

## **Main Topics Presented by the Financial Services Agency (FSA) at a Dialogue with the Industry Association**

**Held by the Japan Securities Dealers Association (JSDA) on June 20, 2023**

### **1. G7 Finance Ministers and Central Bank Governors' Meeting and G7 Summit in May**

- The G7 Finance Ministers and Central Bank Governors' Meeting was held in Niigata from May 11 to 13. After the meeting, the communiqué was published. Among issues highlighted in the communiqué, we would like to introduce some issues relating to the financial sector— including the recent developments in the financial sector, sustainability reporting, and transition finance.
- First, on the recent developments in the financial sector, the communiqué presents three key points:
  - (1) The G7 Finance Ministers and Central Bank Governors (FMCBGs) reaffirmed that the financial system is resilient, supported by the financial regulatory reforms implemented after the 2008 global financial crisis.
  - (2) They also agreed that they would continue to work closely to monitor financial sector developments and stand ready to take appropriate actions to maintain financial stability and the resilience of the financial system.
  - (3) The Financial Stability Board (FSB) and standard-setting bodies (SSBs) will take stock of lessons learned from the recent episodes and consider the consequent priorities for its future work to enhance the financial system. They also agree to continue to prioritize addressing vulnerabilities in non-bank financial intermediation (NBFI) and strongly support the work of the FSB and SSBs on enhancing the resilience of NBFI.
- On sustainability reporting, the G7 FMCBGs looked forward to finalization of the ISSB's standards for general reporting on sustainability and for climate-related disclosures as well as the ISSB's future work on disclosure on biodiversity and human

capital.

- On sustainable finance, the G7 FMCBGs recognized that transition finance has a significant role in advancing the decarbonization of the economy as a whole. In terms of financed emissions (those of greenhouse gases related to investment and lending), they encouraged the public and private sectors to enhance availability and credibility of information, which would help promote transition finance by enabling assessment of the progress on transition in a forward-looking manner and accounting for the trajectory of financed emissions.
- The G7 Summit was held in Hiroshima from May 19 to 21 as well. The Leaders' Communiqué also refers to the recent development in the financial sector, sustainability reporting, and transition finance.
- Following the G7 meetings, many international conferences are scheduled for the second half of 2023. We will continue to communicate with financial institutions and contribute to global discussions.

## 2. Results of the IOSCO Annual Meeting

- The International Organization of Securities Commissions (IOSCO) held its annual meeting in Bangkok, Thailand, from June 13 to 15. I would like to share outlines of its results.
- The IOSCO Board reported and discussed sustainable finance, NBFI, and other issues.
  - In terms of sustainable finance, they exchanged opinions with the Chair of the ISSB. They also discussed whether the IOSCO should endorse the sustainability disclosure standards proposed by the ISSB, and decided to announce how they would respond promptly after their finalization.
  - In terms of NBFI, they discussed revisions proposed in the IOSCO guidance to strengthen liquidity risk management of open-end funds (OEFs), and decided to start public consultation in or after July. A new topic, future examinations of private finance, came up for discussion.

- The Asia Pacific Regional Conference (APRC) also held a meeting, sharing information on developments of sustainable finance and crypto-asset regulations in the region.
- These councils have roles to play in the examination and coordination of actions especially for addressing challenges in international regulations. As a vice-chair and chair of the Board and APRC, respectively, we will work to get our state of affairs and principles reflected in international discussions. We are grateful for the remarkable contributions of the JSDA to activities of the IOSCO. We are looking forward to continuing the close cooperation between us.

### 3. Cybersecurity Self-Assessment

- As a new initiative for strengthening cybersecurity, the FSA, together with the Bank of Japan (BoJ) and the Center for Financial Industry Information Systems (FISC), developed a "Check Sheet for Cybersecurity Self-Assessment". Around late June, financial institutions will be asked through the JSDA to perform self-assessment according to the Check Sheet.
- Using the Check Sheet, the executives of financial institutions are encouraged to examine the state of cybersecurity of their organizations, including management frameworks, staffing and financial resources as well as training and human resource development, and to take initiatives to improve their cybersecurity. Results of the self-assessment will be summarized to give feedback to the respondents.

### 4. Results from the monitoring of customer-oriented business conduct of dealers of risk-involving financial products

- I have three topics to introduce on the development of mechanisms for practicing customer-oriented business conduct and ways to secure their effectiveness.

