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Keynote Speech by Masamichi Kono (Financial Services Agency of Japan)
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It is my great pleasure and honor to be here with you today.

I would like to take this opportunity to share with you some of my thoughts on the importance of capital markets in finance for growth, and the critical role that exchanges play in the global capital marketplace. I would also like to lay down the main challenges from the viewpoint of a market regulator in this context.

The standard disclaimer applies, that any views I might express today would be my own, and not necessarily identical to the official views of the FSA of Japan or other international bodies such as the FSB and IOSCO in which I have been participating as member for many years.

I. The importance of capital markets in providing finance for growth and the role of exchanges

I must start with an honest recognition that, after some six years since the global financial crisis deepened, growth prospects are still below our expectations. Finance for growth has been held back by an impaired banking sector, with bank loans stagnating in many advanced economies. Inevitably, the focus of policy has been on enhancing the resilience of the financial system, resulting in stronger bank capital and liquidity rules. Financial stability has been the primary concern of regulators and supervisors around the world.

While there may be differences of views among stakeholders about the appropriateness of individual policies and the effects of those policies on bank lending, in my view there is no denying that such policies were needed in restoring confidence in the financial institutions and in maintaining financial stability in a deflationary environment. However, as governments including my own government have proclaimed and are now pursuing, a globally coordinated growth strategy is needed. As an important part of this growth strategy, how to enable sustainable finance for global growth is becoming a real challenge when bank lending is constrained by excessive leverage and increases in non-performing loans in some parts of the world, and/or slow growth in the real economy in many countries, both advanced and emerging.

Hence, the call on capital markets to provide a growing and viable alternative to bank finance is gaining momentum, with policy initiatives for developing corporate bond markets and promoting securitization being pursued in many countries. In this regard, IOSCO, in a recent report, upheld that sustainable market-based finance could play an important role in addressing the gap between the supply and demand for long-term finance.

The provision of alternative means of capital market finance such as crowd funding has been initiated in several countries as well. To the extent that such measures are consistent with regulation to ensure sound and efficient markets, they are not only useful but in fact necessary in enabling growth finance.

With regard to financial market infrastructures including exchanges, measures are now being taken to make the derivatives markets safer, by introducing central clearing requirements and trading requirements for OTC derivatives. Principles for mitigating systemic risk, enhancing transparency, and preventing market abuse have been developed for financial market infrastructures. They are an integral and critical part of the global financial regulatory reform agenda, and discussed extensively and their implementation monitored in the context of global financial regulatory reform.

However, what has not been discussed very much, in my view, is the critical role of financial market infrastructures in the provision of finance for growth. While talking about new or alternative means of raising funds such as crowd funding and peer-to-peer loans etc., the role of equity financing continues to be central for firms that aspire to grow and expand, and firms that are born as new businesses.

Needless to say, exchanges play a central role in enabling equity finance, and ensuring a sustainable basis for intermediation of saving to investment. Derivatives markets provide crucial venues for hedging and diversifying risks for firms. Exchange markets that are deep, liquid and well-regulated are essential for any economy that aspires to grow, or recover from recession and deflation.

So my call today is for us to embrace this renewed need for ensuring sustainable platforms for financing growth in the form of sound and efficient exchanges. We should not look at exchanges as only a practical means to make any trade efficient and transparent, but as a critical market infrastructure for ensuring the integrity and maintaining confidence in capital markets to finance sustainable growth. Efforts for strengthening corporate governance and work towards convergence of accounting standards with the ultimate goal of achieving a single set of high quality global accounting standards should be an increasing focus of attention for exchange operators.

In guaranteeing that exchanges do play such a useful role in the financial system, the fairness, efficiency and transparency of exchange markets are critical. Technological advances are double-edged swords in this endeavor, as they provide more risks and better means to deal with these challenges. Exchanges need to be continuously adaptive to technological change therefore, and repair the weaknesses and harness the vast opportunities that technological advancements bring. Investment is increasingly needed to effectively counter cyber-threats and strengthen the resilience of systems that exchanges manage. Robust business continuity plans and recovery plans need to be developed to ensure a swift resumption of services after system failures and other unforeseen disruptions of services. IOSCO is currently working on a report regarding business continuity and recovery planning for trading venues. The aim is to publish a consultation report by early-2015.

In financing sustainable growth, there is an increasingly strong call for increased long-term financing for infrastructure development, particularly in emerging market economies. Improved financing for SMEs has also been called for. Capital market finance is seen as a promising venue for such long-term financing and SME finance, and exchanges can certainly play useful and important roles in promoting such finance.

