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Outline of State Minister Fujimaru's Official Visits to Switzerland and France

State Minister for Financial Services FUJIMARU Satoshi officially visited Switzerland and France from July 3 to 6, 2023.

In Switzerland, he visited Basel and exchanged views with Mr. John Schindler, Secretary General of the Financial Stability Board (FSB).

In France, he visited Paris and met Mr. Jean-Charles Simon, CEO of Paris Europlace, and Mr. Benoît de Juvigny, Secretary General of the Autorité des Marchés Financiers (AMF), to have discussions on issues concerning securities markets.

1. Basel, Switzerland

Meeting with Mr. John Schindler, Secretary General of the FSB

State Minister Fujimaru met Mr. John Schindler, Secretary General of the FSB, and exchanged views concerning the FSB's priority issues and the latest economic conditions, etc.



A ceremonial photograph with Mr. John Schindler, Secretary General of the FSB

2. Paris, France

Meeting with Mr. Jean-Charles Simon, CEO of Paris Europlace

State Minister Fujimaru met Mr. Jean-Charles Simon, CEO of Paris Europlace, and exchanged views

concerning initiatives for achieving sustainable finance and the creation of a global financial city.



A ceremonial photograph with Mr. Jean-Charles Simon, CEO of Paris Europlace

Meeting with Mr. Benoît de Juvigny, Secretary General of the AMF

State Minister Fujimaru met Mr. Benoît de Juvigny, Secretary General of the AMF, had discussions on initiatives for promoting people's asset building, and mutually confirmed both countries' commitments to continuously deepening cooperation and collaboration.



A ceremonial photograph with Mr. Benoît de Juvigny, Secretary General of the AMF

Additionally, State Minister Fujimaru met people of Japanese affiliated financial institutions in Paris, France, and exchanged views concerning economic conditions and current status of businesses in Europe.

Meeting of Directors-General of Local Finance Bureaus – Remarks by Parliamentary Vice-Minister Suzuki –

On July 27, 2023, the Financial Services Agency (FSA) held the current year's first meeting with Directors-General of Local Finance Bureaus,* and Parliamentary Vice-Minister for Financial Services SUZUKI Eikei gave remarks in the conference room where the bureau chiefs and senior FSA officials gathered.



Photo: Parliamentary Vice-Minister Suzuki giving remarks

Remarks by Parliamentary Vice-Minister Suzuki

As full-fledged repayment for effectively interest-free and unsecured loans provided by private financial institutions has commenced, we will conduct intensive interviews, etc. with financial institutions in cooperation with Local Finance Bureaus to check their efforts for supporting companies and will encourage them to continue offering support to companies in accordance with actual conditions thereof.

Roles to be played by Local Finance Bureaus in promoting sustainable finance differ depending on the characteristics of individual local areas, such as their industrial structures and local governments' initiatives. We expect that individual Local Finance

Bureaus will continue to exercise their originality and ingenuity in fulfilling their expected roles in collaboration with the Financial Services Agency (FSA).

While referring to the "Issues and Practices for Dialogues Regarding IT Governance of Financial Institutions," which the FSA published in June 2023, financial institutions are expected to develop their IT governance mechanism in accordance with their size and characteristics and make efforts for DX by making the best use of their originality and ingenuity. Local Finance Bureaus are requested to back up those initiatives by financial institutions.



Photo: Meeting of Directors-General of Local Finance Bureaus

At the meeting, in addition to the remarks by the Parliamentary Vice-Minister, senior FSA officials and Directors-General of Local Finance Bureaus exchanged views concerning immediate challenges in financial policies and initiatives of the FSA. Participants shared awareness on these challenges, etc. with Directors-General of Local Finance Bureaus and confirmed that the FSA and Local Finance Bureaus will continue efforts in an integrated manner.

* The FSA delegates part of its authority over the inspection and supervision of regional private financial institutions, etc. to the 11 Local Finance Bureaus (including the Okinawa General Bureau of the Cabinet Office) based on laws and regulations. In order to ensure sufficient cooperation between the FSA and the Local Finance Bureaus, Directors-General of Local Finance Bureaus and FSA officials meet once every three months to discuss a variety of issues.

Results of Monitoring Customer-Oriented Business Conduct (2022 Program Year)

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With the aim of promoting the shift of personal financial assets "from savings to investment," the FSA presented the "Principles for Customer-Oriented Business Conduct" (the "Principles") in March 2017 and expects that distributors will exercise their originality and ingenuity based on the Principles and compete with each other to achieve best practices by offering high-quality customer-oriented financial instruments and services.

