

Recent Trend of Financial and Capital Markets, Regulatory and Supervisory Challenges

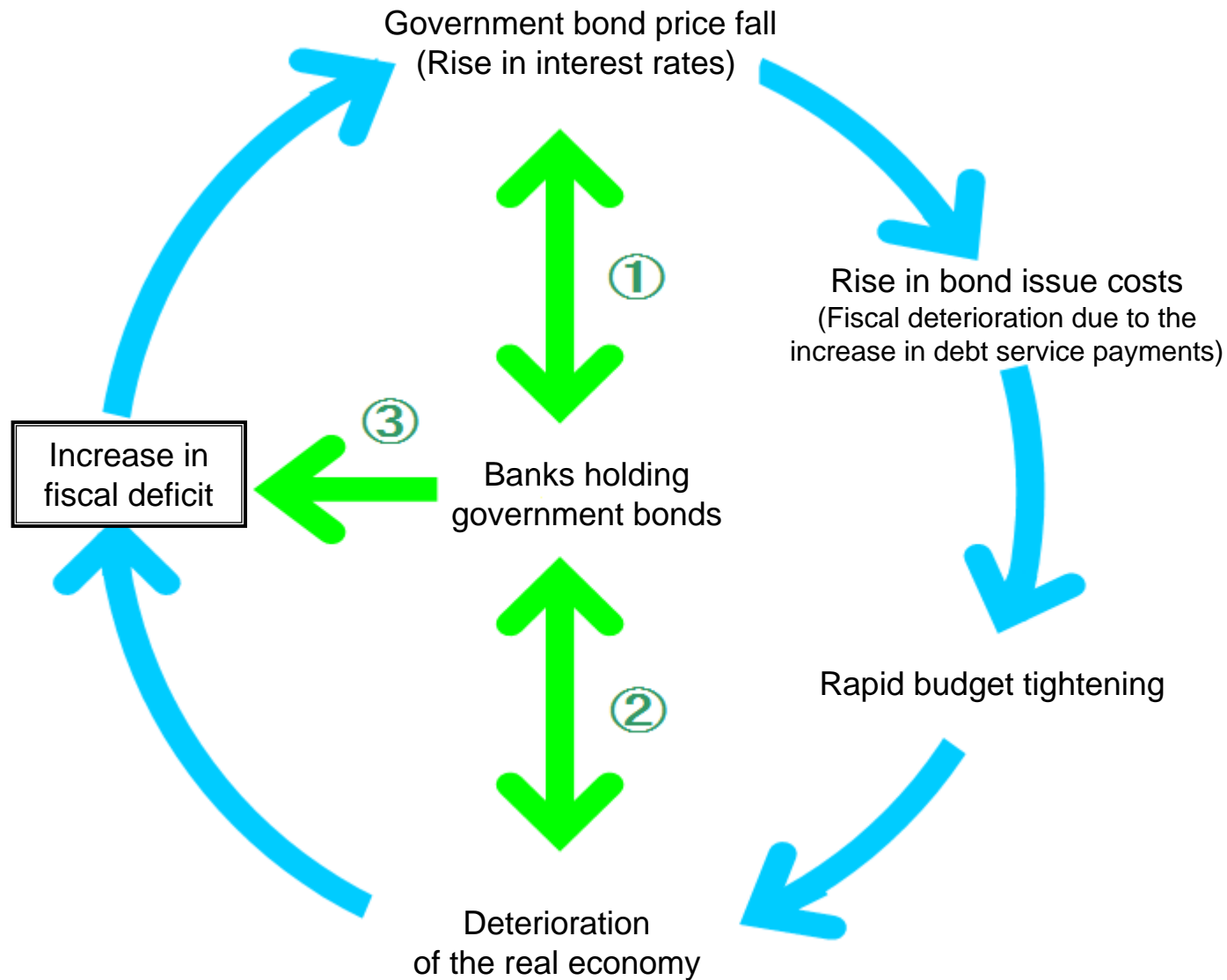
Ryutaro Hatanaka

Financial Services Agency

