

The main issues raised by the FSA at opinion exchange meetings with trade associations

[held on November 16, 2021, with the Japan Securities Dealers Association]

1. Present Circumstances Surrounding Securities Companies

- Account settlements of securities companies for the term ending in September 2021 show that many companies are enjoying relatively good business performance as a whole, reflecting favorable market conditions. Under such favorable circumstances, it is the time for the top management of each company to exercise leadership toward the development of a sustainable management strategy.
- For that purpose, customer-oriented business conduct is the basic premise. Recently, the use of wrap account services and the sale of structured bonds, foreign shares and foreign investment trusts are increasing. It is important to obtain full understanding of customers before soliciting purchase of such services or financial instruments from the perspective of ensuring customer-oriented approaches.
- Sustainable management will never be achieved without the trust of customers. The top management is expected to pay attention to ensure that customer-oriented business conduct is thoroughly disseminated among all employees.

2. Revision of the Comprehensive Guidelines for Supervision of Financial Instruments

Business Operators

- Also in light of requests presented in the report of the Working Group on Review of Voluntary Regulations from the Principle-based Approach, which the Japan Securities Dealers Association published in September 2020, the FSA revised the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators on November 9, 2021. Through this revision, the FSA reviewed points of attention upon solicitation for the sale and switching of investment trusts and other matters from the principle-based approach so as to ensure that explanations are provided truly in accordance with customers' investment objectives and levels of

understanding.

- Specifically, the revision includes the following:
 - From the points of attention regarding solicitation of investment trusts, the statement concerning an explanation of annual rates of sales commissions in accordance with the holding period was deleted.
 - With regard to the points of attention regarding explanation of important items related to investment trust switching,
 - (i) specific items to be explained to customers are deleted and it is newly stated that the information necessary for customers to make a judgment as to whether the switching is consistent with their individual investment purposes is to be provided in accordance with each customer's depth of understanding; and
 - (ii) regarding the development of internal control system for examining explanations to customers, examples of preparing internal records, etc. are deleted and effective verification is newly requested instead.
- However, it is not that explanations may be decreased uniformly. Financial instruments business operators are expected to provide explanations appropriately depending on circumstances of each customer based on a full understanding of the details and purposes of the latest revision of the Comprehensive Guidelines.

3. Preparation for Transition toward the Permanent Cessation of LIBOR

- On November 1, 2021, the FSA published the Summary of Results of the Brief Survey on the Use of JPY LIBOR, which it conducted jointly with the Bank of Japan. We appreciate cooperation in the survey offered by some securities companies that have many contracts referencing JPY LIBOR.
- It should be noted that the Brief Survey covered only limited targets and limited survey items, but the results show significant progress in transition for all loans, bonds on the liability side, and derivatives as of the end of September 2021. Most legacy contracts as of the end of September 2021 are expected to complete transition from

JPY LIBOR by the end of December 2021.

- A small number of contracts are in exceptional circumstances and may not complete transition by the end of December 2021. However, as of the time when responses to the survey were collected, they did not fall under the category of legacy contracts that cannot feasibly be transitioned away from JPY LIBOR (i.e. so-called tough legacy contracts) and there were no contracts for which the use of synthetic yen LIBOR is expected.
- Securities companies, not limited to those covered by the Brief Survey, should properly ascertain existing contracts to which measures are required and proceed with preparations for transition in consideration of the time left, while making adjustments appropriately with related parties so as to avoid any hindrance to customers, who are the counterparty to contracts.

4. Publication of the List of Financial Institutions Relating to Customer-Oriented Business Conduct

- On November 10, 2021, the list of financial institutions was published on the FSA's website, following the publication of the list in September. The list includes only financial institutions that have adopted the Principles for Customer-oriented Business Conduct and have submitted a report to show their willingness to be included in the list (by September 30), and whose policies for efforts for each item cited in the Principles are found to be clear.
- As introduced at the opinion exchange meeting in September, the list was prepared based on the recommendations presented in the report by the Working Group on Financial Markets under the Financial System Council, which was published in August 2020. Reports submitted by financial institutions show some cases where the list was fully utilized for verifying and evaluating the status of efforts.
- More specifically, for example, with regard to follow-ups and other services in Principle 6, "Providing Suitable Service to Customers," some companies describe the timing, purposes, and content, etc. of follow-ups concretely and quantitatively,

instead of using abstract and subjective terms, such as "periodically" or "meticulously." With regard to items for performance evaluations in Principle 7, "Framework for Adequate Motivation of its Employees," some companies present concrete evaluation items, instead of merely providing abstract explanations, such as "contributing to customer-oriented approaches."

