



FSA Newsletter February 2009

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Senior Vice Minister Tanimoto (left) and Parliamentary Secretary Uno speaking at the Meeting of Director-Generals of Local Finance Bureaus (January 29)

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Publication of the Report by the Second Subcommittee of the Sectional Committee on the Financial System of the Financial System Council

On January 14, 2009, the Second Subcommittee of the Sectional Committee on the Financial System of the Financial System Council (chaired by Professor Shinsaku Iwahara, School of Legal and Political Studies, University of Tokyo Graduate Schools for Law and Politics) published its report titled "System Development Concerning Fund Settlements—Promoting Innovation and Protecting Users."

The payment and settlement system is a vital infrastructure that supports financial and capital markets but needs greater improvements in security, efficiency and convenience to boost the competitiveness of Japan's financial and capital markets. In the Better Market Initiative (Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets) announced in December 2007, one of the goals is the "construction of secure, efficient and convenient payment and settlement systems."

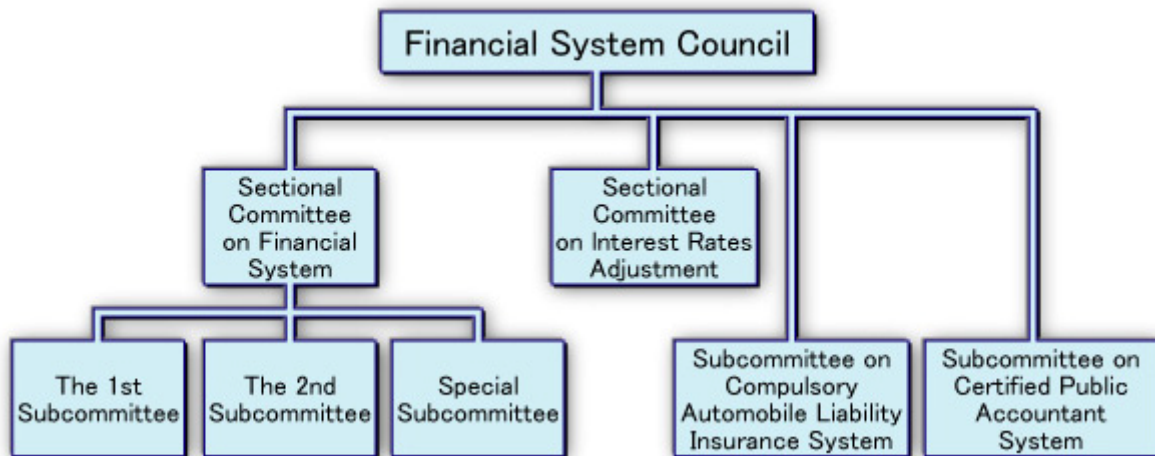
The Settlement Working Group (Settlement WG), which was formed under the Second Subcommittee of the Sectional Committee on Financial System, met 12 times from May to December last year to examine retail payments from an expert perspective. The Working Group deliberated on the creation of a regulatory framework that is balanced in terms of promoting innovation and protecting users, while assuring the security of the financial settlement system vis-à-vis the state of dissemination and development of new services with advances in data communication technologies and spread of the Internet.

Also, the 2nd Subcommittee discussed the creation of a regulatory framework for inter-bank fund settlements for strengthening the payments and settlements system.

In the report submitted by the Settlements WG, a variety of opinions were presented on issues which are difficult to share a common understanding, such as a purchase point service, an agency payment service and a cash-on-delivery (C.O.D.) service.. However, the report concluded that it is not necessary to take immediately action on the development of regulatory frameworks for these schemes and that they should be perceived as issues to be addressed in the future. Furthermore, the report recommends continued monitoring of these schemes so as to prevent any developments that would undermine user protection.

Based on the recommendations of the report, the Financial Services Agency (FSA) plans to take swift action on the development of the necessary frameworks.

Organization of the Financial System Council



Summary of the Report

1. Retail payments & settlements

Regarding matters for which a common awareness of the issues was confirmed in the Settlement WG report, it was agreed that further studies into practical implementation and action on the construction of frameworks are appropriate.

○ **Prepayment measures**

- Treatment of "server-type" prepayment measures should be similar to that for IC-type prepayment measures
- Oversight rules will be developed for custom types
- The current framework requiring notification for custom types and registration for third-party type will be kept in place.
- Regarding ways of protecting deposits issued as prepayment, protection methods that are bankruptcy remote, such as the use of trusts, will be reviewed, in addition to studies into deposits and guarantees made by banks and other financial institutions.
- Cashing and refunding will be prohibited as a general rule, but with cashing and/or refunding made obligatory in case of termination of service by the service provider.

○ **Fund transfer service (tentative name)**

- Non-banking entities will be allowed to engage in "exchange transactions" not involving acceptance of deposits or fund management of loans, etc. (greater versatility in the system related to "exchange transactions")
- User protection must be secured in case of the bankruptcy of a fund transfer business operator, minimizing its impact on society and the economy.
- Funds held by the business operators must be guaranteed in full.
- Regarding protection of funds held by fund transfer business operators, entrustment

to trust banks will be authorized along with deposits and guarantees to banks and other financial institutions, while promoting bankruptcy remoteness.

- The Act on Prevention of Transfer of Criminal Proceeds must be applied to fund transfer business operators

2. Inter-bank payment

It is necessary to develop a regulatory framework necessary for inter-bank payments based on securities settlement systems in various countries.

Report of the Second Subcommittee of the Sectional Committee on the Financial System, Financial System Council: Summary

“System concerning Cash Settlement — Promotion of Innovation and Protection of Users —

(Published on January 14, 2009)

- Focus on boosting the competitiveness of Japan's financial and capital markets
- The financial settlement system is a vital social infrastructure supporting the financial and capital markets

Retail payments & settlements

Advances in information communication technology and the spread of the Internet have led to the growth and popularization of new payment-related services. In addition, conditions today allow operators other than banks the ability to engage in exchange transactions presently authorized exclusively to banks. In order to address these changes, the Settlement Working Group (Settlement WG) was formed under the Second Subcommittee.

