
Progress in the FSA's Efforts Toward Better Regulation



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Four Pillars of “Better Regulation”

I. Optimal combination of rules-based and principles-based supervisory approaches

II. Timely recognition of priority issues and effective response

III. Encouraging voluntary efforts by financial institutions and placing greater emphasis on designing proper incentives

IV. Improving the transparency and predictability of regulatory actions

Five Areas of Immediate Focus

1. Enhancing dialogue with financial institutions

2. Disseminating information more widely and effectively

3. Strengthening cooperation with foreign authorities

4. Enhancing research functions so as to better understand market developments

5. Strengthening human resource development within the FSA

Pillar I: Optimal combination of rules-based and principles-based supervisory approaches

The FSA and the industry reached agreement on “fourteen key principles ” in April 2008

Financial services providers are expected to:

1. Pursue greater customer benefits and fulfill expected roles through voluntary efforts with creativity.
2. Participate in the markets with the resolve to improve the functioning thereof as a whole and secure fairness and transparency therein.
3. Pay due regard to reasonable customer expectations and conduct business with integrity and professional prudence in order to meet their needs.
4. Pay due regard so as to provide customers with information and advice on a timely basis and in a clear and fair manner, thus enabling them to make economically rational judgments.
5. Respond to customer consultations and inquiries with integrity and provide needed information and advice, while making efforts to disseminate financial knowledge.
6. Prevent abuse stemming from conflicts of interest between one's self, including group firms, and the customers, or among different customers.
7. Manage customers' assets in an appropriate manner, corresponding to the responsibilities assumed.
8. Establish appropriate mechanisms for corporate governance, including by way of making necessary personnel allocations, and achieve effective corporate governance, to ensure financial soundness and proper business operation.
9. Conduct appropriate information disclosure, considering the significance of both setting market discipline to work and enhancing transparency of corporate management.
10. Establish mechanisms so as to avoid being exploited by financial crimes, including by way of blocking anti-social parties' access.
11. Maintain sound financial basis corresponding to risk profile.
12. Conduct appropriate risk management in accordance with the size and features of the business operation and inherent risk profile.
13. Establish countermeasures against large-scale disasters and other contingencies in accordance with the role one fulfills in the markets.
14. Provide accurate information with integrity upon reasonable requests from the FSA, and facilitate effective communication with the FSA, including by way of interactive dialogues.

Comparing the JFSA's Principles to the UKFSA's

| Principles for Businesses (UK) | The Principles in the Financial Services Industry (Japan) Financial service providers are expected to: |
|---|---|
| 1.A firm must conduct its business with integrity. | 3. Pay due regard to reasonable customer expectations and conduct business with integrity and professional prudence in order to meet their needs. |
| 2.A firm must conduct its business with due skill, care and diligence. | 8. Establish appropriate mechanisms for corporate governance, including by way of making necessary personnel allocations, and achieve effective corporate governance, to ensure financial |
| 3.A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. | 12. Conduct appropriate risk management in accordance with the size and features of the business operation and inherent risk profile. |
| 4.A firm must maintain adequate financial resources. | 11. Maintain sound financial basis corresponding to risk profile. |
| 5.A firm must observe proper standards of market conduct. | 2. Participate in the markets with the resolve to improve the functioning thereof as a whole and secure fairness and transparency |
| 6.A firm must pay due regard to the interests of its customers and treat them fairly. | 4. Pay due regard so as to provide customers with information and advice on a timely basis and in a clear and fair manner, thus enabling them to make economically rational judgments. |
| 7.A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading. | 6. Prevent abuse stemming from conflicts of interest between one's self, including group firms, and the customers, or among different customers. |
| 8.A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client. | |
| 9.A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment. | 7. Manage customers' assets in an appropriate manner, corresponding to the responsibilities assumed. |
| 10.A firm must arrange adequate protection for clients' assets when it is responsible for them. | 14. Provide accurate information with integrity upon reasonable requests from the FSA, and facilitate effective communication with the FSA, including by way of interactive dialogues. |
| 11.A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice. | 1. Pursue greater customer benefits and fulfill expected roles through voluntary efforts with creativity. 5. Respond to customer consultations and inquiries with integrity and provide needed information and advice, while making efforts to disseminate financial knowledge. 9. Conduct appropriate information disclosure, considering the significance of both setting market discipline to work and enhancing transparency of corporate management. 10. Establish mechanisms so as to avoid being exploited by financial crimes, including by way of blocking anti-social parties' access. 13. Establish countermeasures against large-scale disasters and other contingencies in accordance with the role it fulfils in the markets. |

Providing Interpretations of Rules in Light of Principles

In September 2007, the Financial Instruments and Exchange Act came into effect. The act introduced new requirements for explanation to customers about the associated risks of financial instruments and internal control reporting.

