FSA Newsletter December 2005

Minister Yosano takes over the post from former Minister Ito (November 2)

Parliamentary Secretary Gotoda greets the First Subcommittee of the Financial System Council (November 22)

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[Topics]

Approaches to the Disposal of the Financial Assets (Preferred Stocks, etc.) Acquired through Capital Injections with Public Funds

On October 28, 2005, the Financial Services Agency (FSA) released to the public "Approaches to the Disposal of Financial Assets (Preferred Stocks, etc.) Acquired through Capital Injections with Public Funds" (hereinafter referred to as the "Approaches"), upon sorting out approaches on how the preferred stocks, etc., acquired through capital injections with public funds (hereinafter referred to as the "Preferred Stocks") should be disposed of, pursuant to the "Program for Further Financial Reform."

From the perspective that "it is appropriate to consider it a basic principle to ensure collection of profits accruing on the public funds as the fruit of the stabilization of the financial system, while continually considering the capital policy of each Recapitalized Financial Institution as before, in response to a phase transition in the Recapitalized Financial Institutions, placing more emphasis on the standpoint of "taxpayers' interest"," the Approaches stipulates that:

(i) The disposal should primarily be made upon request by each Recapitalized Financial Institution;

(ii) It is also necessary to be ready to take appropriate and flexible actions founded on the terms of Preferred Stocks, including the conversion option, while taking into account various factors, such as the terms of Preferred Stocks and up-to-date stock price movements

(iii) It is also necessary, as before, to pay full attention to maintaining sound management of the Recapitalized Financial Institutions and avoiding negative impacts on the market; continue to consider the capital policy, etc., of each Recapitalized Financial Institution for the purpose of proceeding smoothly with the disposal as much as possible; and consult with the Recapitalized Financial Institution sufficiently to consider specific measures for dealing with Preferred Stocks.

Following this announcement, "Immediate Guideline for Disposal of Preferred Stocks, etc. Acquired through Capital Injection with Public Funds" (hereinafter referred to as the "Immediate Guideline") was released to the public on the same day by the Deposit Insurance Corporation of Japan (DICJ), which is responsible for the disposal of Preferred Stocks, as a basic guideline for disposal procedures. This is a revised version of "Immediate Guideline for Disposal of Preferred Stocks Acquired through Capital Injection" (July 8, 2004) which stipulated disposal procedures for the sale of preferred shares issued to strengthen the capital base or the repayment proposal of public funds.

(Note: Points of the DICJ Immediate Guideline)

- The disposal should primarily be made up on request by each Recapitalized Financial Institution
- Under very favorable circumstances to make the disposition in view of the terms of Preferred Stocks and stock price movements (i.e., when a certain condition is met, such as that the price of the common stock is maintained for about 30 consecutive trading days at approximately more than 150% of the conversion price), Preferred Stocks may be converted or sold at the discretion of DICJ while no request for disposal by the Recapitalized Financial Institution is expected after DICJ consult sufficiently with it
- Full attention should be paid to maintaining sound management of Recapitalized Financial Institutions and avoiding negative impacts on the market, as before

The FSA is ready to take appropriate actions in line with the above policies.

* For further details, please see "Approaches to the Disposal of the Financial Assets (Preferred Stocks, etc.) Acquired through Capital Injections with Public Funds" (October 28, 2005), under "Press Releases" on FSA's Homepage.

Summary of Results on "Small- and Medium-Sized Enterprise Financing Monitoring (Conducted in August 2005)"

The "Small- and Medium-Sized Enterprise Financing Monitoring" is performed on a quarterly basis by employees of the Local Finance Bureaus and Offices with the help of Chambers of Commerce and Industry etc. for the purpose of accurately grasping the actual status, etc. of small- and medium-sized enterprise (SME) financing viewed from the perspectives of SMEs in the respective regions, as part of efforts towards facilitating SME financing.
The Financial Services Agency (FSA) recently summarized and released to the public the following results of the August 2005 SME Financing Monitoring.
The FSA is poised to continue working on facilitating SME financing by, for instance, actively comprehending voices raised in real scenes of SME financing through the Monitoring and using the findings as important information in our conduct of inspections and supervision of financial institutions.

1. Subjects of Monitoring

We conducted interviews with a total of 453 individuals (from 176 organizations) in the 47 prefectures nationwide who are involved with management consulting in such organizations as Chambers of Commerce and Industry, Federations of Societies of Commerce and Industry, Societies of Commerce and Industry, Small Business Associations, Federations of Chambers of Commerce and Industry, and Small and Medium Entrepreneurs Associations.

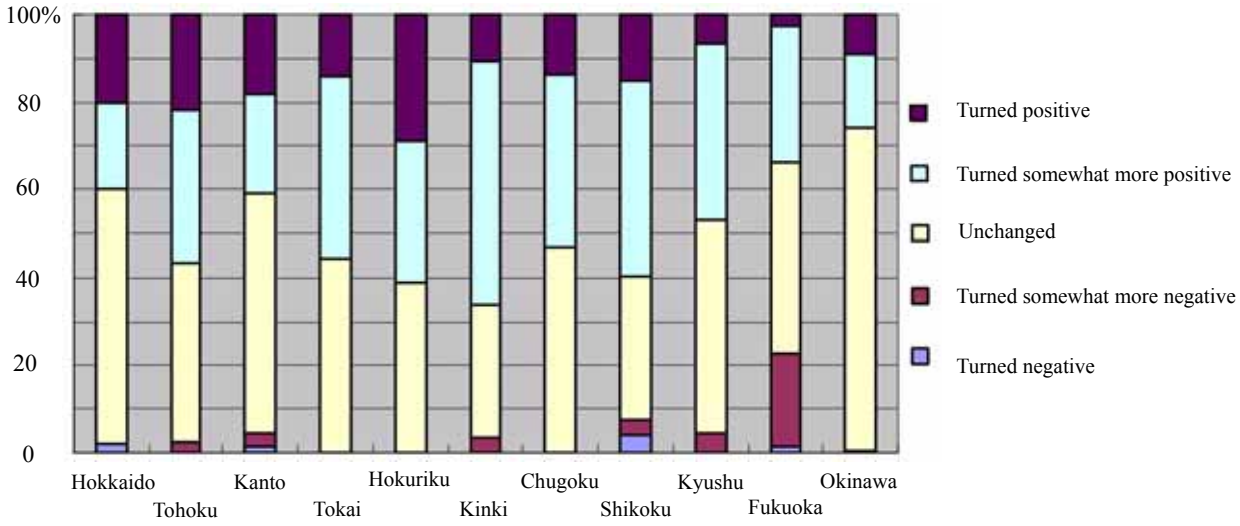
Organization Category	No. of Interviewees (No. of Organizations)
Chamber of Commerce and Industry	169 (68)
Society of Commerce and Industry	92 (65)
Federation of Societies of Commerce and Industry	155 (24)
Small Business Association	27 (14)
Federation of Chambers of Commerce and Industry	4 (2)
Small and Medium Entrepreneurs Associations	6 (3)
Total	453 (176)

(Note) As the Monitoring is not a fixed-point survey whereby inquiries are conducted with the same interviewees every time, the number or makeup of interviewees may be different for each inquiry conducted.

2. Overview of Interview Results

① Overview of interview results on "Lending trend in SME financing over the most recent three months"

While the results vary between regions, "Turned positive" and "Turned somewhat more positive" answers take up a majority in the Tohoku, Tokai, Hokuriku, Kinki, Chugoku and Shikoku regions. The percentage of "Turned negative" and "Turned somewhat more negative" answers is under 10% in 10 of the 11 regions.



(Reference)

Trend over the most recent 3 months	Major banks		Regional Banks, Second-Association regional banks		Shinkin banks Credit unions		Government-affiliated financial institutions		Total	
1. Turned positive	22	13.2%	35	10.4%	36	11.2%	54	16.4%	147	12.7%
2. Turned somewhat more positive	36	21.6%	102	30.4%	111	34.5%	100	30.4%	349	30.3%
3. Unchanged	99	59.3%	179	53.4%	166	51.6%	155	47.1%	599	52.0%
4. Turned somewhat more negative	9	5.4%	17	5.1%	8	2.5%	14	4.3%	48	4.2%
5. Turned negative	1	0.6%	2	0.6%	1	0.3%	6	1.8%	10	0.9%
Total	167	100.0%	335	100.0%	322	100.0%	329	100.0%	1153	100.0%

(Note 1) The Monitoring is not a fixed-point survey whereby inquiries are conducted with the same interviewees every time. As there is no consistency between the numbers of interviews etc. conducted by the respective Local Finance Bureaus (*i.e.,* the numbers vary) due to circumstances etc. on the part of interviewees, the data is presented here as "reference."
(Note 2) The table above shows the breakdown of valid responses and does not include non-responses and unclear responses.
(Note 3) For the reasons described in Notes 1 and 2 above, the number of interviewees and the total number of responses do not match.

・ **Grounds given by those who selected "4. Turned somewhat more negative" or "5. Turned negative" in the table above**

Grounds for Answer 4 or 5 above	Major banks		Regional Banks, Second-Association regional banks		Shinkin banks Credit unions		Government-affiliated financial institutions		Total	
Refusal of new loan requests	6	35.3%	11	40.7%	4	40.0%	7	43.8%	28	40.0%
Collateral and guarantee	4	23.5%	8	29.6%	2	20.0%	5	31.3%	19	27.1%
Interest rates	0	0.0%	2	7.4%	3	30.0%	1	6.3%	6	8.6%
Lending terms	3	17.6%	2	7.4%	0	0.0%	0	0.0%	5	7.1%
Loan assessment procedures	1	5.9%	4	14.8%	0	0.0%	2	12.5%	7	10.0%
Other grounds	3	17.6%	0	0.0%	1	10.0%	1	6.3%	5	7.1%
Total	17	100.0%	27	100.0%	10	100.0%	16	100.0%	70	100.0%

(Note) As a single interviewee may give multiple answers, the total number of answers 4 and 5 (58) and the total number of the responses in the table above (70) do not match.

② **Overview of interview results on "Actual status, etc. of SME financing in the respective regions viewed from the perspectives of SMEs "**

○ **Interviews were conducted on the following eight topics regarding the actual status etc. of SME financing in the respective regions viewed from the perspectives of SMEs:**

[Details of Interview Topics]

A. Lending attitude
B. Collateral and guarantee
C. Management guidance and business startup or revival assistance
D. Attitude in providing explanation when lending
E. Quality and ability of financial institutions
F. Period of loan assessment
G. Interest rates
H. Other

○ **Main comments made with respect to each topic are as follows:**

A. Comments made with respect to the actual status of lending attitude

- Financial institutions show a positive lending attitude and very few grievances on lending crunch or oppressive debt collection have been reported. (Hokkaido, Tohoku, Kinki, Shikoku and Kyushu)
- The lending attitude is becoming increasingly positive. (Hokuriku, Tokai, Kinki, Chugoku and Okinawa)
- In addition to financial showings, financial institutions now consider future prospects and business plan content as well. (Okinawa)
- Although no grievances on lending crunch or oppressive debt collection have been reported, financial institutions have not changed their traditional practice of staunchly requiring a credit guarantee corporation's guarantee and just do not appear to be positive about lending money at their own risk. (Shikoku)
- There is a difference, or dichotomization, in lending attitude depending on the financial conditions of the borrower company. (Hokkaido, Tohoku, Kanto, Kinki, Shikoku, Kyushu, Fukuoka and Okinawa)

B. Comments made with respect to the actual status of collateral and guarantee

- The attitude emphasizing collateral is weakening. (Hokkaido, Hokuriku and Shikoku)
- Emphasis has shifted from collateral to cash flow. (Kanto)
- Better lineups of products that do not rely on collateral or guarantee are now offered and are used as well. (Kanto, Tokai and Kinki)
- There are now more prefecture-backed loans, and financial institutions also offer products with unsecured and unguaranteed features, etc., leading to a wider range of selection. (Kanto and Chugoku)
- The lending attitude relying on collateral or guarantee still appears to exist. (Hokkaido, Tokai, Kanto, Kinki, Shikoku, Kyushu and Okinawa)
- Financial institutions still assume a lending attitude emphasizing a security backing and are scarcely inclined to make efforts towards lending in consideration of technological strengths, know-how and management resources. (Chugoku)
- Although offerings of unsecured and unguaranteed loan products are increasingly broader, loan terms and assessment are still rigid. (Tohoku)
- While many businesses wish to make use of an unsecured or no-guarantor loan program, they have difficulties due to the limited choice available. (Okinawa)

C. Comments made with respect to the actual status of management guidance and business startup or revival assistance

- Efforts in the area of business startup and new business assistance have gotten underway in Hokkaido, including the scheduled launch in October of a joint initiative between industry, academia and public administration together with financial institutions. (Hokkaido)
- Each financial institution is actively working on management and business startup or revival assistance, etc. for borrower companies, which shows that efforts in relationship banking are now bearing fruit. (Tohoku)
- As a result of relationship banking efforts, financial institutions' mentality change and corporate service offerings appear to be improving; seen from the fact that, for instance, they provide business consulting and matching services. (Tokai)
- No positive attitude appears to exist in the area of management and business startup or revival assistance. (Fukuoka)
- Seeing that regional banks and Second-Association regional banks now pay fewer visits to companies, they have only a poor system of providing assistance to small businesses. (Chugoku)
- Awareness on the part of borrowers is naive; *e.g.*, some of them blame poor business records on others. (Kinki)