- Matters where general awareness of issues was reached in the Settlement WG Report
 - Treatment of "server-type" prepayment measures should be similar to that of IC-type prepayment measures
 - The existing framework for prepayment methods will be kept in place while executing the necessary revisions.
 - Exchange transactions by other operators (Fund Transfer Service [tentative name]) are allowed.

⇒ Further studies into practical implementation and action on the construction of regulatory frameworks are appropriate.

- Matters where a variety of opinions were presented in the Settlement WG Report.
 - **Customer loyalty (purchase point) service**
Example of opinions:
 - Consumer protection of some type is necessary because of the large value of customer purchase points that are issued and the expanding scope of purchases or exchanges made with purchase points.

- Creation of a regulatory framework is not necessary because purchase points are issued for free or as giveaway and because the scope of goods and services is limited.

➤ **Agency payment service and cash-on-delivery (C.O.D.) service**

Example of opinions:

- If agency payment service is suspected to infringing on provisions of the Banking Act (as an exchange transaction) and the service provider becomes insolvent, those who have commissioned payment may sustain damages. For this reason, creation of a regulatory framework is appropriate.
- Agency payment service cannot be categorized as an exchange transaction. There is no risk of redundant payment by the payee and user convenience does not decline. For this reason, no regulatory framework need to be created.

⇒ Immediate action to create a regulatory framework is not necessary. It is determined as an issue for the future but requires continued attention to prevent any conditions that would undermine user protection.

Inter-bank fund settlements

Development of a regulatory framework necessary for appropriate oversight, etc. is to be promoted for fair, transparent governance in the management of the inter-bank fund settlement system under the Zengin System.

Note: Zengin System is operated by the Tokyo Bankers Association, a public-interest corporation with membership consisting of banks, and is being managed in effect with a manager bank scheme.

FSA publishes the second progress report on its efforts toward "Better Regulation"

The FSA has been engaged in an initiative to improve the quality of financial regulation (Better Regulation) since the summer of 2007. The state of progress in the Better Regulation initiative, mainly concerning action taken from July 2007 to April 2008, was published in the first report issued in May 2008.

The second report dated December 26, 2008, outlines the status of progress for the period from May to December 2008.

The Initiative toward Better Regulation consists of the following four major pillars of action:

- 1. Optimal combination of rules-based and principles-based supervisory approaches**
- 2. Timely recognition of priority issues and effective response**
- 3. Encouraging voluntary efforts by financial institutions and placing greater emphasis on providing them with incentives**
- 4. Improving the transparency and predictability of regulatory actions**

The progress made in these four areas is reported as follows.

Progress in the four pillars (May-December 2008) (1)

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

- Efforts to ensure all FSA employees are fully acquainted with the purpose of the "Principles in the Financial Industry (the Principles)," on which the FSA agreed in April 2008 with financial institutions and market participants, and **to promote the common understanding of the purpose of the Principles shared by the FSA and the relevant parties**
 - Explicit statement in the Annual Supervisory Policies that the Principles should be applied to daily supervisory activities
 - Conduct inspections with a focus on encouraging financial institutions to make voluntary efforts to improve management in light of the Principles of improvement of user convenience and proper risk management
- Reform of the firewall regulations and introduction of the requirements for financial institutions to establish systems for managing conflicts of interest. **Establishment of a principles-based** regulatory framework in order to promote voluntary efforts by financial institutions to establish these systems, by prescribing fundamental rules and seeking to ensure the effectiveness of regulation through appropriate monitoring of the implementation of the rules by the financial institutions.

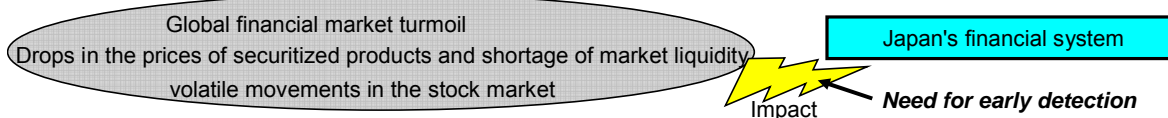
Reference

Rules-based regulation: Rules and regulations that are detailed to a certain extent are established and applied to individual cases

Principles-based regulation: Emphasis on voluntary efforts by financial institutions to improve management based on the principles (the principal code of conduct to be followed by financial institutions)

Progress in the four pillars (May-December 2008) (2)

2. Timely Recognition of Priority Issues and Effective Responses



=> In addition to market developments, **close watch on the financial soundness of financial institutions and the actual practices of their risk management**

- Disclosure about the exposures of Japanese financial institutions to securitized products in light of leading disclosure practices suggested by the Financial Stability Forum (FSF)
- Efforts in inspecting points of attention regarding financial institutions' risk management and application to the Comprehensive Guidelines for Supervision



=> **Prompt investigation into the current situation** and quick implementation of measures **to enhance the stability of the financial system** and **facilitate financing for SMEs**

- Senior FSA officials were dispatched across Japan in order to precisely grasp the actual state of financing for SMEs (Aug 2008)
- Implementation of measures to maintain the financial intermediary function (e.g. change in the treatment of restructured loans and amendment of the Act on Special Measures for Strengthening Financial Functions)
- **Conduct inspections with a priority-driven approach focusing on risks that are particularly important** in managing individual financial institutions
- Development of the 2008PY Basic Policy for Financial Inspection focusing on "Establishment of an appropriate risk management system corresponding to the features of various types of loans and financial products" and "Ensuring smooth financing to SMEs and support for regional industries."
- Introduce simplified inspections aimed at small financial institutions with a limited range of business operations

Progress in the four pillars (May-December 2008) (3)

3. Encouraging Voluntary Efforts by Financial Institutions and Placing Greater Emphasis on Providing Them with Incentives

- Reform of the firewall regulations and introduction of a framework under which financial institutions are required to establish systems for managing conflicts of interest and **make self-disciplinary efforts in light of their own circumstances**
- Introduction of a rule for increasing or reducing administrative monetary penalties. **From the viewpoint of providing an incentive for voluntarily establishing a compliance system and preventing the recurrence of violations**, the administrative monetary penalties may be reduced for entities that report certain violations at an early stage and the amount of penalty may be increased for persons who engage in violations repeatedly
- **Enhanced efforts related to the Financial Inspection Ratings System** intended to strengthen incentives for improving management
Example: Appropriate efforts and creative practices by financial institutions are positively evaluated and are reflected clearly in the financial inspection ratings.
- Provide an incentive for financial institutions to **further promote relationship-based local banking** by compiling and publishing financial institutions' progressive responses