⇒ To mitigate some excessive concerns in reaction to the new requirements, the FSA published the following two documents:

“Our Answers to Your Questions about the Financial Instruments and Exchange Act” (February 2008) <http://www.fsa.go.jp/en/news/2008/20080318-2.html>

“Eleven Misunderstandings about the Internal Control Report System”
(March 2008) <http://www.fsa.go.jp/en/news/2008/20080408.html>

Pillar II: Timely Recognition of Priority Issues and Effective Response

- Response to the global turmoil triggered by the subprime loan problem
 - Vigilantly assessing its impact, and closely monitoring risk management at financial firms.
 - Released aggregate data on Japanese banks' exposures to subprime-related products.
 - Established a new office (Market Analysis Office).
 - International cooperation, in particular at the FSF (Financial Stability Forum).
- Forward-looking, risk-focused approach in our supervision and on-site inspections

Pillar III: Encouraging Voluntary Efforts by Financial Institutions and Placing Greater Emphasis on Designing Proper Incentives

- Full introduction of the Financial Inspection Rating System
- Full implementation of the Basel II framework

Pillar IV: Improving the Transparency and Predictability of Regulatory Actions

- Supervisory guidelines
- Inspection manuals
- “Administrative Action in the Financial Sector”
- Case studies
 - On-site inspections
 - Administrative actions
- No-action letter system
- Q&As
- Public consultations

Progress in Five Areas of Immediate Focus (1)

1. Enhancing dialogue with financial institutions and other relevant parties

- FSA-IBA dialogue, and other regular dialogues with industry bodies
- Dialogue with individual firms at the management level

2. Disseminating information more widely and effectively

- Public speeches, press interviews and articles
- More effective use of press releases
- FSA website
- E-mail alert service

Progress in Five Areas of Immediate Focus (2)

3. Strengthening Cooperation with Foreign Authorities

- International cooperation in response to the global market turmoil
 - FSF, Basel Committee on Banking Supervision and IOSCO
- IOSCO Tokyo Conference (November 2007)
- IOSCO multilateral MOU (February 2008)

Progress in Five Areas of Immediate Focus (3)

4. Enhancing research functions so as to better understand market developments

- Established a new office (Market Analysis Office).

5. Strengthening human resource development within the FSA

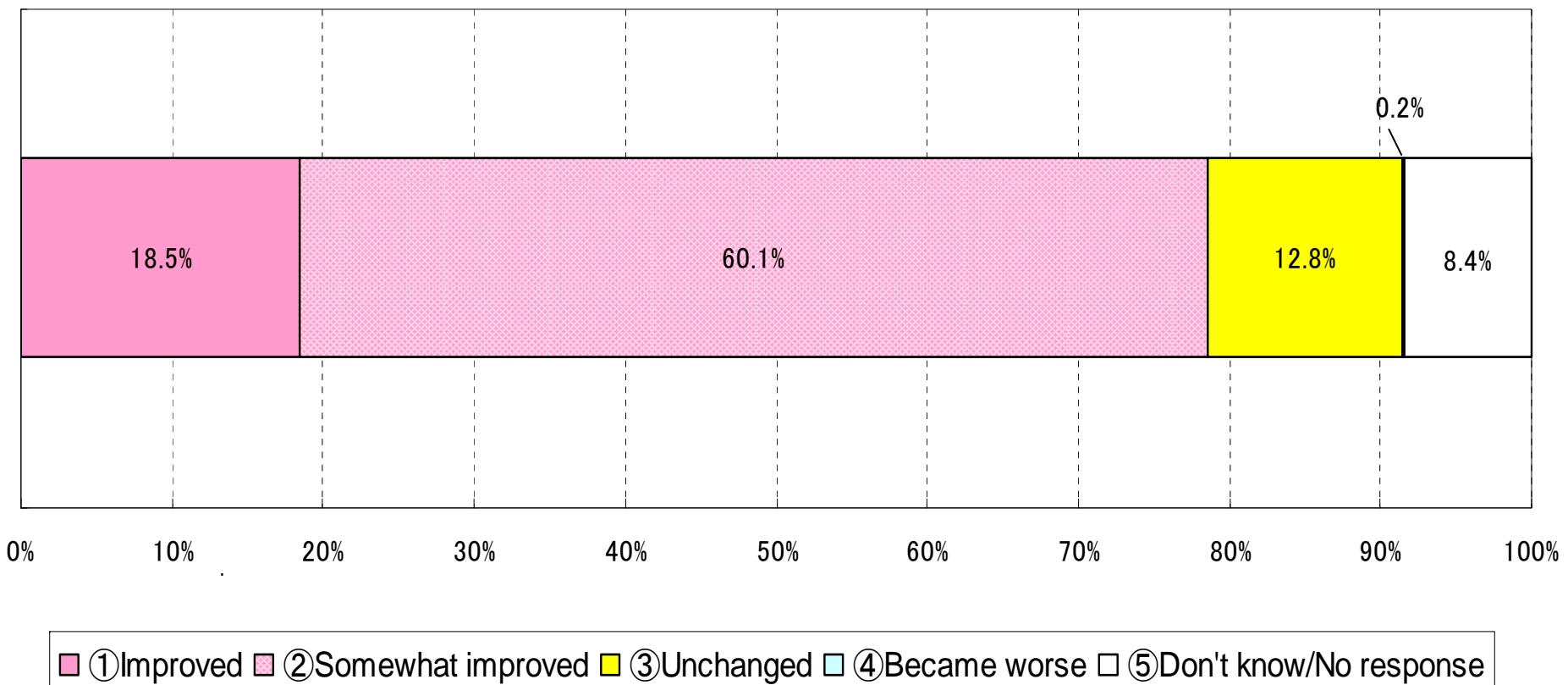
- Staff survey
- Internal training
- Overseas training
- Secondment arrangements
- Recruitment from the private sector

