

Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets

Introduction

In order to sustain the growth of Japan's economy as the population is aging, it is essential that the country's financial and capital markets provide good investment opportunities to the financial assets held by Japan's household sector that amount to more than 1,500 trillion yen (about 14 trillion US dollars), and to supply domestic and foreign companies with adequate amount of capital for growth. Given ever intensifying global competition among markets, strengthening the competitiveness of Japan's financial and capital markets has become a pressing policy issue, so that they will be able to serve the needs of both domestic and foreign users and fulfill their roles sufficiently. It is also expected that, with such markets, Japan's financial services industry will be able to generate high value added, thereby contributing to sustainable economic growth.

In order to strengthen the competitiveness of Japan's financial and capital markets, the following are needed, which requires work in a comprehensive manner:

- Creating reliable and vibrant markets;
- Putting in place a business environment that vitalizes the financial services industry and promotes competition;
- Improving the regulatory environment; and
- Improving the broader environment surrounding the markets.

Firstly, in order to create reliable and vibrant markets, it is necessary to put in place a market infrastructure that enhances diversity in financial services and raises customer benefits while ensuring fairness and transparency. In such markets, which can meet the various needs of domestic and foreign investors and fund raisers, market participants can engage in transactions with a sense of security.

Secondly, the financial services industry should serve the needs of domestic and foreign users appropriately and to provide diverse and high-quality financial services. In order to achieve this, it is necessary to put in place an institutional framework that can meet the needs of the times.

Thirdly, looking at the environment surrounding the markets where competition among major financial centers around the world has been intensifying, it has been seriously recognized that the regulatory environment is important as a crucial determinant of the strength and

competitiveness of the market. For this reason, it is urgently needed to take various measures to improve the quality of financial regulation, not only in terms of institutional setting but also in its application.

Fourthly, it is pointed out that, among other things, a sufficient supply of human resources with expertise and the enhancement of urban infrastructure are also important in determining the strength and competitiveness of the market. To this end, it is also necessary to take a broad-based approach to putting in place a surrounding environment favorable to the development of the markets.

In “Economic and Fiscal Reform 2007” (cabinet decision on June 19, 2007), the Financial Services Agency (FSA) was instructed to put together a plan for strengthening the competitiveness of financial and capital markets by the end of 2007 and it was decided that the plan would be promoted by the entire government. In response to this decision, the FSA hereby publishes the measures for strengthening the competitiveness of Japan’s markets.

The FSA is determined to implement the measures incorporated in this plan in a timely manner, with a view to constructing attractive and high-quality financial and capital markets, to which capital, information and human resources flow in from within and outside Japan.

I. Creation of reliable and vibrant markets

Competition among major financial centers around the world has been intensifying. In order to make Japan's markets more attractive and competitive, a highly secure and user-friendly market infrastructure needs to be put in place and its functions enhanced, which enables a variety of transactions that can meet the wide-ranging needs of domestic and international investors and fund raisers. At the same time, it is also necessary to boost confidence by ensuring the fairness and transparency of the markets further.

1. Providing various opportunities for investment and fund-raising

In some countries, the development of a wide range of products and upgrading of distinctive markets has been promoted rapidly in order to respond to the various needs of investors and fund raisers. Taking into account this global trend, it is necessary for Japan's markets to allow the provision of a broad range of opportunities for investment and fund-raising, including by diversifying the products traded on exchanges and by developing markets with a high degree of freedom for professional investors.

(1) Diversification of financial instruments traded on exchanges

In overseas exchanges, the diversification of financial instruments such as exchange-traded funds (ETFs) and derivatives has been advancing rapidly. Moreover, as international competition among exchanges intensifies, overseas exchanges are forming exchange groups through alliances among exchanges and are offering a wider variety of instruments ranging from stocks, bonds and financial derivatives to commodity derivatives.

In view of these developments, a framework needs to be put in place that enables Japan's exchanges and exchange groups to offer a comprehensive, wide-ranged product line-up in the same way as overseas exchanges do. This will reinforce the competitive advantage of Japan's exchanges and enhance customer benefits.

(i) Diversification of ETFs

ETFs are an investment tool that enables investors to diversify their investment easily and effectively at lower costs compared with investment in individual stocks. In addition, when compared with unlisted investment trusts, ETFs enable more flexible trading decisions as they can be traded in a timely manner at market prices in exchanges. From the standpoint of enhancing customer benefits, there must be further promotion of the diversification of ETFs.

a) Diversification of ETFs linked to stock price indices

In order to allow more quick and flexible creation of ETFs linked to various indices, government regulations related to the Act on Investment Trusts and Investment

Corporations (Investment Trust Act) will be revised within the first half of 2008. The current method of enumerating individual eligible indices in public notices shall be eliminated and revisions will be made to enable a comprehensive designation of eligible stock price indices to the extent permissible from the standpoints of ensuring fair pricing and preventing market manipulation.

b) Introduction of ETFs investing in listed securities other than stocks

The target of ETFs with contribution in kind under the Investment Trust Act is currently limited to stocks. In view of the fact that various types of ETFs with contribution in kind are listed in overseas exchanges, government regulations related to the Investment Trust Act will be revised within the first half of 2008 and measures will be taken to permit listed securities other than stocks that pose no problem from the standpoint of investor protection as investment targets of ETFs with contribution in kind.

c) Introduction of ETFs investing in commodity futures, etc.