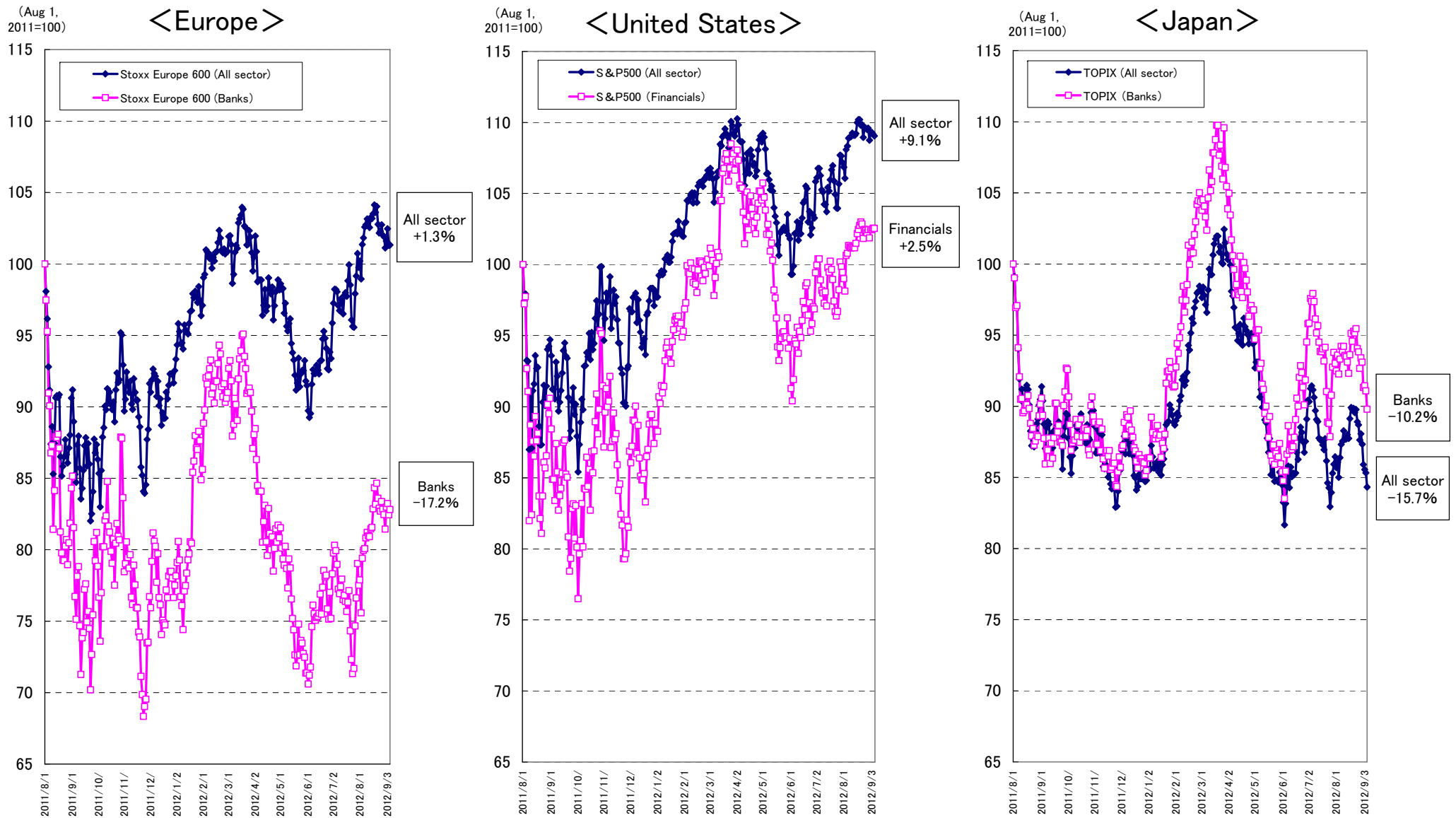
September 12, 2012



Transmission Mechanism of Sovereign Risks



Stock Price Comparison (after August 1, 2011)