In PY2022, based on the sales trends of financial instruments involving risk by business mode and sales amounts by financial institution in comparison by business size, the FSA selected targets for intensive monitoring ("intensive monitoring targets") on a risk basis and conducted in-depth monitoring centered on their structures for sale and management of structured bonds and foreign currency-denominated single premium policies. Additionally, also with regard to distributors other than those intensive monitoring targets, the FSA conducted quantitative and qualitative questionnaire surveys^{*1} or otherwise endeavored to broadly ascertain the current status of their customer-oriented business conduct and to improve the quality thereof.

The FSA compiled the results of the monitoring and publicized them as a report titled "Results of Monitoring Customer-Oriented Business Conduct of Distributors of Financial Instruments Involving Risk (PY2022)"^{*2} (the "Report") in June. Major points of the Report are introduced below.

1. Structures for product governance

Distributors need to develop robust structures for product governance under which they introduce financial instruments involving risk that will contribute to seeking customers' best interest, clarify targeted customer groups, verify the characteristics of introduced financial instruments ex post facto based

on their sales results, and review or abolish those financial instruments as necessary. In internet transactions in particular, it is more difficult to ascertain the true needs of customers, compared with cases of face-to-face transactions. Accordingly, distributors are required to develop a framework to enable customers to select financial instruments suited to their true needs, instead of merely applying the principle of individual responsibility.

However, as seen typically in the sale of structured bonds, etc., many of the intensive monitoring targets have failed to fully verify (i) risk involved in financial instruments that they intend to sell, (ii) the rationality between risk and return that customers expect, and (iii) the correlation between all costs borne by customers and expected return.

When a distributor intends to introduce financial instruments involving risk with a different nature from that of the financial instruments it currently deals in, its top management needs to take part in the process of deciding whether or not to introduce them in consideration of its own customer base and policy approaches.

2. The current status of sales and their internal control systems for sales of financial instruments

(1) Structured bonds

Distributors need to verify risk and return from the perspective of securing customers' best interest and review the characteristics of financial instruments so that customers can receive a return commensurate with the risk involved. Then, they are required to provide information necessary for making investment decisions, such as the risk, return and costs, in comparison with other financial instruments involving risk and meticulously explain the risk to customers, etc.

*1 "Results of the Questionnaire Survey on Structures for Sale and Management of Financial Instruments Involving Risk for 100 Regional Banks" (published in April 2023) https://www.fsa.go.jp/news/r4/kokyakuhoni/20230411/survey_230411.pdf (Available in Japanese)
"Compilation of Quantitative Data on Investment Trust Distributors for the September-term of FY2022" (published in June 2023) <https://www.fsa.go.jp/news/r4/kokyakuhoni/fdreport/03.pdf> (Available in Japanese)

*2 "Results of Monitoring Customer-Oriented Business Conduct of Distributors of Financial Instruments Involving Risk (PY2022)" (published in June 2023) https://www.fsa.go.jp/news/r4/kokyakuhoni/fdreport/fd_202306.html (Available in Japanese)

Nevertheless, many of the intensive monitoring targets solely focused on securing revenue and sold structured bonds even to customers with a low risk tolerance without fully verifying targeted customer groups and the characteristics of those structured bonds, and as a result, some of them received many complaints from their customers.

(2) Foreign currency-denominated single premium policies

Distributors need to accurately ascertain customer needs for investment, security, inheritance, etc., verify whether foreign currency-denominated single premium policies best match such needs or not, and then provide customers with explanations meticulously regarding the characteristics of the relevant financial instruments and the risk involved. Then, they need to propose and sell foreign currency-denominated single premium policies only to customers who can fully understand the characteristics thereof on the premise of holding them for a long term.

Nevertheless, the following problems were found in many of the intensive monitoring targets in the sale of foreign currency-denominated single premium policies by objective.

| | |
|-----------------------------------|---|
| Sales to meet need of Investment | Sales staff failed to explain the risk, return, costs, etc. in comparison with other financial instruments involving risk. |
| Sales to meet need of Security | For a target achievement-type insurance policy, sales staff recommended a customer to cancel the policy and buy other financial instruments after achieving the target of investment, thereby disrupting the security period. |
| Sales to meet need of Inheritance | Sales staff set an amount of insurance benefit significantly exceeding the tax-exemption ceiling at the time of concluding a contract. |

3. Appropriate provision of motives to employees

In order for distributors to promote customer-oriented business conduct, their top management, the second-line of defense and the third-line of defense, not limited the first line of defense, need to continuously verify whether their performance evaluation systems encourage sales staff to take actions in line with their policy and how the revision of the performance

evaluation systems has changed their actions in sales activities.