Excessive short-termism can be prevented by enhancing transparency, improving corporate governance of listed firms, and introducing appropriate rules to deal with excessive market activity.

So, let us be mindful of the critical role that exchanges play in finance for growth, and lend our best efforts to developing capital markets for sustainable growth in this environment of what Christine Lagarde of the IMF recently called the risk of a "new mediocre".

II. Challenges for regulators

i) Dealing with new technologies

In striking an appropriate balance between the required strengthening of regulation and supervision in the context of global financial regulatory reform and the need for developing and implementing a growth strategy backed by adequate means of financing growth, particularly by increasing long-term finance, the challenge for regulators is a hard and complex one.

Let me take an example. When we talk about the pros and cons of high-frequency trading, we must always bear in mind that technology can simultaneously enhance fairness and transparency, promote open and liquid markets, as well as provide more opportunities for market abuse and distort price formation. Investor confidence can be undermined if asymmetry of information grows or availability of trading opportunities is uneven among different types of investors. The malfunctioning of trading and reporting systems have caused great concerns among participants and the general public.

From the regulators viewpoint, the adoption of new technologies is conditional upon the introduction of appropriate safeguards against market abuse and systemic failure. Trading and reporting systems need to be continuously upgraded to deal with any potential failures and disruptions, including excessive market activity caused by herd behavior of market participants.

The increasing challenge for regulators is to keep up to speed with such evolutions and be ready to intervene when needed, on a proactive and forward-looking basis. As you may know, IOSCO has been working on such issues for several years, and has published recommendations for enhancing market integrity and efficiency in front of such technological developments.

While there is always caution expressed in the regulatory community against the risks of stifling innovation and the need to be prudent in imposing new and tougher rules on market activity, there must also be an acute sense of urgency in acquiring the means and the resources to cope with the rapidly changing marketplace. Cyber-crime is an important subject at IOSCO as well as in other regulatory forums.

A somewhat counter-intuitive aspect of new technological developments is a trend in some jurisdictions towards increased market fragmentation as a result of competition among trading venues. According to a report published by IOSCO at the end of 2013, there are signs of substantial market fragmentation in the US, and a growing level of fragmentation in the EU, particularly in the UK.

Competition itself can make capital markets more efficient, and would benefit users by promoting better and more diversified services. However, market fragmentation could increase costs for the investor, as well as costs for market surveillance and provision of market transparency.

Regulators would need to assess the appropriateness of safeguards and organizational structures of markets which need to be commensurate with the degree of market liquidity and risks of fragmentation. Less liquidity in sovereign and corporate bond markets have recently been pointed out as potential risks for financial stability, and regulators do need to keep watch over this latest development.

ii) Cross-Border Regulation

Dealing with cross-border issues arising from the introduction of new rules and regulations on market activity has been challenging. The difficulty of this issue has most recently been evidenced by the on-going work on resolving cross-border conflicts, inconsistencies and overlaps of national rules in the OTC derivatives workspace. Some instances of actual or potential market fragmentation have been reported, as jurisdictions have been taking time in adjusting the content and/or timing of the implementation of regulatory requirements for central clearing, mandatory trading, trade reporting and margins for the OTC derivatives markets.

One cannot deny that notable progress has been made in introducing and implementing new rules and regulations in the major jurisdictions, but this progress is not matched by sufficient progress in resolving cross-border issues, posing challenges for markets and businesses.

While there is a commitment at the G20 level to defer to each other in regulating cross-border transactions and activities, progress in exercising deference by way of making determinations of substituted compliance or mutual recognition has been slow, and transparency over the timing and content of such determinations has been lacking.

Regulators therefore need to step up their efforts to identify and resolve the remaining cross-border issues, exercising deference to each other as much as possible in order to achieve our common goal of making derivatives markets safer without imposing undue costs to market participants and stakeholders.

III. Concluding remarks

While I do not have the time today to go into the details, the policies being implemented by the Japanese government under the Growth Strategy, such as to enhance corporate governance, provide alternative means of finance for growth such as crowd funding, facilitate the listing of SMEs, and strengthening market integration and cooperation with other Asian markets are consistent with the approach I mentioned earlier.

In an increasingly integrated and interconnected global marketplace, increased coordination between policies of jurisdictions and cooperation between regulators and supervisors is essential. There is not enough of this currently, so our objective is clear. On the other hand, increased coordination and cooperation among exchanges is also becoming a necessity, in the interest of global public interest. While sound competition would be required between alternative trading venues, there is a common interest in appropriately protecting investors and providing the continuity of critical market functions and facilities even in times of severe market stress. In my view, we should again remind ourselves of this aspect of public good that an exchange will always perform, and we all rely on your best services.

Thank you very much.