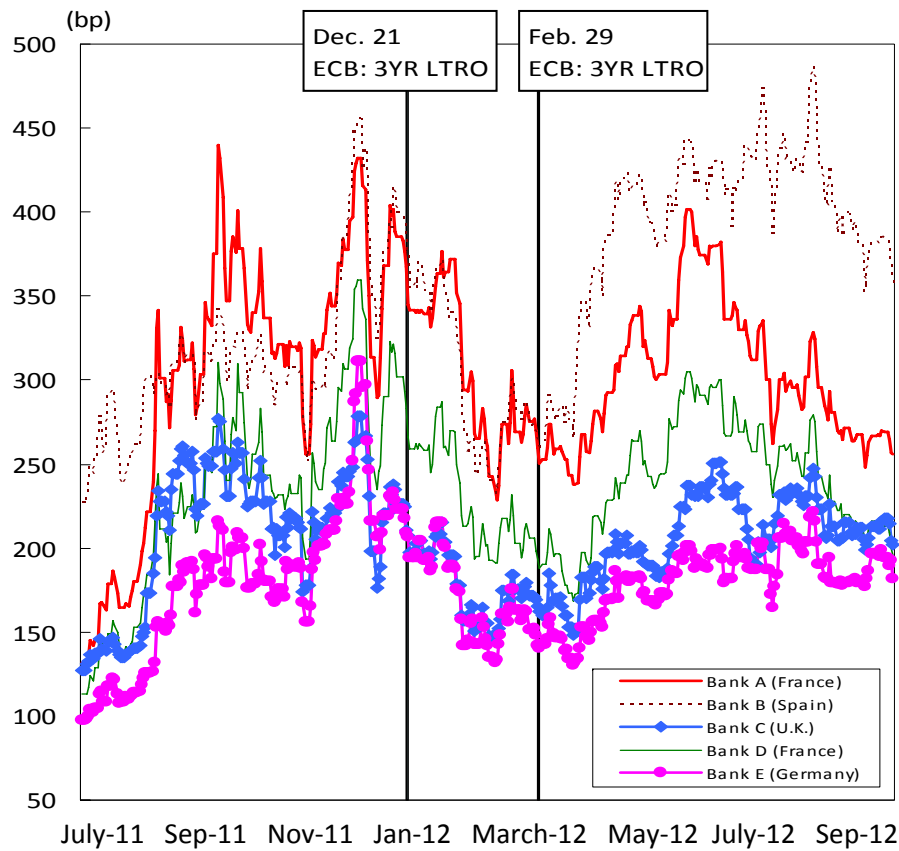
(Source) Bloomberg

Credit Risks of European Banks

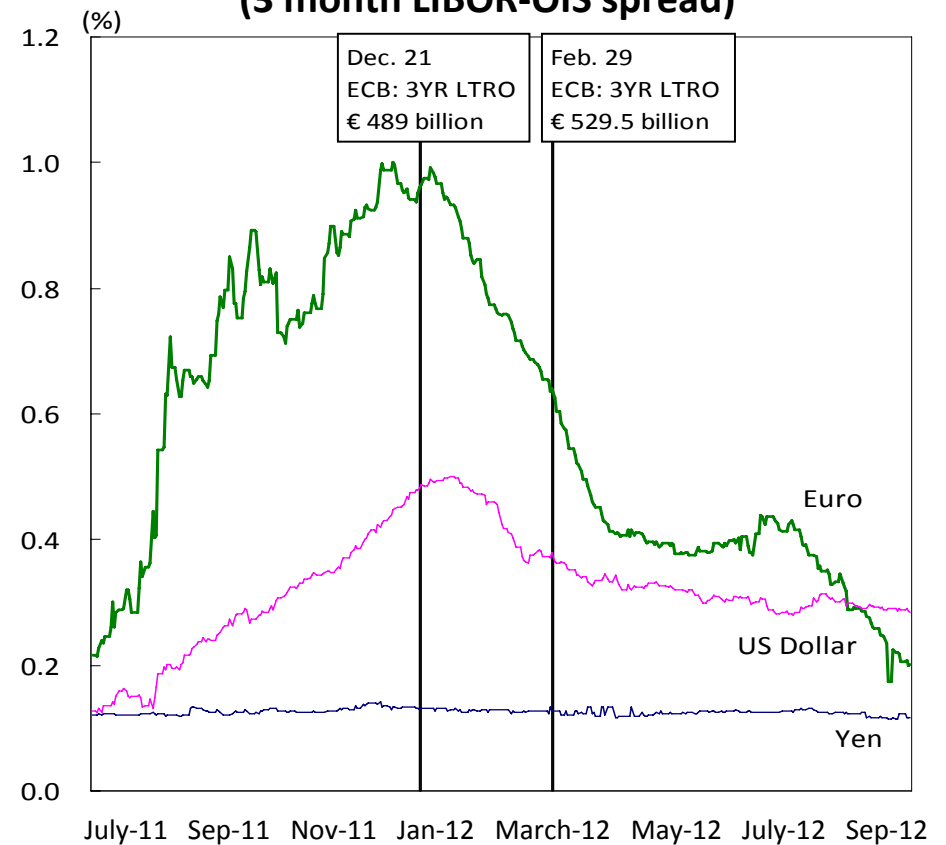
In the second half of 2011, increase in concerns about European banks led to the rise of their funding costs.

After that, liquidity concerns have been alleviated due in part to the fund provisions by the ECB.

CDS of European banks



**Interbank funding costs
(3 month LIBOR-OIS spread)**



(Source) Bloomberg

(Note) LIBOR-OIS spread is derived by removing the effects of market expectation from interbank interest rates.

