

Main Topics Presented by the Financial Services Agency (FSA) at a Dialogue with the Financial Sector Association (major banks, etc.)

July 31, 2024

1. Financial measures in response to the disaster, etc. caused by the heavy rains from July 9, 2024 and from July 25, 2024

- We express our condolences and sympathies to victims of the heavy rains from July 9, 2024 and from July 25, 2024.
- The Disaster Relief Act is applied to Shimane Prefecture in relation to the heavy rains from July 9. 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 Shimane Prefecture on Thursday, July 11.
- Additionally, in response to the application of the Disaster Relief Act to Yamagata Prefecture and Akita Prefecture in relation to the heavy rains from July 25, the Tohoku Local Finance Bureau and the Bank of Japan jointly issued a notice requesting financial measures to relevant financial institutions, etc. on July 25.
- 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.

2. Basic Policy on Economic and Fiscal Management and Reform, and Action Plan for a New Form of Capitalism

- On June 21, the Cabinet decided on the Basic Policy on Economic and Fiscal Management and Reform 2024 the Grand Design and Action Plan for a New Form of Capitalism 2024 Revised Version.

- In relation to the FSA, the following measures are incorporated:
 - Promotion of financial institutions' support for companies in their efforts to improve and reconstruct their business and take on challenges again, as well as for their business succession and M&A;
 - Implementation of initiatives for promoting Japan as a leading asset management center, through such means as facilitating the utilization of the NISA program, enhancing financial and economic education, substantializing the corporate governance reform, and reforming the asset management business and asset ownership;
 - Development of the environment regarding the provision of funds to startups, through such means as facilitating the distribution of unlisted shares;
 - Implementation of initiatives for achieving sustainable finance, through such means as promoting impact investments and transition finance in collaboration with Asian countries, and enhancing disclosure of sustainability information.
- The measures incorporated in the national government's policy are all important, and the FSA will make intensive efforts so that finance can firmly support the real economy and people's lives.
- From the perspective of promoting Japan as a leading asset management center, financial institutions are expected to thoroughly ensure customer-oriented business conduct when dealing with investment products in all departments including the front-line sales departments and departments involved in the planning and development of products.
- The national government has been working to reform asset ownership in line with the Policy Plan for Promoting Japan as a Leading Asset Management Center, which was formulated in December 2023, with the aim of achieving a "virtuous cycle of growth and distribution" in which Japan's household savings flow more into productive investment, and the benefits of increased corporate value are returned to

households, leading to further private sector investment and consumption.

- The FSA has requested major financial groups with group companies engaging in the asset management business to formulate and publish a plan to clarify the positioning of the asset management business in the group's management strategy and enhance operational capability, improve the governance, and strengthen structures. In response, many of them have published their plans already. It is expected that they will steadily implement those plans and promote positive efforts for enhancing the asset management business as a whole.

3. Responses to changes in financial and economic conditions inside and outside Japan

- The environment surrounding the Japanese economy and finance has been changing recently. Since the Bank of Japan's changes in the monetary policy framework in March 2024, many financial institutions decided to raise deposit interest rates and some are moving to raise housing loan rates.
- Changes in interest rates may exert influence on customers in diverse ways. In negotiations on loan interest rates, financial institutions are requested to provide sufficient explanations to client companies and also give advice on appropriate repayment plans as necessary in consideration of circumstances of individual borrowers.
- The FSA will continue monitoring monetary policy and trends in financial institutions, as well as the influence of these trends on SMEs and housing loan borrowers.

4. Stability of the financial system and banks' exercise of their financial intermediary function

- In order to exercise a high-quality financial intermediary function sustainably in

Japan, banks need to maintain their financial health and the appropriateness of their services over the medium to long term.

