



FSA Newsletter May 2008



Minister Watanabe made an address at the meeting of the Director-General of the Local Finance Bureau (April 22)

Table of Contents

[Features]

- The Principles in the Financial Services Industry..... 2

[Topics]

- FSF Announces “Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience” 5

[Explanations of Laws and Regulations]

- Outline of Cabinet Office Ordinance Regarding Foreign Audit Firms, etc. 7

- [Minister in His Own Words] 10

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.



Parliamentary Secretary Toida made an address at the seventh expert committee for measures forward multiple debtors (May 12)

[Features]

The Principles in the Financial Services Industry

On April 18, 2008, the Financial Services Agency (FSA) and the representatives of the financial services industry agreed on the key principles to be shared and respected when financial firms conduct their business or when the FSA take supervisory actions.

Since last year, the FSA has been making efforts toward achieving “better regulation.” This initiative is based on the view that enhancing the attractiveness and competitiveness of Japan’s financial and capital markets and enabling financial firms to provide high-quality financial services to meet user needs is one of the major challenges for Japan’s economy and society. To this end, it is vital to improve the business and regulatory environment for both users and providers of financial services.

In this context, the FSA presented the concept of “optimal combination of rules-based and principles-based supervisory approaches,” and held extensive discussions with representatives of relevant financial firms on key principles, which would become the

cornerstones of principles-based supervision. As a result, the FSA has agreed with the parties involved (see Note) to share the key principles (the “Principles”), as drawn out in the table below.

The “Principles” are a set of key codes of conduct or general behavioral norms that form the basis of individual rules such as laws and regulations. A “principles-based” approach is a supervisory framework that, in line with the abovementioned Principles, places greater emphasis on encouraging voluntary efforts by financial firms aimed at ensuring better management.

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

13. Establish countermeasures against large-scale disasters and other contingencies in accordance with the role it fulfils in the markets.

14. Provide accurate information with integrity upon reasonable requests from the FSA, and facilitate effective communication with the FSA, including by way of interactive dialogues.

Sharing common views on the Principles among a wide range of relevant parties is expected to bring about the following effects:

(1) *Users of financial services* will be able to tell in advance what they can expect in terms of the behavior of financial firms as well as the quality of financial services they offer, and thus purchase financial services with a sense of security.

(2) *Financial firms* that provide financial services will have a clear vision on the way they should act in cases where there are no applicable written rules or where interpretation of existing rules may vary. They could refer to the Principles as guidelines in their voluntary efforts to improve their services as well as develop and provide new ones, in order to respond flexibly to changing circumstances. In this sense, the Principles will indicate the direction in which the financial firms should head in their efforts to improve their services and the foundation of best practices. They may also serve as the basis for interpreting existing rules.

(3) For its part, *the FSA* can (i) ensure prompt and adequate supervisory responses based on the actual conditions of the firms concerned by complying with the basic ideas as outlined in the Principles when interpreting and applying rules at the time of on-site inspections and off-site supervision. Moreover, (ii) when conducting reviews of existing rules such as laws, regulations, the FSA's Inspection Manuals and Supervisory Guidelines, efforts aimed at simplifying and clarifying rules in line with the Principles can contribute to putting in place a market and regulatory environment that does not impede innovation or free competition in the area of financial services.

The FSA expects financial firms to make voluntary efforts towards business improvement based on the shared Principles. The FSA will also make utmost efforts to realize a better regulatory environment based on these Principles. To begin with, the FSA will strive to have all its staff members appreciate the Principles and thereby to carry out effective financial administration. It will also maintain continuous dialogue with financial service providers, and further deepen discussions.

In this connection, the FSA has amended the [“Administrative Action in the Financial Sector”](#) issued on March 1, 2007, following the sharing of the Principles. The

“Administrative Action in the Financial Sector” clarifies the criteria for decision-making on administrative action by the FSA. The amendment has articulated the points to remember in the implementation of administrative action in line with the Principles. Specifically, it has made it clear that, in cases where the financial institution concerned is making voluntary efforts in an appropriate manner based on the Principles, that fact will be taken into consideration as a mitigating factor.

* For more details, please access [“The Principles in the Financial Services Industry”](#) (April 24, 2008) published in the Press Releases of the Financial Services Agency Website.

