



FSA Newsletter February 2008



Minister Watanabe delivered a keynote speech at a dialogue meeting with SME Managers in Niigata (January 16)

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Photograph Gallery

In this corner, we post photographs of the Minister, the Senior Vice Minister, the Parliamentary Secretary and FSA officials at work in meetings, conferences and other events.



The 125th Meeting of the Council on Insurance against Compensation for Automobile Damage Liability. (January 18)



The 11th Meeting of the Financial Markets Strategy Team. (January 31)

[Featured]

Outline of Dialogue Meeting Between Minister for Financial Services Watanabe and SME Managers, etc. (in Niigata)

On January 16, 2008, the Financial Services Agency (FSA) and the Kanto Finance Bureau of the Ministry of Finance held a dialogue meeting in the Tsubame-Sanjo region of Niigata Prefecture, between Minister for Financial Services, Yoshimi Watanabe, and managers of small and medium-size enterprises (SMEs) and representatives of financial institutions in the region. The objective of this meeting was to listen to the voice of the local community and reflect it in financial regulation and supervision going forward.

The meeting follows the direction made by the Prime Minister that the conduct of politics and public administration should be reviewed comprehensively so as to change the mindset of government in a way that ensures public administration reflects the standpoint of consumers and ordinary people. By engaging in dialogue with both the providers and users of financial services in local communities, the meeting was held with the aim to reflect the viewpoints of people actually doing business in local communities in financial regulation and supervision.

<Program>

1. Keynote speech by Minister for Financial Services Yoshimi Watanabe
“Future Development of Regional Industries and the Role of Regional Financial Institutions”
2. Dialogue Session between Minister Watanabe and participants



1. Key Points of Keynote Speech by Minister Watanabe

I. Recent Financial and Economic Developments

- Unfortunately, Japan's competitiveness in the global economy has been sharply eroded. To make matters worse, the global financial markets have been rocked by problems triggered by the subprime mortgage crisis. If the yen appreciates, it will have a direct impact on the prices of products exported from Japan, even as Japanese companies' earnings are being squeezed by rising materials prices. We must tackle these issues with an enhanced sense of crisis.
- Regrettably, Japan's nominal GDP has remained flat, in contrast with the continued growth of that of the United States. Meanwhile, the nominal GDP of China, which is the leading emerging country, has continued to expand and is steadily catching up with Japan's. Japan's per-capita nominal GDP, in particular, has been continuing to decline. Although Japan was ranked second among the member countries of the OECD (Organisation for Economic Cooperation and Development) in terms of the size of per-capita nominal GDP at its peak in 1993, it has now fallen to 18th place. Since the peak period, workers' wages have seriously stagnated, which has been a major impediment to Japan's efforts to completely overcome deflation.
- Regarding the expansion of the market capitalization of major securities markets around the world since 1990, market capitalization of the Tokyo market has grown 1.5-fold compared with that year, while the U.S. market's has expanded 5.7-fold. In China, meanwhile, market capitalization in Hong Kong, Shanghai and Shenzhen expanded 20-fold, 25-fold and 55-fold, respectively. This huge expansion has drawn an influx of funds, which has spurred investment-led economic growth. In contrast with countries trying to stimulate economic growth, China is struggling to come up with

ways to cool down its overheating economy.

- On the other hand, a look at the balance sheet status of Japanese companies as indicated by the Financial Statements Statistics of Corporations by Industry shows that their capital is small relative to their liabilities, with the proportion of capital in the total assets standing at 35% and the proportion of liabilities at 65%. In the era of inflation, taking in loans used to provide a very advantageous means of raising funds. The lesson we have learned over the past ten years or so, however, is that heavy reliance on loans as a fund-raising means leads to a very precarious situation once asset deflation occurs. In most other developed countries, the proportion of capital is larger than that of liabilities.
- From the viewpoint of the relationship between capital expenditure and cash flow, Japanese companies have made capital expenditures only within the extent of their cash flow since the collapse of the so-called bubble economy, which was driven by asset inflation. In the wake of the bubble economy's collapse, private sector companies struggled hard to repay their debts, and signs have only recently appeared that they are starting to raise funds again through loans. The amount of outstanding loans has fallen to a level barely above 400 trillion yen, with the ratio of loans to GDP dropping to 80%. Regarding trends in the amount of funds raised by companies and the amount of financial assets held by households, the two have shown parallel movements in the United States, whereas in Japan, the stagnant fund-raising activities by companies have offered a stark contrast to the steady growth in household sector financial assets. This is a precise reflection of Japanese companies' excessive focus on debt repayments amid deflation.

