

The main issues raised by the FSA at opinion exchange meetings with trade associations
[held on June 15, 2021, with the Japan Securities Dealers Association]

1. Results of the monitoring for this business year

- For this business year, the FSA had deepened talks with the top management of large, network and regional securities companies, in accordance with their business mode, regarding the following points:
 - (i) Provision of services and financial instruments truly beneficial to customers while giving top priority to customers;
 - (ii) Formulation of an operational system with due respect for customers' interests;
 - (iii) Establishment of a compliance system for not merely ensuring compliance in form and fulfilment of governance functions.

Through the monitoring for the last one year, we have noticed the following.

< Large securities companies >

[Formulation of an operational system with due respect for customers' interests and establishment of a compliance system beyond merely ensuring compliance in form]

- Large securities companies are generally making efforts to reform their performance evaluation systems, such as excluding churning or other inappropriate transactions from the credit of performance evaluation, in order to raise awareness of their sales personnel regarding the necessity to make appropriate proposals in line with individual customers' risk tolerance and needs and to conduct follow-ups continuously.
- On the other hand, there were cases where internal control over market manipulation transactions does not work sufficiently. Securities companies are expected to play roles as gatekeepers in the market and make efforts for ensuring appropriate business operations.

[Provision of services and financial instruments truly beneficial to customers]

- It is necessary for each securities company to continue efforts to provide services

and financial instruments truly beneficial to customers, thereby establishing a stable business basis.

- The FSA confirmed that large securities companies were all making efforts for customer-oriented business conduct and management improvement, while facing the prolonged impact of the COVID-19 infection, in addition to tackling with conventional business challenges.
- More specifically, the FSA confirmed cases where consultation functions are being strengthened with taking advantage of the characteristics as securities companies offering face-to-face services, such as through appointing sales personnel dedicated for each customer segment, promoting sales activities to propose an optimal portfolio, and introducing a system for fees linked to asset balance.
- Additionally, large securities companies are endeavoring to improve their operating efficiency and use their management resources more efficiently through utilization of non-face-to-face channels and strengthened cost reduction with the aim of increasing their earning capacity.
- Large securities companies are making positive efforts to respond to business corporates' increasing demand for capital and funds for business restructuring or for other purposes amid the COVID-19 pandemic, which is exerting a prolonged impact. However, on the other hand, as the FSA has pointed out in the previous meeting, regarding moving strike (MS) warrants, there are opinions highly evaluating them as a means to enable flexible fund-raising, but some express concern over a risk of damaging the interests of existing shareholders.
- The FSA is of the view that securities companies need to examine diverse options of fund-raising, in giving advice on fund-raising to business corporates, and provide customers with sufficient explanations so that they can understand the advantages and disadvantages of MS warrants as a means of fund-raising.

[Risk management system]

- Lastly, many problems were found regarding risk management. There were cases relating to systems of large securities companies that exerted influence directly on customers, which included customer information leakage from outsourcees and

suspension of transactions due to system failures.

- Regarding global risk management, in cases where multiple large financial institutions incurred large losses through transactions with an overseas customer, it was found that top management had not understood risks and had failed to put in place sufficient risk management systems or have proper involvement.
- For large securities companies that are becoming involved in expanding overseas business such as global M&As, in addition to engaging in conventional market-related operations, the importance of global governance and global risk management is increasing. The FSA will continue monitoring the situation of how securities companies are developing their governance and business management system and risk management system necessary for global business expansion, in collaboration with foreign authorities.

< Second-tier and regional securities companies >

[Provision of services and financial instruments truly beneficial to customers]

- With regard to second-tier and regional securities companies, their operating profit and loss and balance of deposited assets are recovering thanks to favorable share prices. However, a business environment for companies mainly offering conventional face-to-face services is becoming further severer due to the aging of customers, emergence of network securities companies, and prolonged impact of the COVID-19 infection.
- Under such circumstances, some companies are endeavoring to make a sustainable business model through providing services and financial instruments beneficial to customers as shown below:
 - A company does not follow the current trend to free fees, but endeavors to add value to its face-to-face sales activities to totally offer solutions to customers' problems (including problems concerning inheritance, tax and the like other than securities-related problems).
 - A company tries to adapt itself to new lifestyles and promote digitalization

through combining face-to-face services and digital services and improving operational efficiency by the use of digital tools, etc.

- Additionally, there were also cases where companies are endeavoring to expand business bases or reduce cost, such as through a comprehensive business tie-up with multiple regional banks, an M&A with another securities company, and a business integration among group companies. Second-tier and regional securities companies are expected to continue efforts to establish stable business bases through the provision of services and financial instruments truly beneficial to customers.

