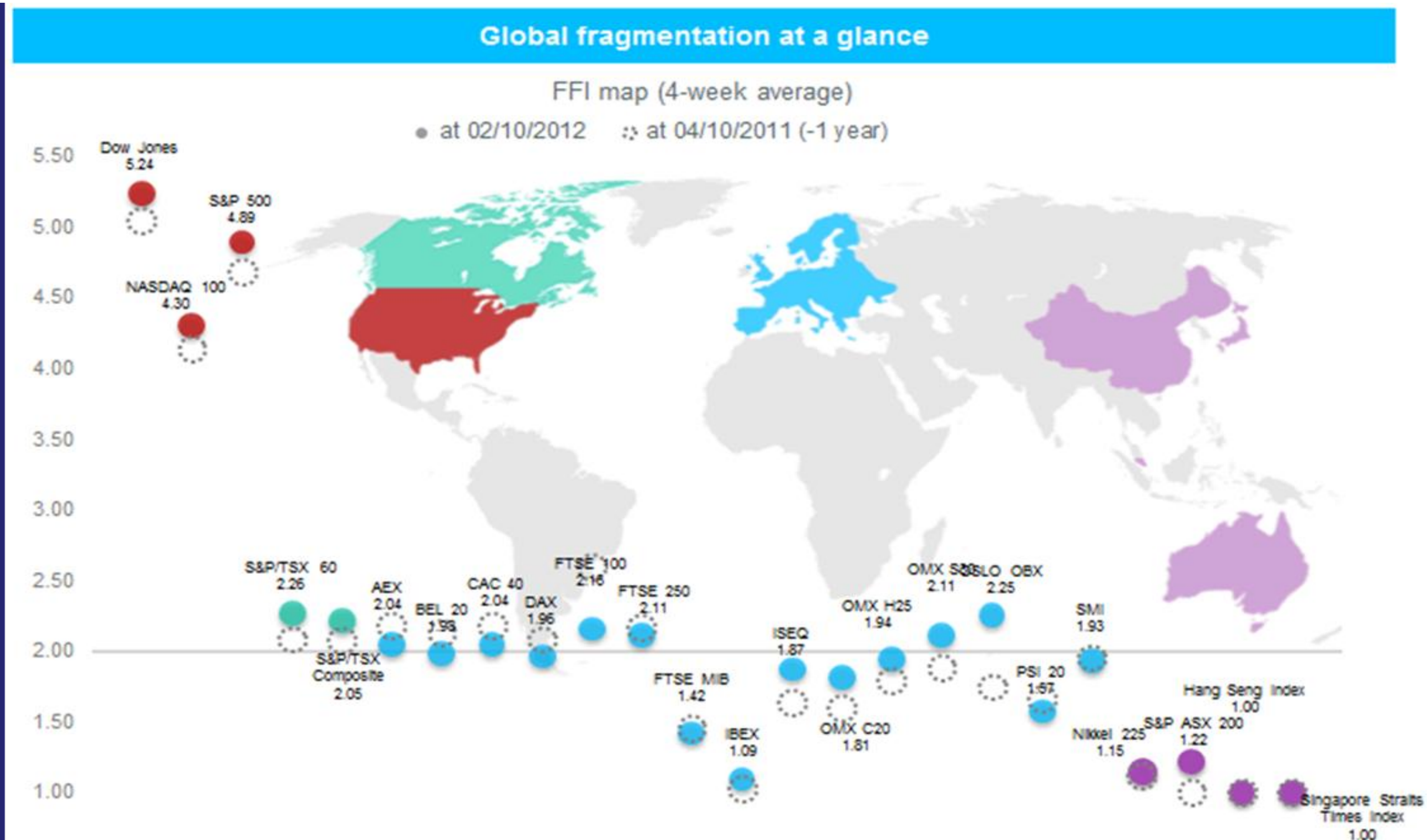
# Possible Regulatory tools on HFT

- Mitigate the risk that technological change may pose to the integrity and efficiency of financial markets.
- A consistent approach amongst global regulators to the latest technological developments is necessary.



# Market Fragmentation

***Fidessa Fragmentation Index - Fragmentation of equity trading volume across Regulated Markets and ATSs****




Source: Fidessa.

* Using a fairly standard methodology, the Fidessa Fragmentation Index as the calculated as the reciprocal of a Herfindahl concentration index (see http://fragmentation.fidessa.com/faq/).