Many of the intensive monitoring targets had committed in their policy to providing customer-oriented consulting services under a performance evaluation system not placing too much focus on revenue. But in reality, they place weight on the sale of foreign currency-denominated single premium policies, for which sales fees are high, in evaluating individual sales staff's performance. As a result, sales staff are endeavoring to sell such insurance policies (Figure 1 and Table 2). The same applies in relation to structured bonds.

Furthermore, distributors also need to develop their own training and personnel systems to have sales staff acquire the required expertise to ensure that they can recommend financial instruments in line with the true needs of individual customers.

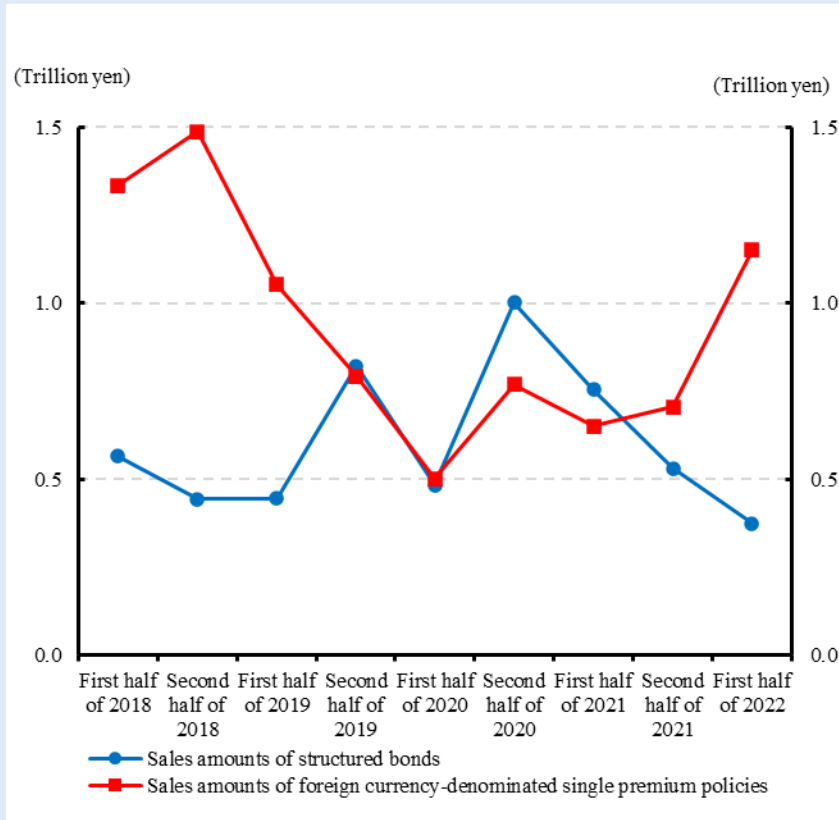
If that is impossible, distributors need to limit the types of financial instruments they deal in within a range that sales staff can sell with their current explanation capability in consideration of their experience, etc.

Nevertheless, many of the intensive monitoring targets provided training only formally, and at some of them, it seemed that sales staff did not fully understand financial instruments' characteristics as they dealt in too many types.

The FSA expects that distributors will refer to the Report and endeavor not only to improve their efforts for ensuring customer-oriented business conduct but to achieve best practices, thereby supporting the shift of personal financial assets "from savings to investment."

This program year as well, FSA will continuously encourage distributors to make these efforts and monitor whether they have developed appropriate structures for sale and management to seek customers' best interest.

