

Progress Status of Initiative toward Better Regulation

—from July 2007 to April 2008—

<Outline>

I. Four Pillars of Better Regulation

1. *Optimal Combination of Rules-Based and Principles-Based Supervisory Approaches*

- (1) The FSA agreed with the relevant parties on 14 key principles that constitute the cornerstones of the principles-based supervisory approach. (April 2008)
- (2) The FSA made efforts to clarify the purpose of its regulatory framework by providing interpretations of rules in light of these principles, in order to prevent financial institutions from engaging in overly cautious business practices. For example, the FSA published reference materials such as “Our Answers to Your Questions about the Financial Instruments and Exchange Act” (February 2008) and “Eleven Misunderstandings about the Internal Control Report System” (March 2008).
- (3) Progress was made in joint efforts by the public and private sectors to coordinate rules-based and principles-based supervisory approaches. The Japan Securities Dealers Association and other organizations revised or drew up a total of 12 sets of voluntary rules in accordance with the summary of issues compiled by the FSA's Consultative Council on Market Intermediary Function of Securities Companies (released in June 2006).

2. *Timely Recognition of Priority Issues and Effective Response*

(1) Response to Subprime Mortgage Problem

- *The FSA intensively allocated administrative resources to measures for responding to the subprime mortgage problem, based on the recognition of the depth and extent of the problem.
- *The FSA sought to grasp and analyze the impact of the subprime mortgage problem on Japan's financial system (as part of this effort, the amount of subprime-related products, etc. held by Japanese financial institutions was disclosed). A careful watch was kept on the risk management status of Japanese financial institutions.
- *The FSA enhanced its organization to adequately identify global market developments in a timely manner (e.g. the establishment of the Market Analysis Office in February 2008).
- *The FSA deliberated over future regulatory and supervisory measures in light of the first report by the Financial Markets Strategy Team (November 2007).

- (2) At the beginning of each program year, the FSA customarily develops and announces basic policies regarding inspection and supervision and clarifies the priority issues for the year. In Program Year 2007, issues such as the advancement of risk management were positioned as priorities.
- (3) The FSA conducted inspections with a focused approach. Among the steps taken in relation to inspection were (i) the introduction of a Japanese version of “examiners in charge” where chief examiners in charge of inspecting major banks will remain in charge for multiple years and (ii) active use of “targeted inspections” and “special inspections,” which focus on specific risks and themes.
- (4) The FSA responded to new challenges in a timely manner. Examples of this included (i) the establishment of the Working Group for the Improved Operations of EDINET and the release of a summary of issues (February 2008) in response to a case of falsified reports on large shareholdings being published on the EDINET system and (ii) the establishment of the Payment and Settlement System Enhancement Office(April 2008) for the purpose of studying on new payment services such as electronic money and promoting the efforts by the people concerned toward enhancing payment and settlement systems from forward-looking viewpoints.

3. Encouraging Voluntary Efforts by Financial Institutions and Placing Greater Emphasis on providing Incentives

- (1) The Financial Inspection Rating System has come into full effect (January 2008). This system was generally appreciated by financial institutions for its function of providing incentives for voluntary efforts.
- (2) In light of recent experiences in the subprime mortgage problem, some pointed out that earlier implementation of Basel II in Japan than most of other countries had contributed to the enhancement of risk management by financial institutions.

4. Improving the Transparency and Predictability of Regulatory Actions

- (1) The FSA has been continuing efforts to improve the transparency and predictability of regulatory actions within its framework of inspection and supervision. It has adopted and published supervisory guidelines and inspection manuals by business type, as well as reference materials such as “Administrative Action in the Financial Sector.”
- (2) The FSA has (i) adopted and published case collections (a collection of cases in which problems were pointed out by inspectors and a collection of cases in which administrative action was taken), (ii) conducted a review of the no-action letter

system with a view to improving convenience and (iii) continued to assemble a database of specific cases related to the interpretation and application of rules by compiling FAQs.