European Banks' Foreign Claims on Peripheral Countries (End of March 2012)

(In billions of US dollars)

		Banks										
		Total banks in 24 countries										
		※	European Banks							Japanese Banks	United States Banks	Non-European, Non-Japanese and Non-U.S. Banks
			Germany	France	Italy	Spain	Switzerland	United Kingdom				
B o r r o w e r s	Consolidated foreign claims	25,791	17,545	2,768	2,870	875	1,480	1,793	4,222	2,784	3,181	2,280
	Claims on Greece (percentage of the consolidated foreign claims)	79 (0.3%)	74 (0.4%)	6 (0.2%)	40 (1.4%)	2 (0.2%)	1 (0.1%)	2 (0.1%)	9 (0.2%)	1 (0.0%)	4 (0.1%)	0 (0.0%)
	Claims on Portugal (percentage of the consolidated foreign claims)	164 (0.6%)	158 (0.9%)	27 (1.0%)	20 (0.7%)	3 (0.4%)	77 (5.2%)	2 (0.1%)	20 (0.5%)	1 (0.0%)	5 (0.2%)	0 (0.0%)
	Claims on Ireland (percentage of the consolidated foreign claims)	415 (1.6%)	337 (1.9%)	94 (3.4%)	25 (0.9%)	15 (1.7%)	8 (0.5%)	13 (0.7%)	137 (3.3%)	21 (0.7%)	44 (1.4%)	13 (0.6%)
	Claims on Spain (percentage of the consolidated foreign claims)	572 (2.2%)	504 (2.9%)	140 (5.1%)	115 (4.0%)	26 (3.0%)	– –	19 (1.1%)	85 (2.0%)	21 (0.8%)	42 (1.3%)	4 (0.2%)
	Claims on Italy (percentage of the consolidated foreign claims)	722 (2.8%)	652 (3.7%)	133 (4.8%)	334 (11.6%)	– –	34 (2.3%)	21 (1.2%)	57 (1.4%)	29 (1.0%)	37 (1.2%)	4 (0.2%)
	Total claims on the 5 countries above (percentage of the consolidated foreign claims)	1,951 (7.6%)	1,725 (9.8%)	401 (14.5%)	534 (18.6%)	46 (5.3%)	120 (8.1%)	58 (3.2%)	308 (7.3%)	72 (2.6%)	132 (4.2%)	22 (1.0%)

(Source) BIS, "Banking Statistics"

※ The 24 countries are, in addition to those listed above, Austria, Greece, Ireland, Netherlands, Portugal, Sweden, Australia, Belgium, Canada, Chile, Chinese Taipei, Finland, India, Norway, Singapore, Turkey.

Foreign Claims on Asian Countries (BIS statistics)

(In millions of US dollars)

Foreign Claims on 9 Asian Countries	End of June 2011 (A)	End of March 2012 (B)	Changes (A—B)
Total Amounts Outstanding	1,795,192	1,809,339	+0.8%*
European Banks	938,740	891,631	-5.0%
France	124,184	87,591	-29.5%
Germany	101,329	99,332	-2.0%
Netherlands	56,204	54,094	-3.8%
Switzerland	84,540	79,840	-5.6%
U.K.	517,777	520,136	+0.5%
Italy	14,501	10,081	-30.5%
Spain	26,407	27,443	+3.9%
Japanese Banks	204,127	225,176	+10.3%
U.S. Banks	367,492	361,723	-1.6%
Banks of other countries**	284,833	330,809	+16.1%

(Source) BIS, "Banking Statistics"

* By country or region, changes in amount outstanding from the end of June 2011 to the end of March 2012 are as follows:

- claims on the six ASEAN members (Viet Nam, Philippines, Thailand, Indonesia, Malaysia and Singapore): +2.6%
- claims on Korea: -5.1%
- claims on India: -1.9%
- claims on China: +4.1%

** In this table, "Banks of other countries" includes banks of Austria, Greece, Ireland, Portugal, Sweden, Australia, Belgium, Canada, Chile, Taiwan, Finland, India, Norway, Singapore, and Turkey.

Measures against Accounting Fraud, such as that conducted by Olympus

Remarks by Minister of State for Financial Services (Abstract) (Dec. 16, 2011)

It is highly regrettable, from the viewpoint of market fairness and transparency, that Olympus Corporation has been engaged in deferring the posting of losses from securities and other investments for many years. The FSA should check to see whether there is room for improvement in the regulations and their implementation, and the FSA should take appropriate preventive measures against recurrence of such dishonest practices.

(1) Corporate governance

Listing rules and disclosure regulations need to be reviewed so as to clarify the role and the degree of independence of independent directors currently required by exchanges.

(2) Auditing

The FSA needs to take actions such as improving auditing procedures so as to deal with accounting fraud in the future.

