

Interview with Shigeru Ariizumi, Deputy Commissioner for International Affairs, Financial Services Agency, Government of Japan

# Digitalization of Financial Services – a New Challenge for the G20

By Japan SPOTLIGHT

The Fourth Industrial Revolution is changing the economy and society. Governments will need to tackle new issues brought about by the digitalization of financial services. Since finance is becoming more globalized, it is important to have international discussions and collaboration on these issues. The G20 Summit in Osaka in 2019 would be a perfect venue for this. *Japan SPOTLIGHT* had an interview with Shigeru Ariizumi, deputy commissioner for international affairs at the government's Financial Services Agency (FSA). He told us how public policy would be changed in dealing with the challenges of financial digitalization.

(Interviewed on Feb. 6, 2019)

## Introduction

**JS: First of all, could you introduce yourself briefly and in particular your professional background?**

**Ariizumi:** I joined the Ministry of Finance (MOF) in 1988. Since then, I have been working mainly in the national budget, international finance and financial sectors. I am now deputy commissioner for international affairs at the FSA, my third posting to the FSA from the MOF in my career. Prior to this assignment which started in summer 2017, I was working for the ministry's International Bureau. My current job at the FSA is to represent the Japanese government in discussions on financial services-related issues in several international fora, such as the G7, G20, IMF and OECD. Since Japan is hosting and chairing the G20 this year, I am in charge of drafting the agenda on financial services issues and promoting discussions on behalf of the host country in the preparation process for the G20 finance track, in collaboration with the MOF.

## Digitalization Transforming Financial Business

**JS: What do you think about the possible consequences of digitalization for financial business?**

**Ariizumi:** I think the impact of digitalization on financial business



Shigeru Ariizumi

would be enormous. With digitalization, we can accumulate large amounts of data, analyze and use them. The financial sector, just like other industries, will benefit from utilizing a wide range of data, including non-financial data. The implications are significant. The sector will achieve more efficiency in business by utilizing such data. Also, new entrants from non-financial business may bring a dynamic change in this industry.

**JS: It is often pointed out that digitalization is progressing much more rapidly in China than in Japan. What do you think about digitalization in Japan in comparison to other countries?**

**Ariizumi:** In terms of the number of newly founded FinTech ventures, digitalization in Japan may not be progressing as rapidly as in other countries. But business, the public sector and academia in Japan are all involved in supporting financial ventures. The government's Council on Investments for the Future regards FinTech and a cashless society as one of the top priority agendas. The FSA issued the Finance Digitalization Strategy in September 2018. I hope these commitments will encourage new players to bring innovation and existing financial institutions to improve user convenience through changes in their business models by collaborating with new players.

**JS: Are there any specific recent ventures that have good potential for rapid growth?**

**Ariizumi:** Yes, in Japan there are a variety of startups which provide a wide range of financial services. Many of them focus on better servicing retail consumers such as providing settlements and wire transfer services. The FSA is keen to support financial innovation by these ventures and any future emerging firms.

## **Policies to Take Advantage of Digitalization**

**JS: Could you tell us about your policies for encouraging financial digitalization?**

**Ariizumi:** Retail consumers who previously had access to only mass products could now benefit from more tailored services by use of big data and technology. For example, insurance companies can utilize new data to dynamically price insurance premiums. The use of XML telegrams in settlements will allow firms to comprehensively and smoothly process finance and settlements.

The FSA is promoting innovation through various initiatives. The FSA revised the Banking Act in 2017 to lay a legal foundation to facilitate an Open Application Programming Interface (API) so that banks could smoothly grant FinTech ventures access to their system with customers' permission. This opens a window for a safe data-based alliance between banks and FinTech companies which has the potential to realize more convenient and high-quality financial services. Most Japanese banks are moving towards accepting Open API, which is a very positive development.

The rapid development in digitalization has also blurred the boundary between financial and non-financial services which has prompted the FSA to start examining how to transform our legal system on financial services from entity-based regulations to more function-based and cross-sectoral ones. We are engaging with various stakeholders including business, the public sector and academia to further look into this medium to longer-term issue.

There are other policy considerations that deserve attention. For example, protection of customers' privacy and cybersecurity have become major policy issues in light of digitalization. We also need to be mindful of its potential to provide easier access and the risk of an increased digital divide for the elderly or people in the local community. Concurrently, there will also be a greater need to promote education on such services to enhance customers' literacy in IT and finance.

