



FSA Newsletter March 2007



Minister Yamamoto delivered an address at an information meeting on the facilitation of year-end lending (March 5)



FSA released a guidebook regarding basic information on financial transactions (available only in Japanese) (February 28)

Table of Contents

[TOPICS]

- Amendment to Comprehensive Guidelines for the Supervision of Major Banks and Small- and Medium-Sized and Regional Financial Institutions2
- Status of Non-Performing Loans as of the End of September 2006.....3
- Study Group on the Internationalization of Japanese Financial and Capital Markets3
- Expert Panel of Task Force for Heavily-Indebted People.....4

[Hot Picks from the Financial World]

- Anti-Money Laundering efforts taken by Financial Institutions.....5
- Issues on faulty accounting of Nikko Cordial5
- G7 discussion on hedge fund.....6
- Selection Process of Acquiring Party of Ashikaga Bank6
- Administrative actions against the Bank of Tokyo-Mitsubishi UFJ6

【Topics】

Amendments to the Comprehensive Guidelines for the Supervision of Major Banks, etc. and Small- and Medium-Sized and Regional Financial Institutions

1. Introduction

On January 23, 2007, the Financial Services Agency (FSA) amended the Comprehensive Guidelines for the Supervision of Major Banks and Small- and Medium-Sized and Regional Financial Institutions (hereinafter referred to as “Supervisory Guidelines”) regarding security measures for ATM systems and Internet banking. This article provides background to and an outline of the amendments to the Supervisory Guidelines.

2. Background to the Amendments to the Supervisory Guidelines

In March 2006, the FSA established the Study Group on Information Security together with the National Police Agency and financial organizations in consideration of the high incidence of ATM-related crime.

The Study Group, which was convened from March to June 2006, exhaustively gathered detailed information on the *modus operandi* of financial institutions’ ATM systems and Internet banking and the foreseeable risks associated with the information security thereof, based on cases both at home and abroad, verified the effectiveness of various security measures, widely informed financial institutions of the study results, and published a summary of the results. The latest amendment to the Supervisory Guidelines was carried out for the purpose of reflecting the results of the study conducted by the Study Group.

Having invited public comments between December 15, 2006 and January 15, 2007 and responded to the questions received on January 23, the FSA decided to adopt the original draft as is.

3. Outline of Amendments

The latest amendments to the Supervisory Guidelines clearly set forth the supervisory aims, etc. with respect to security measures for ATM systems and Internet banking. The main amended provisions are as follows.

(1) Internal Control System

- Are financial institutions making efforts to develop the necessary systems pursuant to the study in accordance with the characteristics of their customers and operations?
- Is the so-called plan-do-check-action (PDCA) cycle—consisting of risk analysis, formulation and execution of security measures and evaluation and review of the effectiveness of measures—functioning?

(2) Ensuring Security

- Are financial institutions taking measures according to the characteristics of their customers and operations based on an understanding of the risks inherent to each stage, such as framework development point, during usage and when damage occurs?
- Are financial institutions seeking to improve overall security rather than adopting ad-hoc measures on a case-by-case basis?
- Have financial institutions selected appropriate personal identification methods commensurate with the risks of transactions, after verifying the robustness of individual authentication methods against various *modus operandi* (Internet banking)?

(3) Response to Customers

- Do the financial institutions’ policies involve taking measures to minimize damage in cases where customers need to be widely informed, such as developing frameworks to inform them promptly?
- Are financial institutions taking measures to enable customers to check their transactions in a timely fashion so that customers themselves can quickly become aware of damage?
- Have financial institutions developed systems to deal with customers in a sincere manner with a view to providing compensation for losses arising from unfair trading, in consideration of the objective of the Depositor Protection Law, in order to strictly enforce customer protection (Internet banking)?

Status of Non-Performing Loans as of the End of September 2006

On January 25, 2007 the Financial Services Agency (FSA) released to the public the status of non performing loans as of the end of September 2006 (available in Japanese only).

A brief explanation of the status of non-performing loans as of the end of September 2006 is given as follows:

The balance of non-performing loans (NPLs) of all banks nationwide (on the basis of loans subject to disclosure under the Financial Reconstruction Law) totaled 12.3 trillion yen as of September 30, 2006, a 1.0 trillion yen decrease from 13.4 trillion yen as recorded on March 31, 2006.

The respective NPL ratios of major banks, regional banks and all banks nationwide were lower than on March 31, 2006, both of which represented record lows since data on loans subject to disclosure under the Financial Reconstruction Law became available to the public on March 31, 1999.

	March 31, 2004	March 31, 2005	March 31, 2006	September 30, 2006
Major banks	5.2%	2.9%	1.8%	1.5%
Regional banks	6.9%	5.5%	4.5%	4.4%
All banks nationwide	5.8%	4.0%	2.9%	2.7%

The NPL ratio of major banks has been steadily decreasing even after the fulfillment of the objective of halving the NPL ratio under the Program for Financial Revival (October 2002). The banks' NPL ratio decreased from 1.8% in the year ended March 31, 2006 to 1.5%.

