

The Principles in the Financial Services Industry

Enhancing the attractiveness and competitiveness of Japan's financial and capital markets and enabling financial firms to provide high-quality financial services to meet user needs is one of the major challenges for Japan's economy and society. To this end, it is vital to improve the business and regulatory environment in the interest of both users and providers of financial services. From this standpoint, the FSA has been making efforts toward achieving "better regulation" since last year.

In this context, the FSA presented the concept of "optimal combination of rules-based and principles-based supervisory approaches," and held extensive discussions with representatives of relevant financial firms on key principles(Note1), which would become the cornerstones of principles-based supervision.¹ As a result, the FSA has agreed with the parties involved on the key principles(the "Principles") as drawn out in Attachment 1(Note2).

(Note1) The "Principles" are a set of key codes of conduct or general behavioral rules that are underlying basis of statutory rules such as laws and regulations, and should be respected when financial firms conduct their business as well as when the FSA takes supervisory actions.² "Principles-based" supervision is a supervisory framework that, in line with the above-mentioned principles, places greater emphasis on encouraging efforts by financial firms to improve management of their business on their own initiative.

(Note2) In putting together the Principles, the FSA held a series of meetings to exchange views with the following major industry associations: the Japanese Bankers Association; the Regional Banks Association of Japan; the Second Association of Regional Banks; the National Association of Shinkin Banks; the National Central Society of Credit Cooperatives; the Trust Companies Association of Japan; the International Bankers Association; the Life Insurance Association of Japan; the General Insurance Association of Japan; the Foreign Non-Life Insurance Association of Japan and the Japan Securities Dealers Association. The FSA also exchanged views on an individual basis with the

¹ Relationship between rules-based and principles-based supervisory approaches:

- (1) There are areas where the rules-based approach tends to be more effective relative to the principles-based approach, and vice versa. For example, the rules-based approach would be more suitable when common rules need to be applied to a large number of unspecified parties, whereas it is more appropriate to take the principles-based approach when encouraging a financial firm to improve its management control system.
- (2) Both approaches can function in a mutually complementary manner. For example, (i) as financial innovation advances, it is impossible to forecast all cases so as to have them covered by rules. Principles are therefore expected to fill the gap between the rules. Also, (ii) making appropriate decisions based on principles when applying rules in the context of supervisory response will contribute to ensuring fairness substantively in the area of financial regulation.

² When actually applying the principles, it is essential to take into consideration individual firms' area of business and size, as well as and other features.

National Association of Labor Banks, the Investment Trusts Association, and the Japan Securities Investment Advisers Association.

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

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

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

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

The FSA will strive to have all its staff members appreciate the principles and thereby to carry out effective financial administration. It will also maintain continuous dialogue with financial service providers and further deepen discussions regarding the Principles.³

It should be noted that, in consideration of the above-mentioned nature of the principles, no administrative action will be taken without statutory basis even when a firm is not adequately conforming to the principles and is making insufficient efforts toward improvement.

On reaching a common ground with the financial services industry on the Principles, the FSA partially amended the "Administrative Action in the Financial Sector", as described in Attachment 2.

³ The FSA has also heard opinions on the principles from the Japan Commodities Fund Association, the Financial Futures Association of the Japan, Japanese Institute of Certified Public Accountants and financial instruments exchanges.