Digitalization also has an impact on the FSA's operation itself. We are looking for ways to take advantage of digitalization to become a more effective and efficient organization in terms of regulation ("RegTech": Regulatory Technology meaning an effort by financial institutions to use technology in their administrative procedures such as reporting to regulatory authorities) and supervision ("SupTech": Supervisory Technology meaning an effort by regulatory

authorities to utilize technology in their supervisory activities).

**JS: The challenge of digitalization of financial services seems to be horizontal and you would need to collaborate with many stakeholders.**

**Ariizumi:** The FSA believes that in a rapidly evolving world of digitalization, it is crucial to engage with important stakeholders to fully understand the recent trends and developments. To meet this end, the "FinTech Innovation Hub" was set up within the FSA last year which operates as a comprehensive platform to engage and interact with business, researchers and developers of technologies. It also annually hosts the "FinTech Summit" which gathers prominent stakeholders from various fields and from around the globe.

## **International Aspects of the FSA's Financial Digitalization Strategy**

**JS: We would like to ask you about the international aspects of your policies. First, in promoting base technologies for digitalization such as blockchain, AI and big data, you are promoting international joint research. Would there be any impediments or challenges to be overcome to achieve open innovation?**

**Ariizumi:** I would like to touch on mainly two domains in digitalized finance: one is crypto-assets, and the other is the underlying technology which supports them, that is distributed ledger technology. Assuming that the latter would widely benefit consumers and the economy, the FSA has been promoting a multilateral international research project in this area since 2017. It has pursued two main themes: the first was the security and vulnerability of the technology, and the second was the anonymity and traceability of transactions.

Financial regulators, including the FSA, have traditionally focused on regulating specific entities such as banks and securities companies in order to provide for customer and investor protection and maintain the stability of the financial system. However, as the distributed ledger technology aims at providing decentralized financial services in an open-end model, it may be difficult to identify any particular entity to regulate. Thus, it becomes important for financial regulatory authorities to study how it should be engaged in such a decentralized system.

**JS: As FinTech prevails, concerns about cybersecurity will increase, I assume, given the current situation in which national governments are increasingly being**

**involved in cyberattacks. Could you tell us about the current international discussions on this issue?**

**Ariizumi:** This issue is mainly discussed by the G7. There are already several publicly available deliverables including fundamental elements of cybersecurity for the financial sector which were issued in October 2016. At the G20, we expect to hear about the Financial Stability Board's (FSB) work on identifying, assessing and reporting on best practices relating to a financial institution's response to, and recovery from, a cyber incident.

**JS: What issues related to finance overall will the FSA raise at the G20?**

**Ariizumi:** There are three priorities for the G20 financial sector agenda. One is addressing the risk of market fragmentation, resulting from inconsistent, incompatible or duplicate regulatory and supervisory practices. These issues could affect cross-border activity in the global financial market, and the financial institutions intermediating the transactions may have to bear additional costs to meet different regulations. We would hope that discussions at the G20 could find possible processes and approaches to prevent further proliferation of market fragmentation.

The second is financial innovation. We need to ensure that the potential benefits of technology in the financial sector can be realized while risks are mitigated. In addition to addressing various risks of crypto-assets, we will embark on a longer-term journey on how we can make sure that the new distributed financial technology will achieve its full potential.

The third priority is how we can realize financial inclusion in an aging society.

**JS: Could you give us more details about the third issue?**

**Ariizumi:** We are already starting to witness a rapid progress of aging across the globe, including in emerging and developing countries. In Japan, half of the people born in 2007 could live over the age of 100. The population over 60 years old will exceed 2 billion globally in 2050 and there will be more aged people in developing countries than those in developed ones. Given such a background, we need to assess the impact of aging from the viewpoint of financial inclusion. There are many issues that may require thorough discussions. For example, what kind of financial services could be provided for the elderly in light of their physical and cognitive decline? Given their extended longevity, what kind of financial services, products and wealth accumulation will best suit their needs after their retirement? What are the implications of digitalization for

the elderly? On the one hand, it could provide for easier access to financial services and but on the other it could accelerate the digital divide by a more complex provision of digitalized finance.

As a frontrunner of aging, we believe that this is an issue of relevance not only for Japan but also for other countries, and it has received broad support from G20 countries including emerging and developing economies.

**Rules-based Approach to Digitalized Finance**

**JS: The G20 must be a forum to promote rules-based diplomacy, given that the world today is facing a crisis of global governance due to aggressive foreign policies initiated by the two superpowers. In the domain of finance, how can we ensure that a rules-based approach is among the issues for discussion at the G20?**

**Ariizumi:** There are several issues that could be taken up in the context of international financial regulation and one key topic is how we deal with digitalization. As I mentioned, under the G20 finance track, the FSA has prioritized technological innovation and will discuss the issues of crypto-assets and distributed ledger technology.