4. Improving the Transparency and Predictability of Regulatory Actions

- Revision of the Inspections Manuals to specify matters that should be borne in mind in financial inspections (Example)
 - Priority-driven approach focusing on important risks
 - Identification of problems, evaluation of improvement efforts and examination of static and dynamic aspects
 - Promotion of accurate understanding of examination findings (sense of satisfaction)
- **Clarification of the priority issues for regulatory activities** in program year 2008, in light of the environment surrounding financial institutions (the increasingly severe economic situation and the growing need to properly manage risks inherent in financial instruments)
 - The Basic Policy for Financial Inspection emphasized "establishing an appropriate risk management system corresponding to the features of various types of loans and financial products" and "ensuring smooth financing to SMEs and support for regional industries"
 - The Annual Supervisory Policies placed priority on ensuring the "exercise of the financial intermediary function and a sense of security and convenience for users" as well as "risk management and financial stability"

The progress made in the five areas of immediate focus, aimed at realization of the four pillars, is outlined below.

Progress in the five areas of immediate focus (May-December 2008) (1)

1. Enhancing Dialogue with Financial Institutions and Other Relevant Parties

- **Start of direct dialogue with SME managers and SME associations across Japan**
- Increasing frequency of hearings regarding the financial result of major banks and the monitoring of inspections
- Active holding of forum for an exchange of opinions with market participants and financial industry representatives

2. Enhancing Dissemination of Information

- Effective communication with regard to the current global financial situation and Japan's programs and schemes to present the FSA's viewpoints and measures, implemented through the active use of lectures, speeches and interviews with media organizations
- **Number of English-language press releases issued on its website doubled** compared with the previous year, while simultaneous issue of English-language press releases increased as well

	May-Nov 2007	May-Nov 2008
Press releases in English	20	38
Simultaneous Japanese/English press releases	7	18

- Briefing sessions held across Japan for better acquaintance with FSA's Basic Policy for Financial Inspections and Inspection Manuals, to facilitate SME financing

Progress in the five areas of immediate focus (May-December 2008) (2)

3. Strengthening Cooperation with Overseas Authorities

Dissemination of information at **international forums at the top and ministerial levels**

- **Dissemination of information regarding the experiences Japan has had and the lessons it has learned** as a result of its efforts to stabilize the financial system following the collapse of the bubble economy in the 1990s

World Economic Forum on East Asia (June 2008)
 G7 Meeting of Finance Ministers and Central Bank Governors (Oct 2008)
 Summit on Financial Markets and the World Economy (Nov 2008)

Promoting international cooperation and participation in international debates

- **Active participation in international debates and deliberations** on how to stabilize the financial system, not only at summits and ministerial meetings but also at a variety of international conferences and those held by international organizations. Strengthening cooperation with foreign supervisory authorities in line with the globalization of financial institutions' business operations and financial transactions

- Quick and steady implementation of measures that authorities were urged to implement in the April 2008 report by the Financial Stability Forum (FSF)
- In May, the FSA joined the Senior Supervisors Group, which comprises the supervisory authorities of major countries and which concerns major LCFIs (large and complex financial institutions), and exchanged opinions and information with foreign authorities
- Establish Supervisory colleges inviting major foreign authorities relevant to large financial institutions based in Japan

Progress in the five areas of immediate focus (May-December 2008) (3)

4. Enhancing Research Functions for Prompt Recognition of Market Developments

- Office for Supervisory Policy, Financial Market & Risk Analysis established in July 2008 in order to **promote the advancement of risk analysis**, such as the timely identification of market trends and risk characteristics through the collection and analysis of indexes and other statistical data related to financial institutions and an exchange of opinions with working-level officials of financial institutions and market participants.
- Inspection departments also made efforts to identify important risks in light of the scale and characteristics of individual financial institutions and used the results of analysis in actual inspections.
- In cooperation with the Bank of Japan, **efforts devoted to identify the conditions of the short-term money markets as well as the markets for corporate bonds and CP**. The information thus collected was shared throughout the FSA.
- **Establish new information-gathering service** regarding the provision of financing by financial institutions (called “*Daijin Meyasubako*”, or the Minister’s mailbox for facilitation of financing) and this information was reflected in FSA inspections and supervision. Information regarding financing for SMEs was shared with the Small and Medium Enterprise Agency.

5. Redoubling Efforts for Human Resource Development

- Action starting in July 2008 toward establishing **a personnel appointment policy based on expertise**, with appointments based on findings in a career path questionnaire survey and assignment of young employees to positions requiring a high levels of expertise, in order to develop skills and knowledge in such areas
- Improvement of in-house training programs to better help employees acquire expert knowledge and skills and develop international perspectives and skills, and an increase in employees sent as trainees to foreign governments’ agencies, Japanese and overseas graduate schools, and diplomatic missions abroad
- **Active employment of professionals** such as lawyers, CPAs, and people with experience in the business sector, including recruitment of computer systems experts and market risk experts in the Inspection departments.

The first progress report on efforts toward Better Regulation also highlighted tasks to be tackled in the future — namely (1) efforts to better acquaint FSA employees with the concept of Better Regulation, (2) enhancement of working-level dialogue and (3) expansion of opportunities for disseminating information. The status of the progress in these areas is outlined below.

(1) Efforts to better acquaint FSA employees with the concept of Better Regulation

- Five items that are particularly important in improving the quality of the conduct of inspections were specified in FSA Inspection Manuals, and efforts were made to ensure that all inspectors are acquainted with the items and act accordingly. Supervisory departments held training programs intended to ensure that all supervisors are fully acquainted with the aforesaid principles and act accordingly.
- Continued efforts will be made to further ensure that FSA employees are acquainted with the concept of Better Regulation and act accordingly.