D. Comments made with respect to attitude in providing explanation when lending

- Financial institutions are trying to enhance their system of providing explanation and, on the whole, now do provide sufficient explanation to customers. (Hokkaido, Tohoku, Tokai, Kinki, Shikoku and Okinawa)
- Financial institutions are committed to providing careful explanation and appear to be making efforts in enhancing their system of explanation. (Kyushu)
- There are some cases where sufficient explanation is found not to have been given. (Tokai and Kinki)
- The depth, etc. of explanation is different depending on who provides one, *e.g.*, branch manager or service representative. (Shikoku and Fukuoka)

E. Comments made with respect to the actual status of quality and ability of financial

institutions

- Financial institutions are trying hard to improve their quality and ability and have made improvements from the past. (Hokkaido)
- Some financial institutions now have a larger staff base with specialized knowledge. Financial institutions have also recently developed a "better eye" for making lending decisions. (Kyushu)
- Service representatives lack, among other things, a "good eye" for making lending decisions as they rely too heavily on loans with a credit guarantee corporation's guarantee and have insufficient hands-on experience. (Kinki)
- As the lending attitude changes when a different service representative is assigned as a result of, for example, the predecessor being transferred, it is requested that financial institutions take utmost care in the event of service representative takeover. (Chugoku)
- Quality and ability vary substantially between sales representatives. (Chugoku)
- Financial institutions lack the ability to determine and assess technological strengths, etc. of SMEs. Their training itself is also only of a makeshift nature and is void of organized and systematic programs. (Hokkaido)
- Emphasis is placed on past records (financial statements) while no consideration is taken of the proprietor's quality and the company's future potential. (Kyushu)

F. Comments made with respect to period of loan assessment

- Assessment periods are generally getting shortened, leading to quick loan decision-making. (Hokkaido, Okinawa and Shikoku)
- Assessment periods are becoming increasingly shorter owing to offerings of products with immediate loan decision features and to computerized assessment systems. (Tohoku, Kanto and Kinki)
- Cases that entail main office involvement or go through a branch without a dedicated assessment section tend to require more assessment time. (Hokkaido and Tohoku)

G. Comments made with respect to the actual status of interest rates

- Complaints about a unilateral interest rate rise have not been heard recently. (Shikoku)
- Interest rate determination by means of rating scales has resulted in higher interest rates. (Hokuriku)
- According to the business conditions and state of financial affairs, the difference in interest rate between preferred borrowers and other borrowers is widening. (Hokkaido, Tohoku and Kyushu)

H. Other comments made

- Regional SMEs and micro enterprises are reluctant to borrow because they are apprehensive about future repayments due to declining sales, aging of proprietors, and shortage of successors. (Hokkaido)
- Capital demand of SMEs has continuously been on the decline. (Chugoku)
- As stagnant regional economies, etc. have caused many companies to suffer poor business records, their capital demand stands out to be backward-looking, including requests for longer loan repayment terms and loan applications intended to pay arrears such as delinquent taxes. (Kanto)

③ Overview of interview results on "Case examples showing the penetration of the measures for facilitating SME financing"

- In the Small- and Medium-Sized Enterprise Financing Monitoring, a specific theme

concerning inspection and supervision is set each time for the purpose of inquiring about cases showing the penetration of the measures for facilitating SME financing.

- The following theme was set this time around:

Degree of awareness among SMEs, of the Supplementary Issue to the Financial Inspection Manual [for Small- and Medium-Sized Enterprise Financing] (revised version)

[Main comments received]

- Although SMEs do know the existence of the Supplementary Issue to the Financial Inspection Manual, only a small number of SMEs know what is written there.
- As steps have been taken to raise the awareness among management counselors through information sessions, etc., the Manual is increasingly, though slowly, becoming known to SMEs.
- As SMEs do not feel as threatened now due to recent turns in financial institutions' lending attitude in a positive direction, the degree of awareness of the Supplementary Issue to the Financial Inspection Manual is weakening.
- The fact that many technical terms are used in the leaflet makes it a difficult read for SMEs.
- It would be more effective to place a full-page newspaper advertisement rather than issuing a large number of leaflets.

3. How the "SME Financing Monitoring" Results Are Used

(1) Conducting Interviews

Making use of the information on specific financial institutions that was obtained through the Small- and Medium-Sized Enterprise Financing Monitoring, we conducted interviews with them as to their action policies and relevant structures, etc.

(2) Making Requests at Discussion Meetings (Use by the FSA)

At discussion meetings (held every month) between top FSA officials and business association representatives and on other occasions, we have presented cases learnt through the Small- and Medium-Sized Enterprise Financing Monitoring. More specifically, we requested participants to, for example: further facilitate a supply of funds to sound SMEs, including loan arrangements focusing on cash flows from business activities and not rely excessively on collateral and guarantee; provide sufficient explanation, sufficient enough for the customer to be able to reach an understanding and satisfaction, that takes into consideration the past relationship with and the knowledge, experience and asset conditions of the customer; and work on making the Supplementary Issue to the Financial Inspection Manual further known.

(3) Presentation Opportunities at Conference for Regional Financing Facilitation (Use by Local Finance Bureaus, etc.)

On various occasions including the "Conference for Regional Financing Facilitation," which has been established in each prefecture and is organized on a bi-annual basis (with its membership consisting of financial authorities, small- and medium-sized and regional financial institutions and relevant business associations), and meetings between top officials of Local Finance Bureaus and representatives from financial institutions, Local Finance Bureaus have raised the awareness of participants on the subject of developing customer-targeting explanation structures and strengthening consultation and complaint handling functions, and requested them to work on facilitating SME financing.

Joint Lectures with Hiroshima University
"System and Theory of Financial Inspection and Supervision"

Since the Financial System Council commented on the necessity of "consumer education" in the financial field in its June 2000 report, the Financial Services Agency (FSA) has been working eagerly to promote financial and economic education. Having included "Expansion of financial and economic education" in the Program for Further Financial Reform as well, we have stepped up our efforts in this area in accordance with the Program's direction by, among other measures, establishing in March of this year the "Financial and Economic Education Advisory Council," a private panel serving the Minister.

In the meantime, Hiroshima University, which last year started offering a joint course with the Bank of Japan in the Graduate School of Social Sciences on the subject of "Financial Risk Management Studies," decided to offer a new joint course with the FSA in order to further broaden the School's system of education and research and to develop talented people who are capable of serving immediately in the work force in the field of "financial and capital market analysis."

The FSA started lectures on October 8 of this year on the subject of "System and Theory of Financial Inspection and Supervision: Basic Framework and Approaches in Financial Administration" as part of the joint course in the Finance Program (a program designed for working people) in the Socioeconomic System major in the University's Graduate School of Social Sciences.

The lectures have been developed to teach the basic framework and approaches in financial administration to those who either have experience in financial services, or have taken a course in the basic theory of finance and are interested in working in financial services. Particular emphasis is placed on several topics that carry significance in financial administration: focusing on the points of how to stabilize the financial system, secure sound operations of financial institutions and facilitate financial functions, in keeping with the system of, and approaches taken in financial inspection and supervision; the lectures are scheduled to be given with model examples presented on an as-required basis.

With the start of such joint lectures as just one example, the FSA is committed to further promoting financial and economic education in the future.

Survey on the Counterfeit ATM Card Problem

The Financial Services Agency released on October 14 a report on the counterfeit ATM card fraud cases that occurred between October 2004 and March 2005.

Please refer to the report released on February 22, 2005 for fraud cases that occurred up to September 2004.

The important findings in this survey are highlighted below. Please refer to these for fraud prevention.

<Fraud Background>

- **Most victims say golf clubhouses are the most probable location of card skimming.**
- **24% of the victims noticed the loss within three days.**
- **Nearly half the victims (47%) were using their date of birth as a password; while the figure dropped from the previous survey (57%).**
- **Most of the victims are male, with the age of most victims between 30 and 60.**

<Loss Situation>

- **Withdrawal at ATMs located in convenience stores is increasing.**
- **Withdrawals at midnight (especially between 23:00 and 2:00) still remain high in numbers and amount.**
- **Most victims' accounts and ATMs used for fraudulent withdrawals are located in the Kanto region.**

For fraud prevention, recent cases, such as hidden cameras at ATM booths and fraudulent transfers through internet using so- called spyware, must be considered.

Status of Reception etc. of Consultation Requests at "Counseling Office for Financial Services Users"

1. Background

On July 19 of this year, the Financial Services Agency (FSA) started operating the "Counseling Office for Financial Services Users" (hereinafter referred to as the "Counseling Office") to receive, under a one-stop umbrella, inquiries, consultation requests and comments, etc. concerning financial services, etc. (hereinafter referred to as "consultation requests, etc.") from users, in an attempt to augment the level of convenience for financial services users and utilize the received information for financial administration purposes in an effective fashion.

Data such as the number of consultation requests received by the Counseling Office from users and points of major consultation cases are scheduled to be released to the public on a quarterly basis; the recent release (dated October 27) is data on the period between July 19, the first day of Consulting Office operations, and September 30.

2. Public Release Outline

① We received a total of 6,573 consultation requests, etc. between July 19 and September 30, which makes the average number of consultation requests, etc. 126 a day.

② The distribution of consultation requests, etc. by subject is: 1,774 (27%) on depositing and financing, etc.; 2,487 (38%) on insurance products etc.; 1,534 (23%) on investment products, etc.; 660 (10%) on cash loans, etc. and 118 (2%) on other issues.

③ The characteristics, etc. found in each subject area are as follows:

a. On the subject of depositing and financing, etc.: Consultation requests, etc. with respect to deposit services included general questions, etc. about the system of explanation at the time of making a deposit, as well as about the pay-off scheme and counterfeit or stolen cash cards; the implementation and repayment of financing was among the cases brought on the subject of financing services.

b. On the subject of insurance products, etc: Many consultation requests, etc. concerned insurance payments, etc.; responses from insurance companies at the time of filing insurance claims, etc.; and the system of explanation on the part of insurance companies at the time of solicitation, etc.

c. On the subject of investment products, etc.: Many consultation requests, etc. concerned foreign exchange margin trading, computer system trouble at Internet-based securities companies, and trading of unlisted shares, etc.

d. On the subject of cash loans, etc.: Many consultation requests, etc. concerned with inquiries about the existence of the moneylender registration, and improper conducts, etc.

④ Of the consultation requests, etc. that the Counseling Office received, seven major cases, one from each subject area, are presented as "Consultation Case Examples, etc. and Advice, etc."

(Reference) Details of the seven case examples

a. Supply of information on financial institution accounts used by illicit businesses

b. Consultation request, etc. concerning explanation provided to customers regarding insurance details

c. Consultation request, etc. concerning the duty of disclosure

d. Consultation request, etc. concerning insurance payments

e. Consultation request, etc. concerning foreign exchange margin trading

f. Consultation request, etc. concerning trading of unlisted shares

g. Consultation request, etc. concerning borrowing from illegal moneylenders, etc.

⑤ As the consultation requests, etc. received also contained some information that can be useful for inspection and supervision purposes (see Note), the FSA values and uses such information in its financial administration on an as-required basis, from a perspective of protecting users and augmenting the level of convenience for users as a whole, including supplying it to relevant agencies and conducting interviews with financial institutions named therein.

(Note) Information that can be useful for inspection and supervision purposes

a. Information supplied with respect to lending crunch or oppressive debt collection

b. Information supplied with respect to financial institution accounts used by illicit businesses

c. Consultation requests, etc. with respect to improper conduct by foreign exchange margin trading businesses (*e.g.*, solicitation for customers with no investment experience, presentation of categorical judgments, unauthorized sale/purchase, delayed refund of the balance, etc.)

d. Consultation requests, etc. with respect to improper conduct by insurance company salespersons, etc. (*e.g.*, subornation of non-disclosure, advance payment of insurance premiums, unauthorized agreement establishment, use of someone's identity, etc.)

3. Approach to Future Actions

In line with the fact that the Counseling Office was established in order to serve as part of the efforts to achieve the purpose of "Strengthening the framework for providing information and counseling in order to protect users," one of the measures stated in the "Program for Further Financial Reform," the FSA is committed to continuing the appropriate operation of the Counseling Office so that "a financial system in which the level of users' satisfaction is high" will be realized, as the "Program for Further Financial Reform" describes as a vision of a desirable financial system for the future.

Amendment to Administrative Guidelines (Volume III: For Non-Bank Finance Companies): clarification of Moneylenders' Obligation to Disclose Transaction History

1. Introduction

Following a Supreme Court decision upholding that "moneylenders are obliged to disclose transaction history," the Financial Services Agency amended the Administrative Guidelines for the moneylending business (Volume III: For Non-Bank Finance Companies) with intentions to clearly specify the obligation to disclose transaction history under the "Money-Lending Business Control and Regulation Law" and also to specify personal identification procedures to be used at the time of disclosure. The circumstances leading up to the recent amendment will be explained below, together with the overview of the amendment.

