Provisional translation
As of November 20th in 2018

I. For providing Better Financial Services in the Era of Transition

Accelerating digitalization, reduction and aging of population, and prolonged low-interest rates have been drastically changing the environment surrounding finance. In order to achieve the financial administration, i.e., "Enhancing national wealth through securing sustainable growth of corporations and the national economy as well as promoting long-term personal asset building," it is imperative that financial services be upgraded by taking advantage of these changes in the environment or by appropriately responding to these changes.

To improve financial services, financial institutions are required not only to comply with minimum-standards, such as laws and regulations necessary to protect customers, but also to establish and adhere to customer-oriented business conduct, and to serve financial intermediation functions through both direct and indirect financing, which enables them to more efficiently provide financial services that suit the needs of customers. Through these efforts, financial institutions must enhance user convenience, and thus secure sustainable growth of financial assets held by households as well as supply funds to companies and industries. The Financial Services Agency (JFSA) is also required to encourage financial institutions to develop new services that meet the needs of customers and to provide more efficient services by appropriately responding to the evolution of digitalization in the financial world.

Therefore, to respond precisely to these tasks and to upgrade financial services, the management of financial institutions are required to make appropriate business decisions under effective business strategies and business plans based on corporate visions and environmental changes, and to have such decisions cascade down to operational levels. Equally, the boards of directors of financial institutions are required to make useful contributions to management teams such as showing the broad directions of business strategies, and at the same time to discipline them effectively from an independent and objective standpoint.

Furthermore, to provide financial services suited to the needs of users, it becomes ever more important to promote active capital market through the reform of corporate governance and enhancement of corporate disclosure, as well as to secure market integrity and transparency.

In order to address these issues, improve financial services, secure the sustainable growth of corporations and national economy and enhance national welfare, Japan's financial system must be stable. Although the Japanese financial system is generally stable and robust at this point, the JFSA needs to closely monitor economic and financial market trends at home and overseas and check whether their potential impacts and risks on Japan's markets and financial institutions are being appropriately dealt with by market participants, financial institutions, and others.

In addition, the stability of the global financial system is crucial for that of Japan's financial system. The sustainability of the economic and financial systems in the wake of accelerating digitalization and aging is coming to be recognized as a common global concern. Thus, it is also necessary for Japan to take the initiative to tackle such global challenges.

In order to realize the objectives of the financial administration, the JFSA, as the “Financial Nurturing Agency”, will take firm steps to address these issues so that financial services can be steadily improved in this era of transition. In doing so, given that finance is a far-reaching concept related to almost all economic transactions by various bodies, the JFSA will analyze problems and propose policy tools from the perspectives of realizing an optimal flow of funds across Japan as a whole and reaching a better equilibrium, without being confined to its own jurisdiction alone. The JFSA will also continuously reform itself and accelerate efforts toward its transformation into the “Financial Nurturing Agency” with the view to improving the quality of its financial administration.

1. Responding to the accelerating digitalization- “Finance Digitalization Strategy”-

Digitalization is expected to bring new players into the financial sector, give rise to innovative services, and exponentially enhance user convenience. As digital information is utilized in both financial and non-financial services, which may open the door for more sophisticated consumer-oriented financial services, existing financial institutions are required to adapt their business models in a customer-oriented way so that they can provide financial services better suited to the needs of users. The JFSA developed the “Finance Digitalization Strategy” comprising a total of 11 measures for the improvement of financial services in light of such changes in the environment.

Furthermore, the JFSA created the “FinTech Innovation Hub” under the Strategy, which will hold discussions and interact with venture companies and other experts to better understand the trends and direction of FinTech, and utilize the insights obtained to foster sound FinTech-related businesses.

2. Promoting long-term personal asset building

With the advent of the era of 100-year lifespans, it is needed now more than ever that users be provided over the course of their lives with high-quality, appropriate financial services tailored to their life plans, and realize stable personal asset building. It is therefore increasingly important for financial institutions to establish customer-oriented business conduct that matches the demand in each stage of users’ lives, and to promote long-term, installment and diversified personal investment.

(1) Encouraging customer-oriented business conduct

The JFSA will conduct in-depth monitoring of financial institutions through dialogues with managers, directors and others at financial institutions to see how they incorporate the “Principles for Customer-Oriented Business Conduct” in their corporate philosophies, develop their business strategies to realize the principles and link them to specific efforts, as well as how their corporate visions, strategies and efforts are permeating and being practiced in everyday business operations.

The JFSA will conduct customer questionnaires, utilizing indicators that quantify customer loyalty, and analyze the actual status of implementation to see how customer-oriented business conduct, through efforts of financial institutions, are implemented in their responses to customers in everyday business operations of financial institutions as well as considered in the selection of financial institutions by customers.

