



***Highlights of the  
Financial Monitoring Policy  
for 2014-2015***

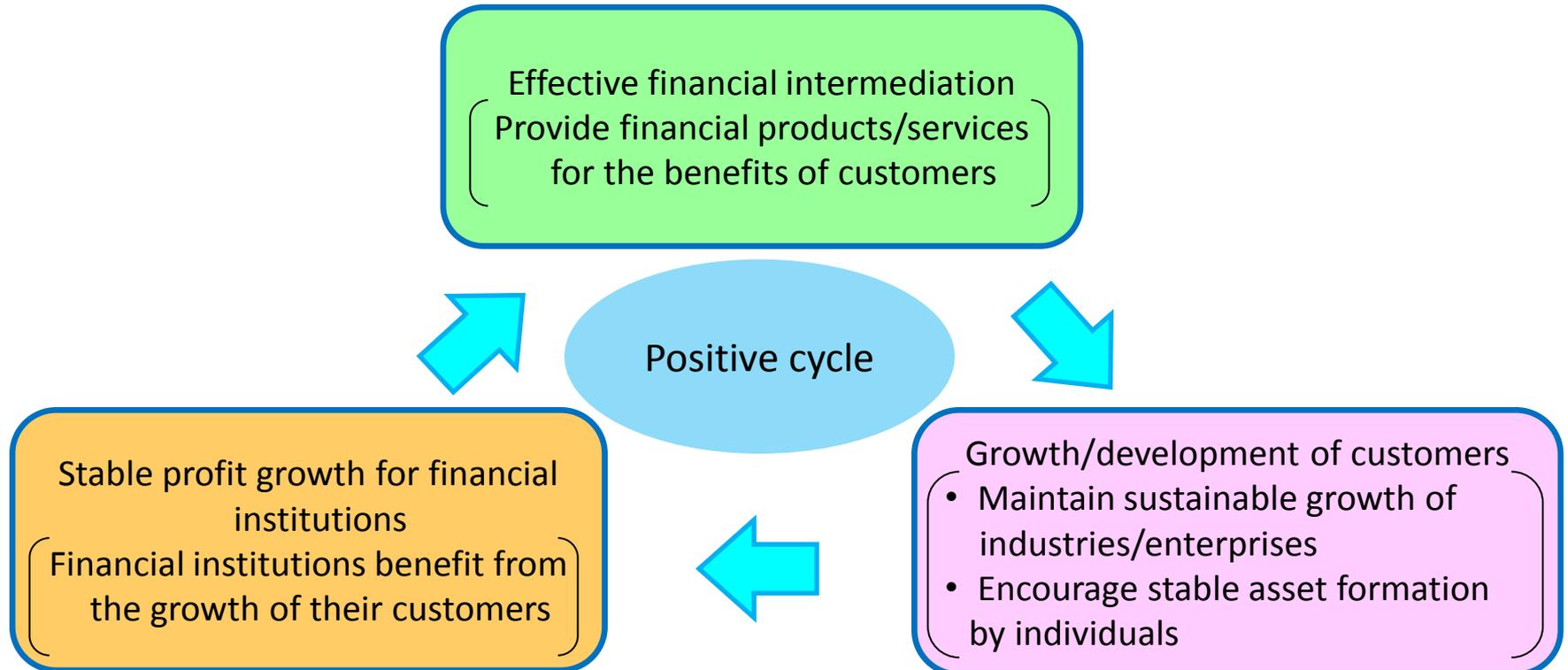
**September 2014**

**Financial Services Agency**

**Japan**

# I Basic concept of supervision and inspection

Overcome deflation and build a positive economic cycle



Maintain safety and soundness of the financial system and financial institutions as precondition for effective financial intermediation