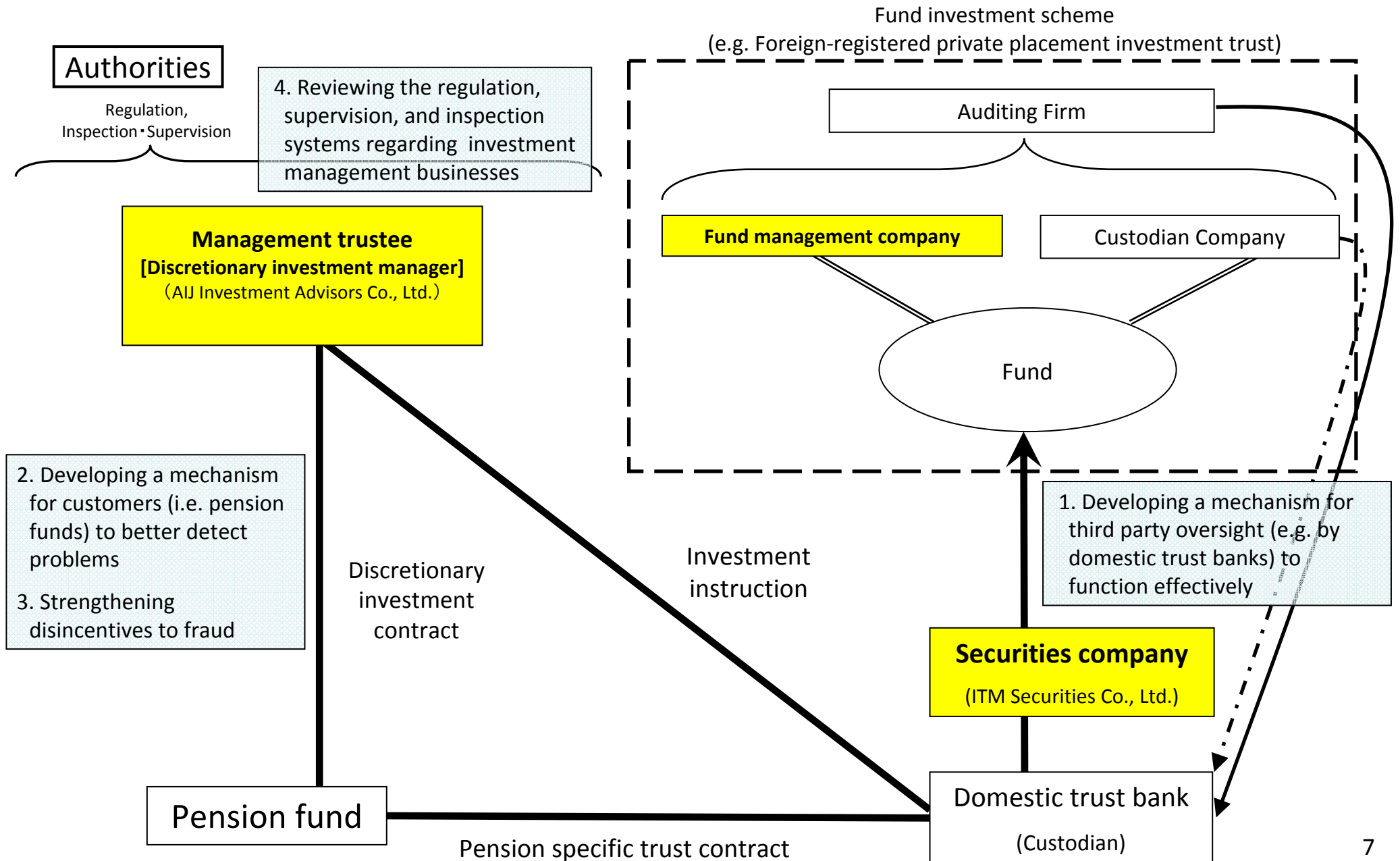
(3) The involvement of conspirators outside the company

The FSA will consider measures to correct and prevent the involvement of conspirators outside the company, such as money brokers, while closely watching new findings on this affair.

(4) Strength of inspection and monitoring functions

The FSA needs to strengthen inspection and monitoring functions to ensure the accuracy of securities reports and other financial disclosure documents. In addition, the FSA and stock exchanges together will consider measures to strengthen disclosure requirements on Mergers and Acquisitions.

Review of the Regulation and Supervision regarding Asset Management building on the Experience from the case of AIJ Investment Advisors Co., Ltd. (draft)



Review of the Regulation and Supervision regarding Asset Management building on the Experience from the case of AIJ Investment Advisors Co., Ltd. (draft)

1. Developing a mechanism for third party oversight (e.g. by domestic trust banks) to function effectively

- (1) Developing a mechanism for domestic trust banks to directly obtain “net asset value” and “audit report” from the reporting source
- (2) Requiring domestic trust banks to perform double-checks of the “net asset value”

2. Developing a mechanism for customers (e.g. pension funds) to better detect problems

- (1) Expanding information provided in Investment reports
- (2) Increasing the issuance frequency of Investment reports
- (3) Stricter eligibility requirements for pension funds to be authorized as “professional investors”
- (4) Introducing check mechanisms by Discretionary investment managers

3. Strengthening disincentives to fraud

Introducing stricter penalties toward Discretionary investment managers for (i) making false statements in investment reports delivered to customers, (ii) making fraudulent statements in the course of solicitation, and (iii) executing Discretionary investment contracts using fraudulent means.