Investment trusts that directly invest in, or exchange beneficiary certificates for, commodities or related derivatives will be made possible. To this end, the Investment Trust Act and related government regulations will be revised. Revisions will also be made in the application of the Act on the Regulation of the Commodities Investment Business with respect to these investment trusts and trusts issuing beneficiary certificates. A bill relevant to these revisions will be prepared for early introduction to the Diet (Japanese parliament).

(ii) Establishment of a framework for alliances among financial instruments exchanges and commodity exchanges

From the viewpoint of reinforcing the international competitiveness of Japan's exchanges, it is essential to put in place an institutional framework that allows, through alliances among exchanges, a full product line-up from stocks, bonds and financial derivatives to commodity derivatives. To this end, consideration will be given by the end of 2008 to revisions necessary to make alliances possible between financial instruments exchanges and commodity exchanges, under the overall framework that financial instruments and financial transactions are regulated under the Financial Instruments and Exchange Act while transactions of commodity derivatives are regulated under the Commodity Exchange Act. Following this consideration, the relevant revisions will be implemented promptly.

(iii) Diversification of J-REITs (incorporation of overseas real estates in their portfolio)

The Ministry of Land, Infrastructure and Transport has been working on the formulation of guidelines on the appraisal and evaluation of overseas real estates with the aim of finalizing by January 2008, in order to enable Japan's real estate investment trusts (J-REITs) to incorporate overseas real estates in their portfolio. On this basis, the FSA will act appropriately in putting in place a surrounding framework that enables this diversification

of J-REITs, including the development of listing rules by the exchanges, while keeping the need for investor protection in mind.

(iv) Expansion of opportunities for trading foreign company stocks in Japan (development of a framework for secondary markets for JDRs)

Based on the examination of the instrument design of JDRs (Japanese depositary receipts), including by the Tokyo Stock Exchange and the Japan Securities Depository Center, Inc., the FSA will promote the work by the parties concerned on the development of an institutional framework for secondary markets for JDRs, aiming at establishing the framework within the first half of 2008.

(v) Improving the functioning of commodity exchanges

In strengthening the competitiveness of financial and capital markets, it is also important to reinforce the competitiveness of commodity futures markets at the same time, since these markets have close relations to financial and capital markets. Therefore, the Ministry of Economy, Trade and Industry and the Ministry of Agriculture, Forestry and Fisheries plan to work on efforts to strengthen the competitiveness of commodity futures markets, including making the markets more user-friendly, allowing a broader line-up of products, and diversifying market participants. The FSA will strive for continued co-operation with these Ministries.

(2) Making transactions among professionals more vibrant

In other countries, markets with a high degree of freedom intended for professional investors are expanding, such as the AIM (Alternative Investment Market) in the United Kingdom and the market based on Rule 144A of the United States Securities and Exchange Commission (SEC). This trend has been intensifying the international competition in creating attractive markets.

Investor protection, including through disclosure, will continue to gain greater importance in Japan. However, it is also essential to differentiate professional investors from general investors and allow the former more freedom in transactions under the principle of self-responsibility, from the viewpoints of making the country's financial and capital markets more vibrant and strengthening their international competitiveness.

It is important to note here that responsible behavior and thorough risk management on the part of professional investors are vital for making these markets successful. If adequate self-discipline is not exercised by professional investors in transactions with a high degree of freedom, it is possible that professional investors participating in such transactions and general investors behind them could suffer unexpected losses due to fluctuation of market prices and other factors.

(i) More flexibility in the qualified institutional investor system

The regulations on the system for exempting offers of newly issued securities limited to qualified institutional investors (so-called “private offerings to professionals”) from disclosure requirements will be revised by end-March 2008 in order to relax the provision on notification periods for becoming qualified institutional investors (currently twice a year).

(ii) Development of a framework for markets intended for professionals

Measures will be taken to establish markets among professionals that allow a high degree of freedom in transactions. The aim of this work is to raise the attractiveness of Japan’s financial and capital markets as the places for financing and investment by expanding financing opportunities for foreign companies and Japanese start-ups in Japan, and to promote financial innovation through competition among professional investors. To this end, a framework utilizing the existing systems, including of private offerings to professionals, will be put in place by the end of 2008. This will be followed by the development of a new framework, based on new disciplines, for an exchange market, the participants of which will be expanded to include specified investors. To this end, a bill relevant to these revisions will be prepared for early introduction to the Diet.