- On the other hand, some companies still seem to lack the understanding that measures for making their initiatives visible are for the benefit of customers.
- The FSA will conduct monitoring of implementation statuses and have dialogues with financial institutions, and it plans to compile and publish best practices. Financial institutions are expected to implement measures, while keeping in mind the necessity to compile the progress of initiatives based on their policies toward the next year.

5. Enforcement of the Act on Provision of Financial Services

- The Act on Provision of Financial Services was put into effect as of November 1, 2021, and the financial service intermediary business was newly defined to enable a company to conduct the financial service intermediary business in all fields of banking, securities, and insurance, by obtaining registration once. Two companies have already been registered.
- The FSA expects that this system will facilitate the provision of diverse financial services and further enhance customer convenience. Financial institutions are requested to utilize this new system by considering such possibilities as
 - newly using the financial service intermediary business for the purpose of expanding the scope of their businesses, and
 - seeking collaboration with financial service intermediaries from the perspective of expanding sales channels for the financial instruments they deal in and enhancing customer convenience.

6. Procedures after the Termination of the Transitional Measure Pertaining to the Obligation to Disclose Individual Numbers

- The tax laws oblige customers holding brokerage accounts to disclose their Individual Numbers, but customers who opened brokerage accounts before 2016 are exempted from the obligation until the end of 2021 as a transitional measure.
- The period for the transitional measure ends at the end of this year. Financial institutions should continue asking customers to disclose their Individual Numbers, while explaining that the disclosure is a legal obligation.
- However, even after the termination of the transitional measure, if there are no legal provisions serving as the grounds, financial institutions do not need to restrict transaction procedures for customers only due to non-disclosure of Individual Numbers.
- The FSA will later issue a notice regarding the above to relevant business associations. We appreciate your cooperation.

7. Promotion of Active Acquisition of Individual Number Cards

- According to data as of November 1, 2021, the number of issued Individual Number Cards reached nearly 50 million, and the dissemination rate increased to 39.1% of the overall population. We appreciate your cooperation in promoting people's acquisition of Individual Number Cards.

(Reference) Dissemination of Individual Number Cards (from November 1, 2020 to November 1, 2021)

Number of issued cards: approx. 27.77 million → approx. 49.95 million (up by around 80% from the previous year)

Dissemination rate among the overall population: 21.8% → 39.1%

- The use of Individual Number Cards as Health Insurance cards was commenced on a full scale and it became possible to view specific medical checkup information using the Mynportal. Furthermore, it will become possible to obtain an electronic COVID-19 vaccination certificate with an Individual Number Card. As the advantages of acquiring an Individual Number Card will thus be increased further, the Digital Agency requested relevant ministries and agencies to cooperate in disseminating

Individual Number Cards. Accordingly, the FSA will also issue a notice requesting cooperation again. The national government will continue efforts for enhancing the functions of Individual Number Cards and for further dissemination thereof. Please offer active cooperation to further promote people's acquisition of Individual Number Cards.

(Reference) Options being considered for enhancing the functions of Individual Number Cards

- Installation of the functions of Individual Number Cards in smartphones (technology verification underway)
- Digitalization of driver's licenses and other national qualification certificates, and integration with residence cards (investigative research underway)
- Optimization of UI and UX, including the Mynportal

8. Achievements of G20 Held in October

- With regard to the G20 Finance Ministers and Central Bank Governors Meeting held in October, I will briefly talk about the following four achievements today: (i) Sustainable finance, (ii) Enhancement of cross-border payments, (iii) Deliberations on virtual assets and stable coins at the FATF, and (iv) Non-Bank Financial Intermediation (NBFI).