# IOSCO Consultation Report on Regulatory Issues Raised by Changes in Market Structure (21 March 2013)

- In the report, IOSCO seeks to gather evidence and views for developing recommendations that promote market liquidity and efficiency, price transparency, and investors' execution quality in a fragmented environment.

- The report makes recommendations to <u>monitor the impact of fragmentation</u> on the following areas:
  - market integrity and efficiency
  - consolidated trade information
  - order handling rules and best execution
  - fair access to liquidity

# Long-tem Financing for Investment (1)

**Communiqué of the Meeting of G20 Finance Ministers and Central Bank Governors held in February 2013:**

"Long-term Financing for Investment" (excerpt)

… "country-specific factors affect access to long-term financing and there is therefore much that countries can do to attract long-term financing."

# Long-tem Financing for Investment (2)

## Removing possible obstacles to incoming foreign investment:

1. <u>Review financial regulation and remove excessive or outdated measures</u> (examples may include: Priority sector lending requirements , caps on the number of foreign bank branches, limits on loan-deposit ratios)

Comprehensive review of existing regulation is encouraged; regulation that hampers foreign direct investment could be removed or replaced by other measures that are conducive to improving economic efficiency and raising growth potential.

2. <u>Address any lack of transparency and predictable enforcement of financial regulation</u>

Initiatives can be taken to improve, such as the "Better Regulation" initiative by the JFSA, to enhance transparency and predictability of enforcement of financial regulation by, for example, publishing supervisory guidelines and inspection manuals of authorities.

# *3. Asia – Its Challenges*

# Capital Flows in and out of Asia

[Capital Inflows/Outflows]

- A large part of Asia's cross-border portfolio investment flows has been directed to the United States and the EU. On the other hand, a majority of foreign portfolio investment flows into Asia comes from the United States and the EU.
- Recently, there are signs of gradual changes in this tendency.
- However, Asia still faces a challenge in utilizing its excess savings efficiently, and could benefit from enhanced circulation of capital flows within Asia, if it could develop in a stable manner conducive to sustainable economic growth.

# Capital Flows into Asia

**2011** (billion dollars)

| | Thailand (Amount: 87.151) | | | Malaysia (Amount: 142.200) | | | Singapore (Amount: 171.658) | | | Hong Kong (Amount: 283.541) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Investment out of | Value | Ratio (%) | Investment out of | Value | Ratio (%) | Investment out of | Value | Ratio (%) | Investment out of | Value | Ratio (%) |
| 1 | EU | 49.368 | 56.6 | EU | 67.046 | 47.1 | United States | 59.552 | 34.7 | United States | 115.644 | 40.8 |
| 2 | United States | 14.046 | 16.1 | United States | 31.005 | 21.8 | EU | 54.565 | 31.8 | EU | 92.435 | 32.6 |
| 3 | Singapore | 11.058 | 12.7 | Singapore | 19.192 | 13.5 | Japan | 12.202 | 7.1 | Singapore | 19.983 | 7.0 |
| 4 | Hong Kong | 4.294 | 4.9 | Hong Kong | 9.072 | 6.4 | Malaysia | 10.682 | 6.2 | Japan | 14.513 | 5.1 |
| 5 | Australia | 2.151 | 2.5 | Switzerland | 2.101 | 1.5 | Hong Kong | 8.621 | 5.0 | China, Macao | 7.978 | 2.8 |

| | Indonesia ( Amount: 112.639 ) | | | Korea (Amount:401.148) | | | Philippines (Amount: 49.244 ) | | | Japan (Amount: 2,026.255) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Investment out of | Value | Ratio (%) | Investment out of | Value | Ratio (%) | Investment out of | Value | Ratio (%) | Investment out of | Value | Ratio (%) |
| 1 | EU | 39.273 | 34.9 | United States | 146.206 | 36.4 | United States | 17.855 | 36.3 | EU | 683.427 | 33.7 |
| 2 | United States | 39.112 | 34.7 | EU | 122.138 | 30.4 | EU | 15.366 | 31.2 | United States | 519.788 | 25.7 |
| 3 | Singapore | 18.812 | 16.7 | Singapore | 46.148 | 11.5 | Singapore | 4.462 | 9.1 | China | 276.934 | 13.7 |
| 4 | Japan | 6.020 | 5.3 | Japan | 22.280 | 5.6 | Norway | 3.888 | 7.9 | Singapore | 76.812 | 3.8 |
| 5 | Bermuda | 1.489 | 1.3 | Hong Kong | 18.695 | 4.7 | Japan | 2.830 | 5.7 | Switzerland | 54.565 | 2.7 |