(1) Many financial institutions leave challenges to be solved in their systems for the sale and administration of risk-involving financial products. For instance, their risk-

return analysis of the products, as well as identification of expected customer groups based on the analysis, is less than satisfactory. There also remain concerns over whether proposals they advance to customers are truly relevant to their needs. They are expected to consider again what will bring the greatest benefit to their customers and what they should do for that end.

(2) It turns out that most of the policies prepared by banks for their initiatives for customer-oriented business conduct follow the wording of the Principles for Customer-Oriented Business Conduct. They leave unclear what specific initiatives they will carry out to pursue "the best interests of customers" that they seek to realize. In most of them, there is some divergence observed between their policies and the realities of what their sales people do on the ground for the initiatives. What is critical to secure customer-oriented business conduct is to align, based on their policies, the concept of customer-orientation and the recognition of specific initiatives for that end throughout the organization and reform their culture in a manner helpful to getting the concept firmly established. Through the process, they are expected to pay attention to what impact a performance evaluation may have.

(3) In terms of three-line management, many financial institutions remain focused on compliance when inspecting/auditing sales of risk-involving financial products and complaints about them. What is critical for them is to develop a PDCA mechanism to perform inspections beyond the viewpoint of compliance, including management and culture audits, and carry out improvements.

- The FSA will release the results of the monitoring on its website at the end of June. In reference to the results, the management is expected to take the leadership in securing and promoting customer-oriented business conduct, which should help the Doubling Asset-based Income Plan come to fruition.

## 5. Self-regulatory Rules for Structured Bonds

- Self-regulation guidelines for complex structured bonds will come into force in July 2023. I know that some days ago, the JSDA issued to its members a notice on

disclosure of structuring costs and analysis and disclosure of risks and returns.

- We understand that financial institutions are considering, with full understanding of what the new rules aim at and stipulate, whether they will continue to sell complex structured bonds under the new rules, or if so, what sales and solicitation regime they should prepare, including for rigorous narrowing-down of target customers. Anyway, the FSA recognizes that they will refrain from continuing to offer complex structured bonds to a broad range of customer groups as ever. The sector is expected to take the enforcement of the new rules as an opportunity to eliminate sales of complex structured bonds to customers who lack a full understanding of what characteristics or risks they have.
- As part of our monitoring, the FSA will follow up to see whether they will comply with the Guidelines when selling complex structured bonds. The JSDA is also expected to perform rigorous examination at its audit and other opportunities.

#### **6. Solicitation for Sale of Risk-involving Financial Products**

- Among the risk-involving financial products, the ordinary corporate bond and share are standardized, general products, while other instruments, called hybrid bonds, have intermediate characteristics between them. Hybrid bonds are indeed classified into several types, but we understand that in general, investors are required to have more sophisticated expertise to deal with them than with ordinary bonds or shares because information, such as their risks and returns, critical when making investment decisions, is more difficult to evaluate.
- We request that security companies targeting ordinary investors in solicitation for, and sale of, these types of products act with special care in light of laws and regulations and policies they have announced for their initiatives for customer-oriented business conduct. Specific examples are as follows:
  - whether, before offering individual hybrid securities, they, as a dealer, have fully examined their features as a product and risks, among others;

- whether they have any mechanism in place to keep their solicitation relevant to attributes of their customers (knowledge, experience, wealth, and purpose of transactions) by, for instance, narrowing down target customers for solicitation, taking fully into account features and risks of individual products; and
- whether they see to it that their people, especially those working on the ground, fully understand they must avoid lacking objectivity when giving explanations about individual products to their customers by laying emphasis solely on their benefits or giving insufficient explanations about their risks.

Security companies should examine again the points above, regardless of marketing channels concerned.

#### 7. Consolidation of Identity Verification Tools into "My Number Card (MN Card)"

- The Priority Policy Program for Realizing a Digital Society, decided upon by the Cabinet on June 9, sets out policies of the government, stating that tools to verify identity under the Act on Prevention of Transfer of Criminal Proceeds and the Act on Prevention of Fraudulent Use of Mobile Phones should be consolidated into the Japanese Public Key Infrastructure (JPKI), using My Number Card (MN Card), that the way of sending the image of a driver's license or using an ID verification document with no photo of the holder's face on it or similar methods should be discontinued, and that the JPKI should also be adopted for face-to-face identity verification, instead of photocopying any ID verification document.
- Given the significant impact the change of ID verification methods would give on the business practice of the financial sector, we would like to ask them for feedback on the disuse of eKYC solutions for non-face-to-face transactions (NFFT) and the consolidation into the JPKI as well as examine the state of their business practice while working with the Digital Agency, the National Police Agency, and other ministries and agencies concerned to consider what improvements and revisions should be made.
- We will have an opportunity to ask the JSDA to give feedback on the state of use of

the JPFI and current methods of ID verification. We would be grateful for their active participation in dialogues.