(2) Enhancement of working-level dialogue

- Dialogue was enhanced by an increase in the frequency of hearings regarding the financial results of financial institutions and an extensive exchange of information conducted by the newly established Office for Supervisory Policy, Financial Market & Risk Analysis with working-level officials of financial institutions about the institutions’ conditions.
- In the future, the FSA needs to deepen discussions with financial institutions about the Principles, through its dialogue with them, and improve the predictability of regulatory actions by enhancing its framework for hearings held to identify financial institutions’

queries regarding the interpretations of laws and regulations.

(3) Expansion of opportunities for disseminating information

- A variety of speeches has been delivered by the Minister of State for Financial Services, the FSA Commissioner and senior FSA officials (frequently delivered in English). Efforts have also been directed to enhance the content of the FSA website, including revisions in the design of its home page.
 - Continued efforts will be made to expand opportunities for disseminating information.
- ✂ For further details, access [Progress Status of Initiative toward Better Regulation \(from May 2008 to December 2008\) \(December 26, 2008\)](#) under "Press Releases" in the FSA website.

Japanese GAAPs are found to be equivalent to IFRS by the European Commission

On December 12, 2008, the European Commission (EC) of the European Union (EU) announced the conclusion of its equivalence assessments of third-country accounting standards and also its recognition of Japanese GAAP equivalence to the International Financial Reporting Standards (IFRS) adopted in Europe. The following directive and decision were also published in the EU official bulletin dated December 19, 2008. The approval has allowed Japanese businesses listed on the EU market to maintain their status, with financial reporting in accordance with Japanese GAAP.

- Commission Regulation (EC) No. 1289/2008 amending Commission Regulation (EC) No. 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council
- Commission decision on the use by third countries' issuers of securities of certain third country's national accounting standards and International Financial Reporting Standards to prepare their consolidated financial statements

* The EU official journal is available from EC [News section of the European Commission website](#).

The Background and Developments in Equivalence Assessment

As part of EU's Lisbon Strategy for Growth and Jobs (March 2000), the Regulation on the application of international accounting standards (IAS¹) was adopted in July 2002, followed by the Regulation on the application of all international accounting standards in existence on 14 September 2002 except IAS 32, IAS 39 and related interpretations in September 2003 and the Regulation on the application of all IAS in existence on 14 September 2002 starting in 2005. Furthermore, the Prospectuses Directive (July 2003) regarding disclosure on issue and the Transparency Directive (December 2004) for continuing disclosure have been adopted. These two directives require non-EU issuers whose securities are admitted to trading in the regulated markets within the EU to comply with IFRS or equivalent accounting standards starting in January 2007. As a result, Japanese GAAP came under study for equivalence assessment.

Note: This issue was originally called the "2005 problem" when application of IAS became compulsory in the EU. Although January 2007 was set as deadline for non-EU foreign businesses, it was called the "2007 problem" and later the "2009 problem" with extension of equivalence assessment by two more years (to be described later).

Actual equivalence assessment started with the assignment of the Committee of European Securities Regulators (CESR) by EC in June 2004 to provide technical advice on assessment of GAAPs of Japan, the US and Canada.

In July 2005, CESR issued the CESR final technical advice (Ref. No. 05-230b) to the European Commission, in which Japanese GAAP was found to be "taken as a whole, equivalent to" IFRS adopted in Europe but to have "26 significant differences." with which remedies such as additional disclosures are necessary.

¹ The International Accounting Standards Committee (IASC) was reorganized as the International Accounting Standards Board (IASB), with the accounting standards to be established renamed from IAS to IFRS.

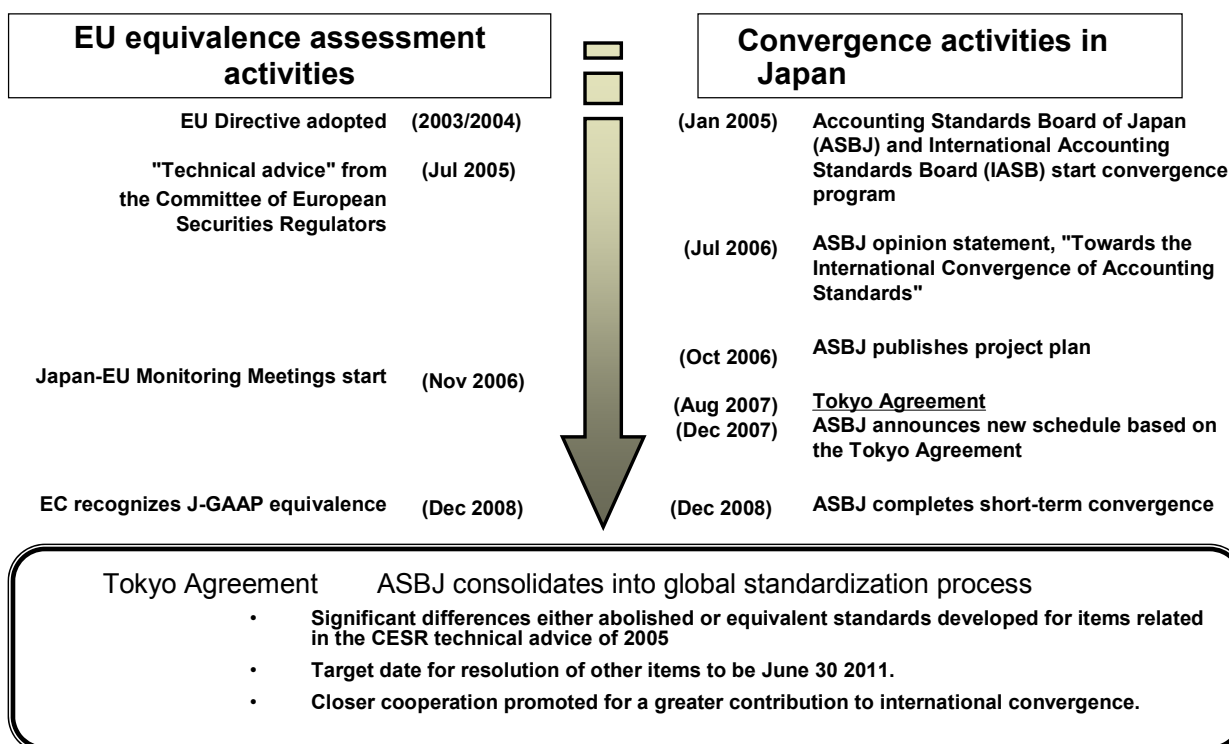
In the meantime, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) had worked for discussions on convergence between IFRS and US GAAP since the Norwalk Agreement of September 2002. Subsequently, the February 2006 Memorandum of Understanding (MOU) on the convergence plan was concluded. In Japan, the Accounting Standards Board of Japan (ASBJ) also took steps to accelerate international convergence and began deliberations on convergence with IASB in March 2005 and with US FASB in May 2006.