Outline of the Survey

- Survey conducted in March to assess the actual progress toward “better regulation.”
- 3 specific areas of inquiry:
 - Transparency and predictability
 - Dialogue with industry
 - Dissemination of information
- Sent to 1,464 individuals at regulated firms, and 67.6% replied.
- Respondents grouped by job positions:
 - Presidents and CEOs
 - Board directors, executive officers and general managers
 - Division managers

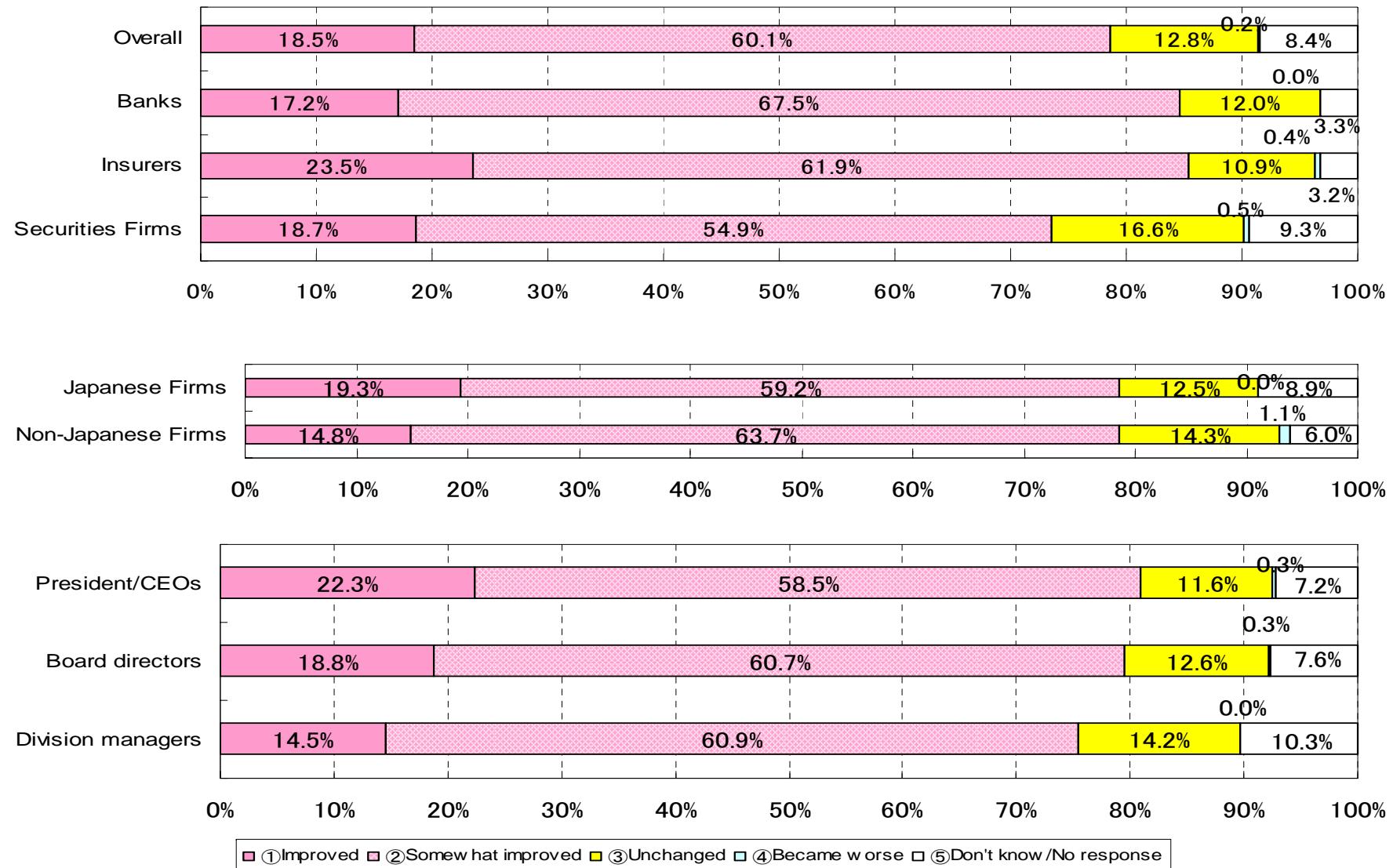
Predictability and Transparency (1)