#### 8. Guiding principles for securing stable provision of essential infrastructures services under the Economic Security Promotion Act

- On April 28, a Cabinet Decision was made on the guiding principles for securing stable provision of essential infrastructure services under the Economic Security Promotion Act. The framework under the Act requires operators of essential infrastructure, when planning to introduce critical facilities, to have them inspected by the relevant authorities before their installment.
- That day, each ministry and agency, including the FSA, set up a Consultation Desk for receiving pre-filing consultations of infrastructure operators on the introduction of specified important facilities and other matters, and keeping constant communication with them as well as other operators concerned. Financial institutions are encouraged to make effective use of the Desk of the FSA to properly manage risks concerning economic security.

#### 9. Bold Policy and Action Plan for a New Form of Capitalism

- On June 16, the Cabinet decided on the Basic Policy on Economic and Fiscal Management and Reform (Bold Policy) 2023 and the 2023 Grand Design and Action Plan for a New Form of Capitalism, among others, which include many policy programs the FSA should pursue.
- First, to facilitate the Doubling Asset-based Income Plan, prepared in November 2022, the FSA will do the following:
  - make preparations for the inauguration of the new NISA system;
  - establish a mechanism for promoting the provision of neutral and reliable advice for consumers;

- enhance economic and financial education; and
  - stimulate the financial and capital market by, for instance, reforming corporate governance.
- When the Council on Economic and Fiscal Policy met on April 26, the Prime Minister gave an instruction that "radical reforms be carried out in the asset management industry of Japan together with other sectors concerned" to develop asset management as a pillar of the national economy. Based on the instruction, the Bold Policy and the Action Plan state that a specific policy plan should be prepared for undertaking radical reforms in the asset management industry by, among others, improving governance in asset management companies and owners and enhancing the mechanisms for that, or turning stewardship activities more substantial; enhancing support and fostering competition for encouraging new asset management companies to enter into the market, both from Japan and overseas; and developing environments helpful to improve asset management competency and diversify investments. They also state that information of the plan and reforms should be actively disseminated both in Japan and overseas.

In this respect, some news media have suggested that we were ready to present something determined. In fact, the FSA has left the matter fully open. We intend to communicate with business operators and other parties concerned both in Japan and overseas when developing the plan. We understand that some financial institutions work closely with asset management companies in their own group to provide services. What could be done to improve such services? Or beyond that, if you offer us any suggestion helpful to make the Japanese financial market more attractive, we will be grateful to accept that as what we should refer to.

- The Bold Policy and the Action Plan for a New Form of Capitalism also include several policy programs for enhancing the status of Japan as an international financial center, such as the following, other than those for radically reforming the asset management industry, mentioned before, those for making corporate governance



reforms more substantial, those for encouraging green transformation (GX) investment and lending, and those for examining what action to take in the taxation system for making Japan an international financial hub.

Especially, policy programs for developing an Asian GX hub were mentioned by the Minister of Finance at a Japan-ASEAN Ministerial Meeting. Some of the programs, specifically those for human resource development, data preparation, and establishment of a consortium for project development, among others, must be carried out with the participation of the JSDA. We would like to ask for your cooperation.

- The Bold Policy and the Action Plan include a broad range of programs together with those mentioned above. To carry them out, we would also ask for your continued close cooperation.

#### **10. Progress Report on Enhancing Asset Management Business**

- As for what we should take into account when considering the policy plans mentioned above, the Progress Report on Enhancing Asset Management Business 2023 has been published. The Report summarizes what we are aware of as challenges to address in the current state of the services provided by asset management companies in Japan. We would be grateful if you would read through the Report. Here, I would like to pick up on five topics on the current state of their services.

(1) Fund wrap: While the range of products offered in the mass market is growing, investors, when looking at some of them, may find it difficult to understand whether they are a combination of investment trust funds or a service of providing advice on wealth building on a continuous basis. The design of a fund wrap itself is formed in a manner such that dealers and asset management companies will have incentives to manage conflicts of interest and deliver the the greatest benefits to customers. At the same time, what added value the dealers will bring with their services is difficult to understand in some respects.

