

Despite discussions between our respective air transport negotiators, as well as communication through diplomatic channels, Japanese officials have refused to grant Canada any new capacity or slots at Narita. Canada remains concerned that these exclusions will compromise Canada's opportunity to expand air services to Tokyo for years to come. Canada will continue to press Japan to reconsider its position on these issues, which would result in enhanced services for the travelling public and commercial benefits for the airlines of both countries.

Financial Services

Japan has made significant progress in deregulating the financial services sector in recent years. With the entry of many foreign financial services providers (although they still do not hold major market shares) and with continued progress by Japanese banks toward a more sustainable business model, Japan's financial sector is well on the path to a major transformation. Competition is increasing in the marketplace, non-performing loans are on a downward trend and credit practices are improving. Clearly, this has led to more competition, more consumer choice and a more resilient financial system.

However, the system remains vulnerable to economic shocks, and new lending is still low as banks remain focused on balance-sheet improvements. Continued and robust financial sector reform, increased shareholder accountability and aggressive action on industrial revitalization are required to foster a dynamic, sustainable and efficient financial sector.

Macro-level Supervision Is Required

In order to introduce genuine and transparent regulatory reform, a regulatory system that focuses on macro-level financial supervision is desirable. Despite improvements, Japan's financial supervisors still apply a micro-level regulatory and supervisory approach, often focusing too much on day-to-day operations of financial institutions or on product approval. Applying an *ex post* supervisory approach that promotes efficiency and competition, rather than the current *a priori* regulation and supervisory approach, would enhance the efficiency of Japan's financial system without harming its safety or soundness.

The Public Sector Should Play by the Same Rules

Canada continues to have a general concern that most government financial institutions in Japan provide services that significantly overlap with those that private sector institutions can provide efficiently. The involvement of government enterprises in the financial sector, some of which (such as the Postal Savings system or *yucho* and the Postal Life Insurance system or *kampo*) have very sizable market shares, distorts competition significantly and could be seen to contravene Japan's GATS commitments.

Public institutions should be made to compete in a manner that does not discriminate against the private sector. Canada supports the efforts of Prime Minister Junichiro Koizumi's government to streamline and privatize government financial institutions. As much as possible, Japan should seek to use private institutions to promote increased financing and corporate rehabilitation. Foreign financial institutions and companies can play a useful role in achieving the Japanese government's reform efforts.

Banking and Securities

Most major industrialized countries have moved to a regulatory framework that allows for greater synergies among the financial activities of financial conglomerates. However, the requirement in Japan for so-called firewalls between banking and securities has been a concern for Canadian financial institutions operating in Japan. It imposes considerable additional costs and does not allow for optimal efficiencies for clients. In some cases it may actually increase risk. Canada continues to request that the Financial Services Agency (FSA) offer a more flexible regime that is sensitive to smaller institutions' need to contain costs. A longer-term goal, which fits with the FSA's current efforts to define a medium-term "vision" for the financial sector, should be to break down the wall between the lines of business noted above.

Life Insurance

The Postal Life Insurance system or *kampo* holds about 40% of life insurance assets in Japan. The passage of legislation to establish the Postal Service Public Corporation is a concrete step toward reform of the institution, but this legislation does not alter