- Nearly 80% of respondents replied that the FSA has “improved” or “somewhat improved.”



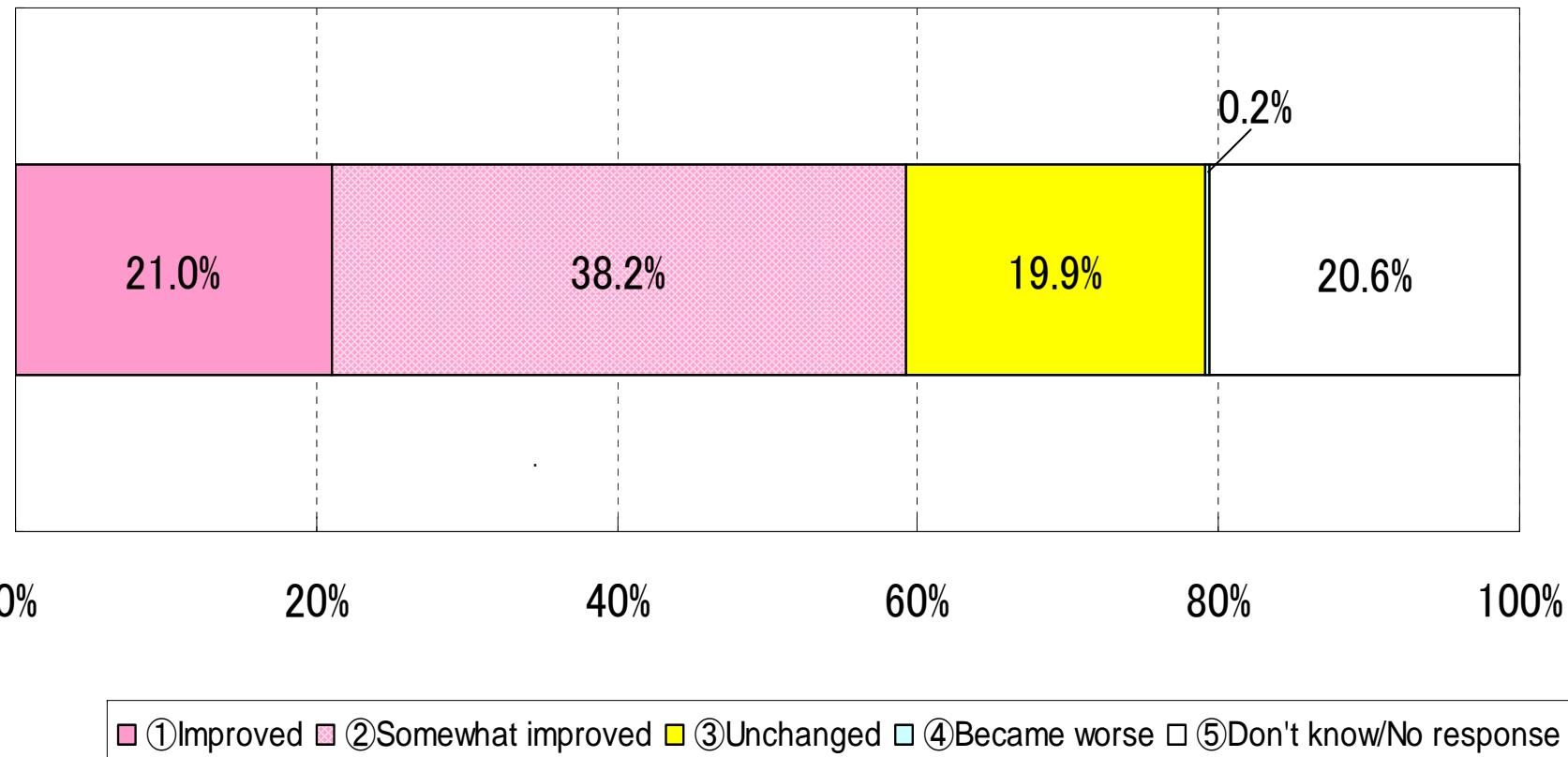
Predictability and Transparency (2)

