~~DRAFT -~~ Financial Services Supplement
50th U.S.-Japan Business Conference
U.S.-Japan Business Council/Japan U.S.-Business Council
November 15, 2013

The Councils believe that a robust financial services sector, based on market principles, effective regulation, transparency, and strong global institutions is vital to achieving sustainable growth in both Japan and the U.S., as well as in the global economy. The financial system promotes sustainable economic growth not only through the development and strengthening of the financial services industry itself and the creation of jobs, but also through the industry's support of businesses and consumers. The Councils therefore urge both governments to adopt the following measures and principles, which the Councils believe will contribute to achieving a sound, robust, and well-regulated financial services sector in both countries that will serve the global economy well. These principles are all the more important now that both governments are part of a large, prolonged restructuring of the global financial regulatory regime through various international standards setting bodies.

■**Transparency:** The Councils believe transparency contributes to policy effectiveness by reducing uncertainty in the decision-making of market participants, and promotes financial and systemic stability by enabling better understanding of government policies. Transparency is critical to the confidence that commercial entities require to make management and investment decisions, and is undeniably in the interests of consumers as well. In this regard, the Councils urge regulators in both countries to continue to expand the dialogue with the financial industry and consider views of market participants when crafting and implementing new regulations.

■**International Coordination and Regulatory Consistency:** The Councils are of the view that, as regulatory bodies implement a large array of new and globally significant regulations, it is crucial to harmonize this activity between jurisdictions in order to avoid fragmentation and higher costs to end users of financial services, which will slow economic growth.

When local conditions in any two jurisdictions call for variation in approaches to managing systemic risk, but regulators of those same jurisdictions seek to achieve similar outcomes, regulators of one jurisdiction should avoid applying rules on an extraterritorial basis. The Councils welcome the increased awareness and use among, notably, U.S. regulators of "substituted compliance" over the past year, particularly in the area of derivatives, an example of reaching similar regulatory goals without lowering standards, at least where Japan and the U.S. are concerned. The Councils encourage the continued use of this important tool with careful attention to timing of regulatory implementation. Moreover, the Councils urge regulators to streamline the rule making process between agencies within each jurisdiction, as well as with other jurisdictions, so as to achieve consistency of outcomes, which in turn will enhance the smooth functioning of a global financial marketplace.

Moreover, measures to ring fence the capital and liquidity of local entities (e.g. U.S. regulation on foreign banking organizations) lead to regulatory fragmentation across national jurisdictions and thus pose the risk of decreasing the efficiency of the global financial system and reducing systemic resilience globally. Accordingly, the Councils urge regulators to promote greater international regulatory consistency through the development of effective resolution regimes based on strong mutual trust, so as to rebuild a resilient international financial system that benefits the global economy.

■**Assuring Liquid Financial Markets:** The Councils welcome the continued efforts by regulatory authorities, in the wake of the 2008 crisis, to shore up the global financial system through the overhaul of the regulatory system currently underway. There is a concern, however, that the cumulative impact of all these new reforms will constrain liquidity and thereby hinder market making functions. In the years ahead, the financial industry will have to grapple with: i) Basel III's introduction of higher capital charges, liquidity and leverage ratios: ii) restrictions on proprietary trading and market making by such regulations as the Volcker rule; iii) shadow-banking regulations; and iv) new margin requirements on a variety of derivative transactions. All of these rules encourage institutions to restrain liquidity. Investors, by turn, will invest less in illiquid markets, hampering the ability of corporations or consumers to borrow or raise capital. The drag on growth will be considerable. The Councils specifically warn against any more regulations that might further constrain liquidity, such the introduction of restrictive leverage ratios that fail to allow for the netting of offsetting positions when calculating the denominator.

■**Volcker Rule:** The Councils understand U.S. regulatory agencies are making a concerted effort to finalize the Volcker rule limiting proprietary trading by year end. The Councils support the rule's worthy goals of systemic stability, as well as consumer and investor protection while not imposing undue impact on credit availability, liquidity and the convenience of end users. The Councils urge the U.S. to expand the range of exempted securities substantially, to include, at a minimum, Japanese government bonds, interests in joint ventures and subsidiaries, and other investments where the costs of the rule might outweigh the benefits.

■**Accounting for Differences between Banking and Insurance:** The Councils call on the U.S. and Japanese Governments to ensure that the International Association of Insurance Supervisors, as it develops a global insurance capital standard as well as a backstop capital requirement for global systemically important insurers, take fully into account the difference between insurers and banks. The Councils urge the two Governments and IAIS to consider an alternative capital framework that is tailored to insurance companies, ensures sufficient capital to protect solvency, comprehensively covers risks, provides a basis for comparison among banking and insurance and other financial institutions and can be implemented easily.

■**Ensuring Inclusive Growth:** The Councils encourage the United States and Japan to exert their leadership within the G-20 and the Basel processes so that policies do not impede prudent financial intermediation and jeopardize growth among small- and medium-sized enterprises ("SMEs").

■**Level Playing Field:** Like regulation for like products and service providers (i.e. a level playing field) is a key regulatory principle for strengthening financial and capital markets and avoiding market inefficiencies and distortions. The Councils urge both governments to avoid distortions that arise when one market participant enjoys favorable treatment over another. It is important to establish a level playing field between mutual aid cooperatives (*kyosai*) and FSA-regulated private sector financial service providers. The Councils also welcome the Abe administration's clear vision regarding postal reform and stand ready to play a constructive role as the Government continues to take steps to create a level playing field between the postal financial institutions and the private sector.

■**U.S. Insurance regulation:** Over the past 150 years, the U.S. state-based regulatory system for insurance has been responsive to the needs of the local marketplace. The Councils welcome continued efforts to further modernize U.S. state-based insurance regulation. In addition, the Councils are encouraged by the recent developments in the field of U.S. reinsurance regulation and will continue to monitor the further progress closely.

■**Commercial Finance:** Japan's commercial finance laws should be updated to promote a competitive and transparent asset based lending market. The Councils recommend modernization of the Civil Code and relevant lending laws so as to achieve (1) a more uniform and exclusive system for registration and perfection of security interests, eliminating risks of "hidden liens"; (2) broad coverage by such system of various classes of collateral, encompassing movable and immovable property as well as intangibles such as receivables; (3) a clear legal infrastructure for DIP financing with adequate lender protections; and (4) a uniform set of commercial lending regulations that would enhance clarity and regulatory parity among lenders. Such measures would encourage liquidity for business and ultimately business growth.

■**Neutrality in the Consumption Tax:** The Government of Japan should ensure that its consumption tax regime is consistent with global best practices for value-added taxes (VAT). In particular, the consumption tax law and related regulations should be revised to ensure neutrality in the treatment of sales of financial services offered through sales agents.

■**Promote Ease of Cross-Border Funding for Multinational Affiliates:** Promotion of cross-border investment requires allowing multinationals to flexibly fund operations in other countries. Unlike in other developed markets, though, Japan's Money Lending Business (MLB) Law subjects such affiliate lending to impractical registration requirements. This makes it harder and more expensive for companies to bring funding into Japan, thus discouraging FDI at a time when it should be encouraged. Other major markets (U.S., UK, Germany, Hong Kong, Singapore) do not restrict or require money lending registration merely for affiliate funding. Exceptions are already recognized for parent/subsidiary lending pursuant to FSA No-Action letters, yet sister company lending does not benefit from this exemption, even where they are each 100 percent under common ultimate ownership. Such sister company lending should be made exempt from MLB registration.