

The main issues raised by the FSA at opinion exchange meetings with trade associations

**[held on July 18, 2023, with the Japan Securities Dealers
Association]**

1. Doubling Asset-based Income Plan

- The national government decided the Doubling Asset-based Income Plan at the end of last year and has been taking various measures for accelerating the shift of personal financial assets from savings to investment and developing an environment to enable people: centered on the middle-income group, to broadly participate in capital markets and enjoy the fruits of growth. In order to ensure the effectiveness of these measures, we consider it important that securities companies well recognize the significance of their roles and support financing of companies with growth potential and fulfil their roles to the extent possible to assist households' asset building.
- From such perspective, securities companies are expected to ascertain the true needs of customers and endeavor to provide high-quality goods and services that will contribute to people's stable asset building and offer follow-up services.

2. NISA and financial and economic education

- The national government positions 2023 as the first year of the Doubling Asset-based Income Plan and intends to enhance financial and economic education and further disseminate and promote people's use of the NISA program.
- Since the beginning of 2023, the national government has conducted the following:
 - Positive PR activities targeting all generations using various media, including TV, internet and SNS;
 - Holding of joint seminars with relevant bodies around the NISA Day (February 13);
 - Holding of seminars targeting national government officials to start at the first step.

- We ask for your continued cooperation from the perspective of promoting environmental development to enable people to make investments without worry.

3. PR activities for disseminating NISA

- We decided to establish inquiry counters regarding NISA at Local Finance Bureaus to support asset building-related initiatives by local governments and member companies of commerce and industry organizations.
- The inquiry counters will accept consultations about dispatch of lecturers for asset building seminars targeting individual entities' employees and staff members. Relevant organizations including the Japan Securities Dealers Association offered cooperation for developing a framework to respond to such consultations. Thank you very much.
- The FSA has endeavored to introduce the inquiry counters established at Local Finance Bureaus and has explained the significance of employers' support for their employees' stable asset building to local governments and prefectural associations, etc. nationwide. To start at the first step, the FSA held an asset building seminar targeting national government officials on June 16.
- We ask securities companies, including their front-line sales personnel, to actively carry out PR activities for supporting asset building at each job category, centered on the use of the NISA program, and also to strengthen collaboration with the FSA and other relevant organizations.

4. Asset Management Nation

- Roles to be played by asset management companies and asset owners are considered to be significant in accelerating the shift of personal financial assets from savings to investment and facilitating people's stable asset building. Accordingly, the national government is planning to commence initiatives to achieve an Asset Management Nation to strongly promote enhancement of the asset management business and strengthen functions of asset owners.
- As part of such initiatives, the national government set the period from

September 25 to October 6 as "Japan Weeks" to hold various promotion events with the aim of intensively inviting foreign financial business operators to Japan.

- Additionally, a specific policy plan for fundamentally reforming the asset management business is to be compiled by the end of 2023 under the Council of New Form of Capitalism Realization. The details of the specific policies will be discussed while having communications with internal and external related parties. Please provide us with your constructive opinions.

5. Japan Weeks

- As stated in the Basic Policy on Economic and Fiscal Management and Reform, etc., which was published recently, the national government will strengthen information provision concerning its initiatives for achieving an Asset Management Nation and establishing Japan's position as an international financial center, by such means as holding promotion events during the Japan Weeks to intensively invite foreign financial business operators to Japan. The Japan Weeks will be set from September 25 to October 6. We may ask for your cooperation for holding related events during this period. We would appreciate your cooperation.

6. International discussions in light of the bankruptcy of SVB and other serious circumstances

- The FSA provide an update on the current international discussions in light of the bankruptcy of SVB and other serious circumstances.
- On June 6, 2023, the Basel Committee on Banking Supervision (BCBS) held a meeting and issued a press release. In the press release, the BCBS announced the following agreements regarding the recent banking turmoil:
 - ✓ The first and most important source of financial and operational resilience comes from banks' own risk management practices and governance arrangements.
 - ✓ It is critical that supervisors have the ability and willingness to act early and

effectively to identify and promptly correct weaknesses in bank practices.