- Without regard to sector and rank, nearly 80% of respondents replied that it has “improved” or “somewhat improved.”



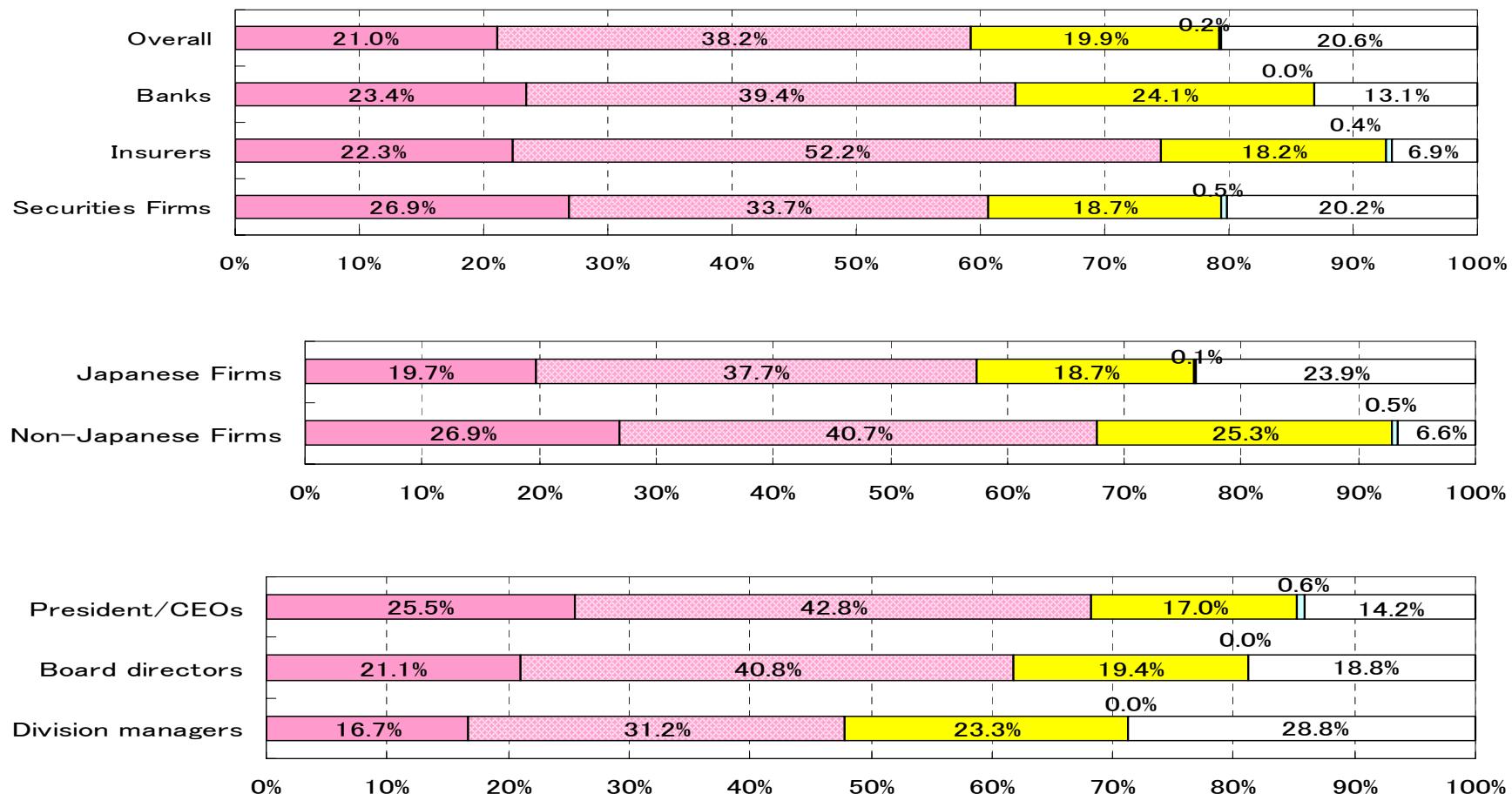
Dialogue with Industry (1)

