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Senior Vice Minister Tanimoto at the Ordinary General Meeting of the Association for Real Estate Securitization (ARES) (May 21, 2009)

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SESC's Basic Inspection Policy and Inspection Program for Business Year 2009

On April 24, 2009, the Securities and Exchange Surveillance Commission (SESC) announced the basic inspection policy and Inspection Program for Business Year 2009, which described the Basic Inspection Policy and the number of inspections planned for the year. The outline of the Basic Inspection Policy and Inspection Program for the fiscal year is described below. This time, the period subject to inspection has been changed from a business year basis (from July to June of the following year) to a fiscal year basis (from April to March of the following year).

I. Basic Inspection Policy

(1) Basic concepts

The SESC conducts market surveillance to ensure fairness and transparency of the Japanese markets and to protect investors. Considering the recent expansion of the scope of business operators subject to SESC's inspection and the current global financial risk, it is necessary now, more than ever before, to conduct detailed and rigorous inspections. Under such circumstances, it is important to adopt a "risk-based, flexible approach," which takes into account the size and risk characteristics of each business type and of each operator. In addition, from the perspective of further improving efficiency and effectiveness, it is necessary to conduct inspections that focus more on the status of internal control systems, while ensuring fair trade and the protection of the interests of the public and investors.

Moreover, the inspections need to be performed in a way that responds to market changes in a timely and flexible manner; such an approach should be taken toward the emerging risks in order to prepare for future developments. Bankruptcies of globally operating financial instruments firms could cause considerable confusion in the markets, and possibly systemic risk. In conducting inspections, it is therefore necessary to pay enough attention to the overall status of the management of the risks involved, including the financial soundness of financial instruments firms.

To respond to these considerable changes, it is considered necessary for the SESC to perform more efficient and more effective inspections in pursuit of its basic mission.

"An efficient inspection," as mentioned here, indicates that it harnesses and adds to the self-improvement efforts by financial institutions. "An effective inspection" indicates that it leads to sustainable improvement in the firms' internal control systems and other outcomes.

More specifically, the SESC's efficient and effective inspection will be achieved on the following terms:

- (i) Taking the basic approach of verifying conducts in violation of laws, regulations and market rules; and in consideration of the protection of the interests of the public and investors, focus on verification of appropriateness of the internal control systems, etc., of financial instruments firms, taking into account the size and characteristics of those

firms.

- (ii) To analyze and identify risk areas in the financial instruments firms to be inspected and adopt a sharper risk-focused approach to inspections.
- (iii) To put more emphasis on interactive dialogues with the financial instrument firms with a view to encouraging their voluntary efforts toward developing stronger internal control functions.
- (iv) To enhance transparency, in inspection methodology, through the publication of revised inspection manuals.

(2) Areas of focus in inspections

In this fiscal year, the SESC will conduct inspections that focus on the areas listed below.

- (i) Verification of market intermediary functions of financial instruments firms
- (ii) Verification of risk management systems of financial instruments firms
 - Verification of risk management systems of globally operating financial instruments firms, including management systems on the system risk and the financial soundness of financial instruments firms
 - Verification of the risk management systems of financial instruments firms that are engaged in foreign exchange margin trading
- (iii) Verification of the management of undisclosed corporate information (prevention of unfair insider trading)
- (iv) Verification concerning appropriateness of asset management business
- (v) Verification of conduct that may hinder fair price formation
- (vi) Verification of the appropriate exercise of function of Self-regulatory Organizations (SROs)
- (vii) Verification concerning financial firms to be newly inspected and new financial instruments
- (viii) Improvement of problems identified in previous inspections

II. Basic Inspection Program

On the basis of this fiscal year's Basic Inspection Program, the SESC will conduct inspections of 130 Type I Financial Instruments Business Operators, etc. (including 110 firms to be inspected by the Local Financial Bureaus), and 65 asset management firms and investment advisories/agencies (including 35 firms to be inspected by the Local Financial Bureaus). In addition, it will perform inspections of SROs and Type II Financial Instruments Business Operators, etc., on an as-needed basis.

* For details, please access [Basic Inspection Policy and Inspection Program for Fiscal Year 2009 \(April 24, 2009\)](#) on the SESC website.

