



Summary Points from

For providing better financial services in the era of transition

Financial Services Policy: Assessments and Strategic Priorities 2018

Financial Services Agency
September 2018

Contents

For providing better financial services in the era of transition

- I. Responding to the accelerating digitalization - “Finance Digitalization Strategy” -
- II. Promoting long-term personal asset building
- III. Promoting active capital market and securing market integrity and transparency
- IV. Securing effective financial intermediation and financial stability
 - The roles and responsibilities of management and governance -
- V. Ensuring customer confidence - challenges in conduct and compliance -
- VI. Contributing to global policy discussion and building global network
- VII. Reforming the JFSA

Changes surrounding finance

- Accelerating digitalization
- Declining population and aging
- Prolonged low-interest rate environment

The JFSA, as “Finance Nurturing Agency”, achieves better financial services with the seven initiatives;

The JFSA's mission

Enhancing people's welfare
through long-term personal asset building and sustainable growth of corporations and economy

1. Responding to the accelerating digitalization - “Finance Digitalization Strategy” -
2. Promoting long-term personal asset building
3. Promoting active capital market and securing market integrity and transparency
4. Securing effective financial intermediation and financial stability - The roles and responsibilities of management and governance -
5. Ensuring customer confidence - challenges in conduct and compliance -
6. Contributing to global policy discussion and building global network
7. Reforming the JFSA

In the program year 2018, with the aim of making its PDCA cycle more coherent, the JFSA prepared this document as an integrated report by combining its former reports, “Strategic Directions and Priorities” and “Progress and Assessment of the Strategic Directions and Priorities.”

I. Responding to the accelerating digitalization(1)

- Finance Digitalization Strategy -

- **Digitalization has been accelerating in every corner of our lives with all sorts of “goods and events” being digitalized in daily lives and digital technology adopted in businesses of all sectors as well as public administration.**

- **New players are entering into the financial sector** where they single out certain financial services such as payment (i.e., unbundling) and partially combine them with other business operations such as e-commerce services (i.e., re-bundling) .
- **Data accumulation and analysis**, significantly larger in size and more robust in substance, **will advance the use and application of information**.
→ This could bring drastic changes in the existing business.

Business environment needs to be improved to encourage new players to bring innovation.
Existing financial institutions (FIs) are also required to improve user convenience through changes in their business models by collaborating and competing with new players.

【11 measures of Finance Digitalization Strategy by the JFSA】

For an easier use and application of information

1. Accumulation and utilization of information

To improve environment for various players to properly utilize information; (1) improve the environment for information sharing (promotion of sophisticated financial payments and open APIs), (2) consider regulatory aspects (function-based, cross-sectoral financial regulations), and (3) organize dialogues with FIs on strategic IT utilization as well as IT governance.

2. Customer protection in terms of privacy and anonymity, credibility of customer data, and others

Besides promoting digitalization in terms of customer identification, (1) ensure anonymity of customers in the use and application of their information; (2) protect personal data including ensuring the credibility of customer data; and (3) promote initiatives toward customer protection with new technologies such as blockchain technology.

3. Information/financial literacy to make use of digitalization

Promote improvement of information/financial literacy in society to see what kind of financial services are available to customers, and how their personal information is utilized and applied in FIs' solicitation of financial/non-financial products and services.

I. Responding to the accelerating digitalization(2)

- Finance Digitalization Strategy -

Digitalization of
public and private
infrastructures

Support for new
business
challenges

Improvement of various
infrastructures
toward digitalization

4. Digitalizing financial infrastructure that enables the transmission of financial/non-financial information

With the aim of enhancing user convenience and corporate productivity, as well as developing infrastructure toward the realization of cashless system, (1) **sophisticate corporate finance and payment processes** and (2) **utilize blockchain technologies in securities industry**.

5. Digitalization of financial administrative services

- (1) Consider **the future establishment of RegTech eco system** that enables: a) financial institutions to decrease system expenditures and b) the authority to grasp the actual state of financial institutions (FIs) in a timely manner, and
- (2) Offer disclosure information via open API of EDINET.

6. Promotion of various innovative challenges via sandbox platforms, etc.

- (1) Establish **“FinTech Innovation Hub”** and meet with 100 FIs and new players to understand trends regarding FinTech, and
- (2) Encourage companies to use **sandbox tools such as FinTech PoC Hub and FinTech Support Desk**.

7. Promotion of innovation via open architectures

Encourage collaborations between existing FIs and FinTech startups by **promoting Open API**

8. Global authority networks

- (1) **Establish framework for cooperation with foreign authorities on FinTech**,
- (2) Organize **“FinTech Summit”**, and
- (3) **Consider multilateral responses in the area of crypto-assets**

9. Promotion of blockchain, AI, and big data technologies that serve as the infrastructure for digitalization

- (1) **Undertake multinational joint research projects** regarding practical application and issues of blockchain technologies, and
- (2) **Hold meetings at “FinTech Innovation Hub” to understand trends of underlying technologies**.

10. Response to the issues concerning cyber security and other challenges in the financial system

- (1) **Encourage FIs to consider new and effective measures to mitigate and manage cyber-risks**,
- (2) Promote international cooperation regarding cyber security, and
- (3) **Consider measures to address new risks for the financial system associated with the development of digitalization**.