II Current State of Regional Economies

- Regional economies face a supply-demand imbalance amid intensifying global competition. I feel that that the greatest cause of Japan's failure to completely overcome deflation lies precisely in the state of regional economies.
- In this context, a variety of initiatives have been implemented in regions across the country. For example, there is an initiative to achieve regional development by connecting with the global economy. Kucchan Town in Hokkaido has attracted investment from Australians who have found out that this town offers fine powder snow for skiers.
- On the other hand there are cases, like an initiative by Nagahama City in Shiga Prefecture, in which regional revitalization is achieved within the framework of the domestic economy. Nagahama City acquired a Meiji-era building known as "Black-Wall Bank" as part of its effort to create an attractive townscape. In addition, the city established a glass-making workshop for souvenir goods, which has become a very popular tourist site. This is a successful example of an initiative to revitalize an entire region by focusing on a specific specialty.
- A similar initiative is also under way on a remote island. The island town of Ama, in Shimane Prefecture, has started an initiative to establish its own local brand of beef, which is taken from cows fed with grass rich in mineral ingredients stemming from the surrounding sea. In addition, the town offers a specialty dish called "Sazae" curry, which features turban shell as an ingredient, and other specialty produce, with the entire island looking like a department store offering a variety of goods.

This initiative has prompted some people who have deserted the island to return there, leading to an increase in the town's population.

- Meanwhile, there is a town that has turned away from the bitterness of the present time to the good old days of the Showa era. Bungo Takada City in Oita Prefecture created streets whose appearance recalls the Showa era.
- The Tsubame-Sanjo region has resolved the problem of supply-demand imbalance by continuously adapting local businesses to suit the needs of the time, with its strength in metal processing technology as an industrial base. Moreover, this region has created its own brand of products in a bold attempt to connect with the global economy, made active use of new materials and developed new products, and these activities have drawn our attention. This region really deserves our respect, as it has played the role of a very sensitive "antenna" that identifies market needs correctly.
- Meanwhile, regional financial institutions also have a new, additional role to play. There is an attempt to provide loans actively without relying too much on land as collateral. And there is an initiative to use movable assets or accounts receivable as loan collateral. Moreover, the Electronically Registered Receivables Act was enacted in the Diet last year in order to ensure the security of procedures for securitization and transfer of debts and facilitate corporate fund-raising. This is an era of paperless transactions. There are accounts receivable totaling tens of trillions of yen that are held by SMEs alone, and the total value of accounts receivable, including those held by larger companies, is well over 100 trillion yen. If accounts receivable are registered electronically and the ones thus backed by the effect of public registration are securitized, a drastic change could occur in corporate fund-raising.
- So-called LCFIs (large complex financial institutions) have received capital from sovereign wealth funds in exchange for issuing preferred shares when they faced a capital shortage. An arrangement like this may be used by SMEs to receive funds similar in nature to capital from regional financial institutions. As I told you earlier, the balance between capital and liabilities is greatly distorted in Japan. In order to reform the distorted balance sheet structure, we may consider going further than now in the supply of funds similar in nature to capital. Government-affiliated financial institutions have started providing subordinated loans similar in nature to capital on an experimental basis. An approach like this will probably have to be closely examined in the future as an element of regional finance.
- Although know-how regarding the pinpoint approach used in the rehabilitation of individual companies has been accumulated in various ways, regional revitalization needs an area-wide approach. The planned establishment of a Regional Power Revitalization Corporation in the next fiscal year represents just such an approach. As I have been involved in this issue for a long time, I strongly hope that the new Corporation will make great contributions to regional revitalization. Regional financial institutions have accumulated a large volume of corporate information concerning SMEs as well as regional economic matters and social affairs. I am sure that personnel at regional financial institutions have in-depth knowledge regarding their regions and are highly motivated to work hard for the sake of their regions. I am sure that they have a keen business sense and readiness

to act speedily – traits that are lacking at public institutions like local governments. Under our plan, a Regional Power Revitalization Corporation will provide support for business rehabilitation related to wide-area revitalization. For example, a sight-seeing area or a hot spring resort may make a region-wide effort to attract visitors, or rehabilitation of a regional department store may be carried out in conjunction with revitalization of the surrounding shopping streets. I strongly hope that regional financial institutions will work on wide-area revitalization while bearing in mind the planned functions of a Regional Power Revitalization Corporation in this regard.