The JFSA will spread and permeate the common KPIs comparable across investment trust distributors, and encourage financial institutions to publish them to “visualize” their efforts. Furthermore, the JFSA will aim for further “visualization” of the features of financial instruments to users, including savings-type insurance products as well as investment trusts.

(2) Realizing long-term, installment and diversified personal investment

The JFSA will conduct a concrete study on the scheme to support the lifelong long-term personal asset building referring to ISA in the UK and in cooperation with other ministries and agencies.

The JFSA will drastically expand the number of school visits by officials of the JFSA and the Local Finance Bureaus of the Ministry of Finance for lectures on finance and economy while acknowledging that improving financial literacy is an important role of the JFSA and the Local Finance Bureaus. Considering the lessons from the school visits and the progress of digitalization, the JFSA will improve the content of the lecture and teaching materials, and build a network to promote financial and economic education.

(3) Developing financial services in the aging society

As longevity increases, people need to form a plan to build, withdraw, and inherit their assets suited to their own individual situations, preparing for long lifespans.

In view of this, the JFSA plans to have discussions on (a) the promotion of financial services and products suitable to respective life stages and situations of customers, (b) “visualization” of post-retirement income and expenditure and the features of financial products and services appropriate to the conditions of various users, (c) financial services for smooth inheritance of personal assets and business operations, and (d) investor protection in light of financial gerontology. On the basis of these discussions, the JFSA intends to assemble the principles regarding the direction in which the financial industry should be headed, and matters customers should note, such as the switchover to customer-oriented conduct models and cooperation with non-financial sectors.

3. Promoting active capital market and securing market integrity and transparency

The JFSA will address the following issues in order to promote active capital market and secure market integrity and transparency, which serve as the basis for enhancing financial services and the stable formation of household assets.

(1) Promoting further corporate governance reform

The JFSA will hold "The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Corporate Governance Code" to review the reduction of cross-shareholdings, ensuring diversity of boards, and disclosure of proxy voting results by individual company and agenda basis. The JFSA will further promote corporate governance reform through the announcement of best practices of effective dialogues between companies and investors as well as initiatives taken by companies.

(2) Developing the asset management industry

Development of the asset management industry matters in revitalizing capital market and long-term personal asset building. With this awareness, the JFSA will proceed with comprehensive measures and efforts to revitalize and upgrade the asset management industry, such as enhancing the infrastructure for business operations, facilitating new entries, and training and recruiting human resources for investment management through dialogues with relevant parties, such as asset management industry operators, institutional investors, and trust banks. Regarding asset managers, the JFSA will seek to establish a more sophisticated attitude of their business operations by verifying and conducting dialogues about (a) attitude in controlling potential conflicts of interest among group companies, brokers and customers, (b) governance enhancing their investment capabilities, (c) attitude in investment management, and (d) attitude in selecting and supervising outside the management, based on examples of advanced cases overseas that contribute to the development of their operations.

(3) Reforming corporate disclosure and audits

The JFSA will develop a principles-based guidance, and collect and announce best practices, in addition to amending the applicable Cabinet Office Orders, to improve companies' disclosure, including the disclosure of business strategies and corporate governance information (cross-shareholdings, officers' remuneration, etc.).

In order to ensure the credibility of auditing, the JFSA will also examine how auditors should provide more detailed information to the capital markets in exceptional cases where their auditing opinions are different from those generally observed.

(4) Developing institutional infrastructure for financial and capital markets

In light of views that the credit markets, including the corporate bond market, do not offer adequate returns commensurate with risks involved and the markets are not fully performing their functions, the JFSA will study issues and measures to develop deep credit markets with a diversity of participants.

The JFSA will also seek an early establishment of the comprehensive exchange by strongly working on various parties concerned as the establishment of the comprehensive exchange that allows one-stop trading in a broad range of listed financial instruments should strengthen its international competitiveness, expand a market for derivatives trading, and also improve investor convenience.

(5) Enhancing market surveillance function

The SESC will improve the existing market surveillance method and points for monitoring, while continuing with timely market surveillance based on a macro perspective focusing on potential risks, by organically linking micro information with the macro perspective and utilizing such information. On top of making recommendations for administrative disciplinary actions, the SESC will share issues through dialogues with relevant parties and enhance public relations activities. Furthermore, the SESC will consider introduction of a new market surveillance system, including the utilization of AI and other advanced technologies.

4. Securing effective financial intermediation and financial stability

-The roles and responsibilities of management and governance-

Enhancing financial services and promoting active market require financial institutions to fully exercise their financial intermediation function while ensuring their sound management under the stable financial system. Thus, the JFSA will make the following efforts.