(3) Development of a framework for a secondary market for delisted stocks (“Green Sheet” market)

In order to provide investors with a venue to sell their holdings of delisted stocks, the FSA will promote the work by the parties concerned to develop, by end-March 2008, a framework for a secondary market for these stocks, including the separation of “phoenix stocks (delisted stocks)” from the “Green Sheet” market, the relaxation of the criteria for designating phoenix stocks, and handling of delivery and settlement operations by the Japan Securities Depository Center, Inc.. This effort will be based on the deliberations made by the Japan Securities Dealers Association and others.

(4) Taxation scheme for promoting changes in investment trends (“from savings to investment”)

Greater participation by retail investors with various financial needs will contribute to increasing the depth and breadth of Japan’s financial and capital markets. The FSA will make efforts to put in place a taxation scheme that promotes changes in investment trends (“from savings to investment”) and is favorable to investment by retail investors in risk assets.

(5) Enhancing financial literacy of the public through promotion of better financial education

In order to promote market participation of retail investors who underpin financial and capital markets, enhancing the financial literacy (basic knowledge of finance, capacity to make use of financial services) of each and every Japanese citizen is essential. To this end, efforts will be

made to further strengthen financial education in co-operation with relevant groups, including through distribution of textbooks and handbooks that contribute to understanding by a wider range of people of the basics of finance, and through arrangement of symposiums and seminars.

2. *Ensuring fairness and transparency of the markets*

Ensuring confidence is indispensable for the proper functioning of the markets. Enhancing the competitiveness of Japan's markets requires strengthening the confidence of domestic and foreign investors in the markets through improved fairness and transparency, while not stifling financial innovation achieved through enhanced functioning of the markets.

To this end, regulators and market participants need to make continuous efforts to make discipline through laws and regulations or self regulations more effective, for example by reinforcing measures to deter violation of rules and strengthening market surveillance functions. On this assumption, market participants also need to exercise a high level of self-discipline.

(1) Making the administrative monetary penalty system more effective against market misconduct

In order to improve fairness and transparency and to ensure confidence in the Japan's markets, more effective deterrence against market misconduct is needed. From this standpoint, the administrative monetary penalty system under the Financial Instruments and Exchange Act will be reviewed, including with respect to the scope of application, the amount of penalty charges and the statute of limitation, for early introduction of a relevant bill to the Diet.

(2) Strengthening market surveillance functions

Ensuring market fairness and transparency requires further improvement in supervision and market surveillance by regulators. At the same time, it is also important to promote further strengthening of self regulatory functions by the industry, which complements the regulators' activities.

(i) Strengthening of the market surveillance mechanism including the Securities and Exchange Surveillance Commission (SESC)

With a view towards further enhancing fairness and transparency of the Japan's markets, the FSA will make continuous efforts to reinforce the overall mechanism of market surveillance, including the strengthened SESC, in order to respond to the strengthening of market surveillance functions that includes the review of the administrative monetary penalty system.

(ii) Strengthening of self-regulatory functions

Self-regulation complements the discipline exercised through laws and regulations, while taking advantage of their features such as autonomy, specialization and responsiveness. As financial instruments and services are becoming more and more sophisticated and complicated, proper functioning of self-regulation is becoming increasingly significant in achieving enhanced customer protection and greater customer benefits, while ensuring market fairness and promoting financial innovation. From this standpoint, self-regulation will be strengthened through the schemes listed below.

a) Promotion of seamless self-regulatory networks

Industry associations with respect to transactions of respective financial instruments have changed their articles of association and expanded the scope of their self-regulations for firms that newly became subject to regulations under the Financial Instruments and Exchange Act. In the years to come, each association will be encouraged to examine how its self-regulation can be applied to firms that fall in the niches between different self-regulations, while checking the actual situations of the firms already covered.

Trouble-shooting and mediation are the particularly important functions of self-regulatory organizations from the standpoint of customer protection. Industry-wide measures to reinforce these functions by five financial instruments firms associations will be promoted promptly. Integration of the contact points of these associations for trouble-shooting and mediation is a good example of these industry-wide measures.