III Strengthening the Competitiveness of Financial and Capital Markets

- We plan to submit in the current ordinary Diet session a bill related to the Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets. Of the financial assets held by Japan's household sector, totaling around 1,500 trillion yen, 750 trillion yen is parked in deposits, etc., rather than invested in financial products. We must review and reform the Japanese markets once again.
- Whereas the commodity markets around the world have continued to grow rapidly, Japan's commodity market remains. We must first rebuild this market. As a first step, we may have to consider merging the exchange for financial products and the exchange for commodities by offering both types of product in the form of ETFs (exchange-traded funds). In addition, we may have to consider establishing a market specifically intended for investment by professional investors from around the world.
- We will also have to review the “firewall” regulation concerning the separation of banking and insurance businesses. For example, although it may be impossible to allow a bank to engage in cash commodity transactions, it will be worth considering allowing a company affiliated with the bank to engage in such transactions. Moreover, we may have to consider drastic deregulation concerning Islamic finance. Since Japan excels in technologies related to energy conservation and low carbon emission, we may have to implement major deregulation concerning emissions trading. Furthermore, as I told you earlier, major deregulation may be necessary with regard to share ownership related to corporate rehabilitation.
- From these viewpoints, we have drawn up the Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets and plan to submit the necessary bill in the current Diet session.



2. Dialogue with Participants

The following are examples of opinions and comments expressed by participants in the question-and-answer session that followed the keynote speech.

【Company managers】

- In the Tsubame-Sanjo region, the number of companies that go out of business is far higher than the number of companies newly created, and the number of companies operating in the region has been declining year after year as a result. Is the government considering measures for increasing the number of companies, such as providing managers of bankrupt companies who are willing to start a new company with an opportunity to do so?
- Shouldn't city banks, which also provide loans to SMEs in regions (as well as catering to large companies in metropolitan areas), engage in initiatives to provide steady support to SMEs and assist corporate rehabilitation?

【Representatives from financial institutions】

- Regarding a proposal to review the institutional framework for cooperative-type financial institutions such as Shinkin Banks and credit cooperatives, what roles does Minister Watanabe think such institutions should play in the future?



[TOPICS]

The Fourth International Conference "Regional Finance in Recent Period and the Way Forward" (held on January 18, 2008)

On January 18, 2008, the FSA's Financial Research and Training Center (FRTC), together with the 21 Century COE-Market Quality project of Keio University, held its fourth international conference with the theme "[Regional Finance in Recent Period and the Way Forward](#)". A total of around 200 people from Japan and abroad participated in the conference, including researchers and government officials as well as representatives from financial institutions and foreign embassies in Tokyo.

In Japan, regional financial institutions have been promoting various initiatives for the rehabilitation of small and medium-sized enterprises (SMEs) and regional revitalization in order to enhance the function of so-called "relationship-based banking." Despite the progress made in such initiatives, however, there are complaints from customers of regional financial institutions, including SMEs, that some initiatives have not produced sufficient results.

Therefore, the participants in this conference compared and examined the situations in Germany, where regional finance is said to have contributed to the revitalization of regional economies, and those in other parts of Asia, where local communities and SMEs have ample access to loans, as well as the situations in Japan. In addition, discussions were held on what kind of role regional finance should play in Japan in the future.



Session 1: Experience and current status of regional finance in Japan

In this session, the FSA first reported on the results of an action program for relationship-based banking implemented in fiscal 2003 and 2004, as well as future challenges, in order to provide a basis for an international comparison of the status of regional finance. Next, the Japan Finance Corporation for Small and

Medium Enterprise explained the role of government-affiliated financial institutions in regional finance and finance for SMEs in Japan and initiatives implemented in recent years, such as securitization schemes. In addition, regional companies reported on the current status of relationship-based banking as assessed from the viewpoint of borrowers.

Issues taken up in the free discussions held after these reports included the need to share information concerning the results of initiatives related to relationship-based banking, such as an increase in loans that avoid excessive reliance on real estate as collateral by using movable assets (inventories) as collateral, and a database of successful examples of corporate rehabilitation leading to regional revitalization.