- ✓ Members unanimously reaffirmed their expectation of implementing all aspects of the Basel III framework in a full and consistent manner, and as soon as possible, in order to further enhance the resilience of the global banking system.
- Additionally, the BCBS agreed to continue to examine the supervisory and regulatory implications stemming from the turmoil, building on existing initiatives already underway. This includes work on strengthening the effectiveness of supervision, liquidity risk management and interest rate risk in the banking book.
- On July 6, 2023, the Financial Stability Board (FSB) Plenary met and issued a press release. The press release mentions the FSB work program has been prioritized, including with an additional focus on the interactions between interest rate and liquidity risk across the financial system, the role of technology and social media in deposit runs and, in particular and as an early focus, on lessons for the resolution framework. Furthermore, it says the FSB members stressed the importance of policy work to address systemic risk in the Non-Bank Financial Intermediation (NBFi) sector, and the FSB will deliver reports to the G20 in September on the financial stability risks of leverage in the non-bank sector and on progress on its work program to enhance resilience in NBFi.
- The FSB Plenary also discussed recent progress made on addressing financial risks from climate change and crypto-assets. The Plenary welcomed the finalization by the International Sustainability Standards Board (ISSB) of its climate-related and general sustainability-related disclosure standards. With regard to crypto-assets, the Plenary approved the FSB high-level recommendations and discussed how to promote their effective implementation. The International Monetary Fund (IMF) is working on macroeconomic risks posed by crypto-assets, and a joint paper that will synthesize the IMF and FSB policy recommendations is underway.
- The FSA will continue to contribute to international discussions .

7. Publication of the Report on AML/CFT/CPF Measures and development of control framework

- The FSA published the report for PY2022, "Anti-Money Laundering, Counter

Financing of Terrorism, and Counter-Proliferation Financing – Current Status and Challenges," ("Report on AML/CFT/CPF Measures") on June 30, 2023 (This is the fourth report following those published in 2018, 2019, and 2022.).

- The report contains issues common to financial institutions ascertained through inspections and monitoring, best practices, and the status of discussions at the FATF.
- Individual financial institutions are expected to make efforts to improve their own control framework and to raise the level of countermeasures in the industry as a whole, while referring to the report.

* Outline of the Report on AML/CFT/CPF Measures

- As advances in technology lead to the diversification of settlement methods, financial transactions are becoming more globalized and complex, while the risks of money laundering, terrorist financing and proliferation financing faced by financial institutions are also changing, with the expansion of non-face-to-face transactions due to COVID-19. In particular, phone frauds and crimes in cyberspace are increasing and crypto-assets and fund settlement services (payment agency services) still have intrinsic risks. Financial institutions are required to enhance their risk management systems continuously in response to changes in risks of money laundering, etc.
- Toward the end of March 2024, which is set as the deadline for financial institutions to complete the development of their control framework for required actions in the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism, the overall level of financial institutions' control framework has been enhanced, but some financial institutions lag behind in taking actual actions as they have spent much time in identifying and assessing risks comprehensively and specifically or in considering plans for enhancing their control framework.
- Through inspections and interviews, the FSA will continue to examine the accuracy of the gap analysis for initiatives designated as "required actions for a financial institution" in the Guidelines and the progress of the Action Plan for completing the development of control framework by March 2024, in order to encourage financial institutions to enhance their risk-based initiatives.

8. Publication of the "Analysis Report on Financial Institutions' Computer System Failures"

- On June 30, 2023, the FSA published the "Analysis Report on Financial

Institutions' Computer System Failures," which compiles the trend and examples of financial institutions' computer system failures that occurred in FY2022 (this is the fifth annual report from the first one published in 2019).