Moreover, it has (iv) compiled and published statistics related to the management of financial institutions and (v) enhanced consultations with the public (public comments were invited in English with regard to two items).

- (3) A questionnaire survey conducted on financial institutions and other entities found that nearly 80% of the respondents perceived “improvement” or “slight improvement” in the transparency and predictability of the FSA’s activities in general.

II. Five Areas of Immediate Focus

1. *Enhancing Dialogue with Financial Institutions and Other Relevant Parties*

- (1) The FSA has expanded the scope of regular forums for exchanges of views with business groups and other organizations. Regarding communication with foreign business organizations, it has started regular dialogue with the American Chamber of Commerce in Japan in addition to the existing dialogue with the International Bankers Association.
- (2) The FSA has increased opportunities for exchanging views with the managers of financial institutions about important tasks in the financial sector in general, priority issues for individual institutions, etc. In addition, the FSA has actively sought opportunities to meet with senior officials of foreign financial institutions and other organizations.

(Reference 1) Meetings with Senior Officials of Foreign Financial Institutions and Other Organizations (officials responsible for policy planning and those in higher posts)

	Program Year 2006		Program Year 2007
		From July 2006 to March 2007	(From July 2007 to March 2008)
Number of meetings with senior officials of foreign financial institutions and other organizations	135	100	113

- (3) A questionnaire survey conducted on financial institutions and other organizations found that nearly 60% of the respondents perceived “improvement” or “slight improvement” with regard to dialogue with the FSA. Regarding the type of dialogue, many respondents expressed hopes for the further enhancement of

working-level dialogue.

2. Enhancing Dissemination of Information

(1) The FSA has sought to disseminate information effectively through the active use of lectures, speeches, interviews with media organizations and contributions of articles to print media (e.g. a lecture given by Minister for Financial Services Yoshimi Watanabe in the Tsubame-Sanjo region regarding financing for small and medium-size enterprises). Dissemination of English-language information has also been enhanced.

(Reference 2) Lectures, Article Contributions, Interviews, etc. (from July 2007 to March 2008)

	Minister, Senior Vice Minister, Parliamentary Secretary		Commissioner		SESC Chairman, CPAAOB Chairman, etc.		Director-generals, deputy director-generals, etc.		Division/office chiefs, policy level officials	
	Lectures, speeches	Article contributions, publications	Lectures, speeches	Article contributions, publications	Lectures, speeches	Article contributions, publications	Lectures, speeches	Article contributions, publications	Lectures, speeches	Article contributions, publications
Total	10	5	11	5	21	3	54	5	78	44
Financial regulation in general	6	4	1	3	-	-	9	2	15	9
Better regulation	-	-	6	2	-	-	14	-	5	2
Strengthening of competitiveness of markets	6	-	4	-	-	-	9	1	11	16
Issues related to Financial Instruments and Exchange Act	2	-	2	-	-	-	7	1	10	11
Issues related to Revised money lending control act (including the multiple debt problem)	-	-	2	-	-	-	2	-	12	9
Corporate accounting/audits	2	-	2	1	12	1	1	1	3	9
Revision of the inspection manual	-	-	-	-	-	-	1	-	7	5
Subprime mortgage problem	3	-	5	1	-	-	5	1	2	4
Relationship banking/financing for SMEs	2	-	2	-	-	-	8	-	11	-
Basic policy for market surveillance	1	-	-	-	9	2	17	2	28	6
Others	3	1	1	-	-	-	5	-	7	2
Interviews, etc.	32		23		11		26		31	

(Note) Some of the above information dissemination activities covered several themes.

(Reference 3) Dissemination of Information in English

	Minister , Senior Vice Minister, Parliamentary Secretary	Commissioner	SESC Chairman, CPAAOB Chairman, etc.	Director-generals, deputy director-generals, etc.	Division/office chiefs, policy level officials
Lectures, speeches	-	5	1	14	7
Article contributions, publications	-	-	-	-	-
Interviews, etc.	3	3	-	-	1

(2) The FSA has also strived to ensure the timely dissemination of information through press releases. In order to directly explain the concept of financial regulation to regional companies and other entities, briefing sessions were held across the country (e.g. briefing sessions for small and medium-size enterprises (SMEs) using a pamphlet about the Financial Inspection Manual).