## II Focus of monitoring (1)

### 1. Effective response to the needs of customers

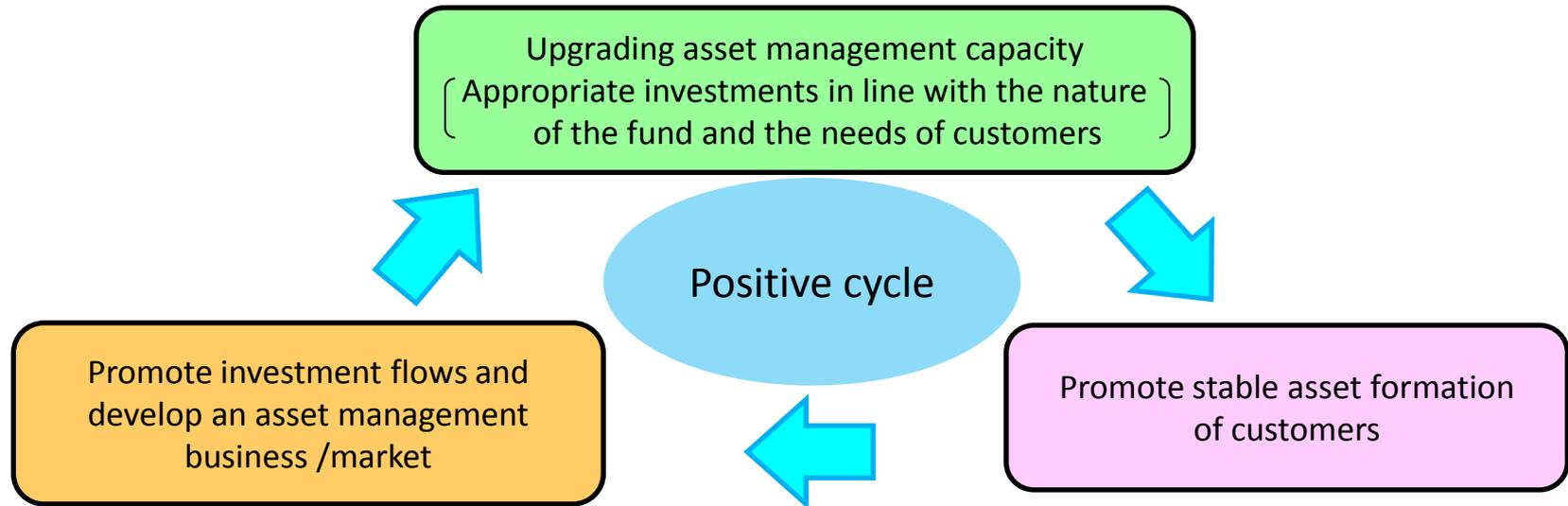
- J-FSA will review whether financial institutions, under their customer-oriented policy, are providing financial products/services that are really beneficial for their customers.
  - (i.e.) ▪ Is there any abuse of a dominant position of institutions or conflicts of interests between institutions and customers?
    - Are there any miss-selling of financial products/services due to inappropriate incentives regarding commissions and business relations?

### 2. Lendings based on customers' business potentials

- Under the globalization of Japanese enterprises and the decreasing Japanese population, the followings are essential for the growth of the Japanese economy:
  - maintain and enhance global competitiveness of Japanese industries/enterprises; and
  - promote employment and wages of local industries/enterprises through improving efficiency and productivity under the current labor shortage.
- J-FSA will review whether financial institutions provide credits and other services based on appropriate appraisal of their customers' business potentials, without depending excessively on customers' financial data and guarantees.

## II Focus of monitoring (2)

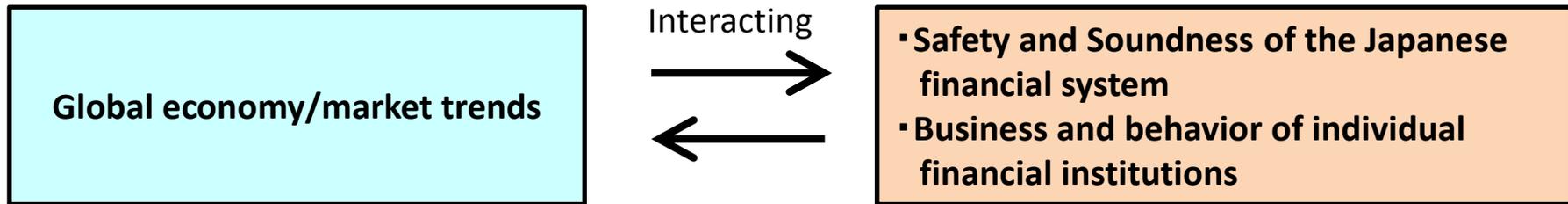
### 3. Upgrading asset management capacity



- Financial institutions which are engaged in each process of asset management, including product origination, sales, and portfolio management, need to fulfill their roles and responsibilities (i.e. fiduciary duty).
- J-FSA will review financial institutions' policy, products/services provided, and incentive mechanism for asset management business.
- J-FSA will review the effectiveness of internal control and risk management for proprietary investment by financial institutions in relation to the size and nature of the invested funds.

## II Focus of monitoring (3)

### 4. Macro prudence



J-FSA will make an analysis of the following issues with a forward-looking perspective and review the risk management framework of financial institutions based on its result.

