

(Provisional translation)  
September 5, 2008  
Financial Services Agency

## **Annual Supervisory Policies for Major Banks for Program Year 2008**

The Financial Services Agency (FSA) publishes its Annual Supervisory Policies for Major Banks<sup>1</sup> for each program year so as to clarify its supervisory priorities. This is prescribed in the “Comprehensive Guidelines for Supervision of Major Banks” which show basic approaches for the supervisory process aimed at major banks.

At the time of establishing the Annual Supervisory Policies for Major Banks for Program Year 2008, global financial markets remain tense, triggered by the subprime mortgage problem. Furthermore, the economy is weakening, and is exposed to further downside risks depending on movements in crude oil prices and other such factors.<sup>2</sup>

In such an environment, major banks are further expected to fully perform their financial function including smooth finance, and help improve security and convenience for users such as depositors and borrowers. In order to fully perform their financial function, it is important for the banks to maintain their own financial soundness at the same time, and it is necessary for them to conduct high-quality risk management. It is also important to develop a business environment that vitalizes the banking industry and promotes competition, while encouraging the banks to make positive use of it, in order to ensure that they highly perform their financial function.

### **1. Financial Function and Security/Convenience for Users**

Finance has much to contribute to supporting national life and economic activities. In the current economic situation, it is important that major banks perform their financial function properly and help improve security and convenience for users by making voluntary efforts based on the banks’ innovative ideas.

---

<sup>1</sup> In this document, the term “major banks” refers to so-called major banks as well as Shinsei Bank, Aozora Bank, Citibank, and Japan Post Bank.

<sup>2</sup> Cabinet Office (August 7, 2008): “Monthly Economic Report” (<http://www5.cao.go.jp/keizai3/getsurei.html>)

### ***Smooth finance***

The Japanese economy is weakening and there is the risk that movements in crude oil prices and other such factors will drag it down further. Borrower companies including small- and medium-sized enterprises (SMEs) face a severe situation, so the financial intermediary functions of financial institutions have become extremely important. It is important that major banks also conduct risk-taking and risk management carefully, in a manner suited to the actual conditions and characteristics of borrower companies, so that the banks' smooth provision of funds for the companies including SMEs and the maintenance of the soundness of the banks' own financial positions may work in a virtuous cycle.

In this program year, the FSA will precisely understand the financing trends of major banks and the situation of borrower companies, and reflect the findings in its supervisory activities.

The FSA will also encourage major banks to carefully examine loan applications based on the actual business conditions and characteristics of borrower companies, and fully explain their decisions to customers (e.g., in reviewing financing products (such as business loans, etc.), a bank is expected to reflect the customer's needs in the review and expend all possible efforts for appropriate handling of the customer associated with such a review).

### ***Meeting asset management needs***

Given the declining birthrate and aging population, it is necessary to promote a shift from savings to investment in order to ensure sustainable growth of Japanese economy. Bearing this point in mind, the FSA will verify whether major banks are explaining the risks accurately when selling investment trusts and on other such occasions, without imposing an excessive burden on customers in terms of time and procedures, so that the banks are dealing with them adequately and appropriately.<sup>3</sup>

### ***Business continuity***

Considering that major banks play a key role in the settlement system, the FSA will confirm whether they are properly conducting risk management when integrating and revising systems and in other occasions of daily system operations.<sup>4</sup> The agency will also confirm their business continuity management in the event of earthquakes, pandemic influenza, etc. Furthermore, the FSA will confirm the banks' preparedness for smooth shift to a paperless stock certificate system scheduled

---

<sup>3</sup> FSA (February 21, 2008): "Our Answers to Your Questions about the Financial Instruments and Exchange Act" (<http://www.fsa.go.jp/policy/br/20080221.html>)

<sup>4</sup> FSA (June 3, 2008): "Regarding System Risk Control at Financial Institutions" (Supervisory Bureau No. 1515) (<http://www.fsa.go.jp/common/conference/minister/2008a/20080603.html>)

for January 2009.

### ***Preventing abuse of financial functions***

In order to ensure security for users, the FSA will verify, based on the following perspectives, whether the major banks' management systems have been developed to prevent financial functions from being abused and to deal with victims properly. In doing so, the FSA will check the management systems to properly confirm customers' identity and to detect transactions that are strongly suspected of being illegal and make appropriate responses (e.g., freezing of bank accounts).

- (1) Does a bank make efforts to eliminate the furikome fraud (e.g., alerting customers of the fraud around ATMs)? Does a bank deal with victims properly and promptly in accordance with the *Furikome* Fraud Relief Act<sup>5</sup>?
- (2) Does a bank make efforts to prevent unauthorized withdrawals from bank account by using counterfeit/stolen cash cards, stolen passbooks, and Internet banking? Does a bank pay compensation to victims properly according to the Depositor Protection Act and agreements within the industry?
- (3) Does a bank take actions to prevent money laundering and terrorist financing in domestic and overseas branches, to the extent that it meets international requirements for major banks?
- (4) To prevent damage inflicted by antisocial groups, does a bank make efforts according to the Comprehensive Guidelines for Supervision of Major Banks amended in March 2008 in consideration of the guidelines to protect private enterprises from antisocial groups (agreement of secretarial meeting of Ministerial Meeting Concerning Measures Against Crime)?