- For that purpose, individual banks are required to have developed a robust governance system, risk management system, and internal audit system, and to have established a sound risk culture and lending disciplines.
- In FY2024 as well, the FSA conducts monitoring through a full-year inspection in order to ensure that individual banks maintain their financial health and the appropriateness of their services over the medium to long term.
- When conducting monitoring, the FSA will check individual banks' risk appetite and risk-taking policy in light of the trends of economic conditions, prices, and interest rates in and outside Japan, and the statuses of domestic and foreign real estate markets, while also considering current circumstances, such as the expansion of non-bank financial intermediation (NBFIs), geopolitical risks, and increasing threats of cyberattacks, and will verify whether they have developed a screening system, risk management system, and internal audit system in accordance with those trends and circumstances and whether they have established a sound risk culture and lending disciplines.
- Major points for verification at this point in time
 - (1) Governance system
 - While fully utilizing the results of the survey on overseas business bases, verify whether banks have established a sound risk culture on a group basis and a global basis and whether their initiatives for enhancing internal audits are progressing.
 - (2) Credit risk management system
 - Verify the status of fulfilment of functions of banks' screening and risk management systems, including the management of large borrowers and loans on real estate in and outside Japan.

(3) Market risk management system

- In light of the changes in interest rate environments in and outside Japan, verify how banks control losses or gains on the valuation of securities, the status of their deliberations and discussions among the organization as a whole when formulating a portfolio of deposits, loans, and securities, as well as their systems for managing interest rate risks that may arise from the entirety of bank accounts.

(4) Liquidity risk management system

- In collaboration with the Bank of Japan, verify how banks review the deposit outflow rate for foreign currency liquidity stress testing and their global measurement systems, etc.

(5) IT and cyber risk management system

- Verify the status of fulfilment of functions of banks' risk management systems also covering risks at their subsidiaries and outsourcees (mentioned later), the status of their implementation and utilization of Threat-Led Penetration Testing (TLPT), and the status of their operational resilience (mentioned later). Centered on three mega banks, verify the whole image and the effectiveness of their IT strategies and IT security on a group basis and a global basis.

(6) Customer-oriented business conduct

- Verify distributors' product governance systems and sales and management systems, focusing on foreign currency-denominated single premium policies, structured bonds, structured deposits, etc.

(7) Climate-related financial risk

- Using a short-term scenario, verify the impacts of transition risks on banks' financial conditions through credit risk.

✓ Conduct the second exercise of scenario analysis jointly with the Bank of

Japan based on common scenarios for climate-related financial risks.

- Verify the progress of financial institutions' climate-related financial risk management and their initiatives to support customers through transition finance, etc.*

* The FSA newly established the Office for Climate-related Risk Monitoring Hub in its monitoring department (August 1, 2024).

- The FSA expects major banks, etc. to provide people and domestic customers with further sophisticated and higher-quality financial services through enhancing their international competitiveness. For that purpose, the FSA will support individual banks' initiatives while having communication with foreign authorities.

✓ In light of rapid progress in AI technology, including generative AI technology, and blockchain technology, and in consideration of a good balance between benefits gained therefrom and their potential risks, the FSA will deliberate on support while sharing risk awareness for sound utilization of technologies for improving work efficiency and creating new financial services, etc.

5. Promotion of cash flow-based lending

- In the ordinary session of the Diet in 2024, the Act on the Promotion of Cash Flow-Based Lending, which incorporates the creation of Enterprise Value Charge (EVC), was enacted.
- In response, the FSA launched a project team for the promotion of cash flow-based lending, with the Vice Commissioner as the team leader, in July 2024, in order to enforce the relevant laws and regulations smoothly or otherwise further promote cash flow-based lending.
- The project team will discuss practical issues, such as screening for credit decisions and treatment in accounting, and will carry out PR activities to disseminate

information on the future development of relevant laws and regulations and the purport of the system so that EVC is broadly utilized as one of the options. Until the time of the enforcement of the Act on the Promotion of Cash Flow-Based Lending, the project team will have sincere consultations with individual financial institutions.

- Through these efforts, the FSA will have close communication with financial institutions, and will endeavor to develop a better environment to facilitate their lending and business support based on the future prospects of borrowers' businesses. If financial institutions have any questions or worries, including criticism, they should feel free to consult with or offer frank advice to the FSA.