(Note) In putting together the Principles, the FSA held a series of meetings to exchange views with the following major industry associations: the Japanese Bankers Association; the Regional Banks Association of Japan; the Second Association of Regional Banks; the National Association of Shinkin Banks; the National Central Society of Credit Cooperatives; the Trust Companies Association of Japan; the International Bankers Association; the Life Insurance Association of Japan; the General Insurance Association of Japan; the Foreign Non-Life Insurance Association of Japan and the Japan Securities Dealers Association. The FSA also exchanged views on an individual basis with the National Association of Labor Banks, the Investment Trusts Association, and the Japan Securities Investment Advisers Association.

[Topics]

FSF Announces “Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience”

Following a statement issued by the Group of Seven (G-7) major industrial nations in October 2007, the Financial Stability Forum (FSF; see Note) analyzed the factors behind the ongoing global financial market turmoil and deliberated on various measures to enhance the resilience of the market from a medium-term perspective. Based on the analysis and deliberations, the FSF recently compiled a report and submitted it to the G-7. At a meeting of the G-7 Finance Ministers and Central Bank Governors in Washington, D.C. on April 11, the G-7 countries agreed to implement the recommendations contained in this report.

The 71-page report comprises as many as 67 items of detailed recommendation. You can look at the original text of this report [here](#).

The recommendations contained in the FSF report consists of the following five areas:

- *Strengthened prudential oversight of capital, liquidity and risk management;
- *Enhancing transparency and valuation;
- *Changes in the role and uses of credit ratings;
- *Strengthening authorities' responsiveness to risks; and
- *Robust arrangements for dealing with stress in the financial system.

These recommendations affect a broad range of entities, ranging from international standard-setting organizations such as the Basel Committee on Banking Supervision, the International Organization of Securities Commissions and the International Accounting Standards Board to the supervisory authorities and central banks of individual countries and financial institutions as well as other private-sector companies.

The FSF report is particularly notable in that it has recommended, as a comprehensive package, a variety of specific measures that concern the full range of entities mentioned above. Also, it is significant that this report has presented a timetable for the implementation of these measures by the supervisory authorities, international organizations, private-sector institutions and other relevant parties in order to cope with the ongoing financial market turmoil that was triggered by the subprime mortgage problem.

Another notable aspect of the report is that it has been prepared by a high-level working group comprising senior officials from the authorities of major nations as well as chairmen and other leaders of international supervisory and regulatory organizations, and it was concluded thanks to the strong commitment of the top-level officials of the countries concerned, as represented by the approval given at the G-7 meeting. From Japan, FSA Commissioner Takafumi Sato participated in the FSF working group as an official member.

In international debate and deliberations conducted at the FSF and other international forums and conferences, the FSA has actively advocated Japan's position on the issues pointed out in [the first report by the Financial Markets Strategy Team](#) announced in November 2007, including the need to ensure communication of information between the parties involved in the securitization process, the issue of risk management, and the importance of Basel II implementation. The FSF report and the latest G-7 statement indicated a recognition of these issues similar to that of Japan and recommended measures similar to those urged by the Strategic Team's report. We therefore believe that an international consensus has been formed on these issues in line with our position.

Regarding the recommendations contained in the FSF report, the April G-7 statement indicated hope that the implementation status of the measures recommended in the report will be reported at a meeting of the Group of Eight Finance Ministers in June and at the G-7 meeting in the autumn. Therefore, the FSA will continue its active and constructive involvement in international debate and deliberations at the FSF and other forums.

(Note) The Financial Stability Forum (FSF) was established in 1999 under the initiative of the G-7 Finance Ministers and Central Bank Governors, in order to promote international financial stability through the enhancement of information exchange and international cooperation in the supervision and surveillance of the financial markets. Among the members of the FSF are the relevant authorities of countries and regions that have important international financial centers, and international organizations comprising financial supervisory authorities (the Basel Committee on Banking Supervision, the International Organization of Securities Commissions and the International Association of Insurance Supervisors) and international financial institutions (the International Monetary Fund and the World Bank). From Japan, the FSA, the Ministry of Finance and the Bank of Japan participate in the FSF.