The downtrend in the NPL ratio is also continuing at regional banks, where efforts to enhance region-based relationship banking functions are making steady progress. Their NPL ratio decreased from 4.5% in the year ending on March 31, 2006 to 4.4%.

The FSA will continue taking all feasible measures to prevent the NPL problem from recurring, by such means as properly identifying the risk management systems of financial institutions.

Study Group on the Internationalization of Japanese Financial and Capital Markets

On January 30, 2007, the Study Group on the Internationalization of Japanese Financial and Capital Markets (chairperson: Kazuto Ikee, Professor of Economics, Keio University) was established under the Sectional Committee on Financial System of the Financial System Council.

The Study Group was established in response to the need to position the financial services sector as a core industry that brings about further economic progress, in addition to further improving user convenience in the financial and capital markets—the basic infrastructure of the Japanese economy—for the purpose of increasing per-capita income, as we approach an era of dwindling population combined with an increasingly aging society with a declining birthrate, as well as globalization.

With such critical awareness, the Study Group will examine a wide range of issues from a broad perspective, addressing not only institutional aspects but also human resources, specialized services and infrastructure, in order to build internationally-appealing financial and capital markets.

Expert Panel of Task Force for Heavily-Indebted People

In December 2006, the bill for the amendment of Money-Lending Business Control and Regulation Law, etc. was passed. With the amended law, the Japanese government intends to promote measures to solve the multiple debt problem in a comprehensive and effective manner by enhancing collaboration among relevant ministries and agencies (Article 66 of the amendment).

In order to smoothly and effectively promote measures against multiple debts, the Task Force for Heavily-Indebted People (headed by Minister for Financial Services Yuji Yamamoto) was established by the Cabinet Secretariat in December 2006.

The Task Force will examine such topics as enhancing the counseling system and public safety net, strengthening financial and economics education, bolstering the executive framework including a thorough crackdown on loan sharks, and facilitating the enforcement of the amended law. It plans to formulate the “Program to Remedy the Multiple Debt Problem (tentative name)” this spring.

In this process, it is vital to maintain understanding of the current state of multiple debts as well as the underlying socioeconomic problems thereof, not to mention specialized knowledge and a broad perspective. Accordingly, the Expert Panel of Task Force for Heavily-Indebted People was established for the purpose of having experts discuss basic policies so as to serve as reference for studies conducted by the Task Force. Expert members were selected primarily from among members of the Roundtable Conference on Moneylending System, etc. which had held a series of discussions on the multiple debt problem. Naoyuki Yoshino, Professor of Economics at Keio University, was again elected as chairperson. Director level staff of relevant ministries and agencies have also attended the Panel meetings and participated in discussions.

The Expert Panel has convened three times to date: Monday, January 29; Wednesday, February 7; and Thursday, February 22.

In the first meeting, the Financial Services Agency (FSA) provided an explanation of the amended Money-Lending Business Control and Regulation Law and issues, etc. to be studied by the Task Force following free discussion among members.

In the second meeting, staff in charge at Morioka City’s Consumer Affairs Center, Iwate Prefecture’s Consumers’ Financial Co-op and the Iwate Bar Association, which are making progressive efforts with respect to the multiple debt problem, were invited to give a presentation on their efforts and then engage in discussion with the members.

In the third meeting, the Japan Federation of Solicitor Associations gave a presentation on their efforts in financial education, etc., which was followed by a discussion between members over the main opinions expressed in the previous two meetings.

【Hot Picks from the Financial World】

* We deliver the hottest information of the times in this section, selected from among questions and answers given at the Minister's press conferences, etc.

If you wish to find out more, we invite you to visit the "[Press Conferences](#)" section of Financial Services Agency's website.

[Anti-Money Laundering efforts taken by Financial Institutions]

Q. Is it your understanding that Japanese banks' measures are insufficient at present, or that there were problems in the form of serious inadequacies at individual banks?

A. Japanese financial institutions' system to prevent terrorist funding and money laundering is at a reasonable level in the first place, even by international standards. Efforts to prevent terrorist funding and money laundering is not only becoming an important issue for Japan itself but also becoming increasingly important in terms of ensuring confidence in the financial market internationally. With this in mind, we decided to revise the supervision guidelines, based on the judgment that it would be appropriate to require financial institutions to undertake even tougher measures to prevent terrorist funding and money laundering by clarifying the focal points of supervision.

(from [the press conference following a cabinet meeting on Friday, January 26, 2007](#))

[Issues on faulty accounting of Nikko Cordial]

Q. There are some reports in the press that Nikko Cordial Corporation had remunerated its former managing director who was convicted in a payoff scandal in the past. What are your views on this?

A. Assuming that the reported facts are accurate, the conditions that have led the company to sustain a negative legacy for such a long period of time needs to be called into question. However, President Shoji Kuwashima deserves to be commended on his decision to switch to a new structure with a view to settling the negative legacy by changing the corporate constitution resolutely in response to such acts, and putting an end to remunerating the ex-managing director so as to comply with laws and regulations. It is hoped that Nikko Cordial Corporation will enhance governance by thoroughly carrying through such efforts, and ensure soundness in its financial position and its operations.