- Nearly 60% of respondents replied that the FSA has “improved” or “somewhat improved.”



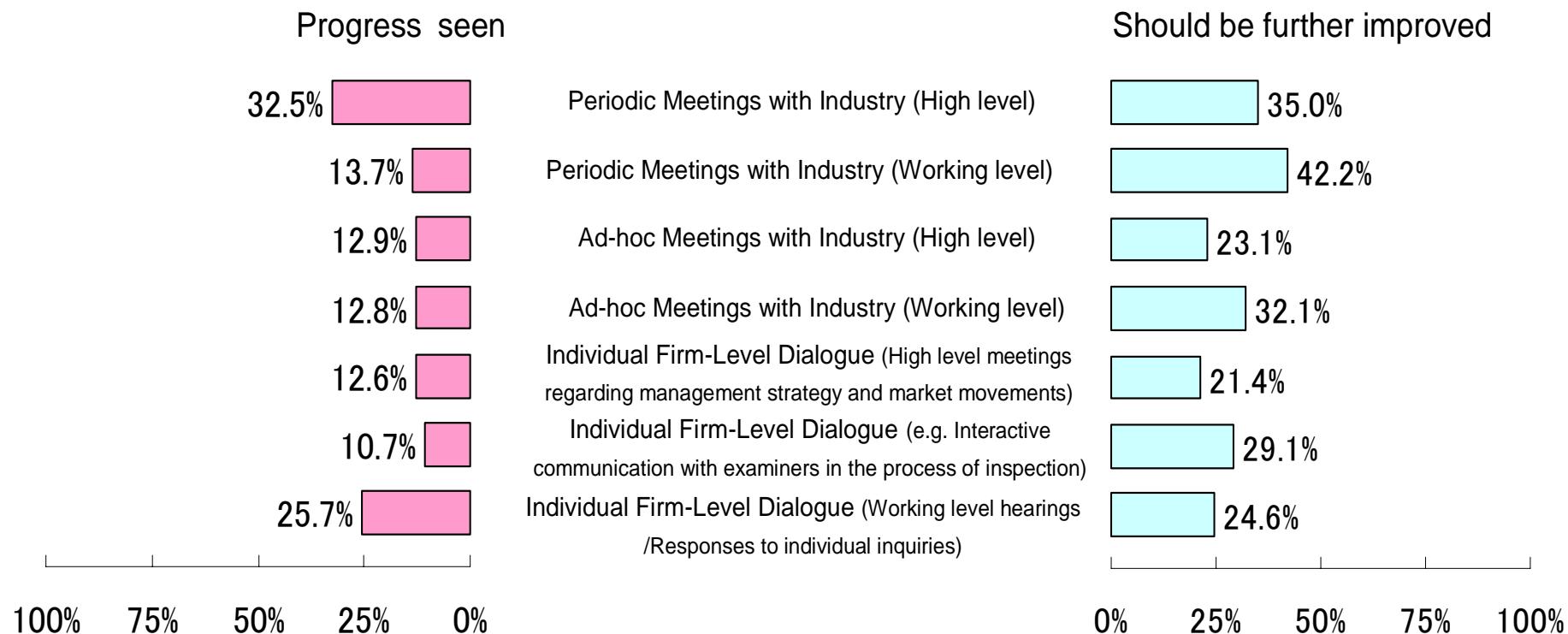
Dialogue with Industry (2)

- Nearly 70% of presidents and CEOs replied that dialogue with the FSA has “improved” or “somewhat improved,” whereas the percentage was below 50% for division managers.