(Reference)

[The original text of the FSF report \(FSF website\)](#)

[The G-7 statement in October 2007 \(Ministry of Finance Website\)](#)

[The G-7 statement in April 2008 \(Ministry of Finance Website\)](#)

[Explanations of Laws and Regulations]

Outline of Cabinet Office Ordinance Regarding Foreign Audit Firms, etc.

The revised Certified Public Accountants Act (hereinafter referred to as the “Act”) was enacted in the 166th session of the Diet (enacted on June 20, 2007 and promulgated on June 27, 2007).

Under this act, a person who makes it his/her practice to audit or certify financial documents for fees at the request of others in a foreign country in compliance with the laws and regulations of said foreign country is required to notify the Financial Services Agency (FSA) in advance when intending to provide services that are found to correspond to the audit and attestation services as specified by the Act with regard to financial documents of a foreign company subject to disclosure rules under the Financial Instruments and Exchange Act (Paragraph 1, Article 34-35 of the Act).

Moreover, the Act empowers the relevant authorities, if necessary, to give instructions to, demand the submission of a report from, and conduct an on-site inspection of the foreign audit firms, etc. that has made such a notification (Articles 34-38, 49-3-2 of the Act).

In preparation of the enforcement of the Act, the Cabinet Office Ordinance Regarding Foreign Audit Firms, etc. was recently established in order to specify the details of the notification requirements for foreign audit firms, etc. The major provisions of the Cabinet Office Ordinance are as follows:

1. Attachment of translations

The ordinance stipulates that when a document that must be submitted to the FSA Commissioner of the FSA cannot be written in the Japanese language for certain reason, a Japanese translation shall be attached thereto. Meanwhile, it stipulates that a translation of an attachment is not necessary if the document in question is written in the English language(Article 1).

2. Agent

The ordinance stipulates that a foreign person who intends to give notification to the FSA shall nominate a person (agent) who resides in Japan and has been granted authority to act as an agent for the notifying person with regard to all matters related to the initial notification (Article 3).

3. Matters to be contained in the notification document

The ordinance stipulates that the notification document as specified by Paragraph 1, Article 34-35 of the Act shall specify the following items (Article 4, format No. 1).

- (i) in the case of a juridical person, the date of incorporation and the name of the jurisdiction of the governing law applicable to the incorporation of said juridical person;
- (ii) in the case where the notifying person is an individual who belongs to a legal person, the name of said juridical person and the location of the principal office thereof.
- (iii) the name and location of the foreign company, etc. for whose financial documents the notifying person provides services that are found to correspond to the audit and attestation services as specified by the Act.

4. Matters to be contained in the attachment

(1) The ordinance stipulates that an attachment to the notification document as specified by Paragraph 1, Article 34-35 of the Act shall specify the following items (Paragraph 1, Article 5).

- (i) articles of incorporation and certification of registry, or any other similar documents

(ii) the name and professional history of the individuals responsible for performing services that are found to correspond to the audit and attestation services as specified by the Act with regard to the financial documents of a foreign company, etc.

(iii) the outline of the audit system in the jurisdiction where the principal office of the notifying person is located

(iv) a document which confirms that the notifying person is in compliance with all the relevant laws and regulations and that the notifying person maintains proper operations in providing services that are found to correspond to the audit and attestation services as specified by the Act

(v) matters related to the business operations of the notifying person (including the description of services, the status of the quality control management, business associations with other auditors and the discription offices)

(vi) In a case where the notifying person has been subjected to criminal penalties under foreign laws and regulations or has been subjected to an administrative sanctions by administrative agencies within a five–years before the initial notification in relation to services that are found to correspond to the audit and attestation services as specified by the Act, the facts and details of such penalties or sanctions

(vii) documents which certify that the notifying person has granted authority on all matters regarding notification specified in paragraph (1) of Article 34-35 to an agent whose residence is in Japan

(2) In a case where the notifying person has found (1) above cannot be specified under laws and regulations of the country where the principal office of the notifying person is located, the following matters may be specified instead. (Paragraph 2, Article 5)

(i) The fact that the notifying person cannot submit information due to constraints imposed by laws and regulations of the country where the principal office of the notifying person is located and the relevant provisions of said laws and regulations

(ii) The legal opinion of the attorney who certifies that the matters described pursuant to (i) above are correct and accurate

(iii) In a case where the notifying person needs to obtain permission, consent and/or approval (“permission, etc.”) in order to submit such information and the notifying person has not been able to provide relevant information due to the notifying person’s failure to obtain such permission, etc., the measures that the notifying person has taken to obtain such permission, etc. as well as the reason why the notifying person failed to obtain such permission, etc.