11. Function-based, cross-sectoral financial regulations to attain the aforementioned issues/challenges

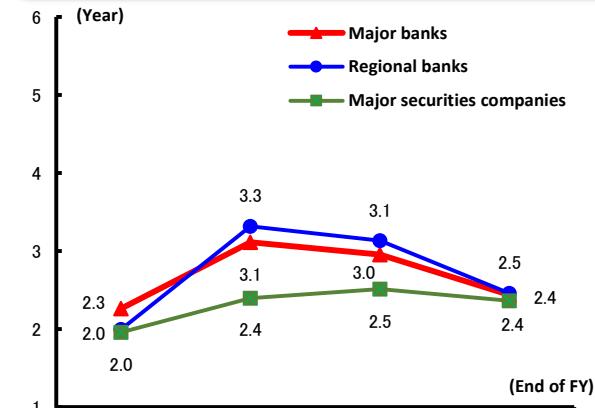
Consider to transform the regulatory framework into a more function-based and cross-sectoral one while taking into consideration recent developments in technological innovation such as FinTech and the of trends of financial services.

II . Promoting long-term personal asset building(1)

Encouraging customer-oriented business conduct

- The average holding period for investment trusts has shortened. This suggests investment trust distributors tend to approach customers based on push strategy in order to meet quarterly profit targets.

Average holding period for investment trusts



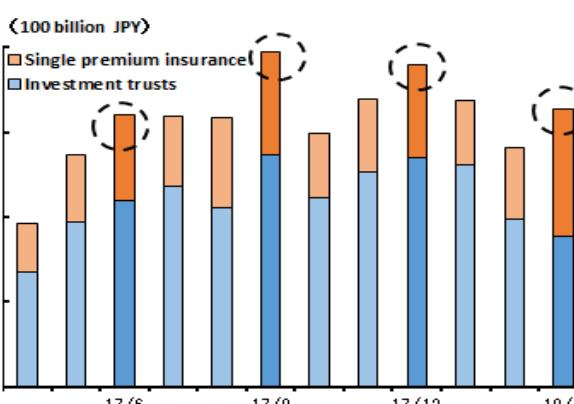
(Note1) 9 major Banks, 20 regional Banks and 7major securities companies

(Note2) Figures include intermediary sales

(Note3) Average holding period = (balance of the previous year + balance of the current year)/2 / (termination +redemption per year)

(Source) JFSA

Monthly sales trends of risk-involving products

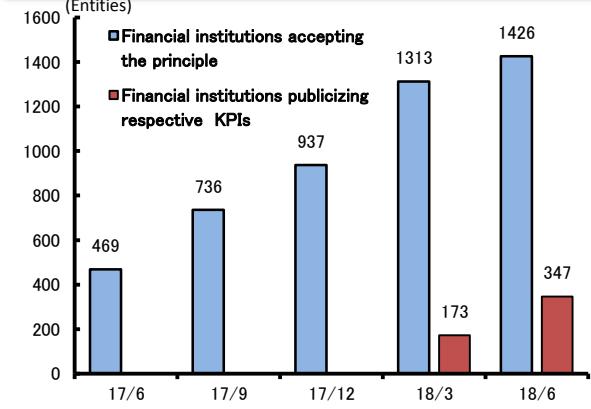


(Note1) 9 major banks and 20 regional banks

(Note2) Sales figure is the total of single premium insurance and investment trusts from April 2017 to March 2018

(Source) JFSA

Financial institutions accepting the “Principles for Customer-Oriented Business Conduct” and publicizing their respective approaches and KPIs



(Note) “Financial institutions publicizing their respective KPIs” is institutions developing their respective directions and approaches publicizing KPIs which show status of implementation

(Source) JFSA

- Visualization of Financial institutions(FIs)’ business activities matters in order to encourage all the FIs in the investment chain (i.e., sales, advisory, product development, asset management) to run their businesses in a customer-oriented manner. To this end, the JFSA will:

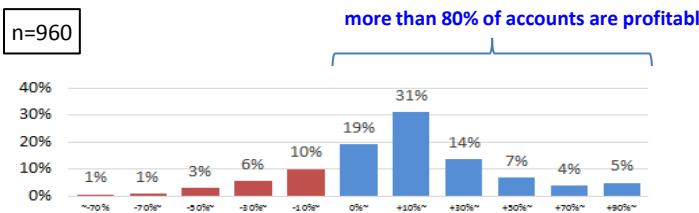
- Focus on the analysis and review of how FIs incorporate the idea of the “Principles for Customer-Oriented Business Conduct” in their corporate philosophies, develop their business strategies, and apply the principles in everyday business operations;
- Analyze and ensure the actual status of implementation through customer questionnaires on whether FIs’ efforts are fully understood and considered in the selection of FIs by customers; and
- Spread and penetrate the common KPIs comparable across investment trust distributors, and further promote “visualization” of the features of financial products, including savings-type insurance as well as investment trusts.

II. Promoting long-term personal asset building(2)

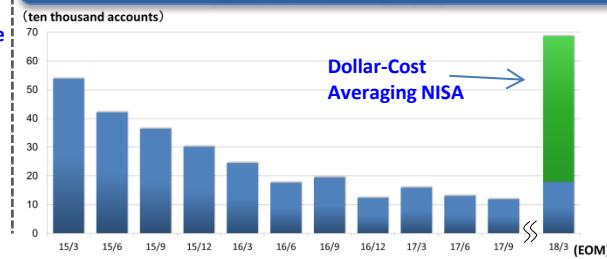
(b) Realizing long-term, installment and diversified personal investment

- Dollar-Cost Averaging NISA introduced in January 2018 has contributed younger generations (mainly 20s~40s) to investment. To further promote the new NISA system, the JFSA will:
 - Consider further measures to promote long-term personal asset building referring to ISA in the UK and in cooperation with other ministries; and
 - Drastically expand the number of school visits to enhance financial literacy while improving the content of the lecture and teaching materials.