- In the same manner as in the last fiscal year, the FSA analyzed the causes and problems with the focus placed on "timings of failures"*¹ of each case. Additionally, in light of the fact that the resilience for early resumption of services in the event of a failure is becoming increasingly important, the report newly incorporates best practices for incident response.*²
- Financial institutions are expected to make further efforts to strengthen their IT system risk management for ensuring stable service provision, while referring to this report.

*1 The report compiles the trend, causes and problems of system failures, focused on each of the following timings (i) to (iv).

(i) Cyberattack, unauthorized access, etc.

Information leakage due to an unauthorized access, infection with malware of equipment for which a support service has expired, or impossibility to access a website due to a DDoS attack; It is necessary to strengthen security measures, including those for material outsourcees, and to strengthen resilience in the event of an incident.

(ii) Daily operation and maintenance, etc.

A redundant configuration's failure to function in the event of a system failure or delay in resumption of services due to a system failure at an outsourcee; It is necessary to develop restoration procedures, including responses at outsourcees, and ensure the effectiveness of the restoration procedures through joint training with outsourcees.

(iii) Integration and update of systems and addition of new functions, etc.

A system failure at the time of updating a program for adding new functions; It is necessary to accumulate system specifications and other IT assets, and develop a framework for conducting review by properly deploying experts, etc.

(iv) Irregular work, such as renewal of programs

Unavailability of ATMs due to an outsourcee's error in setting or in operation upon irregular work, such as renewal of a program; It is necessary to improve the quality of work related to system alterations, such as by developing a framework for verifying work procedures, conducting tests simulating the actual environment, and developing a multi-layered check system.

*2 Example of best practices

When ATMs stopped due to a cloud failure, responsible staff promptly restored ATMs manually based on the contingency plan. The financial institution has prepared a manual so that other staff members can also take actions to restore services and has conducted training.

9. Ideal retail business

- On June 30, 2023, the FSA published the "Results of Monitoring Customer-Oriented Business Conduct of Distributors of Financial Instruments Involving Risk" (this is the sixth annual report since the first one published in 2018)
- The monitoring results are omitted here as they were introduced last month, but the percentage of customers holding installment investment trusts is increasing and this suggests that people's awareness regarding the shift from savings to investment has further strengthened. On the other hand, as typically seen in cases where structured bonds and foreign currency-denominated single premium policies were sold to customers who prefer stable asset building, financial institutions' earnings are sometimes put ahead of customer interest. Such sales practices would impair the shift from savings to investment.
- For achieving customers' best interest, financial institutions are expected to offer support for people's stable asset building, aiming to achieve best practices, instead of merely rectifying the problems pointed out or otherwise making minimum responses.
- The FSA will continue monitoring, etc. to further promote financial institutions' customer-oriented business conduct.

10. Publication of the Draft Cabinet Office Order based on the Economic Security Promotion Act

- A meeting of the Expert Panel on Economic Security Legislation was held recently and public comment procedures were commenced for the following matters out of the specifics presented at the meeting, regarding the draft Cabinet Office Order (until July 14).
 - Criteria for designating businesses subject to regulations
 - Specified critical facilities

- This system requires designated businesses relating to critical infrastructures: including finance, to receive prior screening by the authority when introducing specified critical facilities.

The FSA will have dialogues meticulously with financial institutions towards the enforcement of this system. We would appreciate your continued cooperation.

- The FSA and other relevant ministries and agencies have established inquiry counters to accept prior consultations regarding the introduction, etc. of specified critical facilities with the aim of maintaining constant communications with targeted businesses and other relevant businesses. The FSA's inquiry counters are operated by the Economic Security Office, Risk Analysis Division, Strategy Development and Management Bureau. We expect that financial institutions will fully utilize these services for ensuring their responses to economic security risks.

11. Efforts for sustainable finance

- The FSA published several reports including the following in June.
- On June 30, the FSA published the Third Report by the Expert Panel on Sustainable Finance. The report compiles the status of measures concerning sustainable finance implemented for the last one-year period and future challenges and measures. We appreciate the cooperation of industry organizations for the questionnaire concerning human resources development. The results of the questionnaire show higher needs for in-house development than for mid-career recruitment and point out the significance of industry-wide initiatives from the perspective of securing personnel who will be immediately effective. Industry organizations are highly expected to provide training or otherwise take actions. We hope that they will make relevant efforts while referring to the report.