(Figure 1) Changes in sales amounts of structured bonds and foreign currency-denominated single premium policies



(Note) Total of sales amounts for "major banks, etc." and "regional banks"

(Table 2) Correlation between percentage of sales of foreign currency-denominated single premium policies and performance evaluation

| Distributors where the percentage of sales of foreign currency-denominated single premium policies is high | | | |
|--|--|-------------------|---|
| Item | Bank A | Bank B | Bank C |
| Percentage of sales | Nearly 100% | Nearly 100% | More than 90% |
| Performance evaluation (Revenue goal) | 2.5 to 4 times for foreign currency-denominated ones compared to yen-denominated ones | Sales fees | 3 times for foreign currency-denominated ones compared to yen-denominated ones |

| Distributors that sell yen-denominated insurance policies and foreign currency-denominated insurance policies in a relatively well-balanced manner | | | |
|--|--|--|-------------------|
| Item | Bank D | Bank E | Bank F |
| Percentage of sales | More than 40% | 60% | Nearly 70% |
| Performance evaluation (Revenue goal) | No difference between foreign currency-denominated ones and yen-denominated ones | No difference between foreign currency-denominated ones and yen-denominated ones | No setting |

(Note) The percentage of sales refers to the percentage accounted for by the sales of foreign currency-denominated single premium policies among the total insurance sales for the first half of FY2022.

Monitoring by the Certified Public Accountants and Auditing Oversight Board

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On July 14, 2023, the Certified Public Accountants and Auditing Oversight Board (the "CPAAOB") published the following information from the perspective of proactively providing the findings, etc. from monitoring,* such as inspections of and reports collected from audit firms, broadly to the general public.

1. Basic Plan for Monitoring Audit Firms

Based on the "Basic Policy for Monitoring Audit Firms" published in May 2022, the CPAAOB compiled priorities for monitoring in Program Year 2023 (from July 2023 to June 2024) as the "Basic Plan for Monitoring Audit Firms in Program Year 2023."

[Key points]

(1) Basic Inspection Plan

For inspections of audit firms, the CPAAOB specified 15 common priorities, including their top management's commitment for improving the audit quality and the effectiveness of their operations management system and quality control system, and conducts inspections in accordance with the size of audit firms as follows.

- In consideration of the significance of the roles in the capital markets fulfilled by large-sized audit firms, the CPAAOB inspects them every year, in principle (with regular inspections and follow-up inspections being conducted alternately). The CPAAOB evaluates how top management, including the top executive, and the quality control department fulfill check functions against the front-line audit teams (the operation department, etc.) for securing and improving the audit quality.

- Given that the roles fulfilled by mid-tier audit firms are increasing in audits of listed companies, the CPAAOB decided to increase the frequency of inspections from once every three years in principle to once every two years in principle.

- With regard to small and medium-sized audit firms, in consideration of their increasing roles as auditors of listed companies and the introduction of the legal registration system for auditors of listed companies under the amended Certified Public Accountants Act, the CPAAOB places importance on their inspections this program year as well.

(2) Basic Plan for Non-Inspection Monitoring

Quality control reviews by the Japanese Institute of Certified Public Accountants (the "JICPA") will play further significant roles as a means to check the eligibility of auditors as registered auditors of listed companies under the legal registration system for auditors of listed companies. Therefore, the CPAAOB will have in-depth discussions with the JICPA with the aim of strengthening the system for conducting quality control reviews.

Additionally, the CPAAOB will continue regular dialogues with the top management, including top executives, of large-sized and mid-tier audit firms, thereby collecting information on the latest operations management system, and will also continue dialogues with the top management of relatively large audit firms among small and medium-sized audit firms that audit listed companies, etc.

* Monitoring encompasses both inspections and non-inspection monitoring. Non-inspection monitoring include gleaning information through the collection of reports from and the conduct of interviews with audit firms, through exchange of opinions and cooperation with relevant FSA departments, the Japanese Institute of Certified Public Accountants (JICPA), and industry groups etc. involved in audits, and through dialogues with audit firms.

2. Case Report from Audit Firm Inspection

Results

The CPAAOB creates the Case Report from Audit Firm Inspection Results every year with the aim of encouraging audit firms to make voluntary efforts for securing and improving the audit quality, presenting the audit quality level expected by the CPAAOB, and providing reference information to directors and auditors of listed companies and investors and other market participants through providing specific examples of major deficiencies identified in the CPAAOB's inspections as well as observed effective efforts.

The Case Report for PY2023 adds the latest cases inspected and explains the background, etc. for audit deficiencies found through inspections in an easy-to-understand manner.

[Key points]

- (1) In "I. Operations Management System (Root Cause Analysis)," root causes analyzed by the CPAAOB and concrete examples of root causes are introduced in more detail in light of the significance of root cause analysis.
- (2) In "II. Quality Control System," expanded examples of issues with the quality control system are presented and commendable examples of initiatives that will contribute to the improvement especially for small and medium-sized audit firms are introduced.