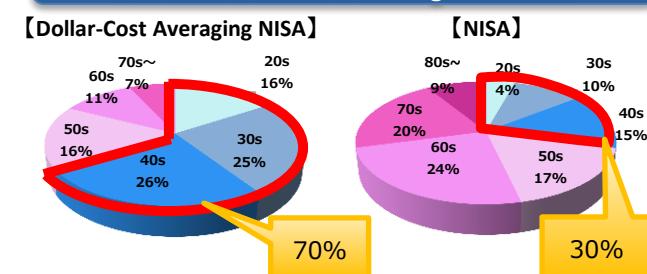
Profit and loss of NISA accounts (activated in FY2014)
(End of March 2018)



NISA and Dollar-Cost Averaging NISA accounts
(End of March 2018)



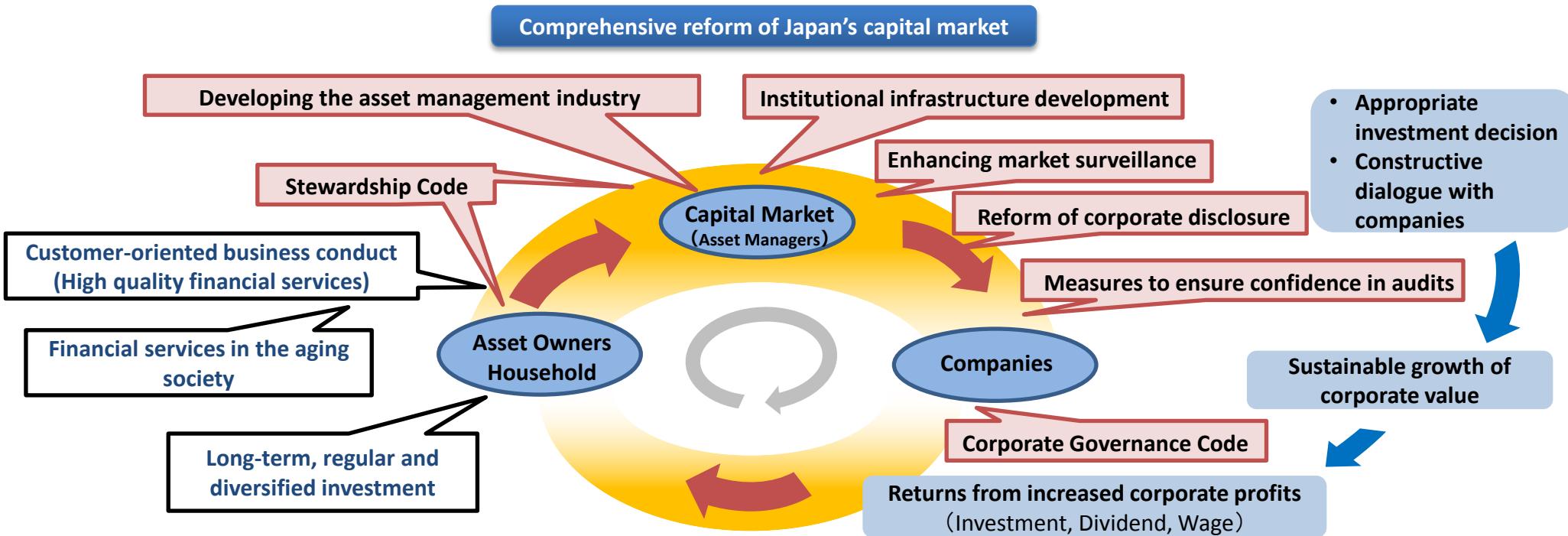
NISA and Dollar-Cost Averaging NISA accounts
(The data in terms of some generations)



(c) Developing financial services in the aging society

- Taking the progression of the aging society into consideration, the Working Group on Financial Markets under the Financial System Council will discuss and deliberate how to develop financial services in the aging society and compile a code of conduct for the financial industry and customers considering the following four issues.
- a. The promotion of financial services and products suitable to respective life stages and situations of customers
- b. Visualizing post-retirement income and expenditure and the features of financial products and services appropriate to the conditions of various users
- c. Financial services for smooth inheritance of personal assets and business operations
- d. Investor protection in light of financial gerontology

III. Promoting active capital market and securing market integrity and transparency (1)



(a) Promoting further corporate governance reform

- Corporate governance reform has progressed, with the two established codes: the Stewardship Code in February 2014 (revised in May 2017) and the Corporate Governance Code in June 2015 (revised in June 2018).

To further promote the reform, the JFSA will:

- Review **the reduction of cross-shareholdings, diversity of boards, disclosure of proxy voting results by individual company and agenda basis** at "The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code"; and
- **Announce best practices of effective dialogues between companies and investors** as well as initiatives taken by companies.