**JS: You are in charge of work covering the OECD, which I guess would be a relevant venue for informal discussions without any obligation to pursue rules-based diplomacy. Do you have any plans to take advantage of the OECD in this light?**

**Ariizumi:** Yes, we expect the OECD to significantly contribute to the G20 process this year. The OECD is an international organization with ample knowledge and deep and comprehensive expertise on global issues. In the G20 finance track, there are several key agendas which we look for and encourage the OECD's contribution: international taxation (including digital taxation – tax on the sales and revenues generated from cross-border transactions), corporate governance and financial inclusion in an aging society.

**JS: Data security is now a crucial international issue. The US and European Union are increasingly concerned about data security in China. How do you think we can pursue a rules-based approach in achieving internationally harmonized data security rules?**

**Ariizumi:** The issue of data security is becoming very important. In

the past few years, data has become a source of critical value, both in the private sector as well as in the public sector. On the other hand, there are several key policy issues that must be considered including treatment of private business companies' information and intellectual property rights and data privacy. Some countries have started to strengthen the rules on data security, as represented by the EU's new General Data Protection Regulation (GDPR). Japan will also need to think about its data security while taking into account business and policy developments in other major countries.

**JS: On other aspects of a rules-based approach, rule-making on virtual currencies is under progress. Could you tell us about this process and also what Japan should be aiming to achieve by it?**

**Ariizumi:** Japan introduced regulation of virtual currency exchange providers earlier than other countries. This was in response to the issuance of the Financial Action Task Force's (FATF) guidance on virtual currencies. The FATF is an international organization in charge of anti-money laundering and countering the financing of terrorism. The bankruptcy of Mt. Gox, the largest virtual currency exchange service provided at the time in Japan, also prompted its introduction. Given our experience of regulation and supervision of virtual currency exchange providers, coupled with lessons learnt from individual incidents, the FSA feels it could contribute and lead the international rule-making discussions in this field.

There are several risks which the G20 has identified related to crypto-assets. One important risk is financial stability risk. Since the use of crypto-assets as a means of payment is still limited, the risk posed by crypto-assets is limited at the moment. However, there is broad consensus that we should continue to monitor the usage of crypto-assets and its implications for the financial system. On risks of money laundering, the FATF has decided to upgrade the existing guidance on virtual asset service providers to mandatory standards to be implemented by the member countries.

There are no international rules or guidance on investor protection and market integrity risks of crypto-assets and the International Organization of Securities Commissions (IOSCO), an international organization of securities regulators, is currently working vigorously on these issues.

Our presidency for the G20 this year is encouraging the work at the FSB and relevant standard-setting bodies and we expect tangible deliverables to the G20 in June 2019.

**JS: International networking and cooperation among various financial authorities would lead to global rule-making on digitalized finance. What are you thinking specifically about this cooperation or networking?**

**Ariizumi:** The FSA is very active to enhance bilateral cooperation on FinTech and has signed a formal Exchange of Letters with eight financial authorities from seven jurisdictions. Through this cooperation framework, the authorities introduce FinTech entrepreneurs which are interested in entering each others' markets and support their entrance by providing consultations and advice. Moreover, through information sharing between authorities, mutual understanding could be facilitated, and we could be updated on recent developments in other countries.

**JS: Japan hosted the "FinTech Summit" in Tokyo in 2018. I believe it was organized at Japan's initiative. What do you think were the major achievements of this international event? Is Japan planning to take initiatives on other occasions?**

**Ariizumi:** The "FinTech Summit" is a landmark event not only for the participants but also for the FSA to help us learn about the cutting edge of financial innovation. For regulators, it is very important to ensure that the benefits of technological innovation are fully utilized while risks are mitigated. Therefore, we need to fully understand the technology from a forward-looking perspective. This will enable us to make a sufficient assessment of developments with an appropriate response. So, financial regulatory bodies including the FSA should devote resources to understand new business in terms of the future potential of digitalized finance. To ensure that we are taking a holistic approach, I think it will be crucial to exchange information and views with academia, engineers and industry executives globally. The "FinTech Summit" serves as an ideal platform which enables such kind of interaction.

**JS: As you said, the private sector must be an important player in FinTech. How do you organize dialogue with private businesses, apart from the "FinTech Summit"?**

**Ariizumi:** The members of the above-mentioned "FinTech Innovation Hub" are engaged in dialogues with more than 100 FinTech-related parties including researchers and engineers working on digitalized finance. We do our best to keep up with the most recent trends in FinTech and have a good sense about the new technology that is about to be introduced by businesses.

**JS**