The section "Implementation of Quality Control Operation" contains a list of the provisions serving as grounds for the matters that are frequently pointed out and points to note.

- (3) In "III. Individual Audit Engagements," descriptions of the matters pointed out and points to note have been enhanced and commendable examples of initiatives that will contribute to the improvement especially for small and medium-sized audit firms are

introduced in sections such as "1. The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statement", "4. Auditing Accounting Estimates" and "5. Group Audit" in consideration of the fact that accounting fraud at listed companies and overseas group companies continue to attract public attention.

3. Monitoring Report

The CPAAOB prepares the Monitoring Report every year, targeting experts in audits and accounting, market participants and the general public as readers, with the aim of deepening readers' understanding of accounting audits through providing relevant information, centered on the status and outcome of the monitoring by the CPAAOB, including the current conditions of the audit sector and responses to environmental changes.

The 2023 Monitoring Report contains data on the overview of audit firms and audited companies and the latest information obtained through monitoring.

[Key points]

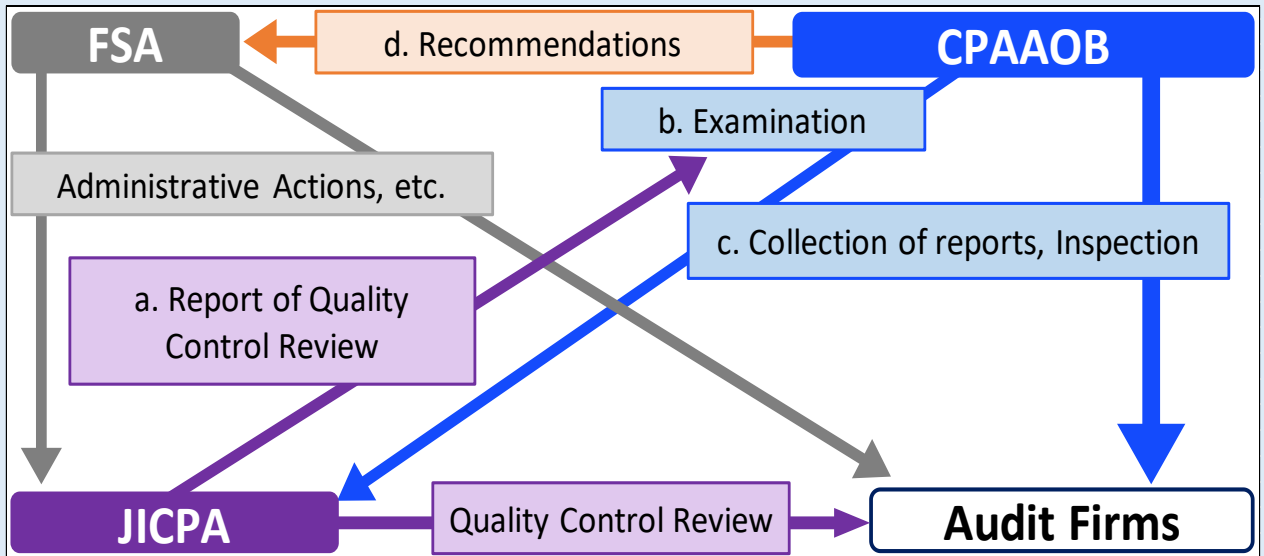
- (1) Overview of the Audit Sector

CPAs, audit firms, and audited companies are overviewed and the entire picture of the audit sector is explained. Concentration of audit engagements at large-sized audit firms is pointed out and the status of responses to the revised "Quality Control Standards for Audits" is described.

- (2) The CPAAOB Monitoring

Monitoring-related data are updated and the entirety of the CPAAOB monitoring, including inspections, is explained (see Figure 1). Overall ratings (in five grades) of audit firms based on the results of the inspections by the CPAAOB are described and the quality control reviews by the JICPA are also introduced.