III. Promoting active capital market and securing market integrity and transparency(2)

(b) Developing the asset management industry

- Development of the asset management industry is important to vitalize capital market and build long-term personal assets.
- The JFSA will consider approaches toward activation and development of the asset management industry including **enhancing operational infrastructures, facilitating smooth entrance of new players, and training/recruiting asset managers for investment management.**

(c) Reforming corporate disclosure and audits

- To enhance companies' disclosure of non-financial information including the disclosure of business strategies and corporate governance information (e.g. **cross-shareholdings, officers' remuneration**), the JFSA will:
 - Develop **a principles-based guidance** in addition to **amending the applicable Cabinet Office Orders**; and
 - Collect and announce best practices across companies.
- To ensure effectiveness and confidence in audits through reinforcing management of audit firms and enhancing provision of information regarding audit, the JFSA will
 - Examine **how auditors should provide more detailed information to the capital markets in exceptional cases where their auditing opinions are different from those generally observed.**

III. Promoting active capital market and securing market integrity and transparency(3)

(d) Developing institutional infrastructure for financial and capital markets

- To make financial and capital markets more efficient and attractive, the JFSA will:
 - Study issues and measures to **develop deep credit markets, including corporate bond markets, with a diversity of participants**; and
 - Strengthen its outreach efforts to stakeholders and lead discussions for **an early establishment of the comprehensive exchange** to achieve following goals:
 - ✓ Strengthen the international competitiveness of the exchange;
 - ✓ Expand derivatives trading markets; and
 - ✓ Improve investor convenience

(e) Enhancing market surveillance function

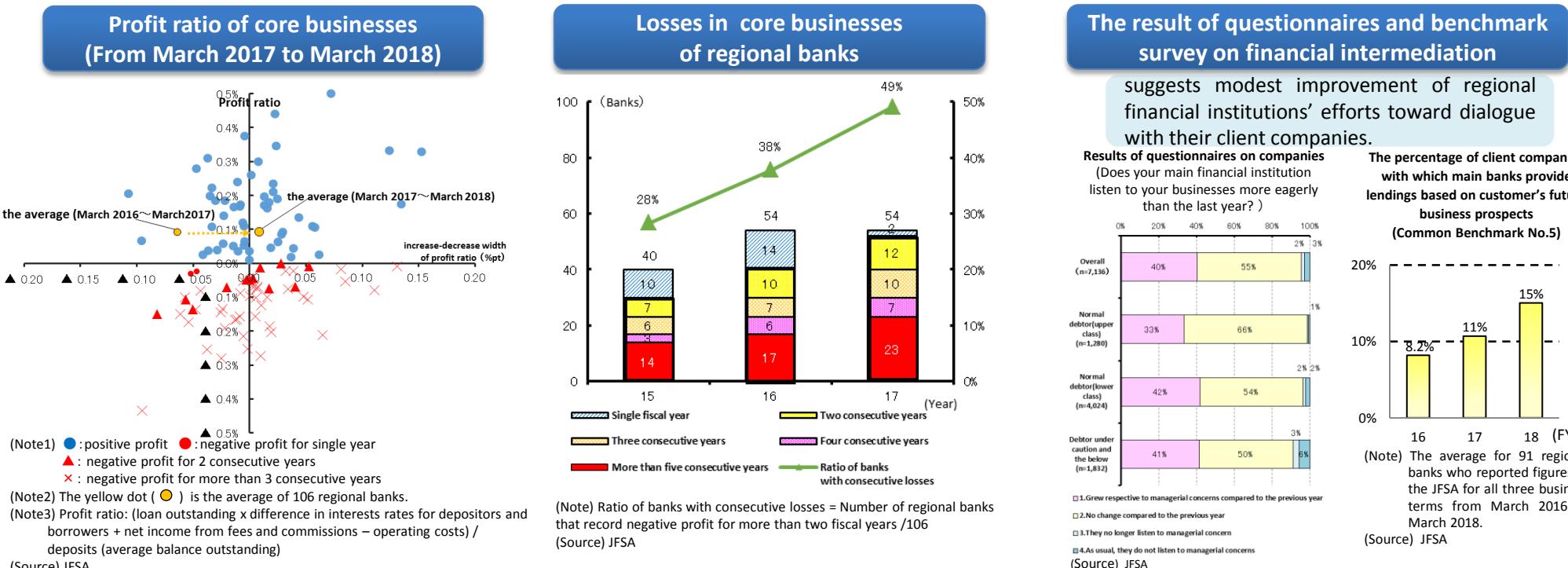
- To handle environmental changes in financial markets including globalization and digitalization, the Securities Exchange Surveillance Committee will:
 - Continue **timely market surveillances** based on a macro viewpoint focusing on potential risks and improve the current monitoring methodologies and focal points;
 - In addition to measures against illegal behaviors (i.e., administrative actions), **share issues through dialogues with stakeholders and provide information externally**; and
 - **Consider introduction of a new market surveillance system** (e.g., AI data analysis).

IV. Securing effective financial intermediation and financial stability (1)

- The roles and responsibilities of management and governance -

(a) Regional financial institutions

- While the annual changes of profit ratio in core businesses (i.e., lending and fee businesses) stopped declining in March 2018 as a whole, **more than half of regional banks (54 banks) are experiencing losses in their core businesses. The number of regional banks experiencing losses in their core businesses are increasing over the years. Unrealized gains from public and corporate bonds, which have been compensating for the losses, are also declining.**
- Some of the regional banks that have issues on the sustainability of their business models and risk-taking in portfolio management are **insufficient in their efforts in implementing business strategies, setting risk-taking limits, and securing effective governance.**
- JFSA's surveys on financial institutions' client companies as well as benchmark indicators on financial intermediation suggest **modest degree of improvement in the awareness and stance of regional financial institutions in dealing with their client companies.**