4. Reviewing the regulation, supervision, and inspection systems regarding investment management businesses

- (1) Expanding information provided in Business reports submitted to the FSA
- (2) Strengthening supervision of Discretionary investment managers
- (3) Strengthening inspection of Discretionary investment managers
- (4) Reinforcing the authorities’ capacity for strengthening inspection and supervision

Measures against Insider Trading related to Public Offerings of Shares

Cases of “Insider Trading related to Public Offerings of Shares”

	Issuance of SESC's recommendation	Administrative monetary penalty payment Order	Listed Company	Announcement of public offering	Violator	Amount of administrative monetary penalty	Unfair profit obtained by funds
①	March 21 2012	June 27 2012	INPEX CORPORATION	July 8 2010	Chuo Mitsui Asset Trust and Banking Company, Limited	JPY 50,000	JPY 14.55 million
②	May 29 2012	June 26 2012	Nippon Sheet Glass Co. Ltd.	August 24 2010	Asuka Asset Management Co., Ltd.	JPY 130,000	JPY 60.51 million
③	May 29 2012	June 27 2012	Mizuho Corporate Bank, Ltd.	June 25 2010	Chuo Mitsui Asset Trust and Banking Company, Limited	JPY 80,000	JPY 20.23 million
④	June 8 2012	—	Tokyo Electric Power Company, Incorporated	September 29 2010	<ul style="list-style-type: none"> ▪ First New York Securities LLC ▪ Individual 	<ul style="list-style-type: none"> ▪ JPY 14.68million ▪ JPY 60,000 	<ul style="list-style-type: none"> — —
⑤	June 29 2012	—	Nippon Sheet Glass Co. Ltd.	August 24 2010	Japan Advisory Limited Liability Company	JPY 370,000	JPY 16.24 million

Measures against Insider Trading related to Public Offerings of Shares

Review of securities companies' systems for managing material non-public information (Announced by the Financial Services Agency on July 3, 2012)

1. Outline

In light of the series of insider information leakage at major securities companies, the FSA ordered 12 major securities companies that recently played an important role in the underwriting of large-scale public offering of new shares to conduct a review of their systems for managing material non-public information

2. Securities companies covered by the review

Securities companies that participated in the recent, large public offerings of new shares as lead managing underwriters

SMBC Nikko, Goldman Sachs, Citigroup Global Markets Japan, JP Morgan Securities Japan, Daiwa, Deutsche Securities, Nomura, Mizuho Securities, Mitsubishi UFJ Morgan Stanley, Merrill Lynch Japan Securities, Morgan Stanley MUFG Securities, UBS Securities Japan