<< (i) Sustainable finance >>

- The G20 Sustainable Finance Roadmap and the Synthesis Report prepared by the Sustainable Finance Working Group (SFWG), which was established under G20, were endorsed. The Roadmap is a multi-year document that will help inform future workplans of the SFWG on climate and sustainability.
- Specifically, as Japan has been advocating, G20 members broadly shared the need for actions on transition finance, which supports steady low-carbonization and decarbonization of hard-to-abate sectors, instead of a binary classification (green or not green). The SFWG will develop high-level principles for a framework for financing a just climate transition.
- G20 members also shared the importance of gradually expanding the target of

sustainable finance to include additional issues, such as biodiversity and social matters. In the G20 Rome Leaders' Declaration published on October 31, the Leaders recognize the importance of work on nature-related financial disclosure. Please also follow up discussions at COP26 and COP15. The latter aims to agree to a new set of goals for nature in the same manner as for climate change.

<< (ii) Enhancement of cross-border payments >>

- The ambitious quantitative global targets for addressing the four challenges of cost, speed, transparency and access faced by cross-border payments were endorsed, which include the reduction of global average cost of payment (to no more than 1%) by the end of 2027. As a first step to achieve the targets, we will promote collaboration between the public and private sector, including through the discussion with the Bank of Japan and private payment service providers on how to collect the necessary data to monitor the targets.

<< (iii) Deliberations on virtual assets and stable coins at the FATF >>

- With regard to the FATF's deliberations on virtual assets and stablecoins, the FATF has published the "Second 12-Month Review of Revised FATF Standards on Virtual Assets and VASPs" in July 2021 and the updated "FATF Guidance for a risk-based approach to virtual assets and virtual asset service providers" in October 2021. The second 12-month review report urges, in particular, implementation of the FATF Standards on virtual assets and virtual asset service providers as quickly as possible. Based on the second 12-month review, the updated Guidance clarifies points including that the FATF Standards apply to stablecoins. Accordingly, when Japanese financial institutions handle stablecoins, they are required to comply with the FATF Standards and are expected to conduct AML/CFT measures in line with the second 12-month review and the updated Guidance, as a matter of course. The FSA has contributed to the FATF's work in this area as co-chair of the FATF's Virtual Asset Contact Group (VACG).

<< (iv) Non-Bank Financial Intermediation (NBFI) >>

- Regarding Non-Bank Financial Intermediation (NBFI), as mentioned previously, standard setting bodies, including the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO), have made progress in analyses, in light of the market turmoil of March last year due to the spread of the COVID-19 infection, and a progress report was presented at the G20 Leaders' Summit.
- Regarding Money Market Funds (MMFs), the final report proposing policy options to improve the resilience of MMFs based on the results of the public consultation conducted this summer was published on October 11 and was approved at the G20 Leaders' Summit in October. The final report describes the vulnerabilities of MMFs highlighted by the March 2020 market turmoil and policy options to improve their resilience considering such vulnerabilities. FSB members are expected to assess MMF vulnerabilities in their jurisdiction and address them in line with their domestic legal frameworks, respectively, given the final report, etc. With regard to measures adopted in individual jurisdictions, the FSB will, working with IOSCO, conduct a stocktake by the end of 2023 and assess their effectiveness by 2026. We will work on this issue in close communication with the Japan Securities Dealers Association and other market players and we would like to ask for your cooperation.
- In addition to the work on MMFs, discussions are also underway on a wide range of topics on NBFI. The FSB and IOSCO have continuously been working on the project to analyze fund liquidity risk management under the impact of COVID-19 pandemic. A report on the project to analyze the corporate bond market liquidity, the behavior of market participants and its drivers under the impact of the COVID-19 pandemic is planned to be prepared by the end of this year.
- Additionally, with regard to the project to analyze margining practices under the impact of the COVID-19 pandemic, the results of the consultative discussions on the analysis results were published on October 26. As consultative discussions will affect the future direction leading to the final recommendations, please examine the details

thereof and provide us with your opinions and background facts and ideas as grounds for your opinions.