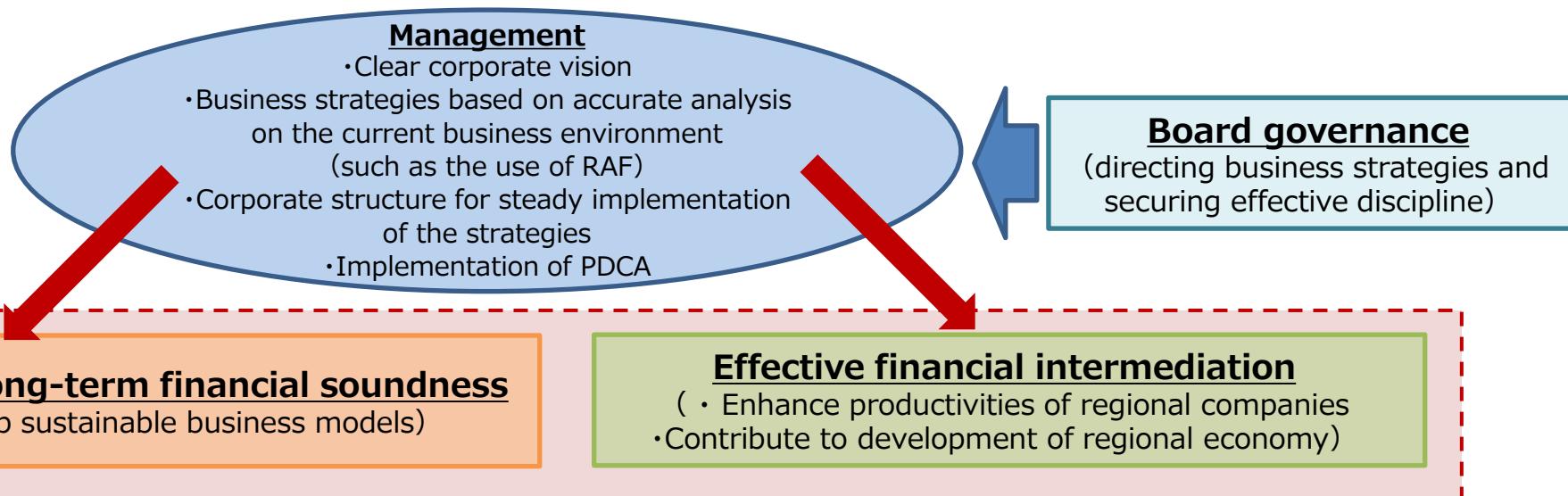


IV. Securing effective financial intermediation and financial stability (2)

- The roles and responsibilities of management and governance -

(a) Regional financial institutions

- Appropriate planning and implementation of business strategies by the management and effective governance by the board of directors are essential for a stable revenue base and long-term fiscal soundness, as well as effective financial intermediation to increase productivities of regional companies and thus contribute to the development of the regional economy.
- In building sustainable business models, it is important for the management to work on these efforts with certain timelines in mind.



- The JFSA will conduct on-site and off-site monitoring to secure long-term financial soundness of regional financial institutions into the future and urge those with serious problems to take early responses. To this end, the Early Warning Mechanism will be reviewed.
- The JFSA's Special Team to Support Regional Productivity Enhancement, in cooperation with the Local Finance Bureaus, will examine in detail the realities of regional companies and economies through the network of and dialogue with local companies and other stakeholders. Founded on this examination, in-depth dialogues with the management and the chief officers of the front line of regional financial institutions will be conducted to enhance their financial intermediation functions.

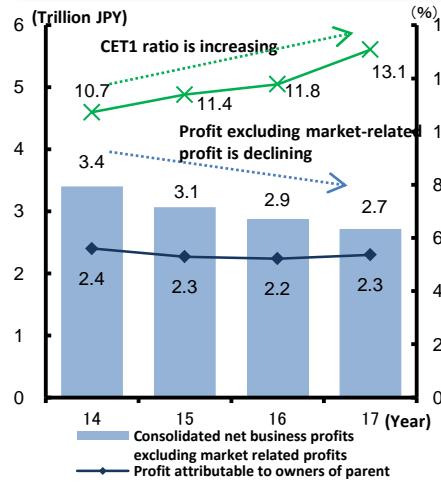
IV. Securing effective financial intermediation and financial stability (3)

- The roles and responsibilities of management and governance -

(b) Major banking groups

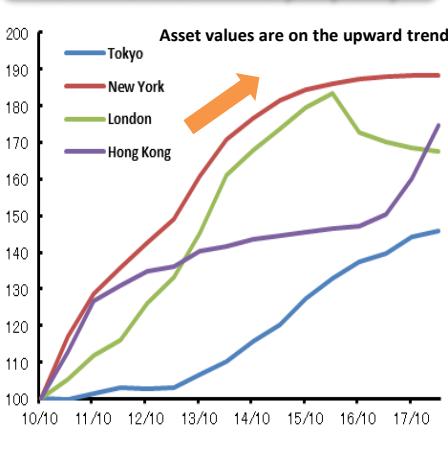
- While the Japanese financial system as a whole remains robust and stable, **banks' profitability is decreasing**.
- Under the low interest rates environment, **risky asset prices are rising and market participants' risk-appetite is increasing**, which implies the accumulation of potential systemic risk globally due to profit-seeking activities by financial institutions.
- Expanding overseas business operations, Japanese major banking groups face challenges to develop measures to **respond to abrupt changes in economic and financial market conditions** as well as to **secure stable foreign currency funding**.