Also, on June 30, the FSA published the Report by the Working Group on Impact Investment. The Working Group had discussions on a total of eight occasions and compiled the significance and basic idea of "impact investment," which will contribute to supporting startups, etc. that play the core role in innovation necessary for balancing the solution of social problems and business

profitability. The Working Group also started to solicit opinions regarding the Draft Basic Guidelines on Impact Investment, which summarizes the basic ideas and requirements, etc. of impact investment. Opinions are sought until October 10, and the Working Group will finalize the Basic Guidelines based on collected opinions and comments. As measures to further promote investment, the report proposes the establishment of a Consortium wherein a broad range of related parties, such as companies, investors, financial institutions, academia, and local governments, collect and share data, measurement methods, case examples, etc. It is pointed out that impact investment may also be utilized for companies intending to start business in local areas. Deliberations on impact investment have just started domestically and internationally, but we hope that you will follow up or participate in discussions on the Consortium, which is planned to be established within this year at the earliest.

On June 27, the FSA published the Report by the Working Group on Financial Institutions' Efforts towards Decarbonization of the Economy. The Working Group had discussions on a total of seven occasions and compiled its recommendations regarding the following as a guide: (i) utilization of various indices relating to the transition; (ii) improvement of GHG emissions data, and (iii) understanding of the suitability of pathways, so that the formulation of companies' transition plans: which is a material theme toward achieving carbon neutrality, would surely contribute to the expansion of financial institutions' engagement. We hope that you will make relevant efforts while referring to the report.

12. Monitoring of securities business for the 2023 program year

- We understand that securities companies are playing significant roles as gatekeepers in the market and actively contribute to securing the fairness in the market, and at the same time are also striving to sufficiently fulfill their financial intermediary function and support stable asset building of households and fund procurement of companies with growth potential.
- With this awareness in mind, we will conduct monitoring for PY2023 basically based on the same idea as in PY2022. However, at the beginning of the new program year, we would like to look back on the status in the last program year and present some points of attention.

< Control environment for sale and solicitation of financial instruments >

- Regarding sale and solicitation of financial instruments, we will continue dialogues on individual securities companies' efforts for customer-oriented business conduct and monitor whether they have established a control environment for sale and solicitation in line with laws and regulations and other various operational rules.

Last month, we issued an administrative disposition against securities companies affiliated with regional banks that violated the obligation to provide explanations in accordance with the principle of suitability and customers' attributes upon solicitation and sale of structured bonds. We will continue taking strict measures when any serious problem is found, from the perspective of protecting investors.

The new self-regulatory guidelines concerning complicated structured bonds, etc. were put into effect on July 1. We would also like to pay attention to sale of complicated structured bonds under the new guidelines.

< Control environment as market intermediaries >

- From the perspective of market fairness, this program year as well, we will continue monitoring whether securities companies have established an effective compliance system and internal control environment as market intermediaries, including a control environment for detecting and preventing market misconduct.

< Business model in light of environmental changes >

- In light of changes in the environment surrounding securities companies, such as increases of online transactions and cheaper transactions and diversification of goods and services, last program year, we had dialogues with many securities companies at various levels: including those with top management, regarding their business models and the status of establishing risk management systems in accordance with those business models. We would like to continue such dialogues this program year as well.

< Overseas business strategies >

- With major securities companies that operate globally in particular, we will talk about their overseas business strategies and monitor whether they have

established an effective governance and risk management system commensurate with those business strategies.