Furthermore, each association is expected to promote the deliberation on how self-regulation should be like in the longer term, and to strengthen the enforcement of its self-regulation, including by an upgrading of the member surveillance mechanism.

b) Further promotion of the certified investor protection organization system

The certified investor protection organization system was introduced by the Financial Instruments and Exchange Act that took effect in September 2007 in order to contribute to the expansion of alternative dispute resolution in the financial sector. Under this system, the FSA certifies private organizations for assisting in the resolution of disputes related to transactions of financial instruments. Efforts will be made to raise further the public awareness of this system so as to promote wider use of the system by consumer organizations, non-profit organizations and various industry organizations.

c) Enhancement of the self-regulatory functions of the exchanges

The FSA will continue to encourage the exchanges to make their efforts toward the enhancement of their self-regulations, including introduction of a penalty fine system being examined at the Advisory Group on Improvements to the TSE Listing System of the Tokyo Stock Exchange.

(3) Further upgrading of the accounting and disclosure systems

The accounting and disclosure systems are an essential infrastructure for ensuring a high level of confidence in the financial and capital markets. Further upgrading the systems should contribute to enhancing the fairness and transparency of Japan's markets through the provision of essential information to investors. In view of the globalization of financial transactions and corporate activities, it is also important to bear in mind the need to ensure that the Japanese systems are fully in line with international trends and developments.

(i) Promotion of international convergence and mutual recognition of accounting standards

In view of the situation where efforts geared toward the international convergence of accounting standards are accelerating mainly in the United States and the European Union (EU), the activities of the Accounting Standards Board of Japan will be supported so that the Japanese accounting standards can keep up with the moves toward convergence and achieve higher quality.

In addition, the EU intends to require third country companies that are listed in the EU market to prepare consolidated financial statements based on the International Financial Reporting Standards (IFRSs) or those standards deemed as equivalent to the IFRSs from 2009. Accordingly, the FSA, in co-operation with the European Commission, will monitor the progress made toward convergence from both sides, and promote dialogue with the aim that the Japanese accounting standards will be recognized as being equivalent to the IFRSs.

Moreover, the FSA will hold active dialogue on various accounting issues with the U.S. SEC.

(ii) Widening the scope of disclosure in English

Government regulations related to the Financial Instruments and Exchange Act will be revised by around spring 2008 in order to increase the type of securities on which disclosure in English is permitted. While disclosure in English is currently permitted only foreign ETFs, it will be permitted to all types of securities issued by foreign issuers, including foreign governments and foreign funds.

(iii) Introduction of XBRL¹ in EDINET

EDINET (Electronic Disclosure for Investors' NETwork) is a system for electronically submitting and reading securities reports and other statutory disclosure documents. XBRL

¹ XBRL (eXtensible Business Reporting Language) is an internationally standardized computer language used for financial reports, etc., which enables advanced usage by attaching attribute information to data.

will be introduced to this system for the documents related to business years starting in or after April 2008 so that users can easily analyze and process financial information.

(iv) Examination of regulatory treatment of credit-rating agencies

Various problems have been pointed out with respect to credit-rating agencies in the context of the recent developments in and around the securitization market. The FSA will examine appropriate response to these problems as necessary, including prevention of conflicts of interest and improvement in disclosure with regard to credit-rating agencies, taking into account the wide range of discussions underway in international fora such as the International Organization of Securities Commissions.

(v) Proper risk assessment and enhanced disclosure of risks associated with securitized products

In order to make the Japanese securitization market more transparent, it is essential that each party involved in securitization perform proper assessment of the risks of the underlying assets and disclose the information, thereby improving the traceability with regard to securitized products. To this end, the FSA will promote the efforts to develop a mechanism for ensuring traceability, including through co-operation with the financial services industry.

(4) Strengthening corporate governance

In order to construct a market where domestic and foreign investors can engage in transactions with a sense of security, it is important that issuers fulfill accountability to investors through improvement of governance and upgrading of internal control. It is also essential that the exchanges promote the efforts made toward strengthening the governance of listed firms.

(i) Better internal control in corporations

After implementation of the internal control reporting system (including certification by management), the FSA will review the system on a timely basis and, based on its results, deliberate as needed on revision or further clarification of the standard and practical standard, regarding the evaluation and audit of internal controls.

(ii) Efforts by the exchanges to strengthen corporate governance

The FSA will continue to encourage the exchanges to make their efforts toward strengthening corporate governance, including the enhancement of the corporate code of conduct that has been examined at the Advisory Group on Improvements to the TSE Listing System of the Tokyo Stock Exchange.

(iii) Study on possible legislation for strengthening governance of listed corporations

Extensive examination will be conducted, including with respect to the possibility of

legislation for strengthening corporate governance of the firms listed in capital markets.

3. *Construction of secure, efficient and convenient payment and settlement systems*

Payment and settlement systems are an important infrastructure supporting the financial and capital markets and a significant element that influences the international competitiveness of the markets. For Japan's markets to strengthen its competitiveness, it is important to improve further the security, efficiency, and convenience of the payment and settlement systems by keeping pace with the advance of information technologies.

