Appendix 2 JFSA's views on the comments submitted in English

(※) The name of the individual legal entity is omitted in consideration of privacy.

No	Comments	JFSA' s views on comments
1.	1) **General** - We support JFSA's initiative to evolve the supervisory approach to one that is based on substance over form, holistic assessment, forward looking analysis and pursuit of best practices. We also welcome the focus on issues of firm-wide priority, continuous monitoring (as opposed to periodic monitoring) and the retraining of supervisory staff to accumulate firm-specific knowledge and specialised analytical skills. 2) **Diversity of business models in asset management** - We also applaud JFSA's philosophy of "no one size fits all" and customising the supervisory approach to the individual firm. It is important to recognise that the asset management business model is fundamentally different than that of other financial institutions such as commercial banks, investment banks and insurance companies. Asset managers act on behalf of clients and receive stable fee-based income stream. They do not invest with their own balance sheets by engaging in principal trades with clients, nor do they guarantee investor principal or provide liquidity for funds. Even amongst asset managers there are many different business models. Some firms manage product and distribute directly to retail; others use an intermediated model; still others focus on managing for institutions; and there is the developing trend of using technological platforms or robo-advisors to offer investment products and advice. There are index, traditional active, and alternatives specialists; and many combinations. Hence we agree with the JFSA's proposal of developing specialised sector-specific and firm-specific knowledge amongst the supervisory staff so that they are able to focus their attention on the most relevant risks. To the extent that the JFSA draw upon industry expertise to help with the evolution of the supervisory approach, It is imperative that a diverse slate of private sector members are assembled. This will ensure	<General> ○ The JFSA believes that the new supervisory approaches based on this report should be implemented commensurate with the size and characteristics of financial institution. Diversity of business models is therefore duly taken into consideration. ○ The JFSA will continuously engage in dialogue with consumers, financial institutions, market participants and other stakeholders to enhance its supervisory approaches. ＜Stress test＞ ○ The JFSA understands that the nature of potential scenarios could be different depending on the size and characteristics of each category of financial institutions. ○ The JFSA will engage in dialogue with financial institutions on stress testing by using a thematic report as a basis of the dialogue.

	FSA receives the benefit of different opinions to form a balanced view. 3) **Stress Test** - We note that in the consultation JFSA proposes the use of universal stress test to ensure soundness of the financial system as a whole. a. We would like to point out that given the difference in the asset management business model vs those of other financial institutions as mentioned above, we do not believe that system-wise is appropriate for asset managers. Macro-prudential stress testing is more appropriate for banks where market and liquidity risks can create solvency issues, thereby generating systemic risk. Regulation of banks directly addresses the fact that government-insured deposits can backstop risky lending and create misaligned incentives, which may lead to excessive risk-taking and excessive leverage and reflects the critical role of banks in intermediating liquidity throughout the financial system. Asset managers do not benefit from any government guarantee or liquidity support, nor do they own the assets they manage or invest their capital in principal trades. Hence their risk profile is very different from that of other financial institutions. b. In view of the variety of business models even within the asset management industry as discussed above, we also do not believe that firm-wide stress testing or stress testing across mutual funds is appropriate. As agents acting on behalf of clients, asset managers manage mutual funds and portfolios in accordance to the investment objectives and restrictions set by clients or the mutual fund constitutive documents. There is a wide range of strategies using different asset classes and instruments and it will be impossible to generalise about risks or flows across the various funds/portfolios under common scenarios. A more useful approach will be to conduct stress testing for individual funds using scenarios that are relevant to that investment strategy and asset class. 4) **Sharing of best practices in governance models** – we agree that JFSA's position as a	＜Disclosure and engagement＞ ○ The JFSA will engage in dialogue with the financial institutions so that they will be able to pursue their own best practices from a diverse range of best practices. ○ The JFSA will explore how better to share examples of best practices which it has accumulated through access to the industry.

	supervisor of the entire financial sector endows it with insights of best practises across firms and across sectors of the industry. It will therefore be helpful for JFSA to share their regulatory interpretation and expectations of compliance standards with the financial situations. More importantly we believe JFSA can play a critical role in sharing best practices in setting the culture and implementing governance models which ultimately drive the conduct of firms. In our view, an effective culture and governance model should include the following 5 elements: a. **Defining the culture** – the values, the principles and behaviours (e.g. customer-centric principles) b. **Messaging the culture** – how the tone is set from the top and from the middle and communicated across the firm c. **Influencing the culture** – how to influence the behaviour of employees and guide them to behave in a way which is consistent with the firm's desired culture. This will include compensation models that align interests (such as bonus deferral and long-term vesting), proper segregation of duties, policies to avoid conflict of interests, etc. d. **Monitoring culture** - evaluate and report how in practice the firm's actions and those of employees aligned to the desired culture. This may include regular reports to senior management from control functions such as Legal & Compliance, Risk, Human Resources, Finance, Information Security and Internal Audit; periodic employee opinion surveys that include questions on the culture of the firm, thematic reviews by Risk and Controls teams, etc. Most important of all, having a robust risk management framework is key. This includes defining the various types of risk facing the firm, putting in place appropriate controls, ensuring independence of the risk management function, setting escalation policies, etc. e. **Governing culture** – establish clear ownership and responsibilities for culture across	