(1) The roles and responsibilities of management and governance

In rapidly changing business environments, financial institutions should ensure that these changes lead to the enhancement of their financial services. To this end, the management of financial institutions should take the initiative and formulate specific business strategies and business plans to appropriately respond to digitalization, establish customer-oriented business conduct, and improve financial intermediation function while managing the various risks and ensuring the soundness of financial institutions. With the business strategies and business plans in place, the management of financial institutions are required to clarify necessary actions, build the attitude for steadily putting them into practice, and ensure that they are cascaded down to operational levels.

Furthermore, the boards of directors of financial institutions are required to make useful contributions to the top management teams by setting the broad directions, including business strategies, as required under the Corporate Governance Code, and improve effective discipline over the management teams from an independent and objective standpoint.

With such recognition of issues, the JFSA will have in-depth dialogues with management teams including the top management, directors including external directors, *Kansayaku*, and persons responsible for the sales departments of financial institutions, and will carefully monitor financial institutions.

(2) Regional financial institutions

Appropriate planning and implementation of business strategies by the management and effective governance by the board of directors are essential for a stable revenue base and long-term fiscal soundness, as well as effective financial intermediation to increase productivities of regional companies and thus contribute to the development of the regional economy. In order to realize their corporate visions, management teams are required to develop business strategies based on accurate analysis on the current business environment and build the corporate structure for steady implementation of the strategies (the use of the risk appetite framework (RAF) etc.). In doing so, it is important for the management to work on these efforts with certain timelines in mind and constantly verify the outcome of these efforts and seek improvements (PDCA cycle). It is important for the boards of directors to exercise governance and make useful contributions to and effectively discipline management teams from an independent and objective viewpoint.

Recognizing these issues, the JFSA will conduct on-site and off-site monitoring in an integrated manner and make use of inspections to secure financial soundness of regional financial institutions into the future. Regarding regional financial institutions with serious problems, the JFSA will urge them to take early responses to solve the problems. To this end, the JFSA will amend the Early Warning Mechanism from the perspective of encouraging them to improve their management as early as possible.

The JFSA's Special Team to Support Regional Productivity Enhancement, in cooperation with the Local Finance Bureaus, will examine in detail the realities of regional companies and economies through the network of and dialogues with local companies and other stakeholders (local governments, the Chambers of Commerce and Industry, etc.). Founded on this examination, in-depth dialogues with the management and the chief officers of the front line of regional financial institutions will be conducted to enhance their financial intermediation functions.

The JFSA will continuously have dialogues with other ministries and agencies about the desirable cooperation between public and private finance in the fields of regional as well as small business finance. Also, the JFSA will make a contribution to government-wide discussions with respect to competition policy in terms of securing regional financial infrastructures and providing better-quality financial services with local companies and residents.

(3) Major banking groups

Although major banking groups are in sound condition and their CET 1 ratios have increased, their profitability is decreasing. Globally, potential systemic risk could be accumulating, as seen in the rising prices of risk assets and increasing risk-appetite. Major banking groups face challenges to develop measures to respond to abrupt changes in economic and financial market conditions at both domestic and overseas level, as well as to secure stable foreign currency funding. Given these conditions, the JFSA conducts horizontal reviews on the seven major banking groups and encourage them to promote the pursuits of best practices including those of the management, et al. The JFSA also holds dialogues with management teams including the top management and executives responsible for internal controls and business divisions, and directors including external directors on enhancing management and governance framework in order to enable them to appropriately respond to changes in the business environment such as digitalization and so on.

(4) Other financial sectors

It is important for insurance companies to build risk management structures and sustainable business models that allow them to flexibly respond to changes while ensuring customer-oriented business conduct amid the changing business environment and risks, including the shrinking domestic insurance market and new insurance needs in association with the changing social environment. To this end, it is necessary for insurance companies to exercise governance. The JFSA will monitor insurance companies from these perspectives.

The JFSA will monitor securities companies on points such as the deployment of a stable revenue base for financial soundness that will not be affected by market conditions, risk management for global business operations, proper considerations for customer benefit on business models, and the board of directors' supervision to ensure appropriate governance functions for strategic decisions and business issues.

With regard to foreign financial institutions, the JFSA will monitor internal control and governance, taking account of changes in risks at Japanese branches and subsidiaries. The JFSA will collect and utilize knowledge and information on best practices of global financial institutions through dialogues with the head offices and the Japanese branches and subsidiaries of foreign financial institutions in order to improve JFSA's supervision and Japan's financial system. Furthermore, the JFSA will strengthen the capacity of the authorities as well as global systemically important banks (G-SIBs) to manage potential crises at G-SIBs operating in Japan.

5. Enhancing trust from customers - conduct and compliance issues -

(1) Compliance risk management

There are financial institutions whose inappropriate conduct could affect their sound management or whose compliance problems, which are not considered to be important management issues, elicit limited responses. The JFSA will monitor financial institutions by gathering broad and diverse information and assess risks in light of the business models.