2. Circumstances Leading Up to the Guidelines' Amendment

The Supreme Court upheld its decision on July 19 this year of the Third Petty Bench that moneylenders, under the duty of good faith, are obliged to disclose transaction history based on the business ledgers that they maintain, as part of their obligation to loan agreements, that are subject to the Money-Lending Business Control and Regulation Law.

In this regard, paragraph 2 of Article 13 of the Money-Lending Business Control and Regulation Law stipulates the prohibition of any deceit or using any unfair or extremely undue means in lending, or managing a loan or taking measures for collection in conjunction with the lending agreement. As "unfair" means "unlawful" (as in the main text of Section 3-2-2 of the Guidelines), unlawful refusal of transaction history disclosure is an act that the Supreme Court has found to violate the duty of good faith (under paragraph 2, Article 1 of the Civil Code), which would constitute the use of unfair means in managing a loan in connection with a lending agreement and could be subject to administrative actions. The recent amendment to the Guidelines was intended to clearly specify and raise the awareness of how the Money-Lending Business Control and Regulation Law is to be applied in accordance with the Supreme Court's decision as described above.

In addition to the above consideration, we also proceeded to create in the amended Guidelines, provisions specific points to be noted by moneylenders in taking personal identification procedures when they are requested to disclose transaction history. Seeing that transaction history is also personal information, adequate and appropriate personal identification procedures are required in disclosure so that it should not be unduly passed on to a third party; in reality, however, this practice was disoriented, as to how strict such personal identification procedures should be conducted and some businesses would supposedly impose excessive burdens on requesters. In the recent amendment, the fundamental approach is clearly stated initially that moneylenders should not impose excessive burdens on requesters, and from this aspect, it specifies matters that moneylenders should pay attention to.

Following public comments sought between August 12 and September 2, the amendment was released to the public on October 14 and came into force as of November 14. The results of the public comments were also released on October 14, in which we provided detailed explanations of various matters in answer to comments received; we hope that they will be referred to in connection with this article.

3. Amendment Overview

(1) Clear specification of the obligation to disclose transaction history (re: Section 3-2-2(6) of the Guidelines)

Section 3-2-2(6) of the Guidelines stipulates that where a customer; or a party who intends to serve as a guarantee obligation on behalf of another customer; or a party who, upon obtaining consent from another customer, intends to serve as an obligation on behalf of that customer (hereinafter referred to as "customer, etc."); or a representative for the customer, etc., requests the disclosure of transaction history in order to accurately comprehend the details of the debt, such as for the purpose of checking the amount of the debt, unduly refusing such a request is quite likely to be an act prohibited under paragraph 2 of Article 13 of the Money-Lending Business Control and Regulation Law.

As also described in our answers to public comments, what is very likely to constitute a violation of the Money-Lending Business Control and Regulation Law is the act of "unduly" refusing disclosure. "Undue refusal" in this case has two implications. The first implication is that even if the act does not formally constitute refusal, by effectively refusing the disclosure, it is treated as a refusal. For instance, a moneylender's actions for imposing excessive or unnecessary personal identification requirements would be considered such a case if it did so, despite the fact that personal identification is possible by means that are less burdensome to the

customer, etc. The other implication is that a moneylender may refuse the disclosure under certain circumstances, in which case such refusal would not constitute "undue refusal." For instance, a moneylender's refusal of the disclosure would presumably not constitute undue refusal if the request was made by someone who is not qualified as a lawyer, etc., whose purpose is to earn fees for debt arrangements.

(2) Personal identification procedures in connection with disclosure (re: Section 3-2-8(1) of the Guidelines)

As already explained, a customer, etc., may request the disclosure of transaction history on the grounds of moneylenders' obligation of disclosure under good faith. Although grounds for disclosure request in such a case does not rest with the Personal Information Protection Law, the moneylender needs to take certain forms of personal identification procedures, due to transaction history being considered as personal information. By taking such personal identification procedures, however, the moneylender should not impose excessive burdens on the person requesting the disclosure. Upon clearly specifying such fundamental approach and taking into consideration the request and confirmation procedures that have been traditionally established as reasonable in practice, the Guidelines provide a list of matters to be noted in personal identification procedures.

The numbering in the square brackets in the following texts show the corresponding sections in the Guidelines.

① When a customer, etc., personally requests the disclosure

It would presumably be appropriate to ask for the presentation of a document verifying identity (driver's license, etc.) required under the Customer Identification Law, if for instance, the person requesting the disclosure has no past commercial relationship with the moneylender or if there is nothing suspicious about the matter described in the document at the time of the request [3-2-8(1)①a].

If, on the other hand, the person requesting the disclosure is in a commercial relationship with the moneylender and there are other methods that are less burdensome to the requester, such as checking his identity by referring to information, etc., stated in business documents retained by the moneylender (*e.g.,* the customer's name and customer number), it would be appropriate to conduct personal identification by that method [main text of and note to 3-2-8(1)①b].)

If the moneylender receives a disclosure request during a meeting or phone conversation with the customer, etc., it would be inappropriate, given that personal identification has already been carried out, to ask again for identity verification. [3-2-8(1)①c]

② When a representative for the customer, etc., requests the disclosure

In the case of disclosure request through a representative, it is necessary to check threeconditions: (i) the customer, etc., requesting the disclosure is the very person connected with the transaction history being requested to be disclosed; (ii) the said customer, etc., has authorized the representative; and (3) the person requesting the disclosure is the representative himself. Particularly for condition (i), appropriate action would be to use a method of identification, if any, that is less burdensome to the customer, etc., as in the case of a customer, etc., personally requesting the disclosure [3-2-8(1)②].

③ When a lawyer or a *shiho shoshi* lawyer requests the disclosure in the capacity of representative for the customer, etc.

While a lawyer or a *shiho shoshi* lawyer is assumed to be more trustworthy than a representative with no such qualification, certain forms of verification may still be deemed

necessary; therefore, the recently amended Guidelines provides a list of points to note, which was developed while also considering the practice that has been widely applied.

First, with respect to checking the authorization relationship, it is not necessary to ask for the presentation of the power of attorney if the authorization relationship can be presumed from the fact, for instance, that the moneylender received a notice from the lawyer or the *shiho shoshi* lawyer specifying that he had been authorized by the customer, etc., in the disclosure request (including a notice of representation concerning debt arrangements) and that the personal verification of the customer, etc., described in that notice is sufficient, unless there is anything particularly suspicious [3-2-8(1)③a]. In the case of the presentation of a so-called notice of representation used in practice, it would not be necessary to present another document showing the authorization relationship, if that notice contains sufficient personal verification of the customer, etc., unless there is anything suspicious, such as an inconsistency between the information in the notice and the matter in the documents retained by the moneylender.

With respect to personal verification of the representative, it is not necessary to ask for identity verification of the representative if the disclosure request produced by the lawyer or a *shisho shoshi* lawyer contains his/her contact information, including the address of the firm, given that it is possible to check his/her identity by referring to the bar association or a *shiho shoshi* lawyer's association, unless there is anything particularly suspicious [3-2-8(1)③b].

Lastly, it is inappropriate to ask again for identity verification or the power of attorney if, during a meeting or phone conversation between the moneylender and the customer, etc., the latter has expressed his/her intention to authorize a representative in the disclosure request or debt arrangement, etc., and the representative who is a lawyer or a *shiho shoshi* lawyer has without delay given notice of representation, unless there is anything particularly suspicious [3-2-8(1)③c].

4. Conclusion

In the above text, we have explained the amendment to the Guidelines with respect to the disclosure of transaction history. As transaction history is a significant piece of information for a customer, etc., to accurately comprehend the details of the debt, it will contribute to the customers' protection if moneylenders comply with the amended Guidelines and appropriately address disclosure requests from customers, etc.; at the same time, it is expected that the resulting improvements in the transparency of their operation, together with the customers' sense of reassurance that they can always check their transaction history if need be, will lead to greater trust in the moneylending business.

Improvement of No Action Letter System

The Financial Services Agency (FSA) has been making efforts to properly implement the Prior Confirmation Procedures on the Application of Laws and Regulations ("No Action Letter System" (Note)). Nine inquiries were handled under the System last fiscal year and two inquiries so far this year.

The Program for Further Financial Reform advocates *encouraging the utilization of the No Action Letter System* with the aim of improving the transparency and the predictability of financial administration. Specific efforts made recently under the Program include conducting a questionnaire survey on requests to improve the No Action Letter System (survey period: June 7, 2005 to July 4, 2005) and amending part of the System based on the survey results.

The nature of the amendment and the summary of the survey results are presented below. We hope they help you use the System based on a better understanding of the System's framework, including the amendments.

For information on the No Action Letter System, please refer to FSA's website: References and Information > No Action Letter System.

(Note) **What are the Prior Confirmation Procedures on the Application of Laws and Regulations ("No Action Letter System")?**

These procedures are to be followed by private enterprises, etc. that are planning to sell new products or provide new services in their business activities, to confirm in advance whether or not the new business violates any laws or regulations.

The name of the inquirer, the nature of the inquiry and the response to the inquiry are made public in order to ensure fairness and improve transparency in administration.

Based on a Cabinet decision, the FSA laid down detailed regulations for the procedures and launched the System on July 16, 2001.

○ **Amendments**

The following three amendments were made:

(1) Response Timeframe: In the detailed regulations, explicitly state "In any case, efforts shall be made to respond as quickly as possible."

Some questionnaire respondents pointed out that a time period exceeding 30 days is long from a business person's viewpoint. Based on their opinion, we decided to explicitly state that efforts will be made to respond as quickly as possible within the set timeframe.

(2) Cases of No Response: Delete the phrase "the inquiry involves rules or regulations that will be revised shortly."

This change was made to reflect suggestions that responses to inquiries relating to laws and regulations due to be revised soon should state the scheduled timing for the revision of such laws and regulations.

(3) Introduction of sample inquiry forms and response forms.

Sample forms were introduced to help inquirers prepare inquiry documents.

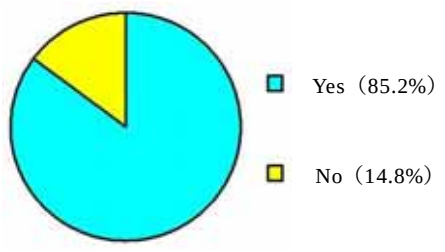
○ **Survey Results**

For reference, the survey results taken into account when making the above amendments are summarized below.

There were 263 effective responses. As some questionnaire respondents gave multiple answers or no answers in some parts of the questionnaire, the percentage may not add up to 100%.

1. No Action Letter System

Do you know about the No Action Letter System of the Financial Services Agency (FSA)?



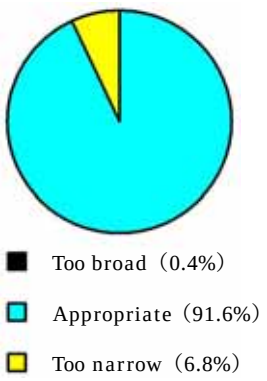
2. Existing System

(1) Scope of Inquiry

The scope of the FSA's No Action Letter System is to deal with any of the following inquiries relating to laws and regulations which fall within the FSA's jurisdiction:

1) Whether or not running the business or performing the transaction in question corresponds to unauthorized operation;
2) Whether or not running the business or performing the transaction in question corresponds to unregistered operation; or
3) Whether or not running the business or performing the transaction in question will result in a suspension of business or revocation of license, etc. (unfavorable disposition).

How do you view its scope?



(2) Scope of Eligible Inquirers

An inquirer must satisfy all of the following criteria in order to be eligible for the FSA's No Action Letter System:

1) The inquiry must be limited to its own business activities;
2) The inquiry must be limited to matters relating to specific activities; and
3) The inquiry must be limited to an inquirer who agrees to have the inquiry made public.

Are these criteria appropriate?

(3) Inquiry Method

It is a requirement that the written inquiry clearly states the inquirer's view on the applicability of laws and regulations and the reasoning behind this. Do you consider this appropriate?

(4) Response Timeframe

In the FSA's No Action Letter System, a response to an inquiry is given within 30 days of receipt of a written inquiry from the inquirer at the contact point as a general rule. Do you consider thisappropriate?

(5) Case of No Response

The FSA may not respond to an inquiry that corresponds to any of the seven cases including "inquiries containing insufficient or unclear factual information upon which to base a decision". Do you consider this appropriate?

(6) Publication of Inquirer's Name, Nature of Inquiry and Response to Inquiry

In the FSA's No Action Letter System, the inquirer's name, the nature of the inquiry and the response to the inquiry are made public. However, their publication may be postponed depending on the reasons if so desired by the inquirer.

Do you think it is appropriate that consent to the publication of the inquirer's name, the nature of the inquiry and the response to the inquiry is a requirement?