(2) Selection of products for investment trust funds: Some thematic fund products,

reaching a peak in net asset under management 6 to 18 months after being put on the market, and marking rapid declines in AUM, have selected and sold even in recent years.

(3) Advanced redemption of investment trust funds: The number of investment trust funds offered by asset management companies in Japan should desirably be optimized as it is considerably larger than overseas.

(4) Electronic delivery of a prospectus: Asset management companies hoping to adopt the HTML format for delivering their prospectuses electronically should not be demotivated in their effort to offer more convenience for customers. We expect the JSDA to work in cooperation with the Investment Trusts Association and consider how initiatives for electronic delivery should be carried out with emphasis placed on efficiency.

(5) Services of administration and management organizations for corporate-type defined contribution pension plans: It appears that many financial institutions provide services for corporations as an administration and management organization. At some of them, a large percentage of the subscribers turn out to have chosen a principal-protected product.

- Here, I have presented the way the FSA recognizes the current state of things and what we are aware of as challenges to address. There will be some who have different recognition and opinions from ours. At any rate, what is important first is to raise the level of the management sector of Japan and its human resources to world class. We believe it critical to share the target with financial institutions. Afterwards, we would be grateful if we could have an opportunity to talk with financial institutions on what specific action would be effective for improvement.

#### **11. Enhancement of the asset management business:**

- In terms of the Progress Report on Enhancing Asset Management Business 2023, we, as supervisory agency, must make some requests to you in two issues: securing

independence of asset management companies and strengthening product governance on an industry-wide basis.

<Securing the independence of asset management companies>

- First, asset management companies belonging to a group of financial institutions might place precedence on benefits of dealers in the group over those of their customers, a danger that often causes a conflict of interests between the group as a whole and the customers. It is one of the issues the Progress Report deals with.
- We understand that some financial institutions work in close cooperation with asset management companies in their group to provide services. In preparing a policy plan for making radical reforms in the asset management industry of Japan, what should we do to make the Japanese financial market more attractive? It is an issue we would like to consider in communication with you. We would like to ask for your understanding and cooperation.

<Strengthening product governance on an industry-wide basis>

- Second, a growing number of major asset management companies start to undertake some initiatives from the standpoint of putting the benefits of customers first by, among others, extracting funds with a poor performance record and deciding principles of action in reducing trust fees for them or redeeming them before maturity. No such initiative could be carried out without the understanding and cooperation of dealers because, in such cases, it is they who may have to respond to the customers concerned.
- It is also important to offer products with specific characteristics to investors suitable to them. When selling any product, dealers are expected to take into account attributes of customers the asset management company assumed when they structured them. It is an example of initiatives for strengthening product governance on an industry-wide basis. We would appreciate their cooperation.

## 12. Initiatives for Sustainable Finance

- The Working Group on Financial Institutions' Efforts towards the Decarbonization of the Economy and the Working Group on Impact Investment, set up in October 2022 under the Expert Panel on Sustainable Finance, have discussed policy programs for promoting effective dialogue between financial companies and businesses for realizing decarbonization and enhancing economic growth and sustainability through investments for solving social and environmental challenges.
- Their discussions form the basis of a report they are each expected to publish in June.
- The Decarbonization Working Group has prepared a set of suggestions to financial institutions as a "Guide" for expanding their engagement, which covers (1) use of a range of indicators about transition, (2) development of emissions data, and (3) understating of the suitability of pathways. Preparation of a transition plan by businesses forms one of the crucial themes for carbon neutrality. We would be delighted if the report is helpful to you as a reference in your work.
- Many major financial institutions have joined the Glasgow Financial Alliance for Net Zero (GFANZ), a coalition of international financial institutions aiming for decarbonization, working to set targets for transition and prepare a transition plan.
- The Alliance launched a branch in Japan on June 9. It is the first country branch for the GFANZ. We hope to work with them for a broad range of activities for decarbonization, including international public relations, human resource development, and awareness-raising in Japan.
- In its report, the Impact Investment Working Group has summarized significance of the impact investment and basic ideas of the concept for supporting start-ups and other parties that should play central roles to realize innovations necessary to solve social challenges and achieve commercial viability at the same time.
- The Working Group will prepare basic guidelines on requirements for such investment, before finalizing them through public consultation. Under the guidelines, investors would be required, for instance, to define in advance the effect and profitability they

intend to achieve through their investment and, after investing, monitor and manage the effect achieved.