## **2. Risk Management and Financial System Stabilization**

Amid the turmoil in the financial and capital markets triggered by the subprime mortgage problem, the financial system in Japan has been relatively stable as compared with those in the U.S. and Europe. However, as tension remains in the global financial markets, it is necessary for the FSA to carefully monitor the markets and the impact on Japan's financial system with a high level of vigilance. Also, the economy is weakening, and is exposed to further downside risks depending on movements in crude oil prices and other such factors. As far as the business performance of major banks is concerned, credit-related expenses are on the increase.

In the midst of such changes in the economic and market environment both at home and abroad, in order for major banks to continue performing their financial intermediary functions

---

<sup>5</sup> Act on Payments, etc., of Distribution as Relief for the Damage related to Funds in Deposit Accounts, etc., Used for Criminal Activities.

properly, they need to conduct high-quality risk management under proper corporate governance; this, in turn, will help stabilize the financial system. The FSA will encourage the banks to make voluntary efforts by giving consideration to the following:

- The FSA has amended the Guidelines for Supervision effective August 6, 2008 to incorporate the lessons on risk management learnt from domestic and foreign financial institutions' experience of the subprime mortgage problem, including risk management related to securitized products, etc. The agency will verify whether such lessons (e.g., the need for proactive efforts by the management) are reflected in risk management at the practical level in major banks, and will also verify whether the banks are managing risks associated with new forms of credit, such as non-recourse loans, in accordance with their product characteristics.
- Bearing in mind that profits play an important role in preparing against risks, the FSA will identify what kind of strategies are being built and executed by major banks to enhance their profit base both at home and abroad. The FSA will also identify their efforts to improve the quality of their capital, which is the foundation for proactive risk-taking.
- Taking international best practices into consideration, the FSA will encourage major banks to make efforts to ensure market confidence by disclosing necessary and sufficient information about risks.
- The FSA will also encourage major banks to actively participate in international forums, and gather and distribute information.

### **3. Better Market Initiative – Business Environment that Vitalizes the Financial Services Industry and Promotes Competition**

The Better Market Initiative (*Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets*<sup>6</sup>) announced by the FSA in December 2007 proposed various measures to vitalize the financial services industry and promote competition in Japan's markets in order to make the markets more attractive to both domestic and foreign customers, as well as to contribute to overseas operations of major banks. As part of the efforts based on the Initiative, the FSA will strive to develop a business environment that will vitalize the banking industry and promote competition, in the course of supervising major banks.

#### ***Broadening the scope of businesses permitted to banking groups***

The FSA will make preparations to facilitate broadening the scope of businesses permitted to banking groups as well as revising the firewall regulations and other initiatives. The agency will also

---

<sup>6</sup> <http://www.fsa.go.jp/policy/bmi/index.html>

endeavor to implement such measures as per their intended purposes, while heeding their applicability to the overseas activities of major banks and activities of foreign financial institutions operating in Japan.

#### ***Enhancing dialogues with domestic and foreign financial institutions***

The FSA will identify issues in making Japan's markets more attractive by engaging in dialogues with both domestic and foreign financial institutions. The agency will also strive to improve the transparency and predictability of its financial administration by engaging in dialogues at various levels.

#### **4. Materializing “Better Regulation”**

Improving the quality of financial regulation is important in order to make Japan's financial markets more competitive. Also, financial regulation should place a greater emphasis on voluntary efforts and innovative ideas by financial firms, in light of the current phase of Japan's financial sector where it should continue and further refine its efforts to stabilize the financial system, protect users, and establish and maintain fair and transparent financial markets.

Under these circumstances, the FSA will continue to be engaged in the efforts to solve supervisory issues in program year 2008 based on “better regulation” which centers on the following four pillars. The agency will have all its supervisory staff appreciate the concept and materialize it by the following efforts.

#### ***Optimal combination of rules-based and principles-based supervisory approaches***

The FSA will utilize “The Principles in the Financial Services Industry,”<sup>7</sup> compiled in April 2008, in its financial administration, and interpret and implement the rules as they were originally intended.

#### ***Timely recognition of priority issues and effective response***

The newly-established Office for Market Analysis and Office for Supervisory Policy, Financial Market and Risk Analysis will gather and analyze information on market trends and risks related to the financial system, and promptly reflect such information in supervising major banks. The FSA will also perform effective supervision by encouraging to cooperate more closely among supervisory divisions, inspection divisions, and the Securities and Exchange Surveillance Commission. Furthermore, the FSA will strive to collaborate closely with foreign supervisors

---

<sup>7</sup> <http://www.fsa.go.jp/news/19/20080418-2.html>

through Senior Supervisors Group<sup>8</sup>, supervisory colleges, bilateral meetings, and daily communications, and to recognize priority international issues and respond to them effectively, in a manner consistent with the international community.

***Encouraging voluntary efforts by financial firms and placing greater emphasis on providing them with incentives***

In order to share the same recognition about rectifying problems with major banks, the FSA will endeavor to analyze and unravel the causes extensively through two-way dialogues. The agency will utilize Basel II which places emphasis on providing the banks with incentives, and also place importance on Pillars II and III.

***Improving the transparency and predictability of regulatory actions***

The FSA will strive to improve the transparency and predictability of its regulatory actions by enriching dialogues with major banks and distributing more information to them. The agency will also properly provide feedback on the results of its fact-finding to the banks.

For the purpose of enhancing the effectiveness of such efforts, the FSA will endeavor to improve the skills of its staff by such means as cultivating and hiring experts, and enhancing training programs.

---

<sup>8</sup> The FSA became the member of the Group in May 2008.