- * As a result of a series of regulatory reforms, including the revision of the Financial Instruments and Exchange Act, the scope of business operators subject to SESC's inspection has increased and expanded dramatically.
- * The inspections should be conducted in such a way as to respond to the current global financial crisis.



How SESC's Inspection Should Be

- Risk-based inspection taking into account the size and risk profiles of each business operator
- Inspection that enhances financial instruments firms awareness of their role as gatekeepers who contribute to ensuring the fairness and soundness of financial and capital markets
- Inspection that takes a proactive approach toward the emerging risks to prepare for the future



More Efficient and More Effective Inspection

[Efficient Inspection] An inspection is efficient when it harnesses and adds to the self-improvement efforts by financial instruments firms

[Effective Inspection] An inspection is effective when it leads to sustainable improvement efforts in the firm's internal control systems

* Initiatives for More Efficient and More Effective Inspection

- Introduction of prior notice inspection, on a tentative basis
- Enhanced dialogue during the on-site inspection, etc.

© Points to Consider Regarding Efficient and Effective Inspections

- 1) Taking the basic approach of verifying conducts in violation of laws and regulations, focus also on the verification of appropriateness of the internal control systems, etc. of financial instruments firms, which could possibly be a factor in causing violations, taking into account the size and characteristics of those firms
- 2) Take a sharper risk-focused approach in the selection of financial instruments firms to be inspected, as well as of areas to be inspected.
- 3) Put more emphasis on interactive dialogues with financial instruments firms.
- 4) Enhance transparency and predictability in the inspection process through the publication of the revised "Inspection Manuals for Financial Instruments Firms."

[Other Agenda]

- In light of the recent subprime loan crisis, one of the SESC inspection's focuses will thus be on the securitization process, namely underwriting examination, risk management, and other systems of financial instruments firms that arrange, underwrite, and market such securitized instruments.
- The Financial Instruments and Exchange Act (FIEA) was revised to relax the firewall regulations among securities firms, banks and other firms, on the condition that their internal control systems for managing conflict of interest be enhanced. The SESC will accordingly look into this new area of disciplines.
- The SESC's inspections of globally operating financial instruments firms will pay due attention to the overall quality of the firms' management of risk, including the financial soundness.

Areas of Inspection Focus

- 1) Verification of market intermediary functions of financial instruments firms
- 2) Verification of risk management systems of financial instruments firms
 - ☞ Verification of risk management systems of globally operating financial instruments firms, including the IT operational risk and the financial soundness of financial instruments firms
 - ☞ Verification of risk management systems of financial instruments firms that are engaged in foreign exchange margin trading
- 3) Verification of the management of undisclosed corporate information
(Prevention of unfair insider trading)
- 4) Verification concerning the appropriateness of asset management business
- 5) Verification of conduct that may hinder fair price formation
- 6) Verification concerning the state of soliciting investors and customer care
- 7) Verification for the appropriate exercise of SROs function
- 8) Verification concerning financial firms to be newly inspected, and new financial instruments
- 9) Improvement of problems identified in previous inspections

Basic Inspection Program

- Type I Financial Instruments Business Operators, etc: 130 firms (including 110 firms to be inspected by the Local Financial Bureaus)
- Asset management firms and Investment advisories/agencies:
65 firms (including 35 firms to be inspected by the Local Financial Bureaus)
- Self regulatory organizations: To be inspected as needed
- Type II Financial Instruments Business Operators, etc.: To be inspected as needed

Japan-EU High Level Meeting on Financial Issues

On April 22, 2009, the Japan-EU High Level Meeting on Financial Issues was held in Brussels. This meeting has been providing opportunities for both Japan and the EU to share information on the financial regulations and make the necessary adjustment of positions. The representatives who attended this year's meeting include Mr. Junichi Maruyama, Deputy Commissioner for International Affairs of Japan's Financial Services Agency (FSA), and Mr. Jörgen Holmquist, Director General of DG Internal Market and Services of the European Commission.

First, FSA and Commission officials discussed the impact of the financial crisis on their own financial systems. Then, the FSA briefed the Commission services on the progress made in the Better Market Initiative and the implementation of the revised Act on Special Measures for Strengthening Financial Functions.

