May 7, 2019
Study Group on International Financial Regulation

Opinion Paper by the Study Group on International Financial Regulation "Recommendations for the G20 Summit"

I. Background

The Study Group was established for the purpose of monitoring developments in recent international financial regulatory reforms, enabling relevant parties in Japan to appropriately express their opinion in the process of introducing various regulations, and supporting Japanese financial institutions in responding smoothly to the new regulatory environment.

This year Japan hosts its first ever G20 Summit, to be held in Osaka on June 28 and 29. Three key issues have been set as priority themes for discussion at the G20 Osaka Summit: risks and challenges to the global economy, concrete actions to strengthen medium-term growth potential, and policy responses to economic and social changes stemming from both technological innovation and globalization.

The Study Group hopes that the first G20 Summit hosted in Japan will provide an opportunity for productive discussion and enable agreements from previous G20 Summits to be further improved. Accordingly, this paper expresses the Study Group's opinion on the G20 Osaka Summit's individual themes for discussion that relate to the finance sector: (i) international coordination and cooperation to avoid financial market fragmentation, (ii) aging-population issues and policy responses, and (iii) investment in high quality infrastructure.

II. Avoiding Financial Market Fragmentation

In December 2017 the Basel Committee on Banking Supervision agreed on the finalization of the Basel III framework. This concluded the process of designing international financial regulatory reforms that had been conducted over the decade following the global financial crisis in line with the earlier G20 commitments. At this point international financial regulatory reforms moved fully into its implementation phase. Against this backdrop, concerns about financial market fragmentation have started to arise in many countries. Such fragmentation results from inconsistencies among regulatory frameworks in different jurisdictions, impeding the progress and spread of beneficial innovations in financial services and compromising the efficacy of measures to promote financial stability. The following have been identified as sources of financial market fragmentation:

- Discrepancies: A single financial institution is subject to incompatible regulations imposed by multiple regulators
- Overlaps: As a result of regulatory extraterritoriality, a single market or transaction is subject to different regulations imposed by multiple regulators
- Desynchronization: The timing for implementing an internationally agreed standard varies among regulators in different countries
- Competition: Jurisdictions introduce policies aimed at securing resources and activities within home markets, such as location policies, ringfencing, or internal TLAC (total loss absorbing capacity) requirements

International coordination and cooperation to avoid financial market fragmentation has been identified as one of the main topics for discussion at the G20 Osaka Summit. The Study Group welcomes international consideration of measures to avoid financial market fragmentation, and hopes that measures such as those listed below will be implemented.

1. Increase trust and coordination among regulators
   - Increase trust among regulators to avoid conflicts between national interests and global interests.
   - Avoid extraterritoriality, but if it is unavoidable, thoroughly discuss details including the scope and timeline with the regulator(s) in the other jurisdiction(s) prior to implementation.

- Put a standardized resolution process in place to prepare for situations in which regulatory discrepancies between different jurisdictions arise. The process should stipulate the procedure for raising issues, the framework for negotiations between regulators, and the estimated timescale for resolution, among other matters.
- Revise systems unique to individual jurisdictions that could potentially harm relationships of trust among regulators, ensuring that they do not harm trust.

2. Use recognition and equivalence assessment extensively and efficiently

- Recognition or assessment of equivalence for regulations in different jurisdictions should be based on efficient, effective assessment of outcomes or risks, rather than focusing on the detailed differences between regulations in different jurisdictions.
- International standard-setters should develop frameworks to enable regulators in individual jurisdictions to apply recognition or assessment of equivalence according to a predictable, consistent, appropriate timescale.
- Provision should be made so that recognition or assessment of equivalence is accepted automatically if the relevant regulators agree as part of a supervisory college or crisis management group, or if a process such as a Financial Stability Board peer review has deemed a newly introduced domestic regulation to be in line with international agreements.

3. Ensure compliance with international agreements

- Having accepted the reality that it is impossible to impose exactly the same level of regulation within every jurisdiction, greater consistency between regulations in different jurisdictions should be ensured by reducing the disparities between internationally agreed regulations and the regulations actually implemented domestically within individual jurisdictions.
- Fundamental principles should be established to curb excessive regulatory competition (a race to the bottom or a race to the top).

- Issues that come to light while legally enacting regulations in individual jurisdictions should be relayed as feedback to international standard-setters, which should develop frameworks for remedying the issues as necessary.
- In jurisdictions where financial activity is relatively inactive, consideration should be given to the methods and timings for application of international standards to ensure eventual convergence with the international agreement.

4. Affirm regulatory policy objectives
- When considering development of new regulations, jurisdictions should recognize the role that the global financial market plays in achieving sustainable economic growth.
- International standard-setters should be accountable for ensuring that regulations are efficient and effective in achieving policy objectives.
- If a series of reforms has resulted in regulations that are complex and multi-layered, the regulations should be retrospectively reviewed to ensure the overall efficacy of regulations.

III. Aging population issues and responses

Populations are aging in many countries worldwide, and especially in the developed countries. Japan in particular has the highest rate of aging when compared with other countries, making it the society with the world's oldest population. Consequently, Japan is under pressure to take the lead in responding to a range of policy issues such as the macroeconomic impact of population aging, the decrease in labor supply as a result of such aging, and the issue of old age and financial inclusion. At the same time, Japan must envisage the type of economy and society it needs for the coming era of the 100-year lifespan.

Japan, host of the G20 Osaka Summit, is currently leading the way in terms of population aging, and the summit will include discussion of aging-related issues. Discussions will cover the financial services required for senior citizens whose physical and cognitive capacities are diminishing; the financial products, services, and wealth accumulation required to meet the demands of increased longevity; and the potential for digital technologies to facilitate or impede financial inclusion for senior citizens.

The Study Group therefore believes that participating countries should discuss the following at the G20 Osaka Summit: (i) policies to provide appropriate livelihood security (through self-help, mutual assistance, or public assistance) in the era of the 100-year lifespan; (ii) the importance of the roles played by private insurance and asset management firms in providing such livelihood security; and (iii) the regulations required to enable financial institutions such as private insurance providers to perform such roles. In addition, every country should share its insights on such issues as approaches to liquidation of assets in old age and public provision for dealing with declining mental capacity and ability to make decisions.

IV. Investment in high-quality infrastructure

Past G20 Summits have acknowledged that high-quality infrastructure is essential to growth in the global economy and have discussed various aspects of this issue, as a result of which certain outcomes have already been achieved. Delegates at the G7 Ise-Shima Summit held in 2016 agreed the G7 Ise-Shima Principles for Promoting Quality Infrastructure Investment, and the importance of those principles' key elements was reaffirmed at subsequent G20 Summits as well as at many other international meetings.

The Study Group believes that the G20 Osaka Summit should aim to promote greater investment in high-quality infrastructure by discussing how to establish conditions that will facilitate private-sector infrastructure investment (e.g., stable policies, and cooperation between the public and private sectors). Furthermore, a key element in quality infrastructure investment will be the need to not only reduce risk, but also to boost returns in order to increase return on risk. It should be possible to increase returns on investment as well as investment appeal by ensuring that returns reflect not only direct revenues from usage fees, but also the benefits that accompany infrastructure development in the form of increased tax revenue and prevention of decreased tax revenue.

V. Conclusion

The Study Group has made a unique attempt in Japan to analyze and assess international financial regulatory reforms across the various types of financial services businesses from the private-sector perspective. It is hoped that the opinions expressed by the Study Group will contribute to discussions during the G20 Osaka Summit under the Japanese leadership.