On the securities regulators' side, in April 2005 the US Securities and Exchange Commission (SEC) unveiled a roadmap toward elimination of the US GAAP reconciliation requirement imposed on financial statements based on IFRS by 2009. Later, in 2006, the European Commission proposed the postponement of the January 2007 deadline for non-EU foreign businesses to adopt IFRS or equivalent accounting standards to January 2009, in view of advances made in international convergence.

In face of these developments, Japanese constituents engaged in discussions on convergence at the Planning and Coordination Committee of the Business Accounting Council (BAC) and issued the statement titled "Towards the International Convergence of Accounting Standards." The statement called for Japan to take proactive efforts on convergence of the standards and for all related parties to work in concert for establishment and reinforcement of a system for mutual cooperation.

Based on this opinion, ASBJ developed and published a project plan for eliminating the 26 items identified as significant differences by CESR. Later, a deadline for eliminating significant differences was set for the end of 2008 (by June 30, 2011 for other differences) in the Tokyo Agreement of August 2007.

Convergence and Equivalence Assessment



Concurrently, the FSA has engaged in a variety of dialogues with foreign regulators and in information-sharing with the relevant parties in Japan, such as regular meetings with the European Commission, active dialogue with CESR, as well as the publication of opinions on the dialogues and interactions with members of the European Parliament through Japan's diplomatic missions.

With subsequent advances in international convergence and the elimination by the SEC of the US GAAP reconciliation requirement for financial statements of foreign businesses based on IFRS, CESR switched from an approach focused on differences between accounting standards at a certain period of time to a holistic approach by conducting assessment of standards as a whole, including the presence of a rational convergence program. With this change, it issued technical advice on the equivalence of Japanese GAAP and US GAAP with IFRS.

In response, the European Commission issued a draft report in April 2008 based on this technical advice, and later, on December 12, 2008, issued its final decision recognizing Japanese GAAP as equivalent to the IFRS adopted in Europe, following consultations with the European Parliament and the European Securities Committee ([Commission Decision of December 2008 on the use by third countries' issuers of securities of certain third country's national accounting standards and International Financial Reporting Standards to prepare their consolidated financial statements](#)).

The Conclusion and Significance of Equivalence Assessment

According to the Decision, "in August 2007 the Accounting Standards Board of Japan and the IASB announced their agreement to accelerate the convergence by eliminating major differences between Japanese GAAP and IFRS by 2008 and the remaining differences by 2011. The Japanese authorities do not require any reconciliation for Community issuers which prepare their financial statements according to IFRS. Therefore, it is appropriate to consider Japanese GAAP equivalent to adopted IFRS from 1 January 2009." A similar decision has also been made for US GAAP. For GAAP of the People's Republic of China, Canada, the Republic of Korea and the Republic of India, a third country issuer is to be permitted to prepare its consolidated financial statements in accordance with the respective GAAP for financial years prior to those starting on or after 1 January 2012, although they have not been finally decided as the equivalent in the decision.

As a direct impact of the decision, Japanese business corporations that raise funds in regulated markets within the EU are able to continue publishing their financial statements based on Japanese GAAP. The FSA evaluates this Commission Decision highly for its recognition of the outstanding quality of the Japanese GAAP, which is a key infrastructure for financial capital markets in the country, from the international perspective and for maintenance of the openness of the financial capital markets of both Japan and the European Union.

This achievement is believed to be the product of the hard work and effort of the parties involved both in Europe and in Japan mainly led by ASBJ. The FSA to continues to enhance the international credibility of the Japanese financial capital markets and to support the efforts in the area of accounting standards.

Results of the Public Comments procedure on the Proposed Cabinet Order and Proposed Cabinet Office Ordinance on the Revamp of Firewall Regulations and the Establishment of Systems for Managing Conflicts of Interest in the 2008 Amendment of the Financial Exchange and Instruments Act

1. Introduction

The firewall regulations separating securities, banking and insurance businesses are aimed at preventing harm caused by conflicts of interest and curbing abuse of the dominant position of banks. However, the existing firewall regulations have been found to involve the following shortcomings in the face of advances in conglomeration of financial institutions:

- **Possible obstruction of user convenience, impeding delivery of comprehensive service as a financial group ; and**
- **Possible obstruction of integrated risk management and compliance required for the financial group as a whole.**

The First Subcommittee of the Sectional Committee on the Financial System of the Financial System Council that in the fall of 2007 also engaged in lively discussion on the existing firewall regulations, from the standpoints of effectively preventing abuse of their dominant positions by banks and other financial institutions as well as conflicts of interest, and of satisfying the need for integrated internal control of financial groups and improving customer convenience. The Subcommittee concluded its deliberations with the recommendation that a new framework founded on the regulations described below should be put in place.