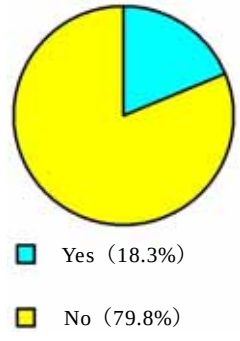
(7) Method of Publication

As a general rule, the inquirer's name, the nature of the inquiry and the response to the inquiry are made public within 30 days of the issuance of the response. Do you consider this appropriate?

(8) Postponement of Publication

1) Publication of the inquirer's name, the nature of the inquiry and the response to the inquiry may be postponed as an exception to the rule if there are reasonable grounds to do so. Did you know this?

2) Should examples of "reasonable grounds" (which are required for postponing publication) be shown in the detailed regulations?



Measures to Proper Disclosure and Stringent Accounting Audits

The Financial Services Agency (FSA) has been making efforts to improve and enhance audits by Certified Public Accountants (CPAs) in collaboration with related organizations such as the Certified Public Accountants and Auditing Oversight Board (CPAAOB), which was re-established under the revised Certified Public Accountant Law in April 2004.
In the process, we repeatedly examined whether it would be appropriate and possible to take additional measures to ensure proper disclosure through strict accounting audits and published the "Measures Intended to Secure Proper Disclosure and Strict Accounting Audits" with CPAAOB on October 25, 2005, based on the view the recent scandals involving CPAs might undermine the reliability of audits, even though the problems occurred before the enforcement of the revised Certified Public Accountant Law.
It stipulates that the following measures will be specifically advocated.

1. Conduct Prompt Inspections, etc., targeting the Big Four Auditing Firms

CPAAOB will:

1) Assess and inspect quality control reviews conducted by the Japanese Institute of Certified Public Accountants (JICPA) targeting the Big Four auditing firms one after the other, and take necessary measures if improvements are deemed essential;
2) Follow up each auditing firm with respect to the improvements pointed out in the inspection, and take necessary measures if improvements are not made within a year; and
3) Strive to ensure the reliability of accounting audits by publishing actual overall status of audit quality controls in the Big Four auditing firms.

2. Review the CPA Rotation Rule

Under the existing rotation rule, continuous audit periods are up to seven years and intervals are two years, aimed at ensuring the independence of auditors. We have decided to request JICPA to amend the continuous audit period to five years and the interval to five years for chief accountants at Big Four auditing firms.

3. Impose Quality Control Standards, etc.

In order to enhance the quality control of audits, we decided to promptly impose quality control standards for audits and request auditing firms to develop a quality control system by next March. We have also decided to revise the auditing standards, so that falsification risks would be analyzed in a precise fashion, based on sufficient understanding of companies and their business environment, and proper auditing procedures would be selected according to the nature of the risks. The Business Accounting Council compiled and published the revised auditing standards, etc., on October 28.

4. Develop Internal Controls for Financial Reports of Disclosing Companies

We have decided to hasten the speed of work being done on the study of standards, etc., at the Business Accounting Council and to conduct studies on the institutional front, in relation to the effectiveness of internal control regarding financial reports of disclosing companies, in order to determine how top management should perform evaluations and how CPAs should conduct audits.

Results of Rechecking of Claims Payment Management System and Reexamination of Non-payment Cases of Insurance Companies

1. Overview of Reporting Request

In order for an insurance company to run a life insurance business, it is absolutely imperative that claims are properly paid. However, there has been an incident recently involving Meiji Yasuda Life Insurance Company which undermined confidence in the life insurance business due to improper application of the provisions for insurance policy annulment on the grounds of fraud and mishandling claims which resulted in the non-payment of death benefits. With this situation in mind, on July 26, the Financial Services Agency (FSA) requested all life insurance companies to report the following pursuant to the Insurance Business Law by September 30:

(1) Results of reexamination of cases in which insurance money and benefits (hereinafter referred to as "claims") were not paid between fiscal 2000 and fiscal 2004, as to whether the non-payment was legitimate in the light of relevant laws and regulations, the solicitation status at the time, the terms of the policy, business manuals, etc. with respect to each fiscal year; and

(2) Results of rechecking of the claims payment management system, such as the extent to which the management team is involved in deciding important matters relating to the payment of claims.

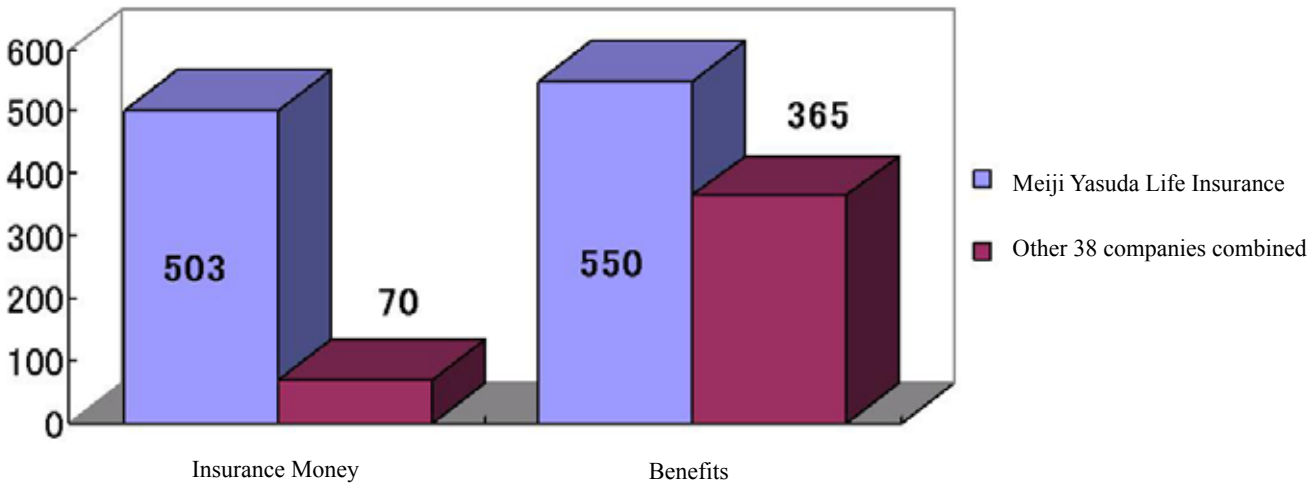
2. Findings based on Reports from Life Insurance Companies

(1) Results of Reexamination of Non-payment Cases

The number of cases of inappropriate non-payment was exceptionally high at Meiji Yasuda Life Insurance Company compared to all the other 38 life insurance companies combined, with respect to both insurance money and benefits.

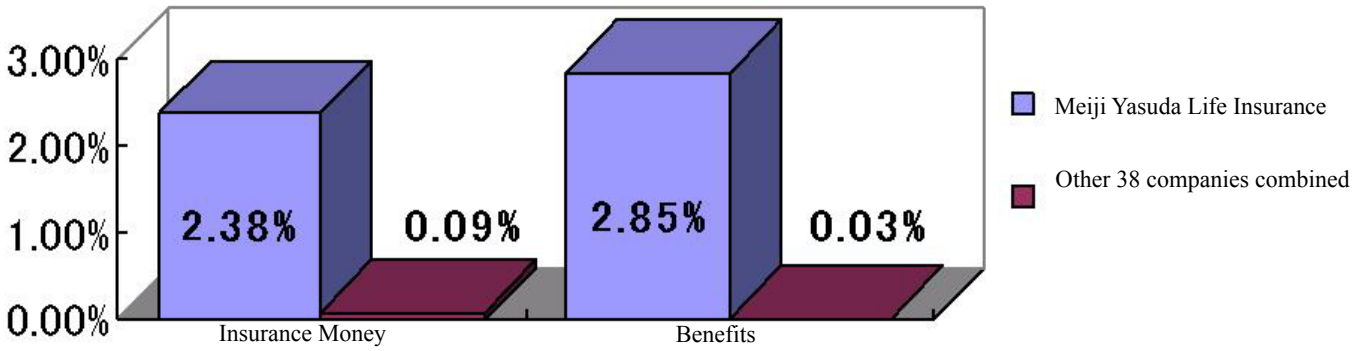
Additional payments made in cases where non-payment was deemed inappropriate amounted to 4.94 billion yen in insurance money and 260 million yen in benefits at Meiji Yasuda Life Insurance Company, compared to 1.93 billion yen in insurance money and 70 million yen in benefits at all the other 38 life insurance companies combined.

[Number of Cases of Inappropriate Non-payment】



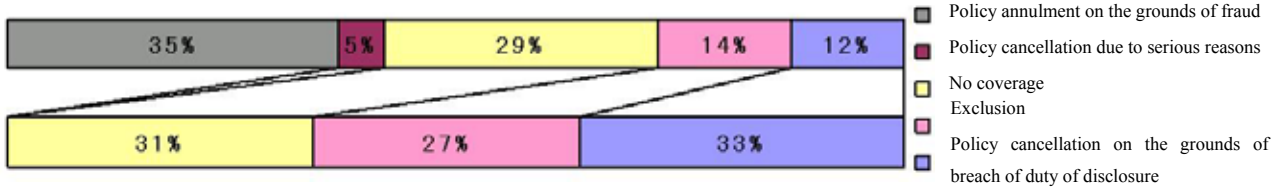
The ratio of inappropriate non-payment cases to the total number of non-payment cases was also exceptionally high at Meiji Yasuda Life Insurance Company compared to the other 38 life insurance companies combined, with respect to both insurance money and benefits.

[Ratio of Inappropriate Non-payment Cases to Total Number of Non-payment Cases]

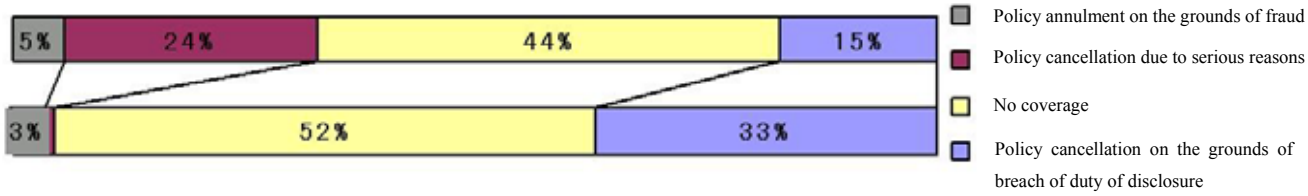


A breakdown of inappropriate non-payment by reason revealed that at Meiji Yasuda Life Insurance Company, policies annulled on the grounds of fraud or cancelled due to serious reasons stood out with respect to insurance money, and policies cancelled due to serious reasons stood out with respect to benefits.
The majority of inappropriate non-payment cases at Meiji Yasuda Life Insurance Company involved applying the provisions for insurance policy annulment on the grounds of fraud when the insured had no knowledge of the name of his/her illness, and applying the provisions for insurance policy cancellation due to serious reasons as an alternative when the insured could not be accused to have breached his/her duty of disclosure due to the expiry of the cancellation period or exclusion period. Inappropriate non-payment cases at the other 38 life insurance companies included determining that there are no grounds for payment because the surgery was mistakenly regarded as being outside the scope of coverage, and applying the provisions for insurance policy cancellation on the grounds that the duty of disclosure has been breached when the causal link between the claim and the undisclosed information could not be challenged.

[Breakdown of Inappropriate Non-payment of Insurance Money]

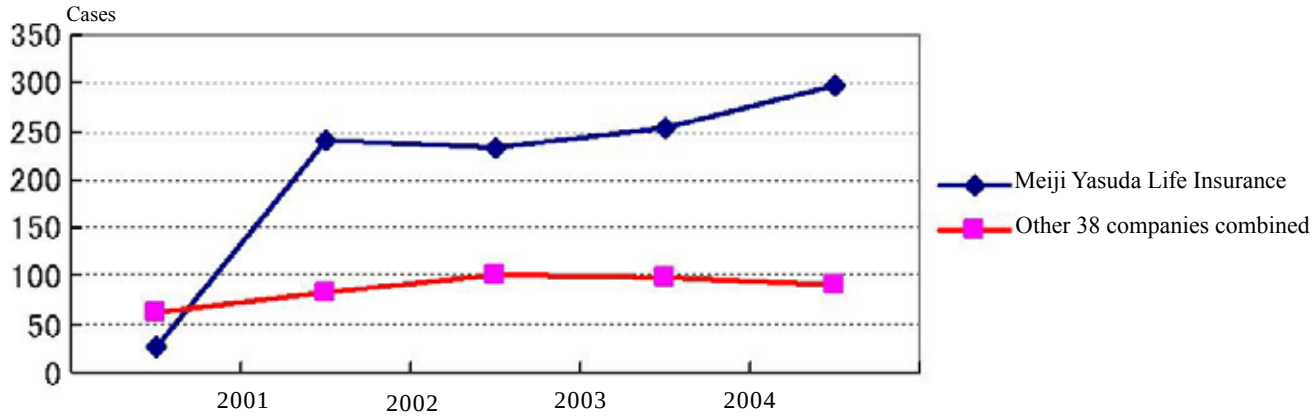


[Breakdown of Inappropriate Non-payment of Benefits]



Annual trends in inappropriate non-payment show that the number of cases has been rapidly increasing at Meiji Yasuda Life Insurance Company since fiscal 2001, whereas the number of cases has hovered between 50 and 100 cases at the other 38 life insurance companies combined.