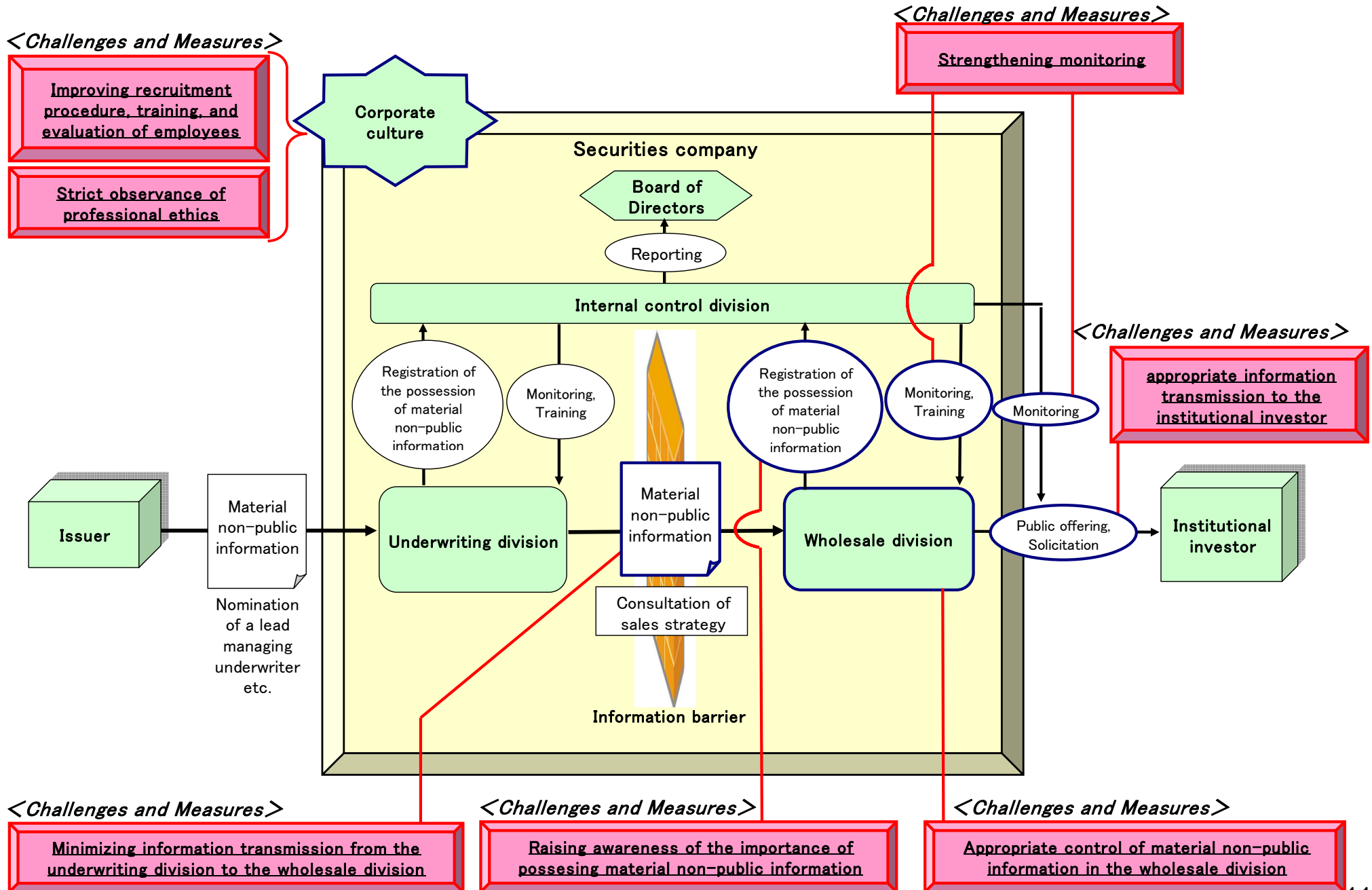
3. Scope of the review

- (1) Internal organizational structure
 - Underwriting division, wholesale division, internal control division
- (2) Status of material non-public information management
 - Internal rules, information barrier
 - Monitoring by internal control division
- (3) Challenges and measures with regard to (1) and (2)

4. Schedule

July 3, 2012 Issuance of the reporting order
August 3, 2012 Reporting deadline

Measures against Insider Trading related to Public Offerings of Shares



Measures against Insider Trading related to Public Offerings of Shares

July 4, 2012

Financial System Council
Chairman Naoyuki Yoshino

Minister for Financial Services
Tadahiro Matsushita

Pursuant to article 7, paragraph 1, item (i) of the Act for Establishment of the Financial Services Agency, the Financial System Council is requested to conduct deliberations on the following theme.

- In view of the recent insider trading related to public offerings, the Council is asked to consider the following issues in order to assure the reliance of investors on the fairness and transparency of the Japanese markets.
 - how to treat the act of communicating insider information
 - the method of calculating the monetary penalty amount
 - revisions of the insider trading regulation that will be required in light of the trend of insider trading cases in recent years and the actual circumstances of financial and business practices

Comprehensive Strategy for the Rebirth of Japan

“Rebirth of Japan: A Comprehensive Strategy” (Cabinet Decision: July 31, 2012)