The Commission services set out the actions taken in view of reinforcing the regulation and supervision of financial services. Special attention was given to the Commission's recent legislative proposals, as well as to the follow-up to the de Larosière report and the EU's future regulatory agenda.

Both sides exchanged views on the regulation of credit rating agencies. The Commission services presented the latest developments regarding the proposed new legislative framework, while the FSA presented its reform plans. Moreover, insurance-related matters were also discussed. The FSA presented recent legislative reforms in the insurance sector in Japan. The Commission services provided latest information on the Solvency II Directive and the next steps for implementation.

Accounting and auditing issues were also an important part of the agenda. The Commission services recalled the Commission decision to grant Japanese audit firms a transitional regime until July 2010, which represents an interim step toward mutual reliance on each other's public oversight systems. The Commission services presented the state of play regarding a possible decision on the adequacy of the competent authorities in certain third countries concerning the access and transfer of audit working papers. The FSA provided an update on recent developments in the public oversight regime of foreign audit firms.

The Commission services also reported on the decision adopted on December 12, 2008, which recognized standards of the Japanese Generally Accepted Accounting Principles equivalent to the International Financial Reporting Standards. The Commission services welcomed Japan's draft interim report on the Application of International Financial Reporting Standards in Japan. The Commission services and the FSA agreed on the need to reinforce the governance of the International Accounting Standards Committee Foundation.

* The next meeting will take place in Tokyo (on a date to be announced).

* For details, please access [FSA and European Commission hold Japan-EU High Level Meeting on Financial Issues \(May 1, 2009\)](#) on the FSA website.

Tokyo Meeting of IOSCO Standing Committee 3 (SC3)

On May 12 and 13, 2009, a meeting of Standing Committee 3 (SC3) of the International Organization of Securities Commissions (IOSCO) was held in Tokyo.

The IOSCO is an international organization consisting of securities market regulators, stock exchanges, and other organizations from over 100 countries and territories. It has ordinary members (securities market regulators), affiliate members (other regulators), and affiliate members (SROs, etc.) totaling 191 organizations (as of the end of November 2008). The General Secretariat of the IOSCO is located in Madrid, Spain.

The SC3 reviews and discusses issues related to the regulation and supervision of market intermediaries in a cross-border environment. The committee consists of the member regulatory authorities from 16 countries and territories in Europe, the United States, and Asia, and is chaired by Tokio Morita, Director of Securities Business Division, FSA.

It is considered that the IOSCO will play a significant role as an international forum in resolving in the current financial market turmoil. In response to the onset of the financial crisis, the IOSCO quickly launched the Task Force on the Subprime Crisis, which analyzed the causes of the financial crisis and recommended specific countermeasures. In addition, last year, it launched three Task Forces (on Unregulated Financial Markets, Unregulated Financial Products, and Short Selling), which worked together with the Task Force on Credit Rating Agencies and the Task Force on Accounting Issues to support G-20 aims.