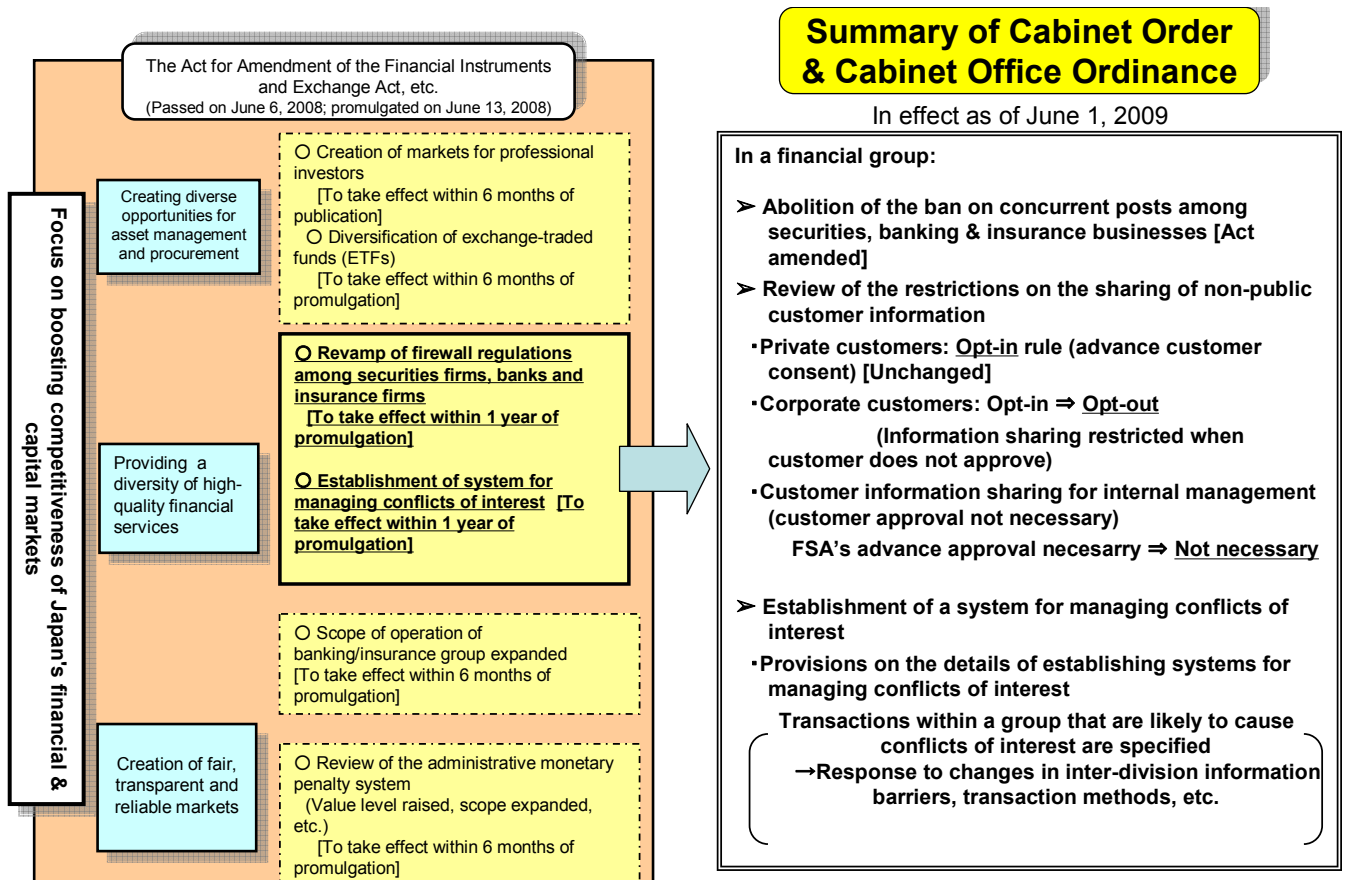
- **A framework should be developed under which financial institutions are required to establish systems for managing conflicts of interest.**
- **Solicitation with the abusive use of the dominant positions of banks, etc. should be prohibited.**
- **The ban on concurrent executive officers and employees should be abolished**
- **The restrictions on the sharing of non-public information regarding clients and customers should be reviewed.**

"The act for Amendment of the Financial Instruments and Exchange Act, etc." (hereinafter referred to as the "Amendment") promulgated on June 13, 2008, abolished the ban on concurrent posts held by senior officers and employees within a financial group and required financial institutions and financial groups to establish systems for managing conflicts of interest, based on the recommendations of the Financial System Council.

Reflecting the Amendment, the recently promulgated Cabinet Order and Cabinet Office Ordinance implemented the following:

- Provisions on the details of how to establish the systems for managing conflicts of interest
- Review of the restrictions on the sharing of non-public information regarding customers
- Provisions on prevention of the abuse of the dominant positions of banks, etc.
- Mitigation of restrictions on lead underwriters

The main changes are described below.



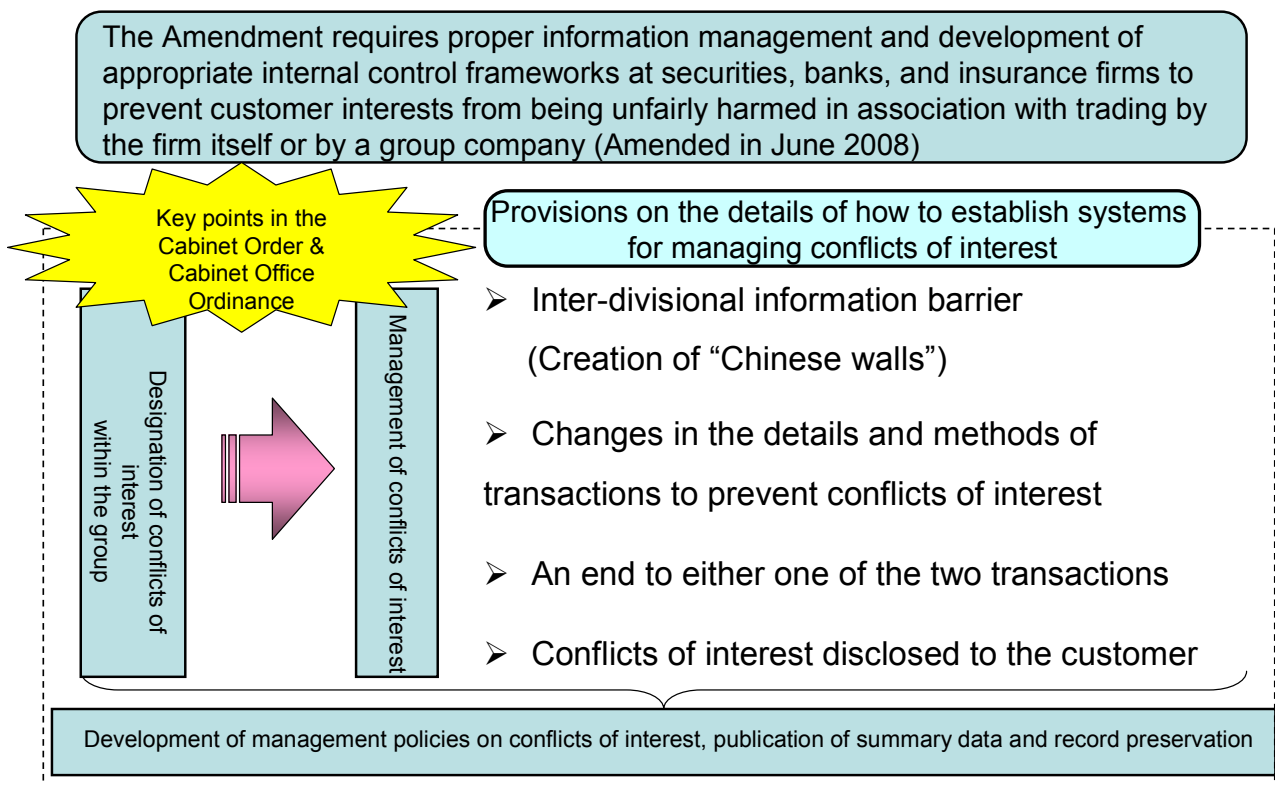
Note: Changes to take effect within 6 months of promulgation have been enforced as of December 12, 2008.