< Network securities companies >

[Provision of services and financial instruments truly beneficial to customers]

- While new lifestyles are prevailing in society, sharp increases are observed in the number of newly opened accounts mainly for large network securities companies backed by favorable share prices.
- In the meantime, competition among companies, including reduction or partial elimination of various fees, has been intensifying.
- Under such circumstances, it was confirmed that some companies are positively increasing financial instruments and services, diversifying businesses, concluding capital or business alliances with other companies, or otherwise making efforts to differentiate themselves from others and independently secure stable revenue sources.

[System risk management system]

- On the other hand, securities companies as a whole, not limited to network securities companies, experienced unauthorized accesses targeting their online transaction services during the last one year. Through these incidents, companies have renewed their awareness of the significance of strengthening their own information security management system and cybersecurity management system.
- We have repeatedly attracted your attention on occasions of opinion exchange

meetings and we appreciate your cooperation in preparing the Guidelines, but there still are cases requiring immediate responses, such as where, for online transaction services by securities companies mainly offering face-to-face services, the same password is used for logging in an account and for making transactions.

- Ensuring that customers are able to use financial services without worries and systems operate safely and stably is the basic premise for obtaining people's trust on financial instruments markets and financial instruments business operators. Network securities companies are requested to take appropriate measures continuously in line with the Comprehensive Guidelines for Supervision and other Guidelines.

< Lastly >

- The FSA will continuously follow up how companies will respond to the problems found through the monitoring for this business year, and would like to utilize various occasions to have discussions with you.

2. Financial Market Entry Office

- On the occasion of the previous opinion exchange meeting (on April 21), we introduced the fact that the first registration for a foreign company to engage in an investment advisory and agency business was completed on April 16 through registration procedures in English at the Financial Market Entry Office. Subsequently, the second registration for an investment management business and an investment advisory and agency business was completed on May 21.
- On June 11, the Financial Market Entry Office was relocated to Kabutocho, Nihonbashi, with the aim of facilitating closer communication with financial businesses, and an opening ceremony was held with the attendance of the Minister and the State Minister. The new office is walking distance from the Taiyo Life Insurance Building, where your association is located.
- We will promote efforts for making Japan an international financial hub with close

collaboration with you. We appreciate your kind cooperation.

3. Commencement of acceptance of applications for vaccination against the COVID-19 infection by job category

- In order to reduce the burdens on municipal governments and accelerate vaccination against the COVID-19 infection, applications for vaccination by job category started to be accepted on a dedicated website on June 8.
- We are receiving many inquiries on procedures from financial institutions. For procedures for vaccination by job category, the Ministry of Health, Labour and Welfare published guidelines on June 8 and Q&As on June 10 in order to respond to those inquiries from individual companies and associations. Please refer to them.
- Vaccination by job category will be commenced with companies that can secure 1,000 or more vaccination targets at one venue. If the number of vaccination targets per venue is less than 1,000, it is possible to add employees' families or employees of other group companies. Please consider means so that as many people as possible can have a vaccination earlier.

4. Checking of countermeasures against cyberattacks towards Tokyo 2020 Olympics and Paralympics

- A number of cyberattacks occurred in the past games. Upon the occasion of the Tokyo Olympics and Paralympics, there is a possibility that not only organizations related to the Games but also financial institutions will be targeted.
- Prior to the opening of the Olympics and Paralympics games, financial institutions are requested to check systems to respond to incidents, including those of vendors or other outsourcees, and strengthen surveillance from the perspective of securing stable financial services.

5. Activation of ransomware attacks

- Cyberattacks using ransomware are increasing. Damages to material infrastructure

have been reported in and outside Japan, and the NISC has been calling for attention.

- If material infrastructure stops functioning and it takes time for restoration, the influence on customers can be significant. Financial institutions should check whether there is any vulnerability in their network equipment and make sure that measures against ransomware infection are sufficient.

6. "Analysis Report on Financial Institutions' Computer System Failures"

- Regarding the system failures that occurred in FY2020, the FSA is analyzing the causes and problems with the focus placed on "timing of failures" (to be published at the end of June).

(1) Integration and update of systems

Failures (delay in transfer, etc.) occurred intermittently upon commencement of the operation of a new system.

(2) Irregular updating work of programs

Due to insufficient prior examination of possible influence of the updating work or inappropriate setting, the influence extended to ATMs or other peripheral systems.

(3) Daily operation and maintenance

Shift to spare equipment did not go well upon a failure at an outsourcee or a failure of the main equipment.

(4) Cyberattacks and unauthorized access

There were cases of unauthorized withdrawals due to improper authentication settings (authentication by only one element) and information leakage due to improper settings of access rights for cloud services.

- Please check your system risk management system again and further strengthen it while referring to this report.