※Data for 2011 is preliminary.
Source: IMF “Coordinated Portfolio Investment Survey”

# Capital Flows out of Asia

2011 (billion dollars)

| | Thailand (Amount: 22.541) | | | Malaysia (Amount: 40.290) | | | Singapore (Amount: 770.427) | | | Hong Kong (Amount: 928.942 ) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Investment into | Value | Ratio (%) | Investment into | Value | Ratio (%) | Investment into | Value | Ratio (%) | Investment into | Value | Ratio (%) |
| 1 | Korea | 6.710 | 29.8 | Singapore | 10.682 | 26.5 | EU | 156.542 | 20.3 | China | 193.316 | 23.6 |
| 2 | United States | 3.012 | 13.4 | United States | 10.115 | 25.1 | United States | 69.949 | 9.1 | Cayman Is. | 180.423 | 22.1 |
| 3 | Australia | 2.318 | 10.3 | EU | 3.744 | 9.3 | China | 62.462 | 8.1 | EU | 149.306 | 18.3 |
| 4 | EU | 1.935 | 8.6 | Hong Kong | 2.375 | 5.9 | Japan | 55.008 | 7.1 | Bermuda | 74.942 | 9.2 |
| 5 | China, Macao | 1.467 | 6.5 | Korea | 2.285 | 5.7 | Korea | 46.148 | 6.1 | United States | 72.976 | 8.9 |

| | Indonesia (Amount: 8.297) | | | Korea (Amount: 103.070) | | | Philippines (Amount: 5.478) | | | Japan (Amount: 3,375.224) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Investment into | Value | Ratio (%) | Investment into | Value | Ratio (%) | Investment into | Value | Ratio (%) | Investment into | Value | Ratio (%) |
| 1 | EU | 3.034 | 36.6 | United States | 36.076 | 35.0 | United States | 1.596 | 29.1 | United States | 1,168.353 | 34.6 |
| 2 | United States | 1.529 | 18.4 | EU | 23.883 | 23.2 | Indonesia | 0.939 | 17.1 | EU | 999.415 | 29.6 |
| 3 | Singapore | 0.508 | 6.1 | China | 6.894 | 6.7 | EU | 0.668 | 12.2 | Cayman Is. | 560.358 | 16.6 |
| 4 | China | 0.312 | 3.8 | Hong Kong | 5.523 | 5.4 | Cayman Is | 0.293 | 5.3 | Australia | 156.562 | 4.6 |
| 5 | Korea | 0.194 | 2.3 | Cayman Is. | 5.109 | 5.0 | China | 0.255 | 4.7 | Canada | 60.659 | 1.8 |

※Data for 2011 is preliminary.
Source: IMF "Coordinated Portfolio Investment Survey"

# Strengthening Cooperation among Asian Markets (1)

## Providing Assistance in Financial Infrastructure Development:

Extending technical assistance for the development of financial market infrastructures in Asian countries; i.e. providing technical support in the development of exchanges and trading facilities, clearing and settlement systems etc.

e.g.) JFSA has started providing assistance to the development of securities markets in Myanmar and Vietnam

## Making the development of capital markets a key item in Growth Strategies:

e.g.) Emergency Economic Measures for the Revitalization of the Japanese Economy (11 January, 2013)(excerpt)

II. Creation of Wealth through Growth

4. Revitalizing financial and capital markets

# Strengthening Cooperation among Asian Markets (2)

## Strengthening cooperation among Asian supervisory authorities :

- Conclusion of MOUs etc. for supervisory cooperation and information sharing have been effective and actively used (Includes instruments such as Memoranda of Understanding (MOU), Exchanges of Letters (EOL), Statements of Intent (SOI); signing of MMOUs of international organizations (IOSCO, IAIS) is also extremely helpful)

- Regional and bilateral meetings of authorities, supervisory colleges for G-SIFIs are increasingly used and becoming active

⇨ Such instruments and initiatives serve to ensure the soundness of financial institutions operating cross-border, and in maintaining financial stability through coordinated approaches to prevention of crises and containment of systemic risk

# Strengthening Cooperation among Asian Markets (3)

**Strengthening cooperation in the area of liberalization of trade in financial services among Asian countries:**

<u>In order to support sustainable economic growth in Asian countries, liberalization of trade in financial services, underpinned by appropriate prudential measures and safeguards against financial market stress, would be beneficial.</u>

Removal of barriers to entry for foreign financial services providers and foreign investment, if properly conceived and sequenced, could help secure stable and secure funding sources for businesses in the region.