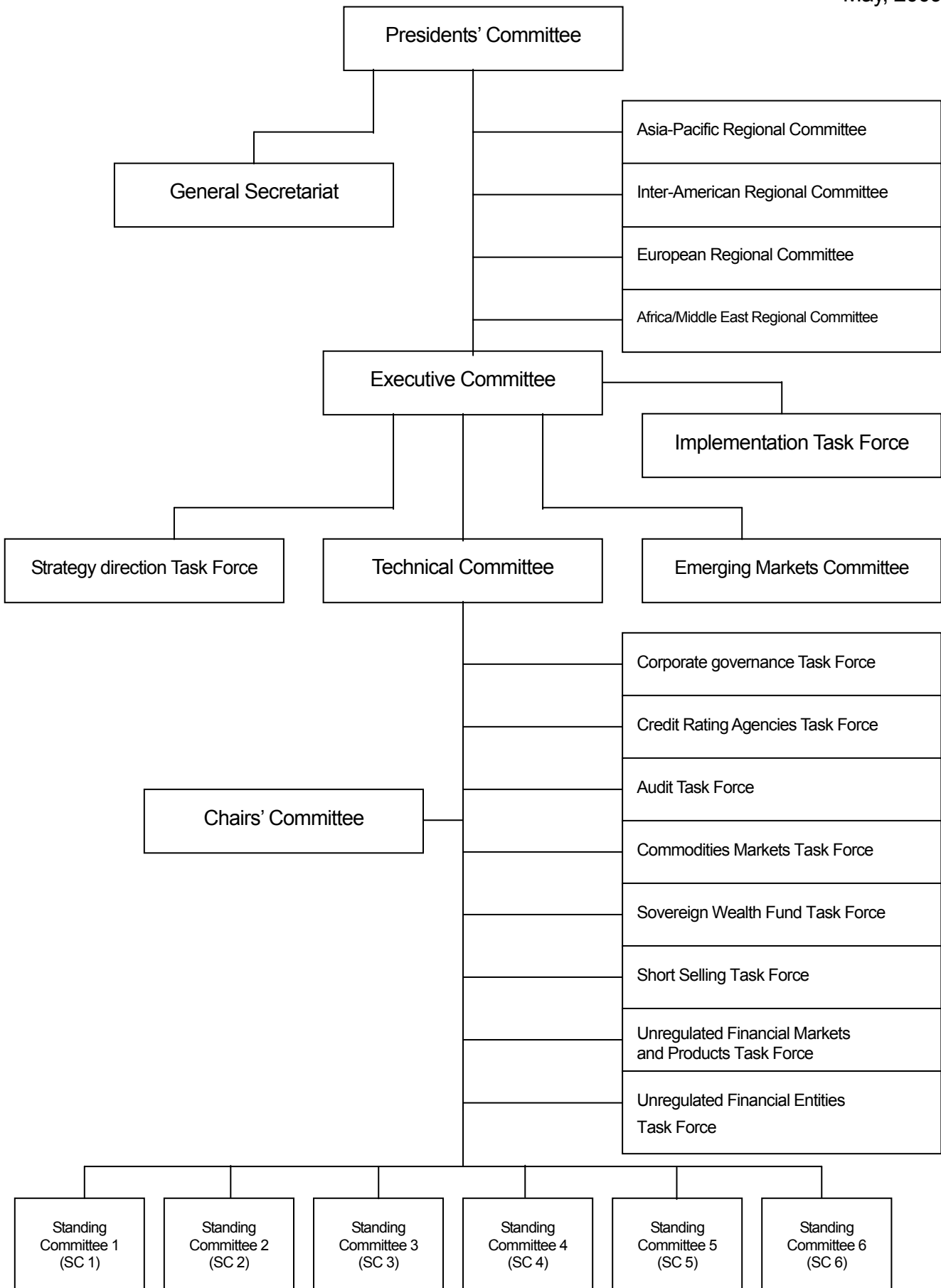
Reference 1: Report on the Subprime Crisis: Final report
([Report prepared by IOSCO Technical Committee](#))

Reference 2: The three IOSCO Task Forces established last year:
([IOSCO Media Release on November 25, 2008](#))

Against this background, the SC3, in collaboration with the Task Forces mentioned above and other groups, has been making efforts to address issues related to the regulation and supervision of market intermediaries such as securities companies. At the SC3 Tokyo meeting, active discussions were held on issues such as those concerning the disclosure of collective investment schemes such as investment trusts at the time of sale as well as those related to the liquidity risk management practices and internal controls of market intermediaries based on the recommendations of the Task Force on the Subprime Crisis. In addition, the SC3 has started to consider the need to address the issue of adequacy when selling complex financial products and of protection of customers' assets at the time of bankruptcy of securities companies. The outcome of this meeting will be reported at the IOSCO Technical Committee Conference that is scheduled to be held in Israel, in June 2009. Based on the results of the conference, further discussions will be held at the next meeting.

IOSCO Structure

May, 2009



The 5th Meeting of the International Forum of Independent Audit Regulators (IFIAR) in Basel

From April 27 to 29, 2009, [the 5th Meeting of the International Forum of Independent Audit Regulators \(IFIAR\)](#) was held in Basel, Switzerland. Chairman Akira Kaneko and other representatives from the Certified Public Accountants and Auditing Oversight Board (CPAAOB) / the Financial Services Agency (FSA) participated in the meeting.

The IFIAR is an association of audit regulators established to promote cooperative relations and share auditing experiences between various countries, for the enhancement of auditing quality. At present, it consists of 31 jurisdictions including the US, UK and other leading countries (as members) and 8 international organizations (as observers).