Profit and CET1 ratio



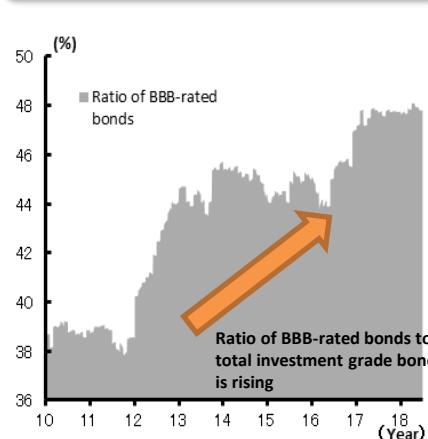
(Note) Earnings and CET1 ratio = the total value and the weighted average, respectively, for three mega bank groups
(source) Disclosure documents of the Three Mega banks groups

Real estate value of commercial office property



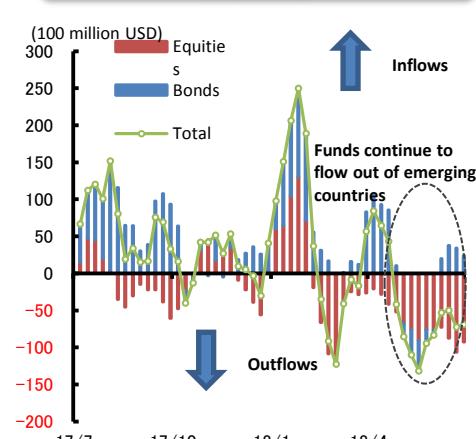
(Note) October 2010 = 100
(Source) Japan Real Estate Institution

U.S. Credit market



(Note1) Data are samples from U.S. Dollar-denominated corporate bonds issued in US
(Note2) Ratio of BBB-rated bond = balance of BBB-rated bonds/balance of Investment grade bonds (market price)
(Source) Thomson Reuters

Capital flow of emerging markets



(Note1) The total value for four weeks backward of stock of 10 countries and bond of seven countries.
(Source) Respective stock exchanges, Bloomberg

- Conducting **horizontal reviews** on the 7 major banking groups to promote the pursuits for best practices including those of the management, et al.
- Holding dialogues to discuss the following from both macro- and micro-prudential perspectives:
 - ✓ Enhance management/governance framework in line with changes in business environment such as digitalization and so on;
 - ✓ Enhance group-based and global-based management framework and of risk management through RAF and stress testing exercise;
 - ✓ Maintain disciplined appropriate lending standards and take necessary measures in preparations of shifting cyber cycle; and
 - ✓ Develop proactive credit portfolio management, ensure stable FX funding, enhance FX liquidity risk management, and reduce cross-shareholdings steadily.

IV. Securing effective financial intermediation and financial stability (4)

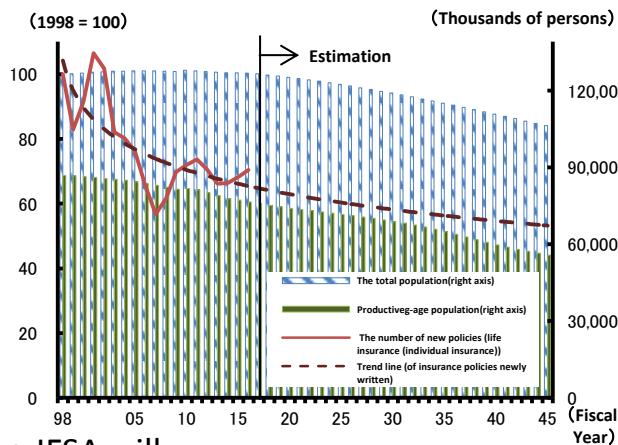
- The roles and responsibilities of management and governance -

(c) Insurance companies

It is important for insurance companies to:

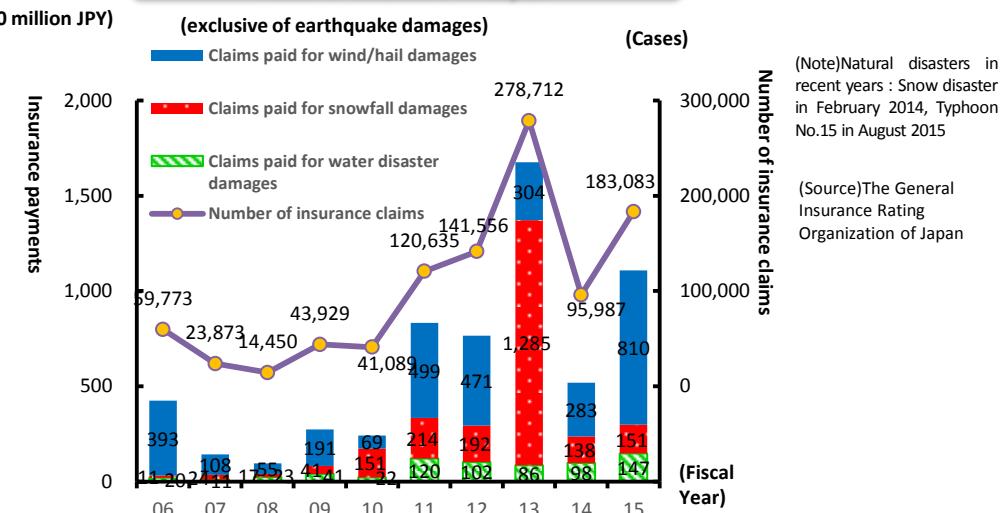
- Improve business mechanism including “**visualization**” of insurance products so as to enable the customers to choose appropriate products which satisfy their needs;
- **Enhance risk management** to address accelerated changes of risks surrounding the insurance industry such as changes in the global economy and financial markets, intensification of natural disasters and emerging underwriting risks from cyber-attacks; and
- **Take appropriate actions in response to changing business environments** such as the shrinking domestic insurance market, increasing medical and nursing care burden from longevity, and new insurance needs from digitalization and development of self-driving technologies.