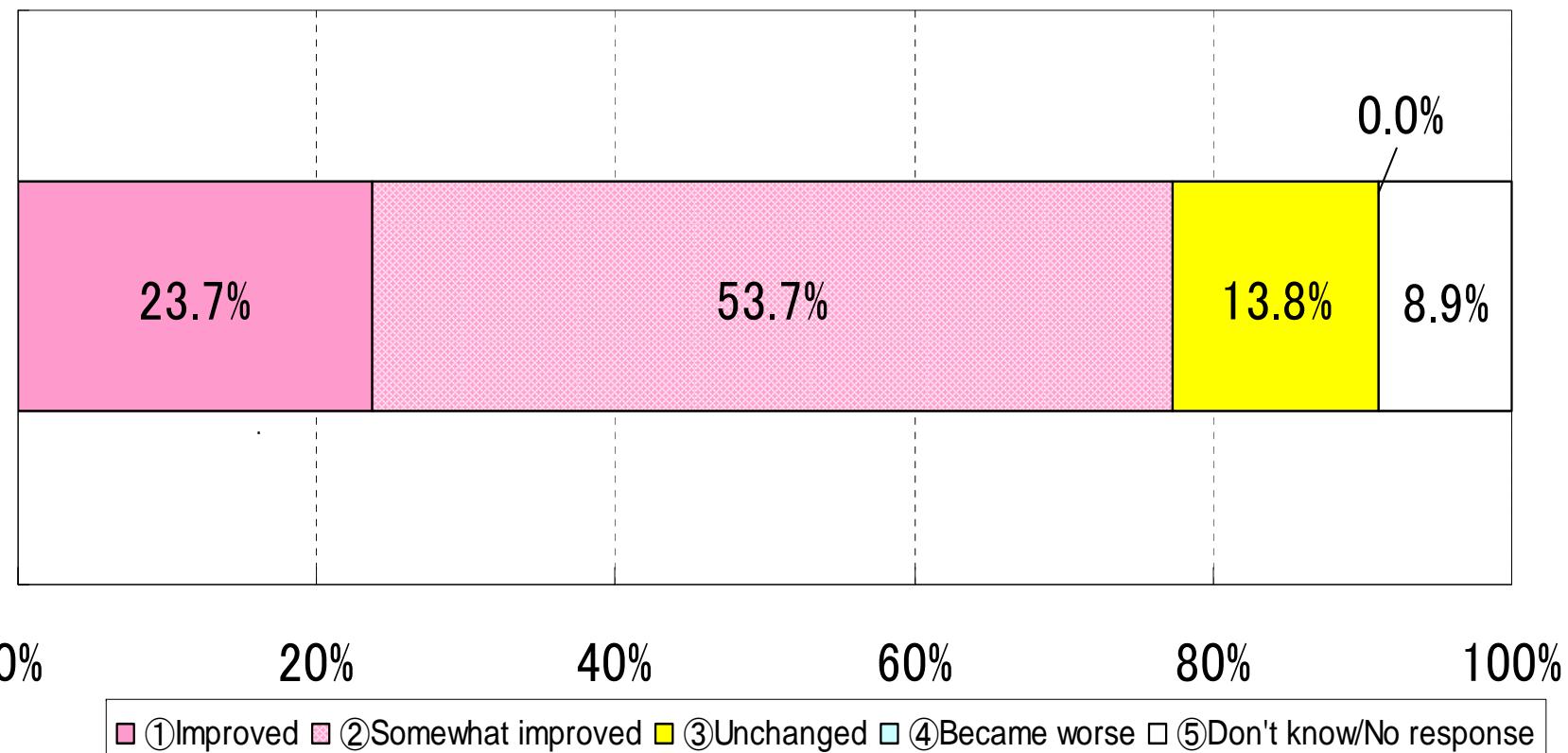
Dialogue with Industry (3)

- Many respondents suggest that dialogue at the working level should be further improved.