<< Review of the G20/OECD Principles of Corporate Governance >>

- Finance Ministers, Central Bank Governors, and Leaders of G20 countries expressed their expectations for the review of the G20/OECD Principles of Corporate Governance. Given the importance of the work that will contribute to the global economic recovery toward the post-COVID-19 era and significantly affect companies' future operations, we would like to listen to opinions of financial institutions carefully.

9. Discussions at and Achievements of COP26

- The 26th Conference of the Parties to the United Nations Framework Convention on Climate Change, or COP26, was held from October 31 to November 13.
- Among various meetings held on the occasion of COP26 including those at the level of the Leaders and Ministers, we would like to share the discussions on November 3, which was designated as Finance Day by the UK COP26 Presidency. During the Day, governments and international bodies held meetings and discussed the roles of public and private funds in addressing climate change issues. The major topics were the following two.
 - Firstly, the IFRS Foundation announced the formation of the International Sustainability Standards Board, which will develop sustainability disclosure standards. National governments, including the Government of Japan, and standard setting bodies welcomed the establishment.
 - Secondly, as efforts in the private sector, the Glasgow Financial Alliance for Net Zero (GFANZ) shared its progress on the Day. The GFANZ is a global coalition of leading financial institutions chaired by the former governor of the Bank of

England Mark Carney, in which some of the Japanese financial institutions also participate. Further expansion of private funds is indispensable for facilitating a shift to new industrial and social structures. We would appreciate it if you could continue providing us with information on initiatives in the private sector.

- Going forward, both public and private sectors will deepen their discussions about specific measures to achieve net zero by 2050, based on the discussions at COP26. The FSA will continue efforts in collaboration with financial institutions for themes such as (i) transition finance to support a steady transition of hard-to-abate sectors and (ii) sustainability issues other than climate change, such as biodiversity.

10. Publication of IOSCO's Final Report on AI and ML

- On September 7, IOSCO published the "guidance for intermediaries and asset managers using Artificial Intelligence (AI) and Machine Learning (ML)."
- The guidance states that the use of AI and ML "may benefit market intermediaries, asset managers and investors by increasing the efficiency of existing processes, reducing the cost of investment services and freeing up resources for other activities," while also warning about the possibility that "it may also create or amplify risks, potentially undermining financial market efficiency and harming consumers and other market participants."
- Based on such awareness, the guidance consists of measures concerning "appropriate governance and controls," "staff with adequate knowledge and experience," "robust and consistent development and testing," and "appropriate disclosures," etc.
- Market intermediaries and asset managers are encouraged to refer to the guidance which shows the code of conduct expected for them when they use AI and ML.

11. IOSCO's Principles on Outsourcing

- On October 27, the IOSCO published its final report "Principles on Outsourcing."

- The final report compiles the basic principles that various market participants should take into account when outsourcing tasks. This final report is intended to apply to market participants including trading venues, market intermediaries, market participants acting on a proprietary basis, and credit rating agencies.
- This final report is addressed to the industry, but has no binding effect. Reviews on implementation status by IOSCO are not scheduled. The principles in this final report are not intended to be applied in a one-size-fits-all manner, and their application should be proportional to the size, complexity and risk posed by the outsourcing.
- The final report presents basic principles that should be taken into account in various circumstances relating to outsourcing, such as the selecting process and monitoring of service providers, negotiations for outsourcing contracts, ensuring data security, confidentiality, concentration of outsourcing arrangements, access to data held by service providers, termination of outsourcing contracts, along with guidance for implementation of those principles.
- This final report contains valuable information, and we hope to see market participants refer to this report when considering outsourcing tasks.

12. Appreciation for Your Cooperation for IOSCO C8's World Investor Week

- World Investor Week was held by one of the IOSCO's policy committees, Committee 8, which conduct IOSCO's policy work on financial education and financial literacy and in which the Japan Securities Dealers Association also participates as an observer.
- The World Investor Week is a project commenced in 2017 for the purpose of raising awareness about the importance of investor education and investor protection. Jurisdictions can choose any other week of October or November to promote financial and investor education, and Japan held the week from October 4 to October 10.
- This year as well, the Japan Securities Dealers Association actively participated and offered cooperation by providing information on YouTube videos and dedicated websites, etc. We would like to take this opportunity to express our appreciation to

you.