[Annual Trends in Inappropriate Non-payment]



An analysis of the causes of inappropriate non-payment in combination with inappropriate non-payment categories revealed that the causes at Meiji Yasuda Life Insurance Company were intentional in nature, such as improper application of the provisions for insurance policy annulment on the grounds of fraud and stretching the interpretation of the reasons for non-payment based on the terms of the policy, etc., whereas those at the other 38 life insurance companies combined were mainly due to insufficient investigation and confirmation of facts and clerical errors. The nature of inappropriate non-payment was therefore found to be different as well.

(2) Results of Rechecking the Claims Payment Management System

Judging from the rechecking results reported by 38 life insurance companies other than Meiji Yasuda Life Insurance Company, there were no common problems that would immediately lead to inappropriate non-payment. However, the following areas were deemed to require improvement:

1) A considerable number of life insurance companies have failed to get the Board of Directors or other divisions sufficiently involved in examining the revision of payment assessment criteria, etc. (for example, they were decided solely by the officer in charge of payments or the head of the department).
2) None of the life insurance companies have established a framework to have the appropriateness of the payment assessment checked by outsiders by adding outside legal experts, academics, etc. as members.
3) At more than a quarter of the life insurance companies, the Board of Directors receives no reports on the non-payment situation, which, based on common sense, should be reported to the management team.
4) At more than a third of the life insurance companies, the division in charge of payments handles non-payment and complaints internally, when they should be playing an important part as a function for overseeing the division in charge of payments.

3. Actions to be taken by FSA

The FSA will encourage the life insurance companies to improve and develop their respective claims payment management systems through inspection and supervision, in consideration of the problems identified by the recent reporting request. Further, the FSA will consider some kind of measures, including revising the comprehensive supervision guidelines for insurance companies, taking into account the analysis results of the causes of such a serious problem as the inappropriate non-payment of claims.

On October 28, the FSA requested the Life Insurance Association of Japan to look into

establishing a sound and speedy claims payment management system and measures to fully ensure the protection of policyholders—including developing industry-level voluntary guidelines for non-payment of claims in general and enhancing systems for handling complaints and inquiries—and submit a report by the end of January 2006.

Review of Guideline on Restructured Loans and Publication of FAQ

In the "Comprehensive Guideline for Supervision of Major Banks, etc.," which was laid down and released to the public on October 28, 2005, the Financial Services Agency (FSA) addressed the interpretation of the Enforcement Regulations of the Banking Law regarding restructured loans by **clearly defining: (1) the purpose of corporate restructuring and support; (2) the provisions for the method of setting the basic rate of interest, etc.; and (3) other interpretations.** In conjunction with this, the FSA compiled the questions and queries received from the parties concerned in the said provisions in the form of FAQ and released it to the public under the title "FAQ: Restructured Loans" on the same date.

A restructured loan is a type of non-performing loan (risk management loan) set forth in the Enforcement Regulations of the Banking Law. In paragraph 1-5-b (4) of Article 19-2 of the said Enforcement Regulations, it is defined as **"a loan for which arrangements have been made in favor of the debtor with the aim to promote the debtor's corporate restructuring or to provide support to the debtor, such as reducing/exempting interest, granting a grace period for interest payment, granting a grace period for the repayment of the principal and forgiving the debt."**
After the said provisions came into force in December 1998, the "Operational Guidelines No.1: Deposit-taking Financial Institutions" was revised at the end of March 1999, which defined "loans with reduced or exempted interest," "loans with a grace period for interest payment," "loans with a grace period for the repayment of the principal," etc. as examples of "arrangements made in favor of the debtor" and clearly defined the disclosure criteria.
This was followed by the establishment of the Industrial Revitalization Corporation of Japan (IRCJ) in May 2003. This triggered the revision of the aforementioned Guidelines, which further clarified the disclosure criteria, aimed at improving the predictability of the parties concerned in corporate revival. Specifically, the basic rate of interest was introduced to serve as the criteria for determining and graduating restructured loans, and provisions were laid down to enable IRCJ and other parties concerned in corporate revival to improve the predictability of the upgrade from restructured loans.
Under the revised Guideline at the time, the basic rate of interest was defined as "the actual lending rate for new loans normally applied to debtors with a similar credit risk as the debtor concerned" which "should be set according to economic rationality". However, the interpretation of such "economic rationality" was not clear at the level of the operational Guideline. As it was generally understood and widely accepted that the effective lending rate must "not be set arbitrarily but must be rationally and objectively demonstrable that returns commensurate with credit risks are ensured," there were some cases where the theoretical value for each individual loan was calculated based on uniquely-established methods and was used as the basic rate of interest, which substantially differed from the "the effective lending rate for new loans normally applied".

In consideration of the practical problems and other issues that arose from such not-necessarily-clearly-defined criteria, the FSA decided to review the provisions for restructured loans in general, including clearly defining the method of setting the basic rate of interest, and to publish FAQ on the topic under the title "FAQ: Restructured Loans", following the recent

formulation of the "Comprehensive Guideline for Supervision of Major Banks, etc." The FAQ explains the gist of the latest revision, how the revised provisions will be applied to small- and medium-sized and regional financial institutions, the timing at which the revised provisions will be applied, and the details regarding the implementation of the clarified provisions.

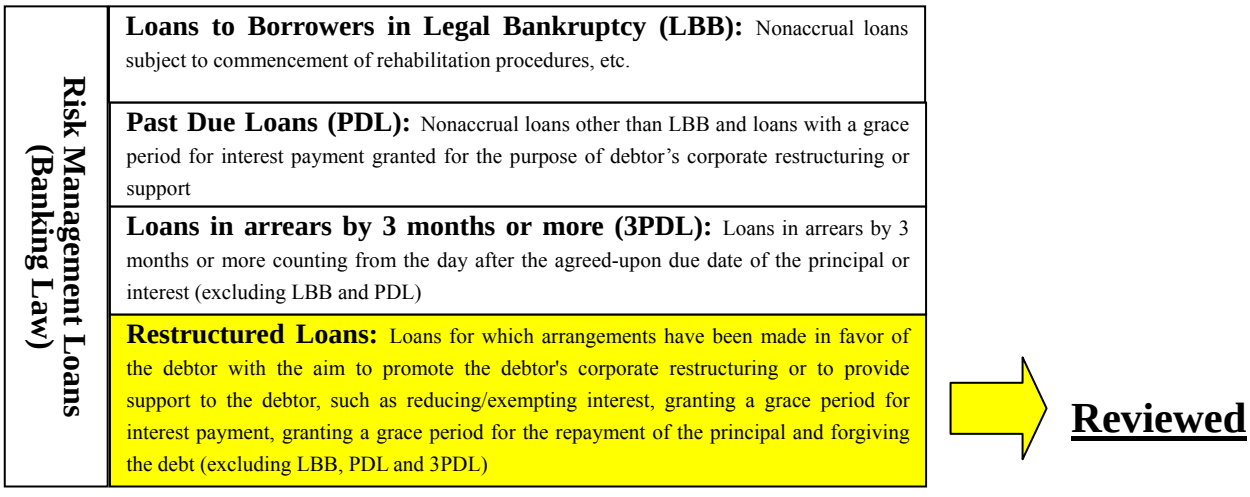
The following is a summary of the revision of the provisions for restructured loans.

(1) ***Clearly defining the purpose of corporate restructuring and support:*** In the latest revision, **it is clearly defined that in cases where "the purpose of corporate restructuring and support" is deemed to be nonexistent, the loans will not correspond to restructured loans.** The FAQ shows examples of cases in which it is deemed that the loan is not for the purpose of corporate restructuring or support (examples include cases in which the relaxed lending terms were decided in view of competition with other financial institutions or had been decided at the time of concluding the contract in the first place).

(2) ***Clearly defining the provisions for the method of setting the basic rate of interest, etc.:*** In the latest revision, **appropriate and detailed categories were established according to the debtor's credit risk, and the "average contract interest rate for new loans" (the weighted average of the respective contract interest rates for new loans in each category) is regarded as the basic rate of interest. If the "average contract interest rate for new loans" in a certain category is substantially lower than the interest rate calculated based on a method that can rationally and objectively demonstrate that returns commensurate with credit risks, etc. are ensured (a theoretical value reflecting the average credit risks, etc. in each category); the said interest rate (theoretical value) is regarded as the basic rate of interest in that category.** The FAQ provides a detailed explanation of how to calculate the average contract interest rate for new loans, the theoretical value, and so on.

(3) ***Clearly defining other interpretations:*** In the latest revision, **provisions for individual types of restructured loans, treatment of loans whose lending terms have not been changed, graduation criteria and the requirements for "feasible drastic plans", etc., were reviewed and clearly defined**. The FAQ provides a more detailed explanation on these topics.

It is hoped that the latest review of the provisions for restructured loans and the publication of FAQ will clarify the provisions for restructured loans and solve practical problems which have occurred in the past. In the event that any practical problems are identified in relation to the clarified provisions, the FSA will amend the provisions and/or the FAQ as necessary in a flexible fashion.



Overview of the Relationship Banking Promotion Plans under the "Action Program to Promote Further Enhancement of Region-Based Relationship Banking Functions (FY2005-06)"

1. Introduction

Following the "Action Program to Promote Further Enhancement of Region-Based Relationship Banking Functions (FY2005-06)" (hereinafter referred to as the "New Action Program") released by the Financial Services Agency (FSA) in March 2005, small- and medium-sized and regional financial institutions (RFIs; *i.e.*, regional banks, regional banks II, credit associations and credit unions) have each drawn up and published their "Relationship Banking Promotion Plans" (hereinafter referred to as "Promotion Plans") and also submitted their contents to the FSA by the end of August. With the aim of further promoting region-based relationship banking, the Promotion Plans describe the efforts to be made in the "Concentrated Consolidation Period," which is until FY2006, toward (1) business revitalization and facilitation of small- and medium-sized enterprise (SME) financing, (2) strengthening of management functions, and (3) enhancement of convenience for regional users.

The FSA compiled a summary of the submitted Promotion Plans and released it to the public on October 26, 2005.

2. Overview of Promotion Plans

The New Action Program requested that in composing and publishing a Promotion Plan, each RFI draw up a unique plan reflecting regional features and other factors, and in implementation, clarify its business model through "selection and concentration" based on regional features and user needs, subject to independent managerial decision-making, and carry it out under the principle of self-responsibility and fair competition. Promotion Plans were drawn up and published by 585 RFIs (65 regional banks, 48 regional banks II, 297 credit associations and 175 credit unions). The plans were not only diverse, reflecting the efforts over the past two years as well as regional features and user needs, but also exhibited signs of contrivance in the way they were released.

(1) Examples of distinctive efforts by RFIs

The RFIs' Promotion Plans included distinctive efforts as described below.

In particular, a relatively large number of distinct efforts was seen in such areas as "strengthening functions to support creation of new businesses," "strengthening functions of management consultations and support for client companies" and "enhancement of convenience for regional users." These can be considered as substantial signs of RFIs' will to build a business model reflecting the features of and user needs in the relevant region.

On the other hand, in the area of "proactive efforts for business revitalization," for example, many plans mentioned methods that are common across different regions. Although the text does not convey the exact nature of the relationship with the regional economy in such areas, it appears that in many individual cases, efforts are being made through regional networks in consideration of the industrial structure and other factors of each region.

I. Example of distinctive efforts in business revitalization and facilitation of SME financing

1) Strengthening functions to support creation and opening of new businesses

- Hold a "patent exhibition" jointly with local universities, and introduce the patents owned by the universities to commercial companies on an individual basis. Also, train 100 branch manager-grade employees as industry-university collaborators at the universities to facilitate the transfer of intellectual property.
- Enhance efforts in business areas which have larger shares in gross production of the prefecture such as agribusiness (agriculture and other related industries) and medical and nursing businesses.

2) Strengthening the functions of management consultation and support for client companies

- Proactively use the information network created by eight regional banks II in order to collect information broadly from the Kyushu region, rather than limiting the scope to the prefecture, and thus provide management assistance such as business-matching services and M&A consultation for clients.
- Commercialize consulting services for establishing locally-incorporated subsidiaries in China as an international business support activity. Further, hold business meetings in Shanghai jointly with other banks that have local offices there.

3) Proactive efforts for business revitalization

- Integrate the management of several ailing Japanese inns featuring hot springs into a new company to be established by utilizing regional revitalization funds, and increase its corporate value in a short period of time by inviting an experienced turnaround manager. The final aim is to sell the new firm to a local company, and thus revitalize the entire hot spring community.
- Exchange information and share revitalization expertise at the "corporate revitalization staff meeting" consisting of RFIs in the prefecture.

4) Promoting loans without excessive reliance on collateral and guarantees

- Announce a nationwide CLO plan with a local regional bank acting as the lead manager, build a scheme that enables efforts at regional banks across the country and carry out securitization.