- As an initiative to further promote investment, the Report also suggests that a range of parties concerned, such as businesses, investors and financial institutions, academics, and local governments, set up a consortium for collecting and sharing data, measuring methods, and case studies.
- In line with the Report, a consortium will be formed this year at the earliest. So, we would be grateful for your active participation and dialogue with businesses towards facilitating a virtuous cycle of funds between problem-solving and commercial viability.

### 13. Preparations for the Invoice System

- There are not more than three months left before the start of the qualified invoice system for consumption tax on October 1, 2023.

(Note) The invoice system is a new method introduced for deducting consumption tax included in the purchasing cost. Using a qualified invoice, the seller informs the buyer of the correct tax rate applicable and the amount of consumption tax the latter must pay. Specifically, a qualified invoice, in the form of paper document or data, carries on it a registration number, a tax rate applicable and an amount of consumption tax in addition to what the current separate accounting invoice has on it. A business operator is allowed to issue qualified invoices after it files an application for registration to a relevant Tax Office.

- We would like to express our gratitude for the JSDA's cooperation for achieving a smooth transition to the invoice system. The Association has issued letters to member companies to recommend those who had yet to file an application for registration to do, and ask the members to inform their agents working on a commission basis of the new system, among others, so that they will make appropriate preparations.
- We understand the invoice system may have some consequences on transactions with tax-exempt business entities. Members of the Association are expected to take

considerable care in responding to their commissioned agents who have been exempted from paying consumption tax.

- We also ask the JSDA for continued cooperation especially for getting the new system fully recognized by all the parties concerned in the sector. When a member comes to the Association with any difficulty, worry or concern, we would be glad to hold a consultation.

#### 14. Obtainment of a My Number Card by More People and Promotion of Its Use

- We would like to express our gratitude again for the various cooperation financial institutions have offered for encouraging people to obtain an MN Card and promoting its use.
- According to the findings of a survey conducted by the Digital Agency in March (released so far), 83.3% of those in the financial instruments business and similar industries held an MN Card.
- We will continue working hard to raise the percentage of MN Card holders. We would also be grateful if you could again offer cooperation for promoting the use of MN Cards.
- As an initiative to persuade more people to obtain an MN Card, the Government is encouraging the use of JPKI services. We would appreciate it if financial institutions could engage themselves actively in their use.
- As part of its effort to encourage the private sector to use the MN Card more commonly, the Government is also working to inform them of the following so that these services will be fully recognized and used more widely:

(1) cases where MN Cards are used effectively;

(2) that private-sector businesses can have electronic certificate issued at no fee

provisionally for three years from January this year; and

- (3) that a download service started in May for a smartphone app equal in functionality to the MN Card, which can be used as an electronic certificate for a signature and user ID verification.

We would be grateful for the cooperation of financial institutions.

#### 15. Progress in Transition Away from LIBOR

- The publication of LIBOR, except for the USD LIBOR, was ceased at the end-December 2021. With regard to USD LIBOR, the publication will be ceased at end-June 2023. We have seen no major obstacles to the transition away from USD LIBOR so far through our monitoring. Given the publication cessation is just around the corner, financial institutions with legacy contracts are required to take necessary actions thoroughly.
- The synthetic USD LIBOR, calculated using market data will be released from July 2023. Financial institutions will be required to take appropriate actions, including explanations for their customers, if they make use of the synthetic USD LIBOR.
- The FSA will continue to monitor the progress in transition arrangements, cooperating with the BOJ, with regard to remaining contracts referencing the USD LIBOR even after July and contracts referencing synthetic USD LIBOR, and require them to take necessary actions depending on their respective situations.

#### 16. Actions Financial Institutions Are Asked to Take after the Disasters Caused in 2023 by Heavy Rainfall along the Baiu (Seasonal) Rain Front and Typhoon No. 2 (Mawar)

- We would like to express our heartfelt sympathy to all victims of the disasters caused by heavy rainfalls that continued from June 2.
- With the application of the Disaster Relief Act to Ibaragi, Saitama, Shizuoka and

Wakayama Prefectures after the heavy rainfall, the Local Finance Bureaus responsible for the regions, jointly with the BoJ, issued a Request for Financial Actions to financial institutions concerned and other relevant parties

- We ask again financial institutions doing business in the affected areas to take into consideration our requests and fully recognize the voices and needs of those suffering from the disasters for providing detailed support tailored from their viewpoint.

(End)