(1) Payment system

With regard to the payment system, efforts will be made toward the introduction of RTGS (real time gross settlement) for large-value payments, processed on the Zengin System, in fiscal year 2011 (April 2011 to March 2012). Efforts toward meeting international standards and diversified customer needs will also be promoted in the sixth-generation Zengin System, which is planned to be launched in fiscal year 2011.

(2) Securities settlement system

As for the securities settlement system, efforts will be promoted for smooth implementation of the electronic share certificate system in January 2009. Afterwards, the FSA will encourage discussions among market participants on the promotion of straight-through processing (STP)² and on the expansion of the repurchase market, with the aim of shortening the settlement interval for government bonds.

(3) Retail payment system

As the innovation of information and communication technology expands, new payment services, such as "electronic money," have been developed and become widespread. In response to this, an institutional framework for such services will be considered from the viewpoint of customer protection, improvement in the security, efficiency, and convenience of the payment system, and promotion of innovation. The Financial System Council will start discussions on these issues from the spring of 2008.

(4) Electronically recorded monetary claims system

The electronically recorded monetary claims system, based on the Electronically Recorded Monetary Claims Act enacted in the 166th Diet session (2007), is designed as a new financial infrastructure that can be used as a payment and settlement infrastructure enabling smooth financing for businesses. Toward smooth introduction of the system, the FSA will finalize the government regulations within 2008, cooperating with the parties concerned in order to establish an electronic monetary claims recording institution. It will also promote the

² STP is a seamless processing of the series of transaction procedures from orders to settlement without involving manual operations.

efforts, including to create standards, such as recording formats, as necessary, and to raise awareness of users.

II. Putting in place a business environment that vitalizes the financial services industry and promotes competition

As the financial services become diversified and sophisticated, and more and more financial firms are forming financial groups, financial groups are expected to provide financial services of higher quality to customers. In order to allow these efforts, the following measures need to be taken to put in place an institutional framework that can meet the needs of the new times while recognizing the need to ensure sound management of financial firms through adequate group-wide risk management and to prevent conflicts of interest or abuse of dominant positions by banks.

1. Revamp of the firewall regulations among banking, securities and insurance businesses

The firewall regulations among banking, securities, and insurance businesses will be revamped and a new regulatory framework will be introduced. These measures are expected to pull out synergies within financial groups with their various business operations complementing each other and efficiently conducted, thereby improving customer convenience and accommodating the demand from financial groups for integrated internal control. At the same time, the measures will ensure the effectiveness of prevention against conflicts of interest or abuse of dominant position by banks.

Specifically, the ban on concurrent posts will be lifted and the restrictions on the sharing of undisclosed corporate customer information will be relaxed between banking and securities businesses. At the same time, measures will be taken to prohibit securities companies from soliciting customers by abusing dominant positions held by banks, in addition to making it obligatory to put in place a system for controlling conflicts of interest described in II.4. below. To this end, a relevant bill will be prepared for early introduction to the Diet.

2. Broadening the scope of businesses permitted to banking and/or insurance groups.

In view of the more diversified, sophisticated, and globalized financial services, the regulation on the scope of businesses permitted to banking and/or insurance groups will be reviewed. Specifically, the following measures will be taken:

- (1) Introduction of a framework for allowing banking groups that satisfy certain requirements with respect to financial soundness and adequate risk management, to provide new businesses, such as spot transactions of commodities, through the bank's sibling companies
- (2) Allowing banking and/or insurance groups to perform settlement by delivery for commodity derivative transactions

- (3) Allowing banks or insurance firms to engage in emission trading directly
- (4) Allowing subsidiaries of banks or insurance firms (including subsidiaries of banking and/or insurance holding companies) to engage in Islamic finance
- (5) Introduction of a framework for agency and intermediary operations on behalf of foreign banks
- (6) Broadening the scope of exemption to the restrictions on holding shareholder voting rights applied to banking groups, from the viewpoint of supporting start-ups and companies under restructuring

To this end, a bill will be prepared for early introduction to the Diet.

3. *Review of the regulations on asset management by insurance firms*

In order to allow insurance firms more managerial freedom and greater agility in the management of assets, regulations on the upper limit ratios by asset types applied to insurance firms will be reviewed and abolished if necessary, based on the results of the examination of the existing criteria for the calculation of the solvency margin ratio.

4. *Strengthening of internal control systems in financial firms and groups*

In response to diversification of services provided by financial firms and the progress in formation of financial groups, security firms, banks and insurance firms will be required to put in place internal systems for controlling conflicts of interest, with the aim to strengthen the internal control systems in financial firms and financial groups. A bill will be prepared for early introduction to the Diet to this end.

5. *Facilitating the financing of small and medium-sized enterprises and revitalizing regional economies*

The measures described above are expected to contribute to enhancing the quality of financial services provided to various types of customers. Especially regarding financial services provided to small and medium-sized enterprises, however, it is important to continue efforts to facilitate such services, particularly because these firms support the foundation of the Japanese economy.