- Promote the introduction of loans focusing on business values, such as those secured by intellectual property, chattel, and claims against third parties, instead of taking real estate as collateral or depending on personal guarantees.

II. Examples of typical efforts in "strengthening of management functions"

1) Enhancing risk management

- Make efforts to improve the accuracy of the calculation method of the capital adequacy ratio and to develop a system for enhancing abilities of risk management.

2) Strengthening compliance

- Enhance efforts for strict management of customer information

3) Strategic utilization of IT

- Enhance Internet banking functions and introduce cash cards with IC chips

III. Examples of distinctive efforts in "enhancement of convenience for regional users"

Enhancement of convenience for regional users

- Make its (a credit association's) president and/or officers visit local elementary and junior high schools and give students lectures on how finance works and what the RFIs are about in an easy-to-understand manner, in order to promote efforts to revitalize the region while showing the significance of the credit associations in the region.
- Share with customers consideration for the environment and awareness of disaster prevention by providing environment- and disaster prevention-related products.
- Promote low-interest loan products applicable to houses using roof tiles which constitute a major local industry, in order to encourage their use .

(2) Efforts with numerical targets

The New Action Program requested that RFIs make efforts to incorporate specific and comprehensible targets—including numerical targets if possible—when drawing up their Promotion Plans, based on their own managerial decisions, so that regional users could fully understand their objectives.

It is noteworthy that in response, a considerable number of RFIs have sought to make improvements by stating voluntary numerical targets in their Promotion Plans with regard to the enhancement of efforts in individual fields such as providing far-reaching support to new and existing borrowers (*e.g.*, extending support for management improvement at client companies and thereby upgrading their borrower classification, supporting creation and opening of new businesses including ventures, etc.) and developing human resources at hand aimed at "improvement of business judgment abilities" in addition to various financial

indicators.

(3) Overall evaluation

Looking at the above Promotion Plans as a whole, the FSA evaluates them highly for having included efforts and targets with varying focus reflecting the nature of region-based relationship banking (Note 1) and "selection and concentration" based on regional features and user needs, while building on the accomplishments made during the "Intensive Improvement Period" (FY2003-04) under the Former Action Program (Note 2).

(Note 1) Improving RFI's profitability as well as strengthening their financial intermediary functions to SMEs by grasping borrowers' business conditions through quality communication including via face-to-face transactions, while utilizing the information acquired through long-term business relationships with borrowers

(Note 2) "Action Program concerning enhancement of Relationship Banking Functions" (released by Financial Services Agency on March 28, 2003)

The FSA expects that RFIs will further promote region-based relationship banking by steadily pushing ahead with various efforts incorporated into their Promotion Plans, and strive toward revitalization and stimulation of regional economies, facilitation of SME financing, and strengthening of their management functions, while winning full trust from their regional users. The FSA will follow up on the progress of the Promotion Plans on a semiannual basis, in order to make sure that region-based relationship banking functions are being enhanced.

[Explanation of Laws and Regulations]

In this section, we provide a detailed explanation of the background and the nature of laws related to the Financial Services Agency (FSA) enacted in the 163rd extraordinary session of the Diet closed recently. This edition features the "Law for Partial Amendments to the Banking Law, etc."

Amendments to the Banking Law, etc.

1. Background to Amendment

The bill for the Law for Partial Amendments to the Banking Law, etc. (2005 Law No.106, hereinafter referred to as "Amended Law") was submitted at the 163rd extraordinary Diet session by the Cabinet on October 4, 2005. It was passed and enacted in its original form in the House of Representatives and the House of Councillors on October 20 and October 26, respectively, and promulgated on November 2.

The latest amendment involves taking the following measures **aimed at improving convenience for depositors, etc. and the efficiency of bank management: (a) review the bank agent system (establishment of bank agency business system, etc.); (b) deregulate subsidiaries, operations, etc. of banks, etc.; and (c) ensure proper business operations of banks, etc.**

2. Establishment of Bank Agency Business System

(1) Background

The bank agent system has been subject to a series of regulatory reforms to the present date, including replacing the licensing system for establishing/abolishing bank agents with a notification system, expanding the scope of agents' operations, establishing and expanding the system of financial institutions' agents. However, under the current regulations, (a) corporate agents are limited to wholly-owned subsidiaries, etc., and (b) agents are prohibited from engaging in non-agency operations on the side.

Therefore, even though agents are potentially effective sales channels, they have not been fully utilized due to their lack of mobility and flexibility and the difficulties involved in meeting diverse customer needs. The financial sector has long been submitting requests for the abolition and relaxation of capital requirements and for the further expansion of the scope of agents' operations.

Further, the Financial System Council reported in the "Medium-term Vision for the Future of the Japanese Financial System" on September 30, 2002 that "a wide range of financial products may be provided by a financial intermediary, not necessarily directly, but at least indirectly via an agency or in some other form." In the recent reform of the financial system, channels for providing financial products and services have been diversified and enhanced in line with such a vision, including establishing securities brokerage services (enforced on April 1, 2004), lifting the ban on banks, etc. (enforced on December 1, 2004), establishing trust banking agents, etc. (enforced on December 30, 2004).

As part of the reform, the "Three-Year Program for Promoting Regulatory Reform and Privatization" approved by the Cabinet on March 19, 2004 sets forth that "the bank agent system will be reviewed including the capital requirements, in consideration of the impact on the soundness of financial institutions and settlement systems, and a study will be conducted and measures will be taken during FY2004."

With this in mind, the Second Subcommittee of the Sectional Committee on the Financial System of the Financial System Council held discussions about reviewing the bank agent system three times between December 2004 and February 2005, and compiled the "Summary of

Agendas for Reviewing the Bank Agent System" on February 2, 2005, which set forth the basic approach to reviewing the bank agent system: "capital requirements, specialization regulations, etc. can be abolished… by improving the system for protecting depositors, maintaining a smooth and reliable settlement system and ensuring the financial system's soundness." The latest amendment is based on the Second Subcommittee's reports and discussions.

(2) Approach to Reviewing Bank Agent System

The basic approach of the latest amendment is to secure and improve users' access to financial services and allow entities to enter into the bank agency business in more diverse ways so that financial institutions can efficiently utilize various sales channels. Accordingly, ordinary businesses no longer have to have a capital relationship with a bank, which was previously a requirement for entering the bank agency business. Further, agents are now able to engage in non-bank agency operations on the side. On the other hand, entry into the bank agency business is now subject to approval aimed at ensuring that bank agency businesses are executed in a proper and steady fashion, while agents who wish to engage in non-bank agency operations on the side are subject to authorization on an individual basis. Further, measures are to be taken to ensure user protection and the soundness of banks.

3. Overview of Bank Agency Business System

(1) Definition of Bank Agency Business

"Bank agency business" is defined as a business involving serving either as an agency or an intermediary on behalf of a bank for the bank's core businesses, namely: (a) accepting deposits or installment savings, etc.; (b) lending funds or discounting bills; and (c) concluding foreign-exchange contracts **(paragraph 14, Article 2 of the amended Banking Law, hereinafter the same with respect to all quoted clauses unless stated otherwise)** and is subject to the bank agency business system (Therefore, for example, if a bank serves as an intermediary for a securities service, it will be regulated by the Securities and Exchange Law as a securities brokerage service.)

(2) Entry into Bank Agency Business

1) Introduction of Approval Scheme

As bank agents take on some economically crucial functions such as settlement and lending, their failure to carry out business operations properly might cause problems in settlement systems and customer protection. In consideration of the peculiar nature of the bank agency business as described above, an approval scheme was introduced with respect to entry into the bank agency business, in order to screen the eligibility of applicants before allowing a wide range of ordinary business entities to enter into the bank agency business **(paragraph 36-1, Article 52 of the Banking Law)**.

The application form for approval must state the following information and be submitted to the Local Finance Bureau in charge, with documents, etc., stating the nature and the methods of the operations of the bank agency business attached **(paragraph 37, Article 52 of the Banking Law)**: (a) trade name, title or name, (b) name of an executive in cases where the applicant is a corporation, (c) the name and location of the branch or office engaging in the bank agency business, and (d) the trade name of the bank with which the agent is affiliated ("affiliate bank"), etc.

2) Approval Criteria

For approval of a bank agency business, the applicant will be screened by the FSA on the basis of whether the applicant: (a) has the financial base deemed necessary to execute a bank agency business; (b) has the capacity required to execute a bank agency business in a precise,

fair and efficient manner and has sufficient social credibility in light of personnel structure, etc.; and (c) is deemed to have no risk of causing any hindrance to running the bank agency business in a proper and steady manner by engaging in other operations **(paragraph 38-2, Article 52 of the Banking Law)**.

If it is deemed necessary in the interests of the public in light of the screening criteria, conditions may be attached to the approval and may be modified to the extent required. For example, conditions may be attached to the nature of the operations of the bank agency business depending on the nature of the non-bank agency operations **(paragraph 38-1, Article 52 of the Banking Law)**.

3) Introduction of Multi-operations Authorization Scheme

Bank agents are now allowed to engage in operations other than the bank agency business and its incidental operations (non-bank agency operations) subject to the FSA's authorization. As stated above, entities already engaged in non-bank agency operations will be screened in the approval procedures for the bank agency business, as to whether they are at risk of causing hindrance to the bank agency business. Additionally, if an entity wishes to newly engage in non-bank agency operations after obtaining approval, it must go through the individual approval procedures based on the same criteria **(paragraph 42-1, Article 52 of the Banking Law).**

(3) Modality of Operations of Bank Agency Business

1) Explicit Statement to Customers

Prior to engaging in any bank agency activities **(activities referred to in the subparagraphs of paragraph 14, Article 2 of the Banking Law),** bank agents are now required to explicitly state the trade name of the affiliate bank and whether or not they are acting as an agent or an intermediary to customers **(paragraph 44-1, Article 52 of the Banking Law).**

2) Provision of Information to Depositors, etc.

In the same manner as banks' duty to provide information to depositors, etc. **(paragraph 2-1, Article 12 of the Banking Law),** bank agents are now required to provide information that will be helpful to depositors, etc. including the nature of the contract relating to deposits or installment savings, etc. **(paragraph 44-2, Article 52 of the Banking Law)**.

3) Measures to Ensure Sound and Proper Administration

In addition to (1) and (2) above, bank agents are now required to provide customers with important information on their bank agency activities, properly handle information on customers acquired in relation to their bank agency activities, and take other measures to ensure sound and proper administration **(paragraph 44-3, Article 52 of the Banking Law).**

4) Prohibited Activities in Bank Agency Business

Activities in bank agency business targeted at customers which have the risk of undermining customer protection or hindering the sound and proper execution of operations of the affiliate bank have been banned, including: (a) making false statements; (b) making an assertion on matters that are uncertain or making a statement that might be misconstrued as a certainty; (c) acting as an agency or intermediary in lending funds or discounting bills on the condition that the customer performs other transactions by abusing the agent's dominant position; and (d) acting as an agency or an intermediary in lending funds or discounting bills under favorable terms compared to the normal terms of trade at the affiliate bank **(Paragraph 45, Article 52 of the Banking Law).**

5) Posting of Signs

Entities that have been approved to serve as a bank agent are now obliged to post signs to that effect. Further, in order to prevent customers from dealing with unapproved entities, non-bank agents are now prohibited from posting signs of bank agents or similar signs that might be mistaken as those of bank agents **(paragraph 40, Article 52 of the Banking Law)**.

6) Prohibition of Name-lending

In order to avoid deviating from the objective of the approval scheme, bank agents are prohibited from allowing anyone else from running a bank agency business under their names **(paragraph 41, Article 52 of the Banking Law)**.

7) Segregated Custody

If a bank agent has received money or any other asset from a customer in relation to bank agency activities, the bank agent is required to manage it separately from its own assets **(paragraph 43, Article 52 of the Banking Law).**

Specifically, if a bank agent has received money or any other asset from a customer, the bank agent must clearly distinguish its storage place from that of its own assets, and manage it in an immediately identifiable way with respect to which affiliate bank it is related to. In the case of money, however, the bank agent is deemed to be allowed to store it in an immediately identifiable way by a ledger with respect to which affiliate bank it belongs to.

8) Holidays, Business Hours, etc. of Bank Agents

In order to ensure stability in the settlement system, bank agents who receive current deposits of behalf of banks are subject to the same regulations as banks with respect to holidays and business hours, i.e., bank holidays and business hours (from 9:00am to 3:00pm) under the Banking Law **(paragraph 46, Article 52 of the Banking Law).**

Branches and offices that do not carry out in any specific bank agency activities are neither subject to the said regulations nor prevented from operating outside the bank holidays and business hours under the Banking Law.

(4) Accounting, etc.

1) Books and Records for Bank Agency Business

In order to clarify the processes and calculations of the bank agency business, bank agents are now obliged to prepare and keep books and records related to the bank agency business **(paragraph 49, Article 52 of the Banking Law).**

2) Reports on Bank Agency Business

Bank agents are now required to prepare reports on the bank agency business each fiscal year or business year and submit such reports to the FSA, which in turn will make those reports available for public inspection **(paragraph 50, Article 52 of the Banking Law)**.