2. Provisions on the details of how to establish the systems for managing conflicts of interest

The Amendment requires securities firms, banks, insurance companies and others to implement proper information management and develop appropriate internal control frameworks aimed at preventing customers' interests from being unfairly harmed in association with trading by the firm itself or by a group company.

In the recently amended Cabinet Order and Cabinet Office Ordinance, rules have been established on details such as the scope of business operators and group companies that are required to establish systems for managing conflicts of interest. Along with this, they specify measures business operators must execute to prevent customers' interests from being unfairly harmed.

Establishment of a system for managing conflicts of interest



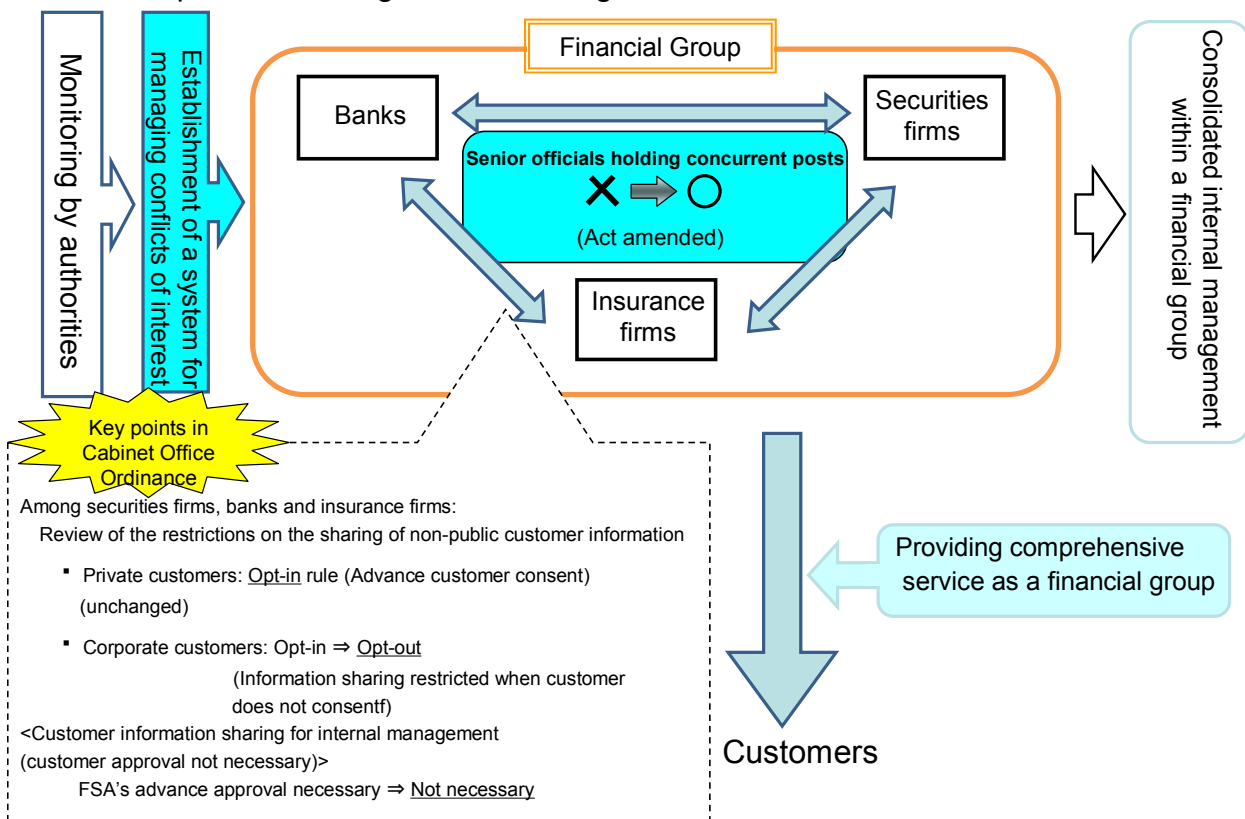
3. Review of the restrictions on the sharing of non-public information regarding customers

Regarding the sharing of corporate customer information within a financial group, advance consent of the customer is no longer necessary, but this sharing is restricted when the customer does not consent (opt-out consent).

Note: Sharing of non-public information on individual customers will continue to require opt-in consent of the customer.

Advance approval of the FSA that is presently required for information sharing for the purpose of integrated internal management will no longer be necessary.

The revamp of firewall regulations among securities firms, banks and insurance firms



4. Prevention of the abuse of the dominant positions of banks, etc.

Measures will be implemented to prevent securities firms and insurance companies from solicitation and conclusion of financial product transactions or insurance contracts by unfairly abusing their dominant positions as the banks within the same corporate group.

Note: Under the Banking Act, banks are already prohibited from taking advantage of their dominant positions in business to have the group companies engage in transactions.

5. Mitigation of restrictions on lead underwriters

As a basic rule, a securities firm cannot be assigned as lead underwriter for securities issued by a corporate group member. An exception to this rule has been added in the case of involvement of other underwriters that satisfy the following requirements in the stock issue valuation process.