(3) The FSA website was revised (August and December 2007) in order to make it easier to understand and more systematic. English-language information regarding important policy measures has been published in a timely manner on the English version of the Web site, and an English-language e-mail service was started (January 2008).

(4) A questionnaire survey conducted on financial institutions and other organizations found that nearly 80% of the respondents perceived “improvement” or “slight improvement” in the FSA’s dissemination of information (more than 60% perceived “improvement” or “slight improvement” in the dissemination of English-language information).

Many respondents requested (i) enhancement of the website, (ii) enhancement of briefings and other similar sessions and (iii) provision of easier-to-understand information.

3. Strengthening Cooperation with Foreign Authorities

(1) The FSA contributed to international debate on the subprime mortgage problem at the World Economic Forum (Davos Meeting), the Financial Stability Forum, the International Organization of Securities Commissions (IOSCO), etc. It also participated in international conferences such as meetings of the Basel Committee on Banking

Supervision, playing leading roles in some conferences. Moreover, it became a signatory to the Multilateral MOU (Memorandum of Understanding; February 2008), which is the IOSCO's multilateral framework for facilitating information exchanges between regulators.

(2) The IOSCO Tokyo Conference was held under the sponsorship of the FSA (November 2007). The conference drew more than 400 participants from 46 countries and regions as well as from five international organizations.

(3) The FSA expanded the number of foreign supervisory authorities with which it holds regular consultations (the authorities of Malaysia and China became regular consultation partners in September 2007 and January 2008, respectively). In addition, the number of countries with which the FSA has a framework for cooperation in supervision was expanded (China and Dubai were included in February 2008 and November 2007, respectively). Meetings with foreign authorities were actively pursued. For example, Minister for Financial Services Yoshimi Watanabe visited China in February 2008 for meetings with Chinese authorities.

(Reference 4) Meetings with Officials of Foreign Authorities, etc. (officials responsible for policy planning and those in higher posts) and Participation in Multilateral Conferences

	Program year		Program year 2007 (from July 2007 to March 2008)
	2006	From July 2006 to March 2007	
Number of meetings with officials of foreign authorities, etc.	116	82	110
Number of multilateral conferences attended	58	43	67
Number of bilateral conferences held	19	14	19

4. Enhancing Research Functions for prompt recognition of Market Developments

The FSA established the Market Analysis Office (February 2008) in order to collect and analyze information on an ongoing basis in light of the growing impact of global economic and market developments on Japan's financial system. Information

collected by the office is shared across individual divisions of the FSA in order to discuss and identify risks involved in the financial system and is used in the inspection and supervisory processes.

5. Redoubling Efforts for Human Resource Development

(1) A questionnaire survey concerning career paths was conducted (January 2008) in order to make personnel transfers with due consideration of individual FSA employees' expert knowledge and skills in their areas of expertise (e.g. risk management, compliance, information systems, accounting standards and financial engineering). This approach will apply to personnel transfers made in and after the program year starting in July 2008.

(2) The FSA sought to enhance employees' expert knowledge and skills by providing theoretical training and sending them to study at graduate schools in and outside Japan and to learn practical affairs at diplomatic establishments overseas.

(3) The FSA actively recruited lawyers, certified public accountants and other people with business experience at private sector companies and accepted them for a limited term as part of a program of personnel exchanges with the private sector, under a law promoting such exchanges.

III. Future Tasks

(1) The result of the questionnaire survey indicates that reasonable progress has been made in the initiative to achieve better regulation.

(2) The followings are the tasks that the FSA needs to tackle:

- (i) To make all employees fully acquainted with the concept of better regulation.
- (ii) To enhance working-level dialogue and to provide more opportunities for exchanges of views in a free atmosphere.
- (iii) To expand opportunities for disseminating information by increasing the frequency of briefings and making the FSA website more user-friendly.