(Figure 1) Entirety of the CPAAOB monitoring activities



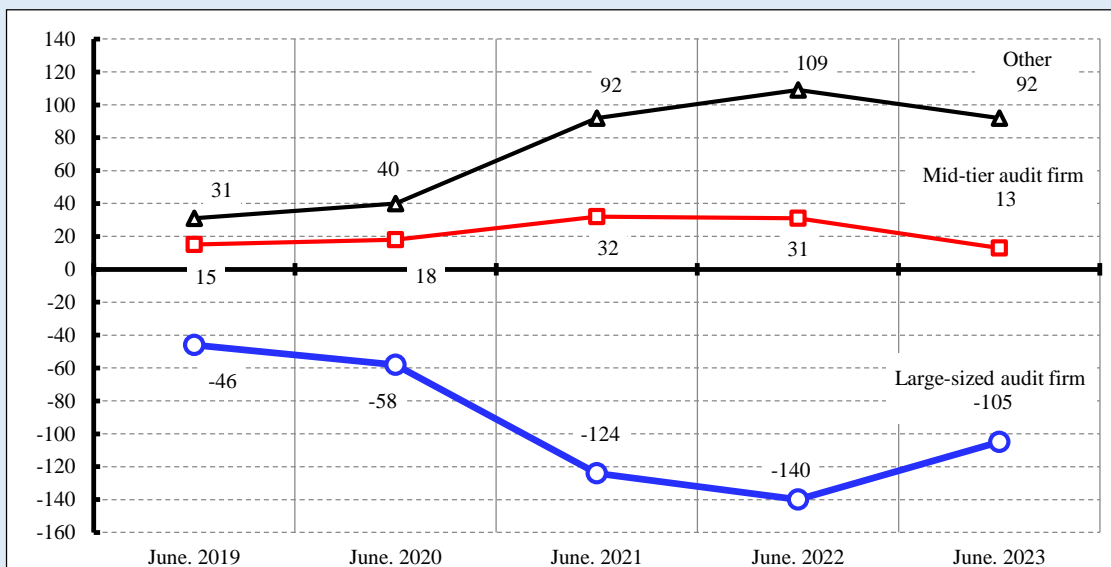
(3) Operation of Audit Firms

The organizational structures and operation statuses of audit firms are explained. The continued trend in which auditors of listed companies are changed from large-sized audit firms to mid-tier or small and medium-sized audit firms is described and this part contains columns to introduce the revision of the Audit Firm Governance Code that incorporates the content aiming to accommodate acceptance of small and medium-sized audit firms (see Figure 2).

(4) Responses to Changes in the Global Environment Surrounding Audits

Trends of small and medium-sized audit firms whose roles as auditors of listed companies are expanding, and moves to revise systems in response to recent changes in the environment surrounding audits, and trends concerning disclosure of sustainability-related information and assurance are described.

(Figure 2) Changes by size of audit firms (net increases and decreases by size) (unit: cases)



(Note) Net increases/decreases in the number of changes

JFSA's Major Activities in July (July 1 to July 31, 2023)



- ["The Third Report by the Expert Panel on Sustainable Finance" Announced \(July 31, 2023\)](#)
- [Invitation for Public Comments regarding "Draft Basic Guidelines on Impact Investment" \(July 31, 2023\)](#)
- ["Report by the Working Group on Impact Investment" Announced \(July 31, 2023\)](#)
- ["the Code of Conduct for ESG Evaluation and Data Providers" : 17 ESG Evaluation and Data Providers have endorsed the "Code of Conduct"\(July 27, 2023\)](#)
- [The second meeting of the Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council \(July 24, 2023\)](#)
- [Progress in Data Integration and Next Steps \(July 21, 2023\)](#)
- ["Formulation of the Transition Finance Follow-up Guidance" Announced \(July 21, 2023\)](#)
- ["Report by the Working Group on Financial Institutions' Efforts towards Decarbonization of the Economy" \(Provisional Translation\) Announced \(July 21, 2023\)](#)

JFSA's official English X(formerly Twitter) account
https://twitter.com/JFSA_en



**We are promoting
information dissemination
using X(formerly Twitter)!**

Editorial Postscript

We have had a heat wave here in Tokyo. How have you been?

Recently, I started to wear a wearable device. I was relieved from the burden of walking around with a slightly heavy and large mobile phone in hand and have been enjoying controlling my everyday life and feeling changes brought about by various functions of the wearable device, such as a schedule reminder and a sleep measuring function, although there are many more functions that I have not mastered. (Those who have already been using a wearable device may say, "You've just learned these things now?")

This month's Policy Commentary Corners are about monitoring activities. The FSA is now accumulating knowledge on the influence of new technologies, such as AI and cloud computing technologies, on the services and operations of financial institutions and is deliberating better ways for monitoring activities. I would like to create new ideas to improve financial policies through trial and error while enjoying technological advancement in my personal life.

YANO Shohei, Director of the Public Relations Office, FSA
Edited and issued by the Public Relations Office, FSA