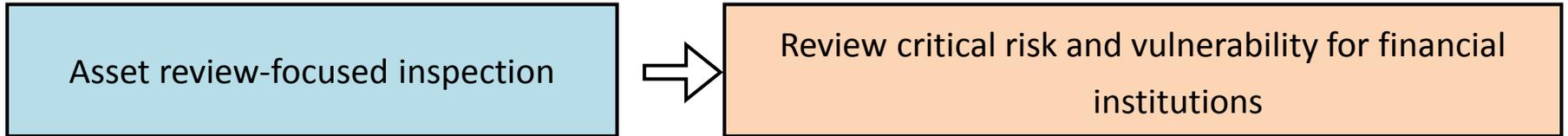
- 1) Impact of the global economy and market trends towards the safety and soundness of the Japanese financial system and financial institutions
- 2) Impact of the business and behavior of financial institutions towards the Japanese economy and markets

(i.e.) ▪ Change in globally expanding credit market

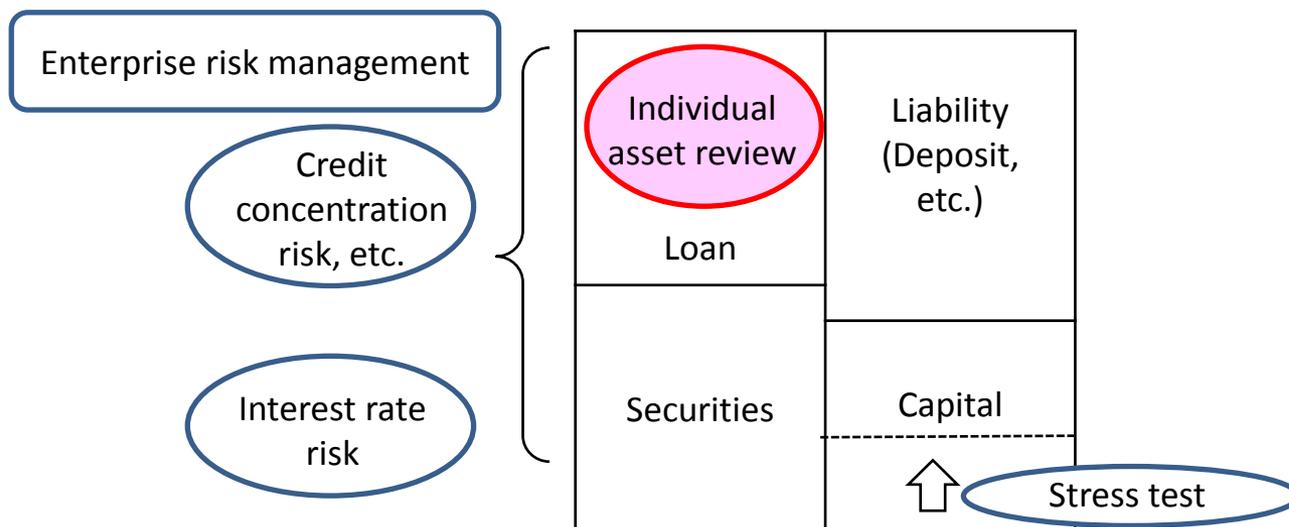
- Change of interest rates and other asset prices in response to overcoming deflation in Japan

## II Focus of monitoring (4)

### 5. Enterprise risk management (ERM)



- J-FSA will review effectiveness of ERM of each financial institution, including interest rate risk, credit concentration risk, as well as deployed stress tests.
- In individual loan and other assets review, J-FSA will respect, in principle, the decision of each financial institution except large-lot credits with potential impact to its safety and soundness, as long as J-FSA deems its ERM and stress test effective.



## II Focus of monitoring (5)

### **6. Sustainability of business model and corporate governance**

- An unsustainable business model might become significant threats to the safety and soundness of financial institutions.
  - J-FSA will discuss with each financial institution the sustainability of its business model under the currently changing business environments including decreasing population.
  - J-FSA will review effectiveness of governance frameworks of financial institution in relation to sustainability of its business model, including the functions of Board of Directors (with outside/independent directors) as well as Audit Committee.

### **7. Ensuring customers' trust/security**

- J-FSA will review effectiveness of internal controls at each financial institution to address information security, abuse of internet banking, cyber attacks, business continuity plan, AML/CFT as well as other issues for the security of customers.

## II Focus of monitoring (6)

### **8. Accelerate recovery from the Great East Japan Earthquake**

- As the recovery has advanced, it is important for financial institutions to support the development of industries/enterprises with significant roles in the regions as well as community development in the new environment.
- J-FSA will urge financial institutions to support the above recovery and continue to address the double loan problem of the disaster-affected people .

### **9. Public finance and private finance**

- J-FSA will develop better understanding of the competing and complementary relations between public and private finance through discussions with financial institutions and their customers, to be followed by discussions with relevant stakeholders on how better relation between public and private financial systems could be established.

## III Concrete measures for monitoring

### **1. Integrate on-site and off-site monitoring process**

- Under the common policy, both Supervisory Department and Inspection Department will work together in close cooperation and mitigate the burden for financial institutions.