7. Anti-money laundering and terrorist financing measures

- On April 28, the FSA requested the industry associations to make their members

complete the requirements of "the required actions" in the FSA's AML/CFT Guidelines by the end of March 2024 (posted on the FSA's website on May 31). The member financial institutions should appropriately monitor the progresses of their action plans, which were reported to the FSA, and complete the required actions by the due date.

8. Efforts toward the lowering of the legal age of adulthood

- Ahead of the lowering of the legal age of adulthood scheduled for April 2022, relevant ministries and agencies (Consumer Affairs Agency, Ministry of Education, Culture, Sports, Science and Technology, Ministry of Justice, and Financial Services Agency) will jointly strengthen efforts for consumer education targeting young people.
- Cooperation of various people in both the public and private sectors is indispensable for promoting consumer education, and financial institutions are also expected to cooperatively transmit information and give due consideration to young people, such as providing information and conducting checking when concluding contracts with young people so that they can properly understand the details of the contracts.

9. Promotion of employment of persons with disabilities

- We consider it to be always important to achieve a society where persons with disabilities can normally participate with hope by fully utilizing their skills and aptitude in accordance with characteristics of individuals' disabilities or a society where persons with or without disabilities work together as common practice.
- As you know, the Act on Employment Promotion etc. of Persons with Disabilities obliges business owners to hire persons with disabilities at a rate above the statutory employment rate. The statutory employment rate for private companies was raised from 2.2% to 2.3% this March.
- Regarding this, the special subsidiary system is put in place. Under this system,

when a parent company has established a subsidiary that gives special consideration in hiring persons with disabilities and certain requirements are satisfied, workers with disabilities hired by the relevant subsidiary are deemed to be employed by the parent company and are counted in the calculation of the employment rate of persons with disabilities for the parent company. We understand that some securities company groups have established special subsidiaries.

- Based on the Action Plan for the Realization of Work Style Reform (decision by the Council for the Realization of Work Style Reform on March 28, 2017), the national government has been making all-out efforts for reforming people's work styles, including the promotion of teleworking of persons with disabilities. In light of this, we ask for your cooperation in promoting the employment of persons with disabilities, while also utilizing teleworking systems, instead of sticking to employees' current work style and content of duties.

10. Review of conventional face-to-face procedures requiring documents and seals

(Regulations requiring documents, seals and face-to-face contact)

- In December 2020, the FSA amended relevant Cabinet Office Orders and Guidelines for Supervision to make it unnecessary to affix seals on applications and notifications submitted by financial institutions.
- Additionally, with regard to procedures among the private sector and the FSA's notices on approval or permission, etc., for which documents, seals and face-to-face contact are required under laws and regulations under the jurisdiction of the FSA or Guidelines for Supervision, we recently had public discussions for necessary review, aiming to promulgate and enforce amendments by the end of June.

(FSA's electronic application and notification system)

- The FSA had endeavored to develop a system and make institutional preparations to enable financial institutions to submit applications and notifications, etc. online by the end of March 2021. The new system is scheduled to commence operation at

the end of June, and this was published on the FSA's website on Monday, May 31.

- For using the new system, financial institutions need to obtain an account for gBizID in advance. The introduction of this online system may cause changes in conventional procedures for clerical work. Please make preparations in collaboration with the FSA and the competent Local Finance Bureau.

* The FSA issued a notice titled "Information for Commencing Use of the FSA's Electronic Application and Notification System" dated March 31, 2021, to financial institutions to announce when the new system will be made available.

(Review of procedures requiring documents, seals and face-to-face contact among the private sector)

- The FSA will continuously follow up how the financial industry as a whole reviews conventional practices requiring documents and seals, etc. We ask you to continue efforts to review those practices based on the summary of issues compiled at the Panel in December 2020 and amendments of laws and regulations mentioned earlier.

11. Recent developments in discussions on the Non-Banking Financial Intermediation

- As mentioned at the meeting in April, international standard setting bodies, including the FSB and IOSCO, are discussing issues in relation to Non-Banking on a full scale in light of the market turmoil due to the COVID-19 pandemic. In particular, the work on Money Market Funds (MMFs) is at the final stage toward the publication of a consultation report by the FSB scheduled at the end of June. We would like to ask you, after its publication, to please examine the content and provide them with your opinions, together with the background facts and ideas supporting your opinions.
- In addition to the work on MMFs, discussions are also underway on a wide range of topics, including a project to analyze the situation of margin and margin calls, and the liquidity and market structure of the corporate bond secondary market under the impact of the COVID-19 pandemic. In particular, with regard to the project on the analysis of margin, we acknowledge that the Japan Securities Dealers

Association has kindly cooperated in responding to the survey. We would like to take this opportunity to express our appreciation and ask for your continued cooperation.