(2) Loans for investment property

Regarding loans for purchasing investment property, including apartments, condominiums and shared houses, there have occurred customer protection problems such as falsification of the information (occupancy rate, rent, assets and income of customers etc.) involving the financial institutions and agents, and cross-selling. Given credit risk management problems, such as losses caused to financial institutions in cases where customers were indebted excessively and defaulted, the JFSA will in-depth monitor lending for real estate investment, making use of industry-wide questionnaires and inspections as necessary.

(3) Virtual currencies (crypto-assets)

The domestic and overseas environments surrounding virtual currencies (crypto-assets) are rapidly changing, such as volatility in price, emergence of new type of transactions such as margin transactions and Initial Coin Offering (ICO) activities, and occurrence of incidents where customer assets in deposits were lost from virtual currency exchanges. Taking this into consideration, the JFSA will seek to ensure that virtual currency exchanges provide appropriate services, so as to protect customers, while paying due consideration to innovation.

6. Contributing to global policy discussion and building global network

(1) Contributing to global policy discussion

There are global issues related to the sustainability of the economic and financial systems associated with the digitalization and the aging society. Towards the Japanese G20 Presidency in 2019, the JFSA is to take initiatives for tackling a wide range of global policy agendas including evaluating effects of the regulatory reforms, addressing market fragmentation, considering multilateral responses in the area of crypto-assets, and promoting financial inclusion in the aging society.

With respect to the Sustainable Development Goals (SDGs), the JFSA will continue to work proactively to achieve the SDGs, including supporting disclosures aligned with the recommendation of the Task Force on Climate-related Financial Disclosures (TCFD).

Regarding anti-money laundering and combating the financing of terrorism, the JFSA will take a lead in discussions in the G20 and the Financial Action Task Force (FATF), particularly in the area of crypto-assets, where Japan has spearheaded introduction of a regulatory framework. The JFSA will also strengthen monitoring of Japanese financial institutions to promote their risk-based management approaches.

(2) Building global network and cross-border cooperation

With respect to cooperation framework with foreign authorities, it is important to build the framework contributing to economic growth and financial stability of both countries. With this in mind, the JFSA will promote cooperation in various frameworks including Japan-U.S. Economic Dialogue, Japan-EU financial regulatory cooperation framework, Japan-China financial cooperation, and technical assistance plans for Myanmar. Regarding technical assistance to Asia and other emerging countries, the JFSA will contribute to capacity building of emerging countries through assistance program in accordance with needs of counterpart countries, taking into account requests of Japanese financial institutions for their possible entry and business expansion. As for the Global Financial Partnership Center (GLOPAC), the JFSA will further improve the quality of programs of the GLOPAC including lectures and networking with its alumni fellows. These initiatives will strengthen regulatory and supervisory cooperation frameworks with counterpart authorities.

7. Reforming the JFSA

In order to appropriately tackle the issues and challenges discussed above, the JFSA, as well as how it pursues its regulatory goals and priorities will need to adapt accordingly. From this perspective, the JFSA will continuously reform itself and review its supervisory approaches.

(1) Reforming the JFSA

In order to improve the JFSA's performance continuously, it is necessary that the JFSA will become a satisfying and fulfilling workplace where the staff can develop their careers.

To that end, the JFSA will foster human resources, mainly young officials, and vitalize the JFSA itself by developing an environment where communication between the group manager and the members can be more effective (formation of small -groups in each division) and establishing a framework under which the JFSA staff, by collaborating with external experts, can proactively make new policy proposals (Open Policy Laboratory).

In order to ensure that these reform initiatives take root firmly, the JFSA will regularly check the progress of cultural and governance reforms, including conducting employee satisfaction survey, and take further actions.

(2) Reforming supervisory approaches

In line with "The JFSA's supervisory approaches -Replacing checklists with engagement-" published in June 2018, the JFSA will make further progress in (a) continuous and seamless on-site and off-site monitoring and (b) monitoring focused on priority supervisory areas.

As a supervisory framework, for such supervisory areas that the JFSA intends to share the direction of monitoring with financial institutions, the JFSA will publish "theme specific reports," use them as a basis of dialogue with financial institutions to develop common understanding of the issues and to conduct accurate profiling, publish concrete examples obtained through the dialogue, and assist financial institutions with their own initiatives.

Furthermore, in order to ensure the quality and depth of monitoring as well as the appropriateness of responses by the supervisory authority, the JFSA will constantly review its monitoring processes. In doing so, the JFSA will ensure thorough quality control through not only internal but also external verification, and continue to make necessary improvements based on the outcome of such verification.

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