### **2. Enhance constructive dialogues between FSA and financial sector**

- J-FSA will continue constructive and interactive dialogues with financial institutions about best practice. J-FSA will encourage sound competition among them towards better operations and services for their customers, as well as more innovative initiatives.

### **3. Enhanced international cooperation**

- With further globalization of businesses of financial institutions and financial transactions, J-FSA will:
  - participate more actively in the discussions of international financial regulation;
  - make its supervision more effective and efficient through enhanced cooperation with foreign authorities; and
  - continue to upgrade its supervisory approaches with reference to those by other regulators.

### **4. Enhance dialogues with stakeholders and collection of information**

- J-FSA will exchange views with and collect information from stakeholders of financial institutions (shareholders, customers, outside directors, staffs, self-regulating organizations, communities, etc.)

## IV Supervision and inspection for major banks

### **1. Provide finance to promote industrial renovation and economic growth**

- Make use of a wide range of business networks, global expertise as well as capacity for sophisticated services as major banks, they are expected to
  - provide their competent services including support for overseas business as well as project finance; and
  - support small and medium sized enterprises by providing solutions in response to the challenges which they are facing .

### **2. Provide services in line with the needs of customers and ensure customers' trust/security**

- Promote real benefits for customers by providing services/products that match their needs.
  - Develop internal controls to manage conflicts of interests and prevent abuse of a dominant position, in response to increased joint business promotions across banks, trust banks, and securities companies.
- Develop a security environment where customers can utilize financial services safely.

### **3. Forward looking and proactive risk management**

- Proactive risk management in response to changes of the nature, scope and size of business, as well as recognized interactions between economic and market developments.
- Address adequately international regulatory and supervisory changes.

### **4. Develop robust governance with international levels**

- More diversified and competence-oriented human resources development and allocation, effectiveness of Board of Directors, including roles of outside and independent directors

# V Supervision and inspection for regional financial institutions

## **1. Effective financial intermediation to support growth of regional economy/industries and renovation**

- Provide solutions based on appropriate assessment of business contents/growth potentials of customers at various life stages.
- Provide finance based on evaluation of customers business potentials and enhance support to improve their management and productivity, including proactive use of Regional Economy Vitalization Corporation of Japan.
- Especially, regional banks that are expected to play an essential role in the regional financial market would take initiatives for stimulation of the regional economy.

## **2. Provide services to meet the needs of customers, ensure customers' trust/security**

- Provide services that are real benefits for customers, and develop a security environment where customers utilize financial services safely.

## **3. Develop sustainable business model on a medium and long term basis**

- Under the anticipated conditions including decreasing population, regional financial institutions need to develop a business model which is sustainable for the medium to long-term (5-10 years).

## **4. Safety and soundness**

- Develop governance which could appropriately address changes of business environments
- Enhance risk management as well as financial (B/S and P/L) management frameworks, and more robust financial foundations.

# VI Supervision and inspection for insurance companies

## **1. Fulfill guarantee/compensation function appropriately**

- Appropriate payment of insurance benefit is the most important responsibility of insurance companies. An insurance payment management framework should be developed accordingly considering the characteristics of beneficiaries including their ages.

## **2. Improve customer protection and convenience for users**

- Develop an effective internal control to provide an easy-to understand explanation to customers in line with their needs, knowledge and experience; in particular, careful attention to elderly customers.

## **3. Upgrade risk management**

- Develop an enterprise risk management (ERM) framework, given more diversified and complex risks surrounding insurance companies.

## **4. Enhance governance**

- Effectiveness of Board of Directors and other governance functions
- Develop management and governance frameworks in response to the business expansion overseas .

# VII Supervision for financial instruments business operators, etc.

## **1. Effective response to the needs of customers (Upgrading asset management capacity)**

- Both investment companies and sales companies should provide products that really meet the needs of or bring benefits for customers.
  - Investment companies: improve investment capacity and appropriately ensure independence of their business from affiliated sales companies.
  - Sales companies: sufficiently explain risks of products and costs like sales commission fee, etc. to customers as well as ensure transparency of the product itself.
- Address the need to improve financial literacy of investors, taking into account the meaning of adoption of the “Nippon Individual Saving Account” (NISA).

## **2. Fulfill the functions towards providing funds for growth**

- Actively fulfill the financial intermediary functions as direct finance, such as appropriate support for development of enterprises and their funding.

## **3. Ensure customers' trust/security**

- Protect users/legal compliance for ensuring customer trust/security and market fairness/transparency.

## **4. Enhance governance and risk management**

- Enhance governance and risk management frameworks of large-scale securities companies groups, etc., taking into account the economic/financial situation and trends of international financial regulation.