3) Public Release of Manuals, etc. of Affiliate Bank

In light of disclosure to customers, bank agents are now required to make available at all times so-called disclosure journals—prepared and made available for public inspection by the affiliate bank or the holding company of the affiliate bank under the provisions of the Banking Law—at the branch or office running the bank agency business and make them available for public inspection **(paragraph 51, Article 52 of the Banking Law).**

(5) Affiliate Bank, etc.

1) Adoption of Affiliate Bank System

Intermediation may be based on (a) an affiliate company system (intermediation for a specific company) or (b) a broker system. Under the bank agency business system, bank agents "shall not engage in bank agency business unless commissioned by an affiliate bank or re-commissioned by a bank agent who has been commissioned by an affiliate bank" (affiliate bank system). It is primarily a system that is designed to ensure sound and proper administration of bank agency business through an affiliate bank **(paragraph 36-2, Article 52 of the Banking Law).**

A bank agent is able to run a bank agency business on behalf of more than one affiliate bank.

2) Guidance, etc. to Bank Agents by Affiliate Bank

The affiliate bank is now obliged to give guidance on operations to its bank agents and otherwise ensure sound and proper administration of the bank agency business **(paragraph 58, Article 52 of the Banking Law).**

3) Affiliate Bank's Liability for Damages

The affiliate bank is now liable for damages inflicted by its bank agent upon a customer. On the other hand, it is stipulated that the affiliate bank, etc., will be exempted from liability if it has exercised considerable caution in commissioning and has made efforts to prevent the loss incurred by the customer from occurring. However, it is claimed that liability without fault is more or less assumed, as there are no legal precedents in which the exemption of employer's liability under the Civil Code has been recognized. Therefore, cases in which exemption of liability would actually be recognized are deemed to be limited **(paragraph 59, Article 52 of the Banking Law).**

4) Original Register of Bank Agents

The affiliate bank is now required to make the original register relating to bank agents available at all times, and depositors and other stakeholders are now able to request the affiliate bank for the perusal of the original register **(related to paragraph 60, Article 52 of the Banking Law).**

(6) Supervision of Bank Agents

The FSA can now issue a reporting request **(paragraph 53, Article 52 of the Banking Law)** and conduct on-the-spot inspection **(paragraph 54, Article 52 of the Banking Law)** with respect to a bank agent if it is deemed necessary to ensure the sound and proper administration of the bank agency business of the bank agent, and even issue a Business Improvement Order, etc. **(paragraph 55, Article 52 of the Banking Law),** revoke the approval for the bank agency business, and suspend all or part of the bank agency business **(paragraph 56, Article 52 of the Banking Law).**

(7) Exclusion of Application

Entities engaged in banking or other finance business (which are due to be defined as financial institutions that handle deposits and savings such as long-term credit banks and shinkin banks) can now engage in bank agency business without obtaining approval and are now subject to essential regulations for bank agency business **(paragraph 61, Article 52 of the Banking Law)**.

(8) Review of Agent System for Cooperative Financial Institutions, etc.

A system similar to the bank agency business system has been developed for long-term credit

banks, shinkin banks, labor credit associations, credit unions, agricultural cooperatives and fisheries cooperatives (including their associations) and the Norinchukin Bank by amending the Long-Term Credit Bank Law, the Shinkin Bank Law, the Labor Credit Association Law, the Law on Banking Business by Cooperatives (hereinafter referred to as "Cooperative Banking Law"), the Agricultural Cooperative Association Law, the Fishery Cooperative Law and the Norinchukin Bank Law.

4. Deregulation of Subsidiaries, Operations, etc.

(1) Lifting of Ban on Joint Establishment of Auxiliary Service Company

Under the existing Banking Law, if a bank wishes to have a company operating auxiliary services (business-purpose real estate management service, welfare service, ATM maintenance and inspection service, cash collection service, etc.) as its subsidiary, the bank's dependency on income (ratio of income to total income) from the bank group (the bank, the bank's holding company and their subsidiaries) must exceed 50%, in view of the objective of prohibiting banks from engaging in other businesses, etc.

Furthermore, unless the company meets the income dependency requirement, the bank and its subsidiaries together cannot hold more than 5% voting power of the company (or more than 15% in the case of the bank's holding company and its subsidiaries combined) **(paragraph 3, Article 16 of the Banking Law).**

This makes it impossible for bank groups to jointly establish an auxiliary service company. The latest amendment allows bank groups, etc., to jointly establish an auxiliary service company provided that the income dependency of the bank group and other bank groups, etc., combined exceeds a certain percentage with respect to the auxiliary service company, in order to help improve the efficiency of bank management, etc.

(2) Abolition of Licensing System for Securities Operations, etc., under Shinkin Bank Law, etc.

In order for a shinkin bank to engage in securities operations, trust operations or trust operations relating to secured bonds, the shinkin bank had to be registered, etc., under the Securities and Exchange Law, the Law for Trust Business in Financial Institutions and the Law on Secured Bonds Trust, and separately, be licensed under the provisions of the Shinkin Bank Law. The licensing system under the Shinkin Bank Law is now abolished. The licensing system for accepting solicitation or management of local government bonds, etc., on trust under the Shinkin Bank Law has also been scrapped **(Articles 53 and 54 of the Shinkin Bank Law).**

Similar amendments have been made for labor credit associations **(Article 58 and paragraph 2, Article 58 of the Labor Credit Association Law),** credit unions **(Article 3 of the Cooperative Banking Law),** agricultural cooperatives **(Article 10 of the Agricultural Cooperative Association Law),** fisheries cooperatives **(Articles 11, 87, 93 and 97 of the Fishery Cooperative Law)** and the Norinchukin Bank **(Article 54 of the Norinchukin Bank Law).**

5. Measures to Ensure Proper Business Operations

(1) Review of Arms Length Rule

As a measure to prevent terms of trade that are available solely to relatives from undermining the interests of depositors, etc., as a consequence, the bank is not allowed to have dealings, etc., with specific parties or customers of specific parties that would be detrimental to the bank in light of the bank's normal terms of trade (so-called arms-length rule). In conjunction with the establishment of the bank agency business system, bank agents have been included in the definition of specific parties, in order to prevent any harmful effects from arising due to bank agents exercising undue influence on the affiliate bank **(paragraph 2, Article 13 of the Banking Law).**

(2) Prohibited Activities in Operations of Banks, etc.

The Banking Law squarely defines bank agents and explicitly states the prohibited activities relating to bank agency business in concrete terms **(paragraph 45, Article 52 of the Banking Law).** By the same token, the Banking Law explicitly states typical prohibited activities of the banks themselves, in consideration of our experience, etc., in supervisory administration **(paragraph 3, Article 13 of the Banking Law)**.

Specifically, activities with the risk of undermining customer protection have been banned, such as: (a) making a false statement to a customer; (b) making an assertion on matters that are uncertain or making a statement that might be misconstrued as a certainty; and (c) providing credit or promising to provide credit on the condition that the customer performs transactions associated with operations run by a closely-related entity by abusing the bank's dominant position.

(3) Reporting Request and On-the-spot Inspection targeted at Contractors of Banks, etc.

Banks are outsourcing their operations in view of improving the efficiency of bank operations and for other reasons. However, problems have occurred in recent years in the form of system problems, leaked client information, etc. There is a risk that reporting requests and on-the-spot inspections targeted at banks might not be sufficient by themselves for the purpose of ensuring sound and proper business operations of banks.

Accordingly, in order to improve the effectiveness of inspection and supervision of banks, etc. (referring to a bank or the bank's holding company), the FSA is now allowed to directly issue a reporting request and conduct on-the-spot inspection with respect to (a) a corporation whose management is controlled by banks, etc., and (b) an entity that has been commissioned to undertake operations for banks, etc. (excluding bank agents), in addition to the subsidiaries of banks, etc., to the extent required if it is deemed particularly necessary in order to ensure sound and proper business operations at the bank **(related to Articles 24 and 25, and paragraphs 31 and 32 of Article 52 of the Banking Law).**

"An entity that has been commissioned to undertake operations for banks, etc.," is deemed to correspond to a contractor of the bank's ancillary operations, a contractor taking on necessary duties to run operations (system administration, etc.) and the like.

(Note) Similar measures have been taken for long-term credit banks, shinkin banks, labor credit associations, credit unions, agricultural cooperatives, fisheries cooperatives and the Norinchukin Bank with respect to 1 through 3 above.

(4) Public Announcement of Interim Financial Results of Banks, etc., and Compulsory Disclosure

The new capital adequacy requirements (Basel II) attach greater importance to disclosure than ever before, for the purpose of improving the effectiveness of market discipline through the enhancement of disclosure, in that they require the disclosure of the capital adequacy ratio, its breakdown, the extent of risk by risk type, the risk calculation method and so on. With this trend in mind, the bank and the bank's holding company are now obliged to make their financial results and disclosure journals available for public inspection with respect to the first half of the fiscal year (April to September) on top of the annual financial results and disclosure journals which were already compulsory, in order to further enhance disclosure **(Articles 20 and 21, and paragraphs 28 and 29 of Article 52 of the Banking Law).**

6. Enforcement Date, etc.

(1) Enforcement Date

The Amended Law will be enforced from the day set forth by government ordinance within one

year of its promulgation (November 2, 2005) (hereinafter referred to as "enforcement date") (The Amended Law is scheduled to come into force on April 1, 2006) **(Article 1 of Supplementary Provisions).**

(2) Interim Measures

1) An entity which is already engaged in a bank agency business, etc., at the time the Amended Law comes into force **(excluding any entity engaged in bank agency business under an agent established under the provision of paragraph 1, Article 8 of the old Banking Law, banks, etc.)** must obtain approval for the bank agency business within three months of the enforcement date if it wishes to continue running the bank agency business, etc. **(Articles 2 and 10, Articles 12 through 14, and Articles 17, 20 and 24 of the Supplementary Provisions).**
2) An entity which is already engaged in a bank agency business under an agent established under paragraph 1, Article 8 of the old Banking Law at the time the Amended Law comes into force (excluding banks, etc.) will be deemed to have been approved for the bank agency business, etc., at the enforcement date and will be subject to the provisions of the Banking Law, etc., accordingly. In this case, the entity must submit an application form for approval of the bank agency business with the necessary information filled out within three months of the enforcement date (**paragraphs 1 and 2 of Article 3 and paragraphs 1 and 2 of Article 11 of the Supplementary Provisions).**
3) Banks, etc., already engaged in a bank agency business under an agent established under paragraph 1, Article 8 of the old Banking Law at the time the Amended Law comes into force must submit an application form for approval of the bank agency business with the necessary information filled out within three months of the enforcement date **(paragraph 4 of Article 3 and paragraph 4 of Article 11 of the Supplementary Provisions)**.

【Primer on Financial Literacy】

* This section provides easy-to-understand explanations on financial terms and various questions related to financial matters that tend to be too specialized and hard to understand.
The keyword for this month is "**Accountant's audit quality control".**

Audit corporations and Certified Public Accountants (CPAs) are required to audit the financial statements, etc. of companies according to generally-accepted auditing standards (GAAS) and express their opinion on those financial statements, etc. based on the audit results. One form of GAAS is the **Auditing Standards released to the public by the Business Accounting Council (BAC), which include standards that should be observed for the quality control of audits.**
The BAC decided at the general meeting held in January 2005 to launch deliberations on making quality control of audits more concrete, stricter, etc., in response to the scandals relating to the quality control of audits based on the screening system, internal control system, etc. of audit corporations. On October 28, the BAC revised the Auditing Standards and established the "Standards for Quality Control of Audit independently of the Auditing Standards," in order to rationally ensure the quality of audit duties performed by CPAs.
The revised Auditing Standards **define quality control as "control of quality required to properly conduct all audits in compliance with GAAS.**" They also state that **"auditors must establish quality control policies and procedures for their own organization and confirm that audits are being conducted in accordance with them."**
The Standards for Quality Control of Audit consists of provisions for standards applicable to audit firms, which are laid down separately from the provisions for standards applicable to audit staff with respect to each item, as quality control to be observed by audit firms is distinguished from quality control to be observed by audit staff who performs the individual audit duties. **Main items of the Standards for Quality Control of Audit are:**

(1) Development and operation of quality control system;
(2) Professional ethics and independence;
(3) Conclusion of new audit contracts and renewal of existing audit contracts;
(4) Recruitment, education/training, evaluation and appointment of audit staff;
(5) Performance of duties (performance of audit duties, screening associated with audit duties, etc.);
(6) Monitoring of quality control system;
(7) Handover between audit firms; and
(8) Joint audits.