6. Promotion of the implementation of the Reform Program regarding Personal Guarantee Provided by Business Owners

- At the end of this June, the FSA published the performance during FY2023 with regard to the progress in the Reform Program regarding Personal Guarantee Provided by Business Owners. The percentage of non-guaranteed loans was 47.5% on average of all business types, showing a significant increase from 33.9% in FY2022.
- The relevant percentage was 60.3% on average among major banks, etc., having increased from 56.6% in FY2022. Efforts for establishing lending practices not relying on personal guarantee provided by business owners have thus been progressing. Together with the performance, the FSA also published a reference casebook of financial institutions' initiatives to further promote lending practices that do not rely on personal guarantee provided by business owners in response to "Reform Program regarding Personal Guarantee Provided by Business Owners." Please continue your efforts while also referring to the reference case book.
- On the occasion of the dialogue held in April 2024, the FSA requested financial institutions to take required measures promptly for contracts for revolving

guarantees concluded in or prior to March 2023 for which explanations on the necessity of guarantees, etc. have yet to be provided to borrowers or no measures have been taken.

- In order to ascertain the current situation, the FSA also surveyed the status as of March 2024 of the provision of explanations concerning contracts for revolving guarantees concluded in or prior to March 2023. As a result, some financial institutions replied that they have yet to provide explanations to over half of the relevant borrowers or that they do not ascertain the status of the provision of explanations.
- In consideration of such circumstances, the FSA compiled a draft amendment of the Comprehensive Guidelines for Supervision, which incorporates the content to be explained to borrowing companies and the content to be recorded regarding the necessity of guarantees in relation to contracts for revolving guarantees concluded in or prior to March 2023, and started to solicit public comments at the end of June.
- Financial institutions that have yet to provide explanations to relevant borrowers are requested to take required measures by the end of March 2025 based on the purport of the draft amendment of the Comprehensive Guidelines for Supervision.

7. Positive PR activities for the Guidelines for Debt Consolidation for Victims of Natural Disasters

- When dealing with double loans held by victims of natural disasters, it is important to utilize the Guidelines for Debt Consolidation for Victims of Natural Disasters.
- Six months have passed since the Noto Peninsula Earthquake, and the number of cases where debt consolidation was commissioned to registered support experts amounted to 132 in total from January to the end of June 2024. It is important to further facilitate the utilization of the guidelines.

- Individual financial institutions are requested to positively disseminate the information on the guidelines to natural disaster victims, including victims of the Noto Peninsula Earthquake, who have worries over repayment of housing loans, etc. In the following cases, for example, please introduce the guidelines:
 - when receiving an application for temporal suspension of the repayment or alteration of conditions for a housing loan, etc.;
 - when receiving an application for an additional housing loan, etc. from a disaster victim already having debts.

8. Actual utilization of the Guidelines for Business Revitalization, etc. of Small- and Medium-sized Enterprises

- On July 5, the FSA published the status of actual utilization of the Guidelines for Business Revitalization, etc. of Small- and Medium-sized Enterprises in FY2023.
- The number of cases where business revitalization and repayment plans were established by utilizing the guidelines in FY2023 was 133, showing a significant increase from 28 in FY2022. Since FY2022, the actual utilization of the guidelines has been reported from 37 prefectures. Regional expansion is thus observed and nearly half of the banks are said to have utilized the guidelines.
- Financial institutions are expected to continue positive efforts for supporting companies' business revitalization, including utilization of the guidelines.

9. Outcomes of the G20 Finance Ministers and Central Bank Governors Meeting in July

- The G20 Finance Ministers and Central Bank Governors Meeting was held in Rio de Janeiro, Brazil, from July 25 to 26, 2024. Major outcomes related to the financial

in the joint communique published after the meeting are outlined below:

