To regain its position as a major regional or global financial hub Japan must be bold and abolish its outdated firewall regulation

Background

Over the past 10 years there has been significant progress in updating financial regulations in Japan and as we know, further enhancements are planned.

One important discussion currently taking place in the Financial Systems Council (hosted by the FSA) is regarding the deregulation of firewalls rule. This regulation restricts the sharing of customer information across banking and securities operating entities within the same financial group without prior written consent or without giving a right to opt-out by customer. No other major jurisdiction has such an all-encompassing rule that discourages investment in innovation, has a negative impact on the quality of customer service and the healthy expansion of financial services in Japan. The consequence is a reduction in the attractiveness of entering the financial services business in Japan or investing in the expansion of existing Japanese operations.

If Japan is to regain its position as a regional or global financial hub the firewall rule in all its aspects should be abolished. That will enable firms to better serve their customers while simultaneously managing conflicts of interest, thus boosting Japan's economic growth prospects.

History

The Japanese regime was modelled on the US Glass Steagall Act which itself was abolished in 1999. Since the introduction of the firewall rule in 1993 the restriction on sharing client information has been a major constraint on the business of financial groups that operate both a bank and a securities business in Japan.

Prior to 1993 banks in Japan were not allowed to establish a securities entity. Legislative changes in 1993 allowed a bank to establish a securities subsidiary and a securities firm to establish a banking subsidiary. However, Japanese regulations require clear separation between the banking entity and a securities entity.

At the same time, to protect a customers' benefits, a rule was introduced that prohibited sharing of customer information across a bank and securities entity in the same group.

FSA's Financial Systems Council Markets Working Group (WG):

Following the inclusion or reviewing the Firewall regulation in the Japanese Government's New Economic Strategy published in Summer 2020, in September 2020 the FSA's Financial Systems Council Markets Working Group (WG) began to discuss the issue including the possibility of revising the information sharing rule. The WG's preliminary report was published in December 2020.

https://www.fsa.go.jp/singi/singi_kinyu/tosin/20201223/houkoku.pdf

Now is the time for Japan to be bold!

In the preliminary report the proposed change on information sharing relates to business with a foreign non-natural person. Based on the FSA consultation on the matter issued on 26 March 2021, problems of definition remain. The perception of seasoned market participants is that the proposal as it stands will in fact complicate matters even further than the current rules and any attempt at clearly defining the terminology, will force firms to make costly, complex systems and process changes. We hope the final version of the proposal will be improved including being more principles based.

The next stage of the discussion regarding the deregulation of information sharing restrictions on domestic clients' non-public information will continue after the public consultation mentioned above is over.

Deregulating information sharing restrictions on domestic clients as well will enable the securities industry to provide far better and more innovative services on cross border as well as domestic business to Japanese corporates as they continue to internationalize and adjust to the post COVID-19 world.

Unlevel Playing Field

Removing the information sharing restriction on business with foreign non-natural person without similar deregulation of domestic client business, Japanese firms will find it easier to compete for business globally, albeit with additional compliance costs. However, non-Japanese firms in Japan will suffer more in terms increased costs and greater competition globally, without any associated benefits, thus creating an unlevel playing field.

Importantly, this will create additional disincentives for non-Japanese firms to invest in existing Japanese operations or for new entrants to come to Japan, hurting Japan's prospects of becoming a financial hub. Overall, Japan will be worse off.

Further discussions are planned.

The abolition of the firewall rule in its entirety could be done without any increase in the risk to customers or markets if firms have robust controls in place as we see in other jurisdictions. However, given the opposing views of key stakeholders, it is unclear whether a consensus can be reached on changing the rules to allow information sharing on domestic client business.

There are many reasons why Japan is attractive to foreign financial services firms. Abolishing outdated rules such as the Firewall rule would send an important message to the world that Japan is serious about regaining its position as a regional and global financial hub, thus attracting investment which will benefit the Japanese economy.

Conversely not doing so would risk Japan's position as the go-to collaborator for other jurisdictions. That would be a tragedy for this great country.

International Bankers Association of Japan

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