For this reason, region-based relationship banking will be promoted further, including by efforts toward better understanding of the “Supplement to the Financial Inspection Manual: Treatment of Classifications Regarding Credits to Small and Medium-Sized Enterprises,” promotion of loans not depending exceedingly on mortgage collateral and personal guarantee, nurturing of venture business, and promotion of corporate restructuring.

It is also expected that these efforts will also contribute to enhanced profitability and financial soundness of regional financial firms as they will contribute to restructuring of small and medium-sized enterprises and revitalization of regional economies.

6. *Minimizing the “PE risk” to attract foreign fund managers to Japan’s markets*

Measures will be taken to ensure that foreign funds or foreign investors are not deemed to have a PE in Japan under domestic tax law when they carry out their business in Japan through an independent agent. These measures will help put in place an environment in which fund managers in Japan’s financial and capital markets can engage in operations with foreign investors more actively.

III. Improving the regulatory environment (“better regulation”)

Efforts toward achieving a better regulatory environment (“better regulation”) will contribute to the strengthening of the competitiveness of the Japan’s financial and capital markets. Concrete measures aimed at qualitative improvement in financial regulation will be pushed forward, which center around the following four pillars:

First Pillar: Optimal combination of rules-based and principles-based supervisory approaches³

Second Pillar: Timely recognition of priority issues and effective response (risk-focused, forward-looking approach)

Third Pillar: encouraging voluntary efforts by financial firms and placing greater emphasis on incentives for them

Fourth Pillar: Improvement in the transparency and predictability of regulatory actions

1. Enhanced dialogue and sharing of principles with the industry

The FSA intends to establish relations with financial firms and other parties in the markets that allow frank exchange of views and to enhance dialogue by making use of various opportunities. This will contribute to improving the transparency and predictability of regulatory actions from the viewpoint of financial firms and others. It will also help the FSA understand the developments in markets and in the financial sector in a prompt manner. Furthermore, the dialogue will facilitate cooperation between the public and private sectors in the search for solutions to problems faced by the financial system and by financial firms.

From these standpoints, the following actions will be taken:

(1) Sharing principles with the industry through dialogue

From a standpoint of creating a better regulatory environment and of further enhancing the attractiveness of Japan’s financial and capital markets, the FSA will hold discussions with financial firms on the principles that can serve as the foundation of best practices to be followed by financial firms and as the basis for interpretation of rules by the parties involved. Following these discussions, the FSA will put together the principles after obtaining common

³ The “rules-based” approach involves establishing detailed rules and applying them to individual cases. The advantage of this approach is that it ensures predictability and eliminates arbitrariness in regulatory actions from the viewpoint of financial firms. The “principles-based” approach is a framework in which several key principles are explicitly stated so as to encourage voluntary efforts by financial firms in line with such principles. Its advantage is that it ensures the maximum freedom of business management for financial firms.

views on them with the industry.

(2) Enhanced dialogue with the industry and related organizations

In order to promote interactive dialogue with the industry, the exchange of views at regular meetings with the industry will be enhanced in substance, while meetings with organizations of foreign firms will be regularized. Moreover, the FSA will conduct a questionnaire survey of financial firms on their requests with regard to regulatory actions, and exchange views and hold discussions with the industry on the efforts necessary or helpful for further improving the transparency and predictability of regulatory actions. The results will be made public by end-March 2009.

2. Enhanced transparency and predictability of regulation and supervision

The FSA will strive to enhance the transparency and predictability of regulatory actions by putting in place an environment that enables the public and interested parties all over the world to access easily the basic information on financial regulation and the FSA's current views on regulatory and supervisory policies. To this end, the FSA will promote, among others, translation of financial laws and regulations into English and active use of the FSA website.

(1) Efforts toward enhanced transparency of financial supervision

(i) Enhanced availability of the No Action Letter System

In order to further enhance the transparency and predictability of financial supervision, the No Action Letter System was revised in July 2007 to: broaden the range of laws, regulations, and provisions subject to the system; keep inquirers anonymous in principle when disclosing inquires/replies; facilitate the processing of letters of inquiry, including by integrating reception windows; and reduce the processing time to the extent possible. Going forward, the FSA will make further efforts to encourage active use of the new system and general reference systems for interpretation of laws and regulations.

(ii) Making greater use of Q&As (FAQs) on interpretation of rules

For the types of inquiries on the interpretation of rules often received from financial firms and others, the FSA will put together its views in the form of Q&As (Frequently Asked Questions) and post them on its website. This will contribute to the accumulation of case examples of the interpretation and applications of rules.