5. Matters to be Publicized When Rectification is Recognized

The ordinance stipulates that in a case where a failure to follow an instruction issued by

the FSA Commissioner has been announced and where rectification is deemed to have been taken with regard to said instruction, the following matters shall be publicized (Article 7).

- (i) the date on which the failure to follow the instruction and the name of the foreign audit firm, etc. that was subject to the instruction were announced
- (ii) the contents of the instruction
- (iii) the facts pertaining to the recognition of rectification and the reason for recognition thereof

6. Notification of Changes and Abolition of Services

The ordinance prescribes the procedures for the notification of changes to the notified items and of the abolition of services (Article 6, Form No. 2 and Article 8, Form No. 3).

7. Other matters

(1) The cabinet office ordinance is due to take effect on the same day as the revised Certified Public Accountants Act (April 1, 2008) (Supplementary Provision 1).

(2) In a case where the notifying person is to execute services deemed to correspond to the audit and attestation services as specified by the Act with regard to the financial documents of a foreign company, etc. in the first year after the enforcement date of the Act, the attachments to the notification document can be submitted up to six months after the submission of the notification document as a transitional measure. (Notwithstanding this, if the audit report is to be submitted before the aforementioned date, the attachments must be submitted by the day before the submission date.) (Supplementary Provision 2)

(3) Please be reminded that matters not specified by the cabinet office ordinance have been clarified in a series of FAQ published on the FSA's website. For details, please access [here](#).

[Minister in His Own Words]

- * This section provides information regarding the hot topics of the moment, selected from 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 the FSA website.

Q: Most major securities companies have released their earnings reports for the fiscal year ended in March. The results were severe, with the companies reporting either profit declines or losses. This is probably due in large part to the deterioration in the market condition caused by the effects of the subprime mortgage problem. Could you tell me how you evaluate the impact of the subprime mortgage problem on Japan's financial markets and on the management of Japanese financial institutions, including indirect effects such as decline of prices in the market? Also, does the Financial Services Agency (FSA) have in mind any measures to revitalize the market?

A: Although not all details are clear as to the earnings of securities companies, I am aware that some of them reported losses due to the impact of the subprime mortgage problem. I do not believe, however, that it means the soundness of their financial conditions has been greatly damaged. Despite the losses in the year ended in March, they have not incurred so much damage as to see their capital base eroded, unlike LCFIs (large and complex financial institutions).

Realizing and booking losses early would be the best way to dispel suspicion. Financial institutions other than securities companies will start releasing their earnings reports one after another. It is important for them to properly conduct corporate governance and risk management and properly disclose any losses they have incurred. My impression about Japan's financial sector as a whole is that there are signs that losses on subprime mortgage-related products and other securitization products are expanding indeed. However, losses suffered by Japanese financial institutions are substantially smaller than those incurred by LCFIs. And so, I do not believe that Japan's financial system as a whole faces a similar problem to the ones seen in the United States and Europe.

Q. Does the FSA plan to take any countermeasure?

A. As I have repeatedly told you, we will enhance the level of our vigilance given that this problem has not come to an end. As for how to revitalize the market, it is important to enact as soon as possible the bill for the amendment of the Financial Instruments and Exchange Act, which are under deliberation in the Diet, and put them into effect, as well as to implement the Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets. The most important thing is to revitalize the economy by keeping Japan's markets open and making effective use of both domestic and foreign funds.

【Extract from the press conference on April 30, 2008】

[Information]

The FSA has started an E-mail Information Service. If you register your e-mail address on the Subscribe Page of the FSA website, we will notify you by e-mail once on each day when new information is posted on our website. For details, please access [Subscribing to E-mail Information Service](#) of the FSA website.