Session 2: Experience and current status of regional finance in Germany

The regional economies in Germany are said to have been successfully revitalized due to regional financing activities. In order to allow the participants in this session to explore the lessons that Japan may learn from regional finance in Germany, the savings and finance group of Deutsche Bank reported on the current status of regional finance and finance for SMEs in Germany and future challenges, and discussions were conducted based on the report. Savings banks in Germany are similar to regional financial institutions in Japan, in that they are non-profit institutions providing loans mainly to SMEs in their regions. Meanwhile, the total amount of assets held by savings banks in Germany as a group is well above the amount of a major financial institution in the United States or Europe, allowing them to exert great influence.

It was pointed out that German savings banks as a group can compete with major financial institutions despite their focus on regional finance and finance for SMEs, mainly because individual regions in Germany have traditionally had unique features of their own. Differences between the characteristics of regions and borrowers in Germany and in Japan were also cited, such as German SMEs' high degree of independence compared with their Japanese counterparts.

Session 3: Experience and current status of regional finance in Asia

In Asia, loans to SMEs are increasing in Thailand and South Korea in particular, reflecting efforts to redress the financial structure of excessive reliance on loans to major companies and direct more finance toward SMEs.

As the Asian economy maintains high growth, regional finance is said to be continuing to expand. This session compared the status of regional finance in Japan and in Asia, after reports were made by representatives from Thailand and South Korea.

First, the Small and Medium Enterprise Development Bank of Thailand explained the background of its foundation and its role, as well as the current status of its activities and future challenges. Commercial banks in Thailand used to be reluctant to provide loans to SMEs, meaning that SMEs tended to turn to a non-institutionalized financial market with high interest rates as a source of funds. In light of this situation, the Small and Medium Enterprise Development Bank of Thailand was founded in 2002 in order to achieve sustainable economic growth by enhancing the competitiveness of SMEs.

Initiatives so far implemented in relation to regional finance include a "one village, one product loan" scheme. The paradigm shift in the role of the development bank from a financial institution for SMEs to an agency charged with realizing an entrepreneurship-oriented society was cited as a future challenge.

Next, the Industrial Bank of Korea explained the background of its foundation and its role, as well as the current status of its activities and future challenges. The Industrial Bank of Korea, which was founded in 1961 in order to support SMEs, is now the only governmental financial institution specializing in financing for SMEs. In South Korea, the Bank of Korea (central bank) has been facilitating fund-raising by SMEs through the operation of an SME promotion fund and other policy financing measures, while measures have also been taken to enhance the credit guarantee system and improve SMEs' access to funds. With regard to future challenges, it was pointed out that there is concern that the government's excessive involvement in financing for SMEs may create moral hazard for borrower companies.

Following the reports on Thailand and South Korea, the Bank of Yokohama reported on the initiatives of Japanese regional financial institutions for relationship-based banking. Techniques for evaluating and managing inventories of frozen tuna were explained, with regard to a loan program using movable assets as collateral. Moreover, it was reported that initiatives for relationship-based banking have produced significant results, such as the development of a loan program for new business start-ups and an increase in the number of business matching deals concluded. How to foster bankers capable of making appropriate judgments in relevant fields was cited as a future challenge.

Session 4: Challenges going forward (Panel Discussion)

First, the FSA reported on recent developments related to regional finance. According to the report, the action program for relationship-based banking implemented in fiscal 2003 and 2004 has produced steady results, while as a future challenge, it will be necessary to adopt the approach of "selection and concentration" with a view to enhancing profitability. Next, Fukuoka Bank reported on unique cases of initiatives for relationship-based banking. Initiatives regarding traditional commercial banking operations included the

database of the characteristics of business sectors and industries and face-to-face sales activities with high value added, while initiatives regarding new types of activity included the use of investment funds for corporate rehabilitation and contributions to local communities.

After these reports, participants, including the people who made the reports, held a panel discussion on what the desirable status of regional finance and finance for SMEs will be. It was pointed out that, in light of the current conditions of regions and SMEs, it is not desirable for financial institutions to rely excessively on loan collateral, whether in the form of real estate or movable assets, and that it is desirable for them to enhance their screening ability regarding business profitability and give managers of failed companies a second chance to start new businesses.

Professor Naoyuki Yoshino (who concurrently serves as professor of economics at Keio University and FRTC Director) concluded the session with a summary report. The report pointed out that, since risk-taking is necessary for revitalizing regional economies and SMEs, it is not desirable that fund demand should be entirely satisfied by the single fund supply source of bank loans. The report argued that a variety of financial institutions should be placed under a financial holding company in order to make multiple fund supply schemes available, such as loans, investment trusts and funds, so that selection can be made according to the degree and type of risk involved in the relevant business project.