(iii) Promoting translation of financial laws and regulations into English

In order to facilitate communication with foreign authorities, financial firms, and market participants, the FSA will actively promote the translation of financial laws and regulations, including supervisory guidelines, inspection manuals, and self-regulatory rules, into English, taking into account the government's initiative to promote the

translation of Japanese laws and regulations into foreign languages. Specifically, the main acts including the Banking Act, the Financial Instruments and Exchange Act and the Insurance Business Act will be translated in the first half of 2008 and other acts highly relevant to foreign financial firms and overseas investors will be translated into English by the end of March 2010.

(2) Promoting better understanding of the regulatory environment

(i) Making greater use of the FSA website

The contents of the websites (both Japanese and English versions) of the FSA will be enriched so that the FSA's policy measures are more accessible and easy to understand. For example, supervisory guidelines and other materials related to financial regulation were put together systematically and posted on the website in November 2007 and this work was announced to financial firms.

(ii) Strengthening of overseas public relations

The FSA will strive to issue press releases in both Japanese and English for subjects relevant to foreign financial firms and financial firms that have overseas bases, as well as press conferences, speeches, and explanations of important policies. The FSA will also try to reach out to the overseas media, including by conducting press briefings for them.

(iii) Implementation of regulatory impact analysis

In order to enhance the quality of the regulation applied to financial and capital markets and to be fully accountable to the public for its activities, the FSA will implement the regulatory impact analysis (RIA) of the establishment, revision, and abolition of regulations under acts and cabinet orders in an appropriate manner. The RIA was introduced in Japan in October 2007.

(iv) Enhancing the transparency of market surveillance

In order to enhance the transparency of market surveillance and promote self-discipline by market participants, the SESC will put together a collection of case examples related to administrative monetary penalties by the end of June 2008 and update it every year thereafter.

The SESC has already made full-fledged revisions of the inspection manual as the Financial Instruments and Exchange Act took effect. It will make efforts to enhance transparency by making use of the manual in conducting inspections.

In particular, the manner in which requirements for regulatory actions (business improvement orders) are stipulated has been changed from specific enumerations under the Securities Exchange Act to a more general description in the Financial Instruments and Exchange Act such as "when recognized as necessary and appropriate for the

protection of public interest and investors” (Article 51 and Article 51-2). Reflecting this, SESC’s policies on making recommendations for regulatory actions will be explained in detail and adequately when making individual judgments for the time being. In the future, comprehensive views on these issues will be put together.

3. *Strengthening cooperation with overseas authorities*

In order to ensure international consistency of regulation and supervision in different countries and to respond to global market trends in an appropriate manner, the FSA intends to make use of international meetings and bilateral consultations to exchange information and views with overseas authorities, thereby cooperating with them to work on issues we have in common.

From this viewpoint, the FSA will hold meetings with authorities in Europe and the United States on a regular basis and strengthen cooperation with supervisory authorities in rapidly growing Asian markets. As a part of such activities, the FSA will start regular discussions with supervisory and other authorities in China.

Moreover, the FSA will broaden bilateral and multilateral networks for information exchange with overseas supervisory authorities to reinforce its capability to collect information on overseas financial systems and financial and capital markets. Through these networks, the FSA will endeavor to enhance the effectiveness of supervision of cross-border activities of financial firms and prevent illegal trading in order to ensure the fairness of cross-border markets.

4. *Swift and accurate comprehension of market developments and effective supervisory response*

As the subprime mortgage problem demonstrates, financial and capital markets are increasingly integrated across borders. It is therefore essential that the FSA be able to analyze and comprehend the impact of developments in the global economy and financial and capital markets on the management of financial firms and the stability of the entire financial system, and take necessary supervisory response in a timely manner.

(1) *Strengthening the supervisory structure toward forward-looking supervisory response*

The supervisory structure will be enhanced and strengthened beginning in Fiscal Year 2008 (from April 2008 to March 2009) with the aim that the FSA can foresee and identify underlying risks in the financial system at early stages and take supervisory actions in a forward-looking manner. Meanwhile, the FSA will also hold dialogue and cooperate with market participants and relevant authorities, both domestic and foreign.

(2) More risk-focused and flexible inspections

Through enhanced dialogue with the management of financial firms as well as proper understanding of firms' efforts and supervisory information, the FSA intends to implement more risk-focused and flexible financial inspection, by identifying and analyzing important issues for management in a risk-focused manner. From this standpoint, a Japanese version of "examiners in charge" will be introduced, where chief examiners in charge of inspecting major banks will remain in charge for multiple years. The FSA will also make great use of targeted inspections that focus on specific risks or business lines, considering the results of the Financial Inspection Ratings. Introduction of simple inspections will also be considered for small-sized financial firms with limited range of operations.