12. Expert Panel on Sustainable Finance

- In order to achieve carbon neutrality by 2050, it is important that financial institutions as well as financial and capital markets fulfill their functions appropriately. For deliberating challenges and measures therefor, the FSA established the Expert Panel on Sustainable Finance in December 2020 and deliberations have been conducted.
- At the meeting held on May 28, 2021, a report (draft) of the Expert Panel was presented. It is scheduled to compile recommendations concerning the enhancement of corporate disclosure, demonstration of capital market functions, and financial institutions' support for borrowers and risk management, including effective use of scenario analysis.
- The FSA will deliberate how to materialize measures based on recommendations of the report. We appreciate your continued cooperation.

13. G7 and IFRS Foundation Initiatives to Establish Sustainability Reporting Standards

- For some time, international conferences such as the G7 and G20 have been held virtually as a result of the COVID-19 infection, including the G7 Finance Ministers and Central Bank Governors (FMCBG) Meeting on May 28, 2021. The G7 FMCBG Meeting meanwhile was held face-to-face in London on June 4 and 5, and participants discussed financial issues. The G7 FMCBG Communiqué was released after the meeting in London, based on the discussions at these meetings in May and June.
- Climate change is one of the top policy priorities for the United Kingdom, which currently holds the G7 Presidency. As a result, climate finance was discussed as a major agenda item at the most recent meeting. The Communiqué makes numerous

references to climate-related financial disclosures, for which the United Kingdom has made significant efforts.

- In the Communiqué, it was agreed that G7 countries support moving towards mandatory disclosure that is based on the Task Force on Climate-related Financial Disclosures (TCFD) framework, in line with domestic regulatory frameworks. Japan is planning to revise the Corporate Governance Code and to request companies listed on the Prime Market to make disclosure based on the TCFD recommendations or an equivalent framework. Minister Aso explained this point at the G7 meeting.
- Additionally, G7 countries welcomed the work program by the International Financial Reporting Standards Foundation (IFRS) Foundation, which is the setting body of the IFRS, for developing the Sustainability Reporting Standards by the International Sustainability Standards Board (ISSB), which is to be established under the IFRS Foundation.
- The IFRS Foundation has been making efforts since last year for establishing a new standard setting body with the aim of developing international reporting standards concerning companies' initiatives for sustainability. This March, the IFRS Foundation presented strategic directions for the new standard setting body: to focus on information that is important for investors' decision making and place emphasis on climate-related reports first based on existing frameworks and work procedures, including the TCFD. At the end of April 2021, the IFRS Foundation published a proposal to amend its Constitution, which provide for the matters in relation to the new standard setting body, including its structure, and commenced public consultation.
- IOSCO also published its statement concerning an urgent need for globally consistent, comparable, and reliable sustainability disclosure standards in February 2021. IOSCO is deliberating such issues as collaboration with the IFRS Foundation and challenges that the IOSCO should address. A report compiling the challenges of IOSCO and its involvement with the IFRS Foundation is scheduled to be published soon.

(Note) IOSCO published a report on issuers' sustainability-related disclosures on June 28.

- The FSA considers it necessary to proactively take part in the development of sustainability reporting standards by the IFRS Foundation and has presented opinions to or otherwise worked on the Foundation in collaboration with you and other related parties in Japan. Regarding the latest public consultation as well, we would like to present a collective opinion of Japan. We would appreciate your cooperation.
- People's attention is being drawn not only to the issue of climate change, but also to other risks relating to nature in general, such as biodiversity loss. In light of this, the Communiqué expressed hope for the formation of a Taskforce on Nature-related Financial Disclosure (TNFD). The TNFD will aim to develop a disclosure framework for nature-related risks and opportunities in the same way that TCFD did for climate change. The discussions have only recently begun, but they are moving quickly, and we must keep an eye on the relevant developments.

14. Publication of the IOSCO's report on business continuity plans with respect to trading venues and intermediaries

- In May 2021, IOSCO published a report titled "Thematic Review on Business Continuity Plans with respect to Trading Venues and Intermediaries." The report reviews the extent to which participating IOSCO member jurisdictions have implemented regulatory measures consistent with the content of the two final reports, published in 2015, regarding the business continuity plans with respect to trading venues and market intermediaries.
- The report evaluates Japan's consistency of implementation as fully consistent with the content of the final reports both for trading venues and intermediaries.
- At the same time, the report points out that in some jurisdictions, application of the requirements to outsourced entities is not ensured or regular review and updates of BCPs are not secured.
- The report does not evaluate the operational resilience of trading venues and intermediaries, but IOSCO plans to carry out work on operational resilience as part

of the initiative to verify risks exacerbated by the COVID-19 pandemic as it has publicized in its Work Program 2021-2022.

- Please read the report available on the FSA website and the IOSCO website. We would appreciate your cooperation when carrying out related work in the future.