*The contents of this conference's program are available at the FRTC Web site (<http://www.fsa.go.jp/frtc>). Detailed key points of the conference and materials used therein are scheduled to be published later.

Regular Consultations with the Chinese authorities

The FSA, which was already maintaining close cooperation with Chinese financial supervisory and other authorities, recently decided to start regular, working-level consultations with the Chinese authorities in order to strengthen cooperation. The first round of such consultations was held in Beijing on January 14-16.

(Reference)

The representatives of the Chinese authorities who held discussions with the Japanese side were as follows:

January 14 (Monday)

China Securities Regulatory Commission:

Yao Gang, Assistant to the Chairman

China Banking Regulatory Commission:

Han Mingzhi, Director-General of the International Department

January 16 (Wednesday)

People's Bank of China:

Hu Xiaolian, Deputy Governor

China Insurance Regulatory Commission

Li Kemu, Vice Chairman

Nobuyoshi Chihara, Deputy Commissioner for International Affairs, served as the Japanese side's chief representative at all of the above discussion sessions.

The Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets, which was announced in December 2007, calls for the enhancement of cooperation with overseas authorities. Specifically, the plan states that the FSA will "strengthen cooperation with supervisory authorities in rapidly growing Asian markets" and that, as part of such activities, it will "start regular discussions with supervisory and other authorities in China."

In this round of consultations, the two sides exchanged opinions about recent developments related to financial supervision in Japan and China, international developments and issues of common concern, including the Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets, responses to Basel II and the subprime mortgage problem. In addition, they confirmed that the two countries' financial supervisory authorities should further strengthen their cooperation.

The FSA believes that it is extremely important to strengthen cooperation with the supervisory and other authorities of China as the country's economy continues to expand rapidly, and as exchanges and cooperation between Japan and China deepen in the financial sector as well as in other fields, enhancing interdependence.

The FSA intends to continue to further promote cooperation between the authorities of the two countries through regular consultations and other means of exchange and communication.

Full Liberalization of Insurance Sales by Banks, etc

The FSA has taken necessary measures in order to further ensure the protection of policy holders, etc. in relation to the full liberalization of insurance sales by banks, etc. that was implemented on December 22, 2007, as scheduled.

I. Background to Regulatory Reform

1. Insurance sales by banks, etc. were gradually liberalized after April 2001, while the authorities closely examined the situation to detect any harmful effect of the liberalization.
2. After an advance liberalization (third stage) was implemented on December 22, 2005, the FSA conducted monitoring in order to examine the status of insurance solicitation by banks, etc. and verify the effectiveness of measures to prevent harmful effects, in preparation for the full liberalization of insurance sales by banks, etc.
3. As a result of the monitoring, the FSA concluded that the situation does not constitute “a case where it is necessary to protect policy holders, etc.” – which is a condition for reviewing the date of the full liberalization, as specified by the Cabinet Office Ordinance for Partial Revision of the Ordinance for Enforcement of the Insurance Business Act, etc. (Cabinet Office Ordinance No. 87 of 2005), – and notified the Financial System Council to that effect. Moreover, the FSA conducted deliberations on whether to implement the full liberalization as scheduled by, for example, soliciting opinions from the parties concerned.
4. As a result of the deliberations, the FSA came to the conclusion that, although it was not necessary to further strengthen existing measures for preventing harmful effects, efforts should be made to further ensure the protection of policy holders, etc. Accordingly, the FSA decided to revise the Comprehensive Guidelines for the Supervision of Insurance Companies on December 21, 2007 and to take other necessary measures.

II. Key Points of Revision of Guideline for Supervision

The following matters were specified as points of supervisory attention:

1. Establishment and Maintenance of System at Banks, etc. to Ensure Responsible Sales Activity
 - (1) Appropriate Division of Work after Signing of Insurance Contracts
 - (i) Does the bank, etc. and the insurance company specify the division of work to be done after the signing of insurance contracts under a consignment contract, etc., and does the bank, etc. make the division of work clear to customers?
 - (ii) Have both the insurance company and the bank, etc. established a system necessary for undertaking their respective part of the work to be done after the signing of insurance contracts by, for example, securing

sufficient staff?