Practical guidelines required for applying the Auditing Standards in practice have been prepared by the Japanese Institute of Certified Public Accountants (JICPA). For quality control, JICPA has published the Auditing Standards Committee Report No.12 "Quality Control of Audits", etc., which also serve as auditing standards to be observed by audit corporations and CPAs.
Further, for the quality control of audits, JICPA has been conducting *quality control review* since 1999. "Quality control review" is a system under which JICPA's full-time staff reviews the status, etc. of quality control of audits conducted by audit firms and recommends improvements to audit firms as necessary. Since April 2004, the Certified Public Accountants and Auditing Oversight Board (CPAAOB) established in the Financial Services Agency (FSA) has been screening "quality control review" and conducting inspections targeted at JICPA, audit firms, etc. as necessary, for the purpose of further improving the "quality control review" functions and enhancing and reinforcing audit duties at audit firms.

【Hot Picks from the Financial World】

* We deliver the hottest information of the times in this section, selected from among questions and answers given at the Minister's press conferences etc.

"Hot Picks from the Financial World" for this month feature an excerpt of finance-related statements made at the inaugural press conference by Mr. Kaoru Yosano, who assumed office as Minister of State for Financial Services and Economic and Fiscal Policy on October 31.

For further information, please access the "Press Conferences" section of Financial Services Agency's official website.

[Opening Statement at Inaugural Press Conference by Kaoru Yosano, New Minister of State for Financial Services and Economic and Fiscal Policy]

As a result of the Cabinet reshuffle today, I have been appointed as Minister of State for Economic and Fiscal Policy and Financial Services. I am committed to making the utmost efforts to fulfill the duties that have been assigned to me.

In regards to financial administration, the percentage of non-performing loans has fallen to less than 3% at major banks and to about 5% in other financial institutions, thanks to substantial efforts made by the parties concerned. As many people have had an extremely tough time in the process, the time has come for financial institutions to take on risks and resume their financial activities to bring about economic growth in Japan.

As financial administration in itself is substantially authoritarian, I believe power should be exercised in a restrained manner and in the interests of the national economy, and for each and every citizen. Banks can now sell products of life and non-life insurance companies over the counter, and in the latest Diet session, the revision of the law on bank agencies was finally approved. In such an environment, a wide range of new kinds of investment business will emerge in the days ahead. I personally believe that certain laws will have to be amended in order to ensure that peoples' assets are safely invested.

Further, there is the question of whether there are any inadequacies in the legislation regarding corporate acquisitions. Various empirical and academic studies are being conducted, so we need to look into whether legislative amendments are required.

Q. What is your understanding of the current status of the financial system, including regional financial institutions?

A. The primary mission or business of a financial institution is to take risks. Without risk-taking, the financial sector cannot stimulate the economy.

My approach is always based on the assumption that the Japanese financial system is extremely well-developed. Indeed, there are problems such as those relating to over-banking, but they will naturally have to be solved.

This may not be a pressing issue for the Japanese financial system, but I imagine the biggest challenge that the system will have to face is how the postal bank will enter the financial system.

Q. What is construed as over-banking?

A. I think this problem has largely been sorted out over the past decade. It has been sorted out through mergers and closure of branches, and a considerable number of branches have been shut by managerial decision. Yet, the number of financial institutions remains higher than in other countries. The question is whether it is fair to simply compare it with other countries. It depends on Japan's economic culture, business relationships stemming from the past and various other factors. Nevertheless, I think we must look at the fundamentals of the economy to see whether it can sustain so many financial institutions.

Q. Does that mean that the number of banks and financial institutions should be reduced in the long run?

A. It will probably come down to the number of financial institutions that is appropriate for the size of the Japanese economy, but this should be subject to the situation at each financial institution. It is not a matter for the FSA to dictate that individual institutions go out of business or scale down.

Q. Is there any particular area in which you intend to concentrate your efforts?

A. Financial administration requires transparency, and inspections need to be conducted properly in order to protect peoples' financial assets. I am not particularly worried about financial institutions in general, but for financial administration in the broad sense, the Financial Services Agency (FSA) must constantly be on the lookout, to determine ways to prevent innocent consumers being caught up in bad situations due to new financial products and to determine whether securities transactions are performed in a fair and transparent manner.

In addition, financial institutions must have a proper vision or screening system that enables them to take risks as mentioned previously, although this is at their managerial discretion. Further, in the reform of government-affiliated financial institutions, I am concerned about what may happen to the financing framework for small and micro enterprises in the future. As politicians, we should be concerned about this in the context of social policy, separate from the so-called market mechanism.

(from the inaugural press conference on Monday, October 31, 2005)

[Notice]

○ Be careful of your Cash Card

Crimes involving withdrawal of deposits/savings at automatic teller machines (ATMs) with stolen and counterfeit cash cards are increasing.

What you can do to avoid becoming a victim of cash card forgery and theft

1. Management of Personal Identification Number (PIN)

- Do NOT tell your PIN to other people. (In some cases, a person pretending to be a police officer or bank clerk may ask your PIN over the phone. A police officer or bank clerk will NEVER ask your PIN.)
- Do NOT use the PIN of your cash card as the secret code for a locker in locker rooms of golf courses, saunas or other public places. (There have actually been cases in which cash cards were stolen from the safety box at a golf course and their magnetic data copied and used to withdraw deposits/savings.)
- Do NOT write down your PIN on the cash card. Do NOT keep or carry around any memos about your PIN (any documents that imply your PIN) with your cash card.
- Do NOT use your date of birth, phone number of your home or workplace, your address, your vehicle registration number or any other number that could be guessed by others as your PIN. (Results of a survey on victims who have had their deposits/savings illegally withdrawn by forged cash cards revealed that about 40% of them used their date of birth or a number that could easily be guessed from their date of birth as their PIN.)
- Check whether there is anyone suspicious-looking around you when using an ATM to make sure that no one is peering into the screen. Watch out to make sure that no one is peering over your shoulders—for example, cover the keypad with your hands when you enter your PIN.

  * There have been cases in which hidden cameras were installed in unmanned ATM booths of financial institutions in the Kanto and Tokai regions, where photos of PIN entry are believed to have been secretly taken. Watch out for any suspicious machines installed when you use an ATM. If you find any suspicious machines, etc. when using an ATM, promptly contact the financial institution.

2. Management of Cash Card

- Carry your cash cards with you and frequently check that they have not gone missing. In particular, do NOT leave them inside a desk drawer or a chest of drawers.
- Do NOT hand over your cash card to other people without careful thought.
- Do NOT treat your cash card in ways that are generally deemed to be at high risk of theft. (In some cases, people have had their cash card stolen while dosing off under the influence of alcohol or when they left their coat on a hanger in a restaurant, etc. There have also been quite a few cases in which people have had their cash card stolen as a result of a mugging, car break-in or burglary.)

(Reference: Security Measures at Home)

- Do NOT own more cash cards than you really need.
- Old cash cards that have not been used for a long time might have security problems. Consult the financial institution that issued the cards.
  For information on other security measures at home, please check the official website of the police department in your prefecture.

3. Account Management

- If your bankbook has not been updated for a long time, you might not notice that money is missing until much later. Check your balance and update your bankbook frequently.
- Do NOT keep a larger amount of cash in your ordinary account than you need.
- Some cash management accounts have a facility that allows you to overdraw up to a certain percentage of the balance of your term deposit by cash card. If this facility is unnecessary, request the financial institution to disable it.

4. Financial Institutions' Services

Some financial institutions offer IC cash cards, give you withdrawal notification, allow you to suspend ATM withdrawals from a computer or a mobile phone, allow you to change the withdrawal limit, and issue cash cards with insurance. Make full use of such services.

If you realize your cash card is missing…

- Report to your financial institution immediately. Even if your cash card has not been stolen during a burglary or car break-in, the magnetic data might have been copied, so make a report to your financial institution just in case.
- If you realize that your cash card has been stolen, report this to your financial institution as well as your nearest police station.

○ Unauthorized Transfers by Internet Banking

In recent years, there have been incidents involving unauthorized transfers executed by using personal information, etc. stolen based on a fraud technique known as "phishing" and programs referred to as "spyware". As the methods used are extremely elaborate, there is no way of preventing damage from occurring and spreading unless the Internet user proactively takes countermeasures.
Internet users are advised to take proper measures by using the information here as reference.

What you can do to avoid becoming a victim

1. Make Sure Your Antivirus Software and Operating System (OS) are Updated to the Latest Version.

- New viruses appear on a regular basis, so keep your antivirus software and OS updated to the latest version at all times. Never disable your antivirus software.

2. Be Suspicious of E-mail First.

- It is dangerous to carelessly open unsolicited e-mails with titles like "Important Message" sent to you by companies. Make it a habit to avoid opening strange e-mails without much thought (do NOT even display them on the preview panel).
- Do NOT respond to e-mails that request your reply or entry of personal information without careful consideration. It might be a good idea to routinely check your bank or card company's customer service center so that you can contact it immediately in the event that you receive any suspicious e-mail.
- In particular, "attached files" are extremely dangerous. As an attached file might be infected with a virus or consist of spyware, never open such a file unless it is from a trustworthy sender.

3. Stay Clear of Suspicious Websites.

- Many spyware programs are installed "simply by browsing a website." Stay clear of suspicious-looking websites. In particular, never browse a website that asks you to disable

your antivirus software first (websites that state "This website will not be properly displayed unless the antivirus software is disabled" or other similar messages).

4. Do NOT Use Suspicious CD-ROMs, etc.

- There have been incidents involving CD-ROMs containing spyware directly sent by a person pretending to be a financial institution. The media format is not limited to CD-ROMs; other media might be used. If an unsolicited CD-ROM is sent to you, do NOT use it without careful thought; first confirm with the financial institution. As the phone number written on the CD-ROM, etc. might be the number of a bogus customer service center, contact the financial institution by an alternative method.

What is Phishing?

"Phishing" is a scam involving e-mail sent by a criminal who impersonates a financial institution (bank or credit card company), etc. (such e-mail is hereinafter referred to as "phishing e-mail," refer to below) which is designed to defraud users of their personal information, such as address, name, bank account number and credit card number. A typical tactic is to dupe a user into visiting a bogus website via a hyperlink on the e-mail and enter his/her personal information on that website. This might result in unauthorized withdrawals from the user's account or unauthorized use of his/her credit cards. In the United States, which already suffered from huge damage in this area, approx. 73 million people have received more than 50 phishing e-mails per year on average, and the related financial damage has reached approx. $930 million (approx. ¥100 billion) according to a survey conducted by U.S. research firm Gartner Inc. Incidents involving thefts of ID and passwords for Internet banking and credit card numbers have already occurred in Japan, and there are concerns that the damage might spread in the years to come.

[Example of Phishing E-mail]

Phishing e-mails may be designed to: dupe users into visiting a website that is an imitation of a service provider's website as in case (1) below; or direct users to a genuine website and then urge them to change the password as in case (2) below.

(1) Scam urging Users to Enter ID and Password at a Website That is an Imitation of a Service Provider's Website

* At first glance, it looks like a hyperlink to the website of ○○ Service but if you click on it, the browser displays a bogus website imitating ○○ Service's website.

(2) Scam urging Users to change Password on Service Provider's Genuine Website

* In this case, if you click on the hyperlink, ○○ Service's genuine website will be displayed. If you change the password to "******" as instructed in the e-mail, your password will be "known to third parties."

Reference

Dear Customer of ○○ Service,
Due to enhanced security measures at ○○ Service, customers are required to confirm their identity online. Failure to perform this step may cause operational problems online. Please take this step as soon as possible.
https://www.○○.co.jp/login/index.htm

Dear Customer of ○○ Service,
Due to enhanced security measures at ○○ Service, customers are required to change their password. Your new password is ******. Please click on the following link to change the password.
https://www.○○.co.jp/login/passchange.htm

Failure to perform this step may cause problems in using ○○ Service securely. Please take this step as soon as possible.

What is Spyware?

There have already been incidents in Japan involving so-called "spyware" that is aimed at stealing ID and passwords for Internet banking. There are concerns that the damage might spread in the years to come. A typical tactic is to install a certain program in the user's computer, and thereby steal the user's ID and password for various services including card numbers and other such information. This information is used for unauthorized withdrawals from the user's account, unauthorized use of his/her credit cards, etc.

Such spyware programs can be installed in the user's computer when the user browses a suspicious website, reads a suspicious e-mail, or installs a program from an unknown source.

[Example of Triggers of Spyware Installation]

Spyware installation is typically triggered either by: browsing a website as in case (1); reading an e-mail as in case (2); or running a file downloaded from the Internet as in case (3).

(1) **Spyware Installation Triggered by Browsing a Website**

If sufficient measures are not taken, spyware installation might be triggered by just browsing a website.

Therefore, if the following links on a website have been maliciously created for the purpose of installing spyware, you might trigger the installation of the spyware by needlessly clicking on the links:

1. Links on bulletin boards, etc.; and
2. Links listed on search engine results page (SERP).

(2) **Spyware Installation Triggered by Reading E-mail**

If sufficient measures are not taken, spyware installation might be triggered by just reading an e-mail. In particular, if your e-mail program is "set to display the content of the e-mail on the preview panel where all e-mails are listed," spyware installation might be triggered just by selecting an e-mail.

(3) **Spyware Installation Triggered by Downloading a File**

If you download and install any game from an unknown source or any software that needs to be installed to browse a suspicious website according to the website, spyware with functions other than those originally anticipated by the user might be installed at the same time.