Moreover, the Financial Inspection Rating System will be fully implemented in January 2008, and the FSA intends to operate the system in an appropriate manner. The main objective of the system is to provide financial firms with the incentive toward improvement in management, and the FSA will strive to enhance the functioning of the system by putting more emphasis on autonomous and proactive efforts by financial firms for improvement in management.

The SESC also intends to formulate the inspection plan of the financial firms in a risk-based manner in order to enhance flexibility and efficiency of its inspections based on the Financial Instruments and Exchange Act. The SESC will select certain themes regarding common problems identified in the markets and implement targeted inspections to the financial firms with such problems. The SESC will continue to act flexibly while being alert to wide-ranging issues in the markets.

5. *Improvement of the skills of the FSA staff*

Finance is a sector that requires extremely high expertise and all of the FSA officials are required to improve their skills to keep pace with the development of financial technologies and market trends. For this reason, various measures shall be examined, for example:

- The establishment of the recruitment and training system that takes employee expertise into consideration, including the creation of expert staff positions;
- Reinforcement of the training system for improving the expertise of the FSA staff, including education at accounting graduate schools and secondment to foreign supervisory authorities or international organizations; and
- The promotion of personnel exchange between the private and public sectors, including employment of experts under limited-term contracts and mid-career recruitment.

IV. Improving the broader environment surrounding the markets

In order to strengthen the competitiveness of the financial and capital markets, it is essential that not only the financial and market systems themselves be improved but also the environment surrounding the markets be upgraded, for instance the development of an environment favorable to the nurturing and pooling of human resources with expertise in finance.

1. Nurturing and pooling internationally competent experts in finance, law and accounting

It is obvious from the examples of international financial centers in foreign countries that the presence of human resources with high expertise is a fundamental and significant factor that determines the competitiveness of financial and capital markets. In order to put in place an environment where a wide range of high-quality financial instruments and services are provided in Japan's financial and capital markets, it is essential to nurture experts in financial services and related professional services such as law and accounting, and maintain and reinforce the pool of these human resources.

(1) Enhancement of advanced and practical financial education and greater use of experts in finance

In order to provide a sufficient number of highly competent professionals in Japan's financial and capital markets, the FSA will strive to enhance and reinforce advanced and practical financial education in cooperation with the Ministry of Education, Culture, Sports, Science and Technology as well as industry organizations, through such actions as supporting professional graduate schools in their efforts in financial education or by having industry organizations set up a contact point for communications with universities and graduate schools who may request for guest lecturers and internships.

(2) Improving the modalities of the Certified Public Accountant (CPA) Examination

In order to make the CPA Examination more attractive to a wide range of people and to increase the opportunities to take the examination, the Certified Public Accountants and Auditing Oversight Board shall take specific measures on implementation modalities of multiple choice tests and essay tests by 2010, for example by conducting multiple choice tests twice a year and essay tests in a more thinking-ability-oriented manner.

(3) Nurturing financial experts

In order to attain higher competitiveness of Japan's financial and capital markets, it is urgent to secure and develop human resources that shoulder the growth of the market. Moreover, providing human resources that can share the common sense of compliance in markets and authorities will contribute to bringing about a better regulatory environment.

For this reason, the “Study Group on Financial Experts” was established in the FSA. It will develop a proposal on the basic concept around the spring of 2008 and issue it for public comment, then finalize the discussions by the summer to consider the design of the system.

(4) Improving predictability of immigration control

In the Japanese financial and capital markets, there is a pressing need to invite human resources with sophisticated expertise in finance and international trade, from all over the world, regardless of their nationality. For this reason, the FSA will support the efforts to improve the predictability in admitting applicants as household helpers who will be employed by expatriates with the residence status of “investor/manager”, including by holding meetings at which the immigration authorities explain to financial firms about the requirements for accepting such household helpers (as stipulated in the Ministry of Justice Notice concerning residence status for special activities) and their applications.

Moreover, in order to secure a greater number of foreign finance experts in Japan than before through improvement in the living environment for foreigners, the FSA will request that measures be examined to allow expatriates who have the residence status of “investor/manager” and are engaged in activities at a financial firm to hire household helpers more smoothly.

2. Upgrading of urban infrastructure functions deserving an international financial center

In addition to improving the legal framework of the financial and capital markets themselves, the development of the urban infrastructure deserving an international financial center and improvement in its functions is also an important issue to be addressed for enhancing the competitiveness of Japan’s financial and capital markets. For this reason, the acceleration of the pooling of various market experts not only in financial firms but also in related professional services such as law and accounting is required, as well as the construction of an urban environment where both domestic and international players can take active roles in the markets safely and comfortably.

The FSA will cooperate with the Urban Renaissance Headquarters in the preparation and promotion of the regional development policy based on the urban renaissance projects that was decided in June 2007, and provide support to private sector initiatives in the financial sector.