(iii) Revitalization of financial capital markets through new capital flows

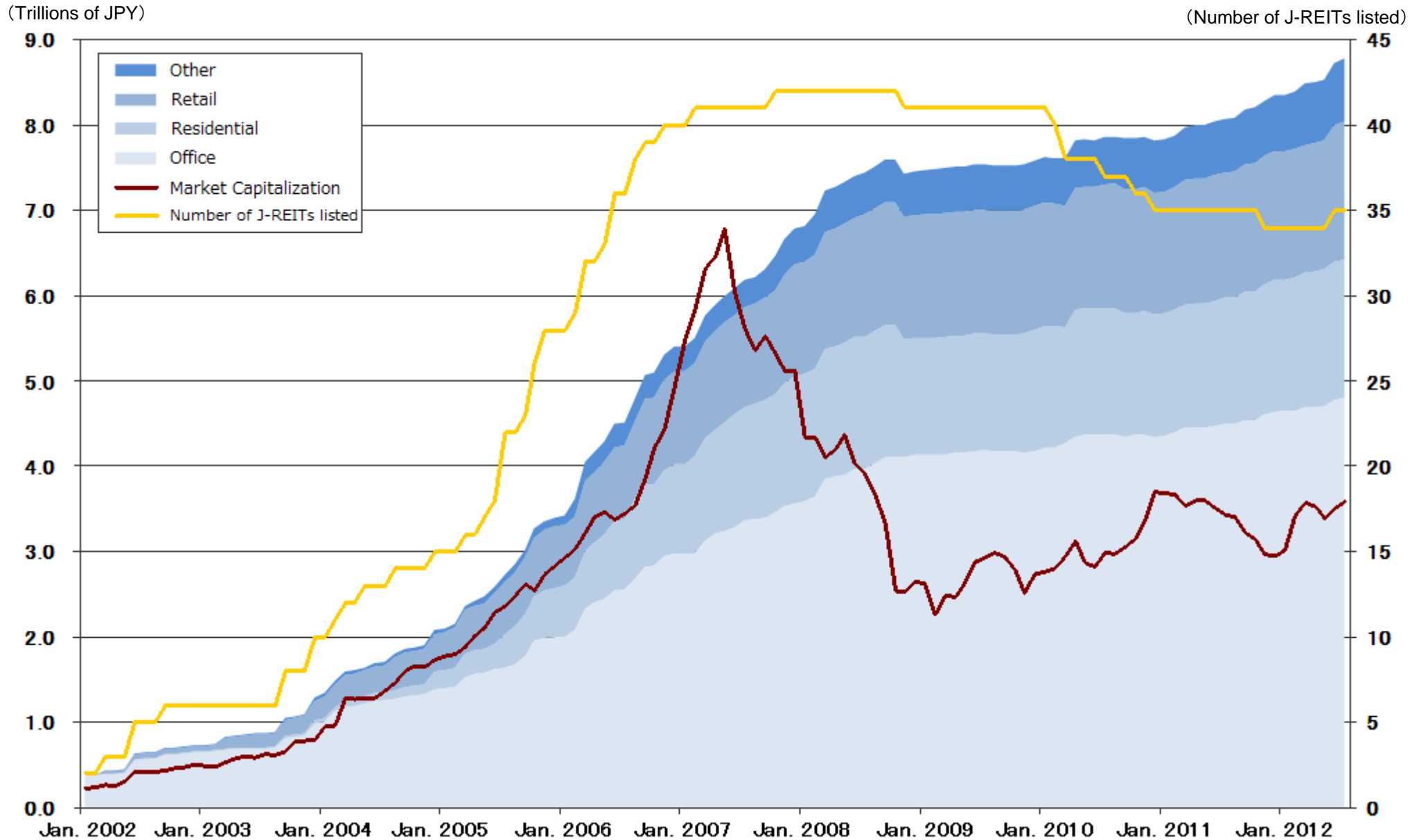
To enhance growth potentials, it is important to stimulate growth-related demand through bold and effective regulatory reform for making growth seeds commercially viable. At the same time, it is important to expand the supply of growth money, which serves for the launching of new businesses, through proper role-sharing between the public and private sectors. Risk capital is not sufficiently available to newly-launched businesses, preventing economic revitalization. Moreover, the financial and real estate industries that serve as an intermediary for capital are themselves slumping. It is necessary to enhance growth potential through the proper fulfillment of the brokerage function. For this reason, the government will expand growth money supply for the financing of corporate growth, business revitalization and reorganization, and start-ups of new businesses, as well as appropriately checking out commercial feasibility and pushing ahead with enhancing the functions of financial capital markets so that necessary funds will be provided to new growth industries/markets. Furthermore, the government aims to strengthen growth potential and the competitive edge of the financial industry and revitalize the real estate investment market.

[Financial Strategy]

(Expansion of funds for growth)

... The government will push to end asset deflation by revitalizing the real estate investment market through the development of infrastructures aimed at revitalizing the J-REIT market and expanding real estate securitization ...

Value of Assets owned by J-REITs and Market Capitalization of J-REITs



(Source) ARES (based on data provided by public documents)

Working Group on the Revision of the Legal Framework for Investment Trusts and Investment Corporations

January 27, 2012

Pursuant to article 7, paragraph 1, item (i) of the Act for Establishment of the Financial Services Agency, the Financial System Council is requested to conduct deliberations on the following theme.

- Revision of the legal framework for Investment Trusts and Investment Corporations in order to develop an environment in which people can effectively utilize their assets.
 - (1) Investment Trusts: Making the regulation flexible to suit trends in international rules and changes in social and economic circumstances, and ensuring the supply of appropriate products in consideration of ordinary investors
 - (2) Investment Corporations: Improvement of the stability of financial foundation, including diversification of financing methods; assurance of management that can be better trusted by investors and of the transparency of transactions