(from [the press conference following a cabinet meeting on Friday, January 26, 2007](#))

Q. Please explain once again what your thoughts are on the series of misconduct at Nikko Cordial Corporation relating to the restatement of its financial reports.

A. I commend the company for having been capable of taking the first step to break away from its past, in the sense that it has established a special investigation committee inside the company, finished its report on the results of investigation in a speedy fashion and disclosed the results thereof without concealing anything.

(from [the press conference following a cabinet meeting on Friday, February 2, 2007](#))

Q. The special investigation committee's report has pointed out that the audit firm was not able to fully prevent illicit acts. How will the FSA tackle this?

A. Generally speaking, in regards to determining our future approach to further improving audit functions in that context, I have extremely high expectations for the fruits to be borne from the upcoming amendment of the Certified Public Accountant Law. As this will naturally be incorporated into deliberations at the current Diet session and questions will be asked, we hope to work out a firm solution in the process of answering their questions in a serious manner.

(from [the press conference following a cabinet meeting on Friday, February 2, 2007](#))

[G7 discussion on hedge fund]

Q. At the G7 meeting to be held in Germany next month, Germany seems to be inclined to put hedge fund regulations on the agenda. What are your thoughts on this?

A. I believe that the G7 nations do not vary in their recognition that the global activity of funds is becoming massive and their influence over economies and international financial systems is steadily growing. However, the rating of fund-of-funds is currently being considered under Basel II in ensuring the soundness of banks, and the transparency and rating of funds are not necessarily unrelated in view of the aforementioned systemic risks, so in that sense, the approach to hedge funds needs to be discussed from here onwards as a matter of course.

(from [the press conference following a cabinet meeting on Tuesday, January 30, 2007](#))

Q. At the G7 meeting, the need to exercise vigilance with respect to hedge fund regulations was mentioned, but no specific measures were incorporated. What is your view on this?

A. Firstly, one way of looking at it is to evaluate hedge funds from the point of view of their contribution to the efficiency of financial markets. Additionally, there is a need to be wary of potential risks. In Japan, we are considering requiring financial institutions that provide loans and other services to hedge funds to perform appropriate risk management in the course of inspections and supervision, while dealing with them under the Financial Instruments and Exchange Law. It is important to collaborate with overseas authorities and international agencies to identify the actual state of funds, so we will respond appropriately in Japan while keeping a close eye on international discussions.

(from [the press conference following a cabinet meeting on Tuesday, February 13, 2007](#))

[Selection Process of Acquiring Party of Ashikaga Bank]

Q. The Governor of Tochigi Prefecture visited you and expressed his opinion on the selection of an acquiring party for Ashikaga Bank. Could you please explain what your thoughts are regarding the selection of an acquirer?

A. The governor, deputy governor and chief treasurer visited me and made some polite requests. Their requests will serve as reference when assessing the business plan, which is to be submitted in the weeks ahead. We will endeavor towards the selection of an adequate acquirer so that Ashikaga Bank can establish confidence among customers in the region centering on Tochigi Prefecture, and demonstrate its financial intermediation functions in a sustainable manner even after it is transferred to the acquirer.

(from [the press conference following a cabinet meeting on Friday, February 9, 2007](#))

[Administrative Actions against the Bank of Tokyo-Mitsubishi UFJ]

Q. The FSA ordered the Bank of Tokyo-Mitsubishi UFJ to suspend some of its operations for having repeatedly provided questionable loans to a certain company despite their having been identified by successive management teams. Please describe your position on this matter.

A. It is extremely regrettable that the bank had been doing favor for non-law-abiding element such as

these for a long period of time. The fact is that this practice had been passed down over many years at the business base whereat the bank handles corporate affairs. Moreover, the management team and the headquarters had failed to deal with the situation appropriately. Considering that it did not examine effective remedies such as concrete countermeasures to revise the dealings, we issued an order as required. The impression it gives to shareholders, creditors, clients, depositors and the general public is an extremely regrettable one, that it is strong against the weak but weak against the strong, and in particular, that such an institution has no countermeasures against problems of violence in society, so we strongly urged the Bank to take measures to tackle this.

(from [the press conference following a cabinet meeting on Friday, February 16, 2007](#))

Q. What do you think about the responsibilities of the top management of the Bank of Tokyo-Mitsubishi UFJ?

- A. It is not enough to just reprimand someone limited to the top management to counter antisocial elements. In making the bank strictly enforce training programs as stated in the business improvement order, what matters is improving its constitution and making everyone work together and tackle the situation in an organized manner across the board. In that sense, to counter organized crime groups, you cannot do anything by confining the matter to the top management alone. In that respect, I think that silent phone calls, harassment by stalking and other such activities cannot be resolved by small numbers of people in upper management alone or by other measures of that kind, unless training programs are based on the idea that all individuals must combine their efforts, form a scrum and tackle the matter together. I therefore hope the management team and all employees will engage in the training programs, and from such a perspective, each and every one of them feels repulsion toward antisocial elements and takes countermeasures against them in all stages of the business procedures starting at the bank counter.

(from [the press conference following a cabinet meeting on Friday, February 16, 2007](#))