(2) Communication of Responsibilities of Banks, etc. and Other Necessary Matters

Has the bank, etc. taken necessary measures to communicate the contents of its guideline for insurance solicitation to all customers, such as providing written explanations to customers and posting a notice of the guideline at sales branches?

2. Establishment and Maintenance of System for Utilization of Customer Information

As a way of ensuring the effectiveness of the requirement for customers' prior consent regarding the use of non-public financial information, has the bank, etc. taken necessary measures to prevent agency or mediation activities from being conducted for the purpose of signing insurance contracts without customers' prior consent?

3. Establishment and Maintenance of System for Compliance with Laws and Regulations by Banks, etc.

(1) Requirement for Appointment of Manager in Charge of Compliance with Laws and Regulations, etc.

As a way of securing the implementation of procedures to ensure compliance with laws and regulations related to insurance solicitation, has the bank, etc. appointed persons with sufficient knowledge of laws and regulations related to insurance solicitation and contracts to the posts of manager and supervisory manager in charge of ensuring compliance?

(2) Establishment of System for Internal Control Audits

Has the bank, etc. assigned persons with sufficient knowledge of laws and regulations related to insurance solicitation and contracts to the division in charge of implementing internal audits regarding insurance solicitation, so as to ensure the appropriate implementation of such audits?

(3) Consideration of Guideline Set by Fair Trade Commission

Do the business operations of the bank, etc. pay sufficient attention to the relevant guideline established by the Fair Trade Commission (Guidelines for Unfair Trade Practices Associated with Relaxation of Controls over Classification of Business, Categories and Expansion of Scope of Business for Financial Institutions), in order to avoid using unfair practices in conducting insurance solicitation activity?

III. Key Points of Revisions of Relevant Cabinet Office Ordinances, etc.

The FSA reviewed and revised technicalities of the relevant Cabinet Office Ordinances, etc. as follows, in order to facilitate the implementation of the full liberalization:

- Review and revision of the insurance benefit calculation method related to a special provision for small and medium-size insurance companies regarding third-sector insurance, such as medical and cancer insurance.
- Abolition of restrictions on the scope of products that may be handled by subsidiaries of banks, etc.

IV. Effective Date

December 22, 2007

V. Others

- The FSA intends to continue monitoring of insurance sales by banks, etc. after the implementation of the full liberalization, in order to prevent any harmful effect of liberalization from the viewpoint of protecting policy holders, etc.
- In addition, the FSA intends to conduct supervision with regard to the system for ensuring compliance with laws and regulations in insurance sales by banks, etc., with due consideration of the purpose of the revision of the guideline for supervision. When a problem is detected, the FSA will take strict action as necessary.
- Under its supervisory policy as described above, the FSA has not only asked individual insurance companies to establish a system that ensures appropriate solicitation when insurance sales are consigned to banks, etc., but also requested the relevant business organizations (associations of insurance companies, banks, etc.) to ensure that their member companies conduct insurance solicitation in an appropriate manner.
- The FSA will review, roughly three years from now, the necessary matters with regard to measures for preventing the harmful effects of liberalization, based on the results of future monitoring, with a view to protecting policy holders, etc. and improving convenience for users.

V. Conclusion

The FSA hopes that the full liberalization of insurance sales by banks, etc. will improve convenience for customers by making a wide selection of insurance products available to them through a variety of sales channels. Moreover, the FSA wants insurance companies and banks, etc. to conduct insurance solicitation in an appropriate manner while continuing to bear in mind the need to prevent the harmful effects of liberalization, with due consideration of the relevant laws and regulations, including the above-described partial revision of the guidance for supervision.

Regarding the Cabinet Order for the Establishment of Relevant Cabinet Orders Following Enforcement of the Act on Establishment of Acts Related to the Improvement of the Securities Market through Reform of the Securities Settlement System, etc., the Ordinance for Partial Amendment of the Ordinance for Enforcement of Action registry of Bonds, etc., the Cabinet Order for Partial Amendment of the Order for Enforcement of the Act on Transfer of Bonds, etc. and the Ordinance for Partial Amendment of the Ordinance Concerning the Transfer of Bonds, etc.

Background

Improvement of the integrated legal framework for securities settlement that covers various types of securities has been implemented since June 2001, in order to reduce the risks and costs related to securities settlement and to establish a securities settlement system that is convenient for users and contributes to strengthening the international competitiveness of Japan's securities markets.