**Japan's population and number of new policies
(Life insurance (individual insurance))**



(Note1)The total population and the productive-age population are as of October 1 each year.
 (Note2) The number of new policies(Life insurance(individual insurance)) is the combined total for Nippon Life Insurance, Dai-Ichi Life Insurance, Meiji Yasuda Life Insurance, Sumitomo Life Insurance, Taiyo Life Insurance, Mitsui Life Insurance, Asahi Mutual Life Insurance and Fukoku Mutual Life Insurance.
 (Source) the Statistics Bureau of the Ministry of Internal Affairs and Communications, National Institute of Population and Social Security Research and the Insurance Institute

Payments of fire insurance claims for natural disasters in Japan



The JFSA will:

- Hold dialogues with insurance companies to encourage their efforts to seek best practices on providing appropriate information to customers when they purchase savings-type insurances (particularly foreign-currency-denominated insurances);
- Incorporate the idea of an economic value-based evaluation of assets and liabilities in actual supervisions and inspections and enhance monitoring capability for underwriting risks regarding natural disasters and asset management, while enhancing insurance companies' risk management; and
- Hold dialogues with the management on developing sustainable business models in response to the changing business environment and effective governance pertaining to overall business operations.

IV. Securing effective financial intermediation and financial stability (5) - The roles and responsibilities of management and governance -

(d) Securities companies

- Securities companies are encouraged to secure a stable revenue base and financial soundness, and to address the changes in their business environment, as markets and economies could affect their profitability and soundness.
- Securities companies with global business operations should deploy flexible risk management, and forward-looking business strategies.
- It is essential that governance mechanism is at work, including the board of directors playing its oversight roles on strategic decisions and business issues.

The JFSA will:

- Monitor how the “Principles for Customer-Oriented Business Conduct” is implemented in sales activities and the KPIs are deployed;
- Supervise and monitor enhancements of business managements’ framework and their practices that support global business, as well as strengthening of risk management of global operations; and
- Conduct in-depth discussions with the members of the board of directors, in the midst of large environmental changes surrounding securities companies, on whether the governance mechanism is appropriately functioning for strategic decisions.

(e) Foreign financial institutions

- Japanese branches and subsidiaries of some foreign financial institutions are recognized to:
 - ✓ Provide Japanese financial institutions having difficulty finding adequate investment opportunities with foreign currency products;
 - ✓ Supply US dollar liquidity to Japanese financial institutions; and
 - ✓ Resume some of their business activities from which they have once retreated after the global financial crisis.
⇒Therefore, it is necessary to forecast how risk-characteristics are to change and reflect them in a more effective monitoring.
- Supervisory responses should be aligned with the new resolution framework under the International Standard of TLAC (Total Loss-Absorbing Capacity) for G-SIBs (Global-Significantly Important Banks) for the resolution is to be implemented in 2019.

The JFSA will:

- Monitor internal controls and governance, focusing on changes in risks in Japanese branches and subsidiaries associated with the transformation of global business strategy;
- Collect and utilize knowledge and information on best practices of global financial institutions through dialogues with them in order to improve JFSA’ supervision and Japan’s financial system; and
- Enhance cooperation with other financial authorities to strengthen the capacity in the event of crises at G-SIBs operating in Japan.

V. Ensuring customer confidence (1) - challenges in conduct and compliance -

(a) Compliance risk management



- There are financial institutions (FIs) whose **inappropriate conduct could affect their sound management** or whose **compliance problems**, which are **not considered to be important management issues**, elicit limited responses.
- The JFSA needs act in advance to gather and analyze information that can expose FIs to risks.
- The JFSA will identify and evaluate risks by gathering wide-ranging information and monitoring FIs in accordance with respective risk profiles.

(b) Internal audits

- Some FIs have to further develop their internal audit function in order to monitor **whether senior management's actions are consistent with the strategies and policies approved by the board, including risk appetite**.
- The JFSA will hold dialogues with the FIs to **convert the current internal audits**, which focus on compliance with internal rules, **into such that support the board and senior management in promoting an effective governance process**, with an emphasis on assessing the effectiveness and efficiency of internal controls.