Governments could help in many ways:

e.g.) Active participation in Economic Partnership Agreements (EPAs)/Free Trade Agreements (FTAs), including provisions for cooperation/technical assistance in financial market development

# *4. Japan – Strategy for the Rebirth*

# Comprehensive Strategy for the Rebirth of Japan

**"Rebirth of Japan: A Comprehensive Strategy" (Cabinet Decision: July 31, 2012)**

**(iii) Revitalization of financial capital markets through new capital flows**

To enhance growth potentials, it is important to stimulate growth-related demand through bold and effective regulatory reform for making growth seeds commercially viable. At the same time, it is important to expand the supply of growth money, which serves for the launching of new businesses, through proper role-sharing between the public and private sectors. Risk capital is not sufficiently available to newly-launched businesses, preventing economic revitalization. Moreover, the financial and real estate industries that serve as an intermediary for capital are themselves slumping. It is necessary to enhance growth potential through the proper fulfillment of the brokerage function. For this reason, the government will expand growth money supply for the financing of corporate growth, business revitalization and reorganization, and start-ups of new businesses, as well as appropriately checking out commercial feasibility and <u>pushing ahead with enhancing the functions of financial capital markets so that necessary funds will be provided to new growth industries/markets</u>. <u>Furthermore, the government aims to strengthen growth potential and the competitive edge of the financial industry and revitalize the real estate investment market.</u>

**[Financial Strategy]**

**(Expansion of funds for growth)**

<u>… The government will push to end asset deflation by revitalizing the real estate investment market through the development of infrastructures aimed at revitalizing the J-REIT market and expanding real estate securitization …</u>

# Outline of 2013 Amendment Act of Financial Instruments and Exchange Act, etc.

Promulgated on June 19, 2013

Challenges arising from the recent global financial crisis

Measures against insider trading and market fraud
Measures against financial crises originating from market disruption
Measures to strengthen the functioning of the financial/capital markets and the financial industry in Japan

## Measures Relating to the Recent Insider Trading Cases, etc.

Strengthening the insider trading regulation

- ◆ A new regulation against the disclosure of inside information and trading recommendations
- ◆ Raising the monetary penalty for violations committed by asset managers on their client accounts

Updating the insider trading regulation to reflect current financial and corporate practices

- ◆ Introducing an exemption for trading in cases where a considerable period of time has passed since the recipient of information last received the information concerning a tender offer

etc.

## Revisions to Asset Management Regulations Building on the Experience of the AIJ Case

Strengthening criminal penalties for fraudulent reporting, etc.

- ◆ Increasing the criminal penalties for false reporting and fraudulent solicitation by Discretionary Investment Management Business Operators

Others

- ◆ Stricter eligibility requirements for pension funds to be qualified as professional investors

etc.

## Establishment of Orderly Resolution Regime for Financial Institutions

To prevent financial crisis that may spread across financial markets, such as the failure of Lehman Brothers, and seriously impact the real economy, an orderly resolution regime for financial institutions based on the agreement by the G20 Summit countries will be established

Scope

- ◆ Financial institutions including deposit-taking financial institutions, insurance companies, financial instruments business operators, financial holding companies

Procedures

- ◆ Financial Crisis Response Council (consisting of the Prime Minister (chair), Chief Cabinet Secretary, Minister of Finance, Minister in charge of Financial Affairs, Governor of the BOJ, Commissioner of the FSA)

Measures

- ◆ Provision of liquidity, etc. under the oversight of Deposit Insurance Corporation, to ensure the performance of obligations for critical market transactions, where it is considered necessary to prevent severe market disruption (financial assistance or capital enhancement as necessary)
- ◆ Necessary measures for an orderly resolution (e.g., through the restriction of early terminations)

Funding

- ◆ Ex post bearing by the financial industry (government financial support in exceptional cases)

etc.

## Enhancement of Provision of Capital by Banks, etc.

Enhancement of provision of capital by banks, etc.

- ◆ Relaxation of the restriction on the holding of voting rights by banks, etc. only in cases where contributions to the corporate restructuring or revitalization of region are expected

Others

- ◆ Regulatory reviews regarding banks, etc. (large exposure rules, regulations governing foreign bank branches, etc.)

etc.

## Enhancement of Robustness of J-REIT Structures, etc.

Provide J-REIT with more choices for financing and capital policy

- ◆ Newly allow J-REIT to repurchase its equity and finance through rights offering

Others

- ◆ Measures to facilitate the acquisition of overseas real estate by J-REIT
- ◆ Newly apply insider trading regulation to J-REIT
- ◆ Provide investors with investment performance data in a simplified format

etc.