- First of all, members reaffirmed their commitment to address the financial system's vulnerabilities and the timely implementation of international financial reforms. In particular, the agreement by the Group of Central Bank Governors and Heads of Supervision (GHOS) in May 2024 to implement all aspects of the Basel III framework in full, consistently and as soon as possible was also reaffirmed by G20 members.
- Members welcomed the Financial Stability Board's (FSB's) Annual Progress Report on enhancing the resilience of non-bank financial intermediation (NBFIs) sector, expressed support for the implementation of the FSB's revised policy recommendations to address vulnerabilities arising from liquidity mismatch in open-ended funds, and encouraged the FSB to finalize its policy work on margin preparedness and leverage.
- On crypto-assets, members also reaffirmed their commitment to implement effectively, timely and in a coordinated manner the FSB's High-Level Recommendations, and expressed support for the Financial Action Task Force's (FATF's) work to accelerate the global implementation of its Standards and to monitor the impact on the financial integrity of emerging technologies and associated risks, including from DeFi arrangements and peer-to-peer transactions.
- Members reiterated their commitment to a timely and effective implementation of the G20 Roadmap to Enhance Cross-border Payments, and welcomed the FSB's stocktake of financial authorities' regulatory and supervisory initiatives and challenges related to the identification and assessment of nature-related financial risks.
- Lastly, on sustainable finance, members expressed support for the discussions advancing "just" transition plans for financial institutions and corporates, and looked forward to the recommendations on how to address challenges faced by

small and medium-sized enterprises (SMEs) and emerging market and developing economies (EMDEs) in particular, and to promote reliable, comparable and interoperable sustainability reporting disclosure standards.

- The next G20 Finance Ministers and Central Bank Governors Meeting is scheduled to be held in Washington D.C. in October 2024. The FSA will continue to communicate with financial institutions and contribute to global discussions.

10. Progress in deliberations on draft revisions of FATF Recommendation 16 (cross-border payment)

- FATF is revising its Recommendation 16 in order to make cross-border payments faster, cheaper, more transparent and inclusive, while observing required countermeasures against money laundering and terrorist financing and ensuring that the FATF Standards remain technology-neutral, in light of changes in the payment market structure with the emergence of new means of settlement, technologies, and players, and standardization of settlement specifications.
- During the period of consultative discussions from the end of February to early May 2024, highly informative opinions were collected from financial institutions.
- At the FATF's plenary session from June 26 to 28, 2024, participants agreed that further dialogue is required among related parties in the public and private sectors for finalizing the revision of the recommendation, taking into account the results of the consultative discussions and giving consideration to the complexity of the content of the revisions and possible influence on the payment system, and thus that they will need more time to deliberate on the details.
- The FSA will continue to contribute to the discussions toward finalization, while closely listening to opinions of individual financial institutions.

11. Management of outsourcees' cybersecurity risks

- There was a case where at a company to which a financial institution outsourced part of its business operations, a server, etc. were infected with ransomware, and as a result, the financial institution's customer information was leaked from that outsourcee.
- The financial institution that outsourced business operations to the outsourcee must verify customer information it had provided to the outsourcee and take appropriate measures for leaked information based on the Act on the Protection of Personal Information.
- In response to this recent case, the FSA will deliberate on ideal management of outsourcees by financial institutions.

12. Operational resilience

- In consideration of the global system failures caused by CrowdStrike's software that occurred on July 19, 2024, the FSA will encourage financial institutions to ascertain the influence of such system failures on their domestic and international business operations, make responses to customers, share information within the industry and with the FSA and foreign authorities, consider the commencement of their own contingency plans, or otherwise strengthen operational resilience of the financial sector as a whole. The FSA will also deliberate on its own initiatives for strengthening collaboration among the entirety of the financial sector and enhancing the overall operational resilience.

13. Countermeasures against financial crime

- In June 2024, the national government formulated the Comprehensive Measures for Protecting People from Fraud. In response, the FSA reorganized the AML/CFT

Policy Office into the Financial Crimes Office.

- Also placing importance on the prevention of damage from financial crime to ensure users' ability to use financial services without worry, the FSA will immediately take measures against investment frauds and other financial crimes, such as measures for the prevention of misuse of deposit or saving accounts including corporate accounts, as described in the Comprehensive Measures, in collaboration with relevant ministries and agencies and industry associations.

14. Provision of information on accounts