	the organisations and to ensure the implementation of policy. Culture and conduct should be a shared responsibility of all employees. At the same time it's preferable to establish accountability of senior management and the various lines of defences across the organisation. Sharing best practices in governance models should not be confused with sharing business strategies and specific products across firms, as the latter are key to the competitive advantage and commercial success of the entities. 5) **Drawing expertise from the industry** – As the proposal is a major shift from the current supervisory approach, it will take some time to retrain staff so that they are equipped with the knowledge to assess what are sustainable business models. We therefore propose that the FSA continues its practice of consulting industry groups and trade associations on a regular basis on the changing business environment and practices. In particular FSA may want to set up working groups with members drawn from the private sector to work on individual regulatory themes. (Omitted) is fully committed to supporting the JFSA by sharing our expertise.	
2.	**Data Centric Technology Approach** To realize JFSA's objectives, (Omitted) sees a real opportunity to apply a data-driven technology strategy. A 'connected' supervisor, with access to the firm's data residing in the firm's own compliance reporting tools, is a first step. We propose to go one step further with the establishment of a continuous flow of data from the regulated entities to the regulator in a form set out by the regulator. Pillar 1: Enforcement	○ Enhancing information infrastructure is an important strategic goal of the JFSA. The JFSA will identify priority needs for analysis under the new supervisory approaches and build necessary information infrastructure utilizing IT technology.

	- Real-Time monitoring of Data and Alerts This would enable the regulator to monitor the incoming data in real-time and apply models based on the minimum standards to this data. This real-time data-stream would then feed into the dashboard view on which the supervisor can, at any point in time, review the company's status. Furthermore, an alerts system could be added on top of this, which would analyse the continuous flow of data through predefined models, alerting the regulator when a breach is about to happen or has happened. When such an alert happens, the supervisor would be able to proactively contact the firm and work together to contain the damage, as well as understanding the root cause. This would enable the regulator to take a preventative and proactive action, instead of writing fines when incidents have happened or spend too much time working on past incidents with a low probability of occurring again in the future. The regulated entities posing the highest risk could be flagged and followed-up on a more regular basis. - Visual Analytics The visualization of the data on the dashboard view is of extreme importance, as it enables the regulators to look at certain data from different viewpoints. It brings the possibility to take a more pragmatic and holistic approach, as the data can be set against different reference points and contextualized. When suggesting the application of visual analytics to the data, we intend to go beyond 'simple' charts and dashboards and including the critical steps of exploration, analysis, and collaboration. Visual analytics enable the thoughts of the user to go in any direction while leveraging the visual perceptual system to guide the user down the most useful paths. They are a means to accelerate the process of understanding and analysing the data. <u>Pillar 2: Dynamic Supervision</u> - Predictive Analytics	

Those companies complying with the minimum standards could be analysed at a different level. With the predictive analytics and the continuous feeding of external information into the system, relevant predictions about sustainability of the business model and profitability can be made. These predictions on probability could serve as the foundation for further analysis. This is especially relevant to the second pillar in which the JFSA is looking to take a more future-aware stance. For those companies whose predictions aren't positive even though they currently comply with the minimum standards, additional monitoring could be set up, or the regulator could take proactive action, as it is in the best interests of the company to be prepared for potential future challenges.

Pillar 3: Disclosure & Engagement

- Alerts system replacing the sandbox

For the third pillar, in which disclosure and engagement are central, this data-centric approach would be very beneficial and highly innovative. A new and global trend amongst regulators is the use of sandboxes in different guises. While this is an absolute positive trend, (Omitted) sees an opportunity to go beyond these and to shorten the time to market of new and innovative products and services still further. Given the pace of the change that is happening and the high need to adapt to this in the most secure and protective way, time to market is a key factor. The alert system monitors the data fed into the system by the regulated entities on a real-time basis. Imagine a new product or service which complies with the minimal standards being brought to market. Instead of running it for a long time in a 'greenhouse' sandbox as it usually is, it can be run effectively with its data being fed into the regulator's system. The real-time data-feed ensures the regulator is able to take action when an orange light appears.

Benefits & Challenges

- Re-allocation of Resources

	Instead of allocating resources to the simple enforcement of minimum standards, this way of working would enable the supervisor to allocate resources to holistic analysis and collaboration with the regulated entities. - Holistic Analysis The use of technology by the supervisor as described above is aligned with JFSA's objectives to transform its approach to focus on the overall effectiveness of a regulated entity on a firm-wide basis instead of individual incidents, taking into account future events instead of looking solely at the past, and to go beyond compliance with minimum standards by creating best practices. This datacentric approach enables the regulator to continuously monitor the regulated entities on a (near) real-time basis and have access to all of its data in order to perform analysis to understand its overall stability. The use of technology to monitor but also to contextualize certain (near) incidents or events enables the authorities to allocate their resources where they are most needed in order to successfully realize this approach: away from the checklists and ad hoc samples to the deep analysis of firm-wide performance and toward proactive remediation and engagement with its regulated entities, based on the information fed into and reviewed by the system. - Challenges Although there are still challenges to overcome, uncertainties to be clarified, and profound analysis to be made, (Omitted) believes in the high value and potential this exercise could bring to the JFSA with a spill over to the regulated firms and ultimately to the Japanese economy and society.	