At this meeting, members elected Mr. Steven Majoor, current Vice-Chairman, as new Chairman of IFIAR for a two year term and Mr. Paul Boyle, current Chairman, as Vice-Chairman for the period up to IFIAR's next plenary meeting in September 2009. Moreover, IFIAR members reached agreement in principle to establish shared Member funding for IFIAR's core administrative and organizational requirements with effect from 2010.

In addition, there were exchanges of views on audit regulators' activities such as the registration and notification of foreign audit firms, on the audit quality, and on the supervision of globally operating audit firms. Following the Oslo Meeting (April 2008) and the Cape Town Meeting (September 2008), the representatives of the so-called six major international audit networks were invited to the meeting for exchanges of views on responses to recent economic crisis by auditors and by audit regulators.

Furthermore, regarding the inspection workshop for IFIAR members that has been held annually to provide an opportunity for the sharing of techniques and experiences in audit inspections, a core area of focus for IFIAR, it was decided that the fourth workshop will be held in Paris in February 2010.

The CPAAOB plans to continue to participate in these meetings and to enhance further improvement of audit credibility and audit quality in Japan, by building and strengthening cooperation and collaborative ties with audit regulators in other countries.

[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. According to the results of the stress tests conducted on U.S. financial institutions that were announced early this morning Japan time, 10 banks were notified of capital shortfalls totaling 7.3 trillion yen. Federal Reserve Board (FRB) Chairman Bernanke pointed out that the results are very reassuring for investors, and many market participants apparently gave the results a positive assessment, regarding them as better than expected. How do you view the results of the stress tests, and do you expect that concerns over the U.S. financial system will be dispelled?

A. I presume that the U.S. government has conducted the stress tests in a conscientious manner. The fact that the capital shortfalls found as a result of the tests were no larger than the figure that can be covered by the funds secured through existing budgetary measures indicates that the condition of the entire financial system is far better than we thought, so the results were reassuring for us.

In addition, many banks do not need any capital injection. So, if capital injection into banks with a capital shortfall begins, it will contribute to stabilizing the financial system further.

【Extract from the press conference on May 8, 2009】

Q. I would like to ask you about Japan's stock market. Yesterday, the Nikkei Average hit a new high for this year, and a bullish sentiment about the future course of the economy is apparently arising. How do you view the current stock price level and the present economic condition?

A. As stock prices are a leading indicator of the economy, the (Nikkei Average's) rise to around 9,400 is very welcome. I presume that this has significantly improved the state of the assets held by banks as well as life and non-life insurance companies. I strongly hope that stock prices will stabilize further.

【Extract from the press conference on May 8, 2009】

Q. I understand that you have called on major banks to use public funds based on the Act on Special Measures for Financial Functions. Do you have any opinion about the fact that all of the three megabanks are set to increase their capital on their own?

A. As the megabanks are private-sector banks, it is natural that they wish to raise capital from the market on their own. We have been worried about whether it is possible for them to do so under the current market conditions. However, we are very glad that they have the prospect of raising capital from the market, and they will not necessarily have to use funds made available by the government. As these funds are intended for emergency use, it would be ideal if they can raise capital from the market.

【Extract from the press conference on May 15, 2009】

Q. Regarding the financial sector, the financial results of all major banks will become known today. Could you tell us how you feel about the financial results of banks and the very difficult situation of regional banks?

A. Banks' losses reflect declines in net business profits and valuation losses on their holdings of stocks and other assets. There may also be other losses. Banks are setting aside reserves to cover losses, and are writing off losses and enhancing their capital bases. The fact is that compared with when major banks previously tried to raise capital on their own, there are much more people who subscribe to the offering of new shares, so capital-raising by financial institutions are now proceeding more smoothly than expected. I believe that banks' management approaches are right as they have properly written off losses or set aside loss reserves and are moving to increase their capital as necessary in order to ensure sound management. Meanwhile, regional banks have been greatly affected by the condition of the real economy. However, there is apparently no financial institution that is in a crunch, so I believe that Japan's financial system as a whole maintains a high degree of soundness.

【Extract from the press conference on May 19, 2009】

[Information]

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