13. Financial measures in response to the disasters, the heavy rains from June 29, 2023 and the heavy rains from July 7, 2023

- We express our condolences and sympathies to victims of the heavy rains from June 29 and from July 7, 2023.
- The Disaster Relief Act is applied to Yamaguchi Prefecture in relation to the heavy rains from June 29. In response, the Chugoku Local Finance Bureau and the Bank of Japan jointly issued a notice requesting financial measures to relevant financial institutions, etc. in Yamaguchi Prefecture on July 3.
- In relation to the heavy rains from July 7, the Disaster Relief Act is applied to Shimane, Saga, Oita, Fukuoka, Toyama, Akita and Aomori Prefectures. In response, Local Finance Bureaus having jurisdiction over the relevant areas and the Bank of Japan jointly issued a notice requesting financial measures to relevant financial institutions, etc. on July 10, 11, 14 and 18.
- Financial institutions in disaster-affected areas are requested to sufficiently ascertain disaster victims' opinions and needs and offer support meticulously from their standpoints based on the issued requests.

14. Progress in Transition Away from LIBOR

- The publication of LIBOR, except for the USD LIBOR, ceased at end-December 2021 and the USD LIBOR ceased to be published at end-June 2023. Financial institutions with legacy contracts are required to take necessary actions thoroughly in order to complete the transition arrangement before the first fixing date after the last publication date.
- Based on the results of the Fifth Survey on the Use of LIBOR (as of end- June 2023), the FSA will continue to monitor the progress in transition arrangements of financial institutions, cooperating with the BOJ, with regard to remaining contracts referencing the USD LIBOR and contracts referencing the synthetic USD LIBOR, which is being temporarily published since July 2023, and

require them to take necessary actions depending on their respective situations.

15. Activities of the Certified Public Accountants and Auditing Oversight Board

- The Certified Public Accountants and Auditing Oversight Board (CPAAOB) has prepared monitoring reports with the aim of providing information to market participants and the general public such as the current conditions of the audit industry, the status of monitoring by the CPAAOB, and responses to changes in the environment surrounding audits, in an easy-to-understand manner. The CPAAOB published the 2023 Monitoring Report on July 14.
- The report states that 79.3% of audit service revenue is marked by large-sized audit firms but that the ratio of large-sized audit firms has been on a downward trend in recent years.
- The CPAAOB's monitoring report shows the situation with overall ratings based on inspection results. There have been no audit firms qualified as "Satisfactory," the highest rating in the overall rating scheme, in inspections conducted in or after the 2016 program year.

In the previous program year, a mid-tier audit firm was rated 4 for the first time.

Small and medium-sized audit firms, partnerships, and solo practitioners tended to have lower overall ratings than large-sized audit firms and mid-tier audit firms. This is because the CPAAOB selects audit firms to be inspected on a risk basis.

- Regarding the operation of audit firms, the report explains that the Audit Firm Governance Code revised (in March 2023) accompanying the amendment, etc. of the Certified Public Accountants Act mandates audit firms that audit listed companies to establish a framework for conducting operations in line with the Code and requiring enhanced information disclosure and that the Code aims to accompany acceptance of small and medium-sized audit firms.
- Additionally, regarding changes of auditors, the report states that there is an ongoing shift from large-sized audit firms to mid-tier and small and medium-sized audit firms.

- As a major change in the environment surrounding audits of small and medium-sized audit firms, the legal registration system for auditors of listed companies was introduced. In response, the Quality Control Oversight Board was newly established within the Japanese Institute of Certified Public Accountants (JICPA), and the Board conducts screening of registrations. Furthermore, the JICPA's Quality Control Review System is to be utilized for confirming the eligibility as auditors of listed companies.
- In light of such circumstances, the CPAAOB decided
 - to increase the frequency of inspections for mid-tier audit firms from once in three years in principle to once in two years in principle in consideration of the fact that their roles in capital market are increasing accompanying changes of auditors of listed companies, and
 - to place more importance on inspections for small and medium-sized audit firms (also in this program year) as the legal registration system for auditors of listed companies was introduced under the amended Certified Public Accountants Act.
- The CPAAOB also creates the Case Report from Audit Firm Inspection Results and the Basic Plan for Monitoring Audit Firms in Program Year 2023 and posts them on its website. Please utilize them as well.