(c) Loans for investment property

- Regarding loans for purchasing investment property, including apartments, condominiums and shared houses, there have occurred problems from the perspective of customer protection such as: (1) falsification of the information (e.g., occupancy rates, rents, assets and income of customers) involving the FIs and agents; and (2) cross-selling.
- There were cases where customers were indebted excessively owing to unduly high-priced properties, as well as where customers defaulted in cases due to vacancy factor/declines in rent, and as the result FIs suffered financial losses
- The JFSA will **monitor FIs in-depth** mainly on the following points by **making use of industry-wide questionnaires and inspections**:
 - ✓ Screening of loan applications and management structure;
 - ✓ Protecting customers by ensuring the rationale of borrowing and explaining risks associated with property income to customers
 - ✓ Structure for compliance with laws and regulations including prevention of undue cross-selling

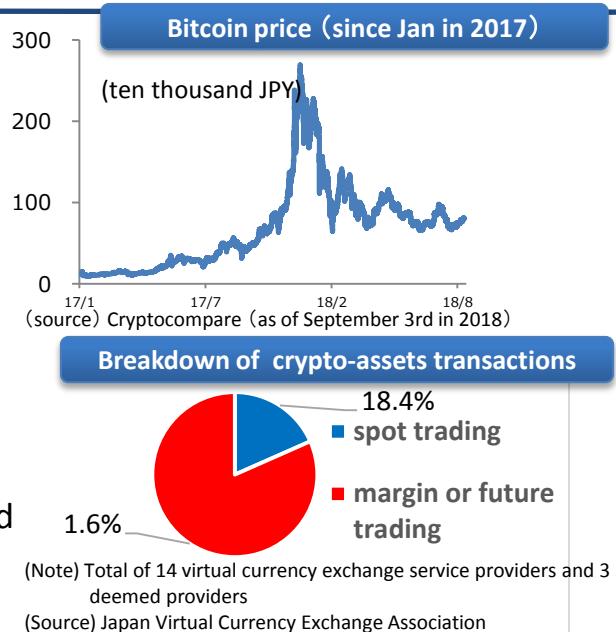
V. Ensuring customer confidence (2) - challenges in conduct and compliance -

(d) Virtual currencies (crypto-assets)

- Rapid changes regarding virtual currencies (crypto-assets) (e.g., volatility in price, new type of transactions such as margin transactions and Initial Coin Offering activities, etc.)
- Thefts of customers' assets managed by virtual currency exchanges
- ⇒ Ensure appropriate services of virtual currency exchanges to protect customers while paying due consideration to innovation.

The JFSA will:

- Tighten registration screenings and monitoring, taking account of issues found in inspections (Interim report August 2018);
- Review certification applications prepared by the self-regulatory organization and encourage them to achieve an early establishment of the self-regulating function;
- Lead the discussion for global cooperation in this area as the chair of the G20 in 2019; and
- Consider necessary regulatory measures at "Study Group on the Virtual Currency Exchange Services" (established in March 2018).



(e) Enhancing convenience of financial services

- Enhancing convenience for foreign tourists
- Enhancing convenience for the disabled persons

(g) Measures to prevent misuse and financial troubles

- Ensuring the safety of non face-to-face transactions via the Internet and responses to illegal remittances
- Responses to Bank transfer frauds
- Responses to Financial crimes/unregistered businesses
- Operation of the Financial Alternative Dispute Resolution

(f) Loans for individuals

- Banking card loans
- Credit information agencies
- Personal multiple loan problems

(h) Other topics

- Responses to natural disasters including earthquakes
- Securing continued operations

VI. Contributing to global policy discussion and building global network

(a) Contributing to global policy discussion

(Global policy agendas including financial regulatory reforms)

- Global issues related to the sustainability of economic and financial systems associated with digitalization and aging society
- Towards the Japanese G20 Presidency in 2019, the JFSA is to take initiatives for tackling a wide range of global policy agendas including evaluating effects of the regulatory reforms, addressing market fragmentation, considering multilateral responses in the area of crypto-assets, and promoting financial inclusion in the aging society.

(Sustainable Development Goals)

- The JFSA will continue to work proactively to achieve the SDGs, including supporting disclosures aligned with the recommendation of the TCFD.

(Anti-money laundering and combating the financing of terrorism)

The JFSA will:

- Take a lead in discussions in G20 and the FATF, particularly in the area of crypto-assets, where Japan has spearheaded the introduction of a regulatory framework.
- Strengthen monitoring of Japanese financial institutions to promote their risk-based management approaches.

(Note1) TCFD: Task Force on Climate-related Financial Disclosures ,(Note2) FATF : Financial Action Task Force

(b) Building global network and cross-border cooperation

- Building cooperation framework with foreign authorities contributing to economic growth and financial stability of both countries.

The JFSA will:

- Promote cooperation in various frameworks including Japan-U.S Economic Dialogue, Japan-EU financial regulatory cooperation framework, Japan-China financial cooperation, and technical assistance plans for Myanmar.

(Technical Assistance to Asia and other Emerging Countries)

- Contribute to capacity building of emerging countries through assistance program in accordance with needs of counterpart countries, taking into account requests of Japanese financial institutions for their possible entry and business expansion.
- Further improve the quality of programs of the Global Financial Partnership Center (GLOPAC) including lectures and networking with its alumni fellows.
- Strengthen regulatory and supervisory cooperation frameworks with counterpart authorities through these initiatives.



VII. Reforming the JFSA

(a) Reforming the JFSA

- The JFSA will become a satisfying and fulfilling workplace where the staff can develop their career in order to improve the JFSA's performance continuously.

The JFSA will:

- Foster human resources and vitalize the JFSA itself in the following ways;
 - ✓ Form **small groups in each division** to make communication between the group manager and the members more effective; and
 - ✓ Establish "**Open Policy Laboratory**" to encourage officials to proactively make new policy proposals by collaborating with external experts.
- Regularly check the progress of cultural and governance reforms, including conducting employee satisfaction survey, and take further actions.

(b) Reforming supervisory approaches

- The JFSA will carry out its supervisory activities in line with "The JFSA's supervisory approaches -Replacing checklists with engagement-" published in June 2018. It will also continuously review and improve the quality of its supervision.