[Promulgated on September 12, 2012]

# Outline of 2012 Financial Instruments and Exchange (Amendment) Act, etc.

Changes in circumstances surrounding Japan's financial / capital markets

- To enhance the international competitiveness of Japan's markets and enhance convenience to users
- To improve the financial system in light of the turmoil in the global financial / capital markets
- To develop appropriate regulations assuring users of secure transactions

## Facilitating the Establishment of a "Comprehensive Exchange"

Based on the "New Growth Strategy", the "Strategy for Rebirth of Japan", etc., the following legal and regulatory frameworks are to be developed to facilitate the establishment of a "Comprehensive Exchange", in which securities, financial derivatives and commodity derivatives are traded comprehensively.

### Development of regulations for commodity derivatives and exchanges

- To enable Financial Instruments Exchange to trade commodity* derivatives
- Financial Services Agency (FSA), on the Prime Minister's delegated authority, conducts supervision of a "Comprehensive Exchange" under the Financial Instruments and Exchange Act (FIEA). **

### Development of regulations for operators

- To develop a framework enabling intermediaries, CCPs, etc. to trade and to process securities, financial derivatives and commodity derivatives comprehensively.

### Cooperation with MAFF and METI

- To ensure mutual cooperation with the Ministry of Agriculture, Forestry and Fisheries (MAFF) and the Ministry of Economy, Trade and Industry (METI) through creation of a framework for prior consultation with these ministries, regarding the exercise of certain supervisory powers over commodity derivatives transactions on a "Comprehensive Exchange"

⇒ **Establishment of a "Comprehensive Exchange"**
**To enhance user convenience**

## Improving the fairness and transparency of OTC derivatives transactions, etc.

### Updating the OTC Derivatives Regulations

- Obligatory use of electronic trading platforms for certain OTC derivatives transactions, in accordance with the international consensus for OTC derivatives market reforms.

⇒ **To ensure fairness and transparency of OTC derivatives transactions**

## Ensuring appropriate regulations against market misconducts

### Revision of AMP (Administrative Monetary Penalty) System

- To expand the scope of AMP system to cover the following conducts;
  - conducts of an external conspirator to help an issuer submit disclosure documents containing falsified financial statements
  - market misconducts by persons other than Financial Instruments Business Operators on other persons' accounts
- To provide legal authority in investigations concerning AMP

⇒ **To deter conducts that hamper fairness and transparency of the markets**

### Revision of insider trading regulations

- To exempt the following conducts related to reorganization from the scope of insider trading regulations
  - succession of equities derived from business transfer in which violation is unlikely to occur.
  - use of treasury shares in compensation for merger, etc.

⇒ **To facilitate management of company groups**

* Rice etc. are excluded for the time being.
** Exchanges handling only commodity derivatives remain subject to supervision by MAFF and / or METI.
*** Of the OTC derivatives market reforms, legislation concerning "mandatory central clearing" and "mandatory storage and reporting of trade data" has been promulgated (Amendment of the FIEA in 2010.)

# Review of Short Selling Regulation in Japan (1)

## Current Rule:

Permanent Measures:

(1) Uptick rule (in principle, prohibition of short selling at the same or lower price than the most recent price published by the exchange)

(2) Verification and flagging requirement for short selling transactions

Temporary Measures:

(1) Prohibition of naked short selling (short selling without ownership or arrangement to borrow shares at the time of sale)

(2) Reporting and public disclosure regime for short positions equal to, or exceeding, 0.25 percent of the issued shares in principle

→ Going forward, taking into account the overall regulatory trends in other markets, the following revisions to the short selling regulation have been proposed.

# Review of Short Selling Regulation in Japan (2)

## Finalized New Rule (commencing from 5 November 2013) :

- ➢ Perpetuation of the framework for prohibition of naked short selling (currently treated as a "temporally measure" )
- ➢ Transactions executed in Proprietary Trading Systems(PTSs)* will be included in the scope of naked short selling prohibition

*PTSs are non-exchange market trading systems in Japan.

- ➢ Perpetuation of the reporting and public disclosure regime for short positions
- ➢ Threshold level for reporting and public disclosure will be changed as follows (introduction of the so-called "two tier model");
    - Short position reporting requirement :
      0.2% of issued shares (currently 0.25%)
    - Public disclosure requirement :
      0.5% of issued shares (currently 0.25%)

Thank you for your attention!

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