- (1) Being registered as an underwriter;
- (2) Having extensive experience in underwriting; and
- (3) Being independent in terms of capital and personnel.

The relationship between the issuer and the lead underwriter, as well as details of the issue valuation method and procedure, must be disclosed by including the information in the security registration statement.

Other major amendments



Key points in the Cabinet Order

○ Prevention of the abuse of the dominant positions of banks, etc.

Prevent securities firms and insurance companies from engaging in transactions by unfairly abusing their dominant positions as the banks within the same corporate group.

Note: Under the Banking Act, banks are already prohibited from taking advantage of their dominant positions in business to have the group companies engage in transactions.

○ Mitigation of restrictions on lead underwriters

As a basic rule, a securities firm cannot be assigned as lead underwriter for securities issued by its group company. An exception to this rule has been added in the case of involvement of other underwriters that satisfy the following requirements in the stock issue valuation process:

- Being registered as an underwriting business;
- Having extensive experience in underwriting; and
- Being independent in terms of capital and personnel.

In such a case, the relationship between the issuer and the lead underwriter, as well as details of the issue valuation methods and procedures, must be disclosed.

6. Effective date

The amendments regarding the revamp of firewall regulations and establishment of systems for managing conflicts of interest were scheduled to come into effect on a date specified by a Cabinet Order, within one year from the date of promulgation of the amendments (June 13, 2008), and they are to be enforced from June 1, 2009, by promulgation of the related Cabinet Order.

[Minister in his own words]

This section provides information regarding the hot topics of the moment, selected from questions and answers given at the Minister's press conferences, etc. If you wish to find out more, we invite you to visit the "[Press Conferences](#)" section of the FSA website.

Q : Today, the first trading day of the year, the TSE (Tokyo Stock Exchange) made a good start as stock prices (as measured by the Nikkei Average) rebounded to 9,000. How do you feel about this? Also, following the largest annual stock price drop ever that was recorded last year, how would you like the stock market to perform this year?

A. If I remember correctly, despite a difficult environment early last year, many people said that the stock market would recover later in the year, while some experts and market participants now predict that this will be a very difficult year. In this situation, countries around the world are implementing a variety of measures on their own and in cooperation with each other. In Japan, too, the government and the private sector must work together and do their best to overcome this crisis situation. In this sense, stable foreign exchange rates and the stock price rise today, which came after a moderate recovery in markets around the world around the turn of the year, reflect the strong resolve of the private sector, or the business circles, to overcome this difficult situation, and we must also do our best to accomplish what must be done with a similar resolve. For the moment, I feel as if we are being encouraged by the market to cheer up. That is my impression of the current market conditions.

【Extract from the press conference on January 5, 2009】

Q : First, Sapporo Hokuyo Holdings, which is based in Hokkaido, announced yesterday that it started considering applying for governmental capital injection under the revised Act on Special Measures for Strengthening Financial Functions. While the screening has yet to be done, it will be the first case of capital injection under this Act if the application is approved. What do you think of this?

A. I know of the announcement yesterday that Hokuyo Bank started considering accepting governmental capital injection. I think it is very good for the local economy for a sound bank to provide funds to SMEs in Hokkaido by strengthening its capital base. So, if I am to speak in general terms, rather than talking about a specific bank, I hope that the recapitalization scheme will be used to achieve the purpose of this Act.

Q : How do you expect this will affect other financial institutions?

A. In the past, there was a similar case, although the purpose at that time was quite different, and some people worried that this scheme could have negative effects. However, I hope that this will prompt other financial institutions to use this scheme, as its use by sound banks would lead to the fulfillment of their duty to exercise their financial functions.

【Extract from the press conference on January 5, 2009】

Q : I would like to ask you about applications for public funds based on the Act on Special Measures for Strengthening Financial Functions. What do you think of Minami Nippon Bank's recent expression of their intention to consider filing an application? Also, while I think that other regional banks may file their own applications as, to a certain degree, drops in stock prices and the (severe) condition of the local economies are problems that are common in the industry, how do you view the current situation?

A. As for the Act on Special Measures for Strengthening Financial Functions, as I have said over and over again, its purpose is to strengthen the foundation of financial institutions and encourage them to provide funds to small and medium-size enterprises and local economies, and financial institutions should make their own judgments and apply for injections of public funds based on that. The announcements by Hokuyo Bank and Minami Nippon Bank that they will consider applying are in accordance with the purpose of this Act. In particular, I would greatly appreciate it if applications were filed in regions such as Hokkaido and Kagoshima, where the economic condition is very severe, so that funds could be provided smoothly there, and I would also appreciate it if applications were filed in other regions or by other financial institutions.

【Extract from the press conference on January 23, 2009】

Q : In relation to financial affairs, I would like to ask you about the current situation of regional banks. I understand that so far, two banks have expressed their intentions to apply for capital injection under the Act on Special Measures for Strengthening Financial Functions. In addition, Kagawa Bank and Tokushima Bank announced their business integration yesterday. What is your recognition of the environment surrounding regional banks and their management conditions?

A. Before I talk about the merger, I would like to tell you about my view about news that umbrella organizations for “shinkin” banks and credit associations are considering applying for governmental capital injection. As I have been saying, liquidity problems faced by financial institutions around the world are affecting the real economy considerably. Therefore, while I would not tell them whether or not to do this, in light of the purpose of this act, it would be very good if they decided to. I would welcome it. As I told you earlier, I could not say whether or not this should be done, nor have I received any formal report about this. However, generally speaking, I think this is also good from the viewpoint of the provision of liquidity to small and medium-size enterprises (SMEs).

As for the merger plan of the banks in the Shikoku region that you mentioned, I do not know anything more than has been reported by the mass media. Previously, I think that one of the major objectives of the Act on Special Measures for Strengthening Financial Functions was to promote mergers. However, this time, rather than promoting mergers, it is intended to give banks the additional capacity and sufficient financial strength to provide loans to SMEs and local economies. So, while promoting merger is not a major direct objective, we will keep a close watch on this because banks’ financial strength may be enhanced by a merger, although I do not know how this merger plan will play out.

【Extract from the press conference on January 23, 2009】

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