As the first step, the Act on Transfer of Short-Term Bonds, etc. was established in June 2001 (and put into force in April 2002) in order to apply the central depository system to short-term bonds (commercial paper), thus realizing “paperless” transactions for such bonds. In June 2002, the Act on Transfer of Short-Term Bonds, etc. was revised as the Act on Transfer of Bonds, etc. and the Act on Establishment of Acts Related to the Improvement of the Securities Market through Reform of the Securities Settlement System, etc. (Securities Market Improvement Act) was enacted in order to apply the central depository system to corporate and government bonds and investment trust beneficiary rights. Furthermore, in June 2004, the Act on Transfer of Bonds, etc. Transfer Act was revised as the Act on Transfer of Bonds, Stocks, etc. and the Act for Partial amendment of the Act on Transfer of Bonds, etc. for the Purpose of Rationalizing Settlement Related to Transactions of Stocks, etc. (Stock Settlement Rationalization Act) was enacted in order to apply the central depository system to stocks, etc., too.

To follow up on the above, on December 14, 2007 the government promulgated Cabinet Orders and Ordinances concerning the Securities Market Improvement Act that specify the details of procedures and arrangements for paperless transactions (e.g. Cabinet Order for Establishment of Relevant Cabinet Orders Following Enforcement of the Act on Establishment of Acts Related to the Improvement of the Securities Market through Reform of the Securities Settlement System, etc. and the Ordinance for Partial Amendment of the Ordinance for Enforcement of the Bond, etc. Registry Act) and a Cabinet Order and Cabinet Office Ordinance related to the Stock Settlement Rationalization Act (the Cabinet Order for Partial Amendment of the Cabinet Order for Enforcement of the Act on Transfer of Bonds, etc. and the Ordinance for Partial Amendment of the Ordinance Concerning Transfer of Bonds, etc.).]

The contents of these Cabinet Orders and Ordinances are explained below.

Contents

1. The Cabinet Order for the Establishment of Relevant Cabinet Orders Following Enforcement of the Act on Establishment of Acts Related to the Improvement of the Securities Market through Reform of the Securities Settlement System, etc. and the Ordinance for Partial Amendment of the Ordinance for Enforcement of the Bonds, etc.

(1) Key Points

The above orders stipulate that:

- (i) In accordance with the Securities Market Improvement Act, the Act on Registry of Bonds, etc. shall be abolished on January 4, 2008 (which means that all transfers of rights to bonds shall be implemented through the central depository system), and beneficiary certificates of exchange traded funds shall shift to the central depository system, starting on the same date.
- (ii) The registry book of bonds, etc. whose registration under the Act on Registry of Bonds, etc., was cancelled as a result of the shift to the central depository system may be stored on microfilm.

(2) Effective Date

The provisions described in (i) were put into force on January 4, 2008 and the provision described in (ii) was put into force on December 14, 2007.

2. Cabinet Order for Partial Amendment of the Cabinet Order for Enforcement of the Act on Transfer of Bonds, etc. and the Ordinance for Partial Amendment of the Ordinance Concerning Transfer of Bonds, etc.

(1) Key Points

- (i) The above orders set forth the following additional cases in which a person who holds shares registered in a special account opened in the name of another person may become the nominee of the shares after the shift to a paperless system:
 - * When a document certifying inheritance is submitted.
 - * When a stock certificate or a certificate of stock acquisition is submitted within one year from the date of the shift to a paperless system.
- (ii) The above orders stipulate that a shareholder may exercise the rights of a minority shareholder, such as the right to present a proposal, during the two-week period from the date when the central depository organization notifies the issuer of the number of shares, etc. recorded on the transfer account registry, upon receipt of the shareholder's request.
- (iii) The above orders stipulate that, in addition to the nominee of a share, the issuer and an heir/heirress to the nominee may request a certificate of the matters recorded on the transfer account registry.
- (iv) The above orders stipulate that when a shareholder of an issuing company regarding which there is a foreign ownership restriction, such as a broadcasting company, is a foreigner, the central depository organization shall notify the company to that effect in order to ensure that the company is aware of foreign ownership.

(2) Effective Date

The above orders shall be put into force on the effective date of the Stock Settlement Rationalization Act (a date (*) that is set by a Cabinet Order and that is not later than five years from the promulgation date (June 9, 2004) of the Stock Settlement Rationalization Act).

(*) Preferably in January 2009