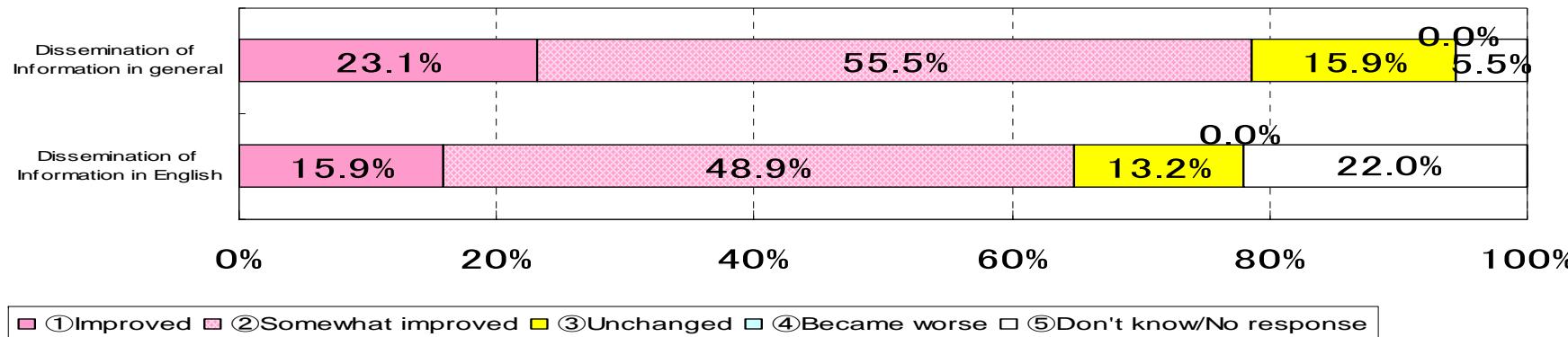
Dissemination of Information (1)

- Nearly 80% of respondents replied that the FSA has “improved” or “somewhat improved.”



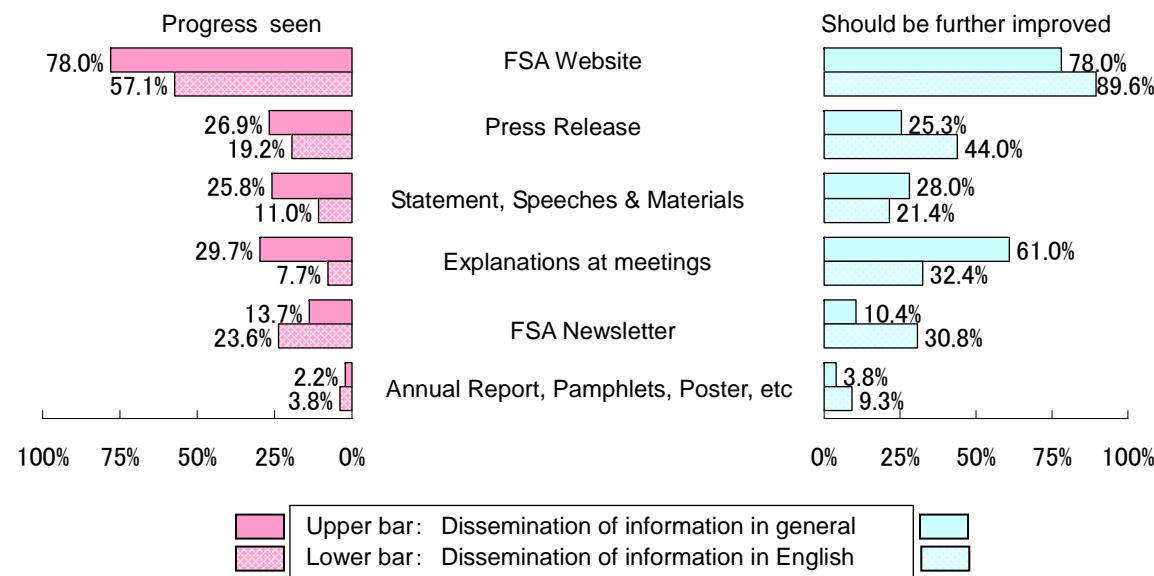
Dissemination of Information (2)

- With regard to dissemination of information in English, over 60% of respondents replied that the FSA has “improved” or “somewhat improved.”



(Survey Subjects: Non-Japanese financial firms)

- Many respondents suggest that the FSA's English website should be further improved.



What We Have Learnt from the Survey Results

- The results confirmed a certain degree of progress in the FSA's efforts toward better regulation.
- Areas requiring further improvements:
 - To make every FSA staff member fully understand the concept of better regulation.
 - To improve dialogue and increase opportunities for frank exchange of views with industry at the working levels.
 - To improve the FSA's dissemination of information, by way of, for instance, increasing the number of briefing sessions and making the FSA website more user-friendly.

“Better Market Initiative”

(Plan for Strengthening the Competitiveness of Japan’s Financial and Capital Markets)

- New legislation (June 2008)
 - Deregulated exchange markets exclusively for professional investors
 - Diversification of ETFs
 - Revamp of firewall regulations
 - Broadening the scope of businesses permitted to banking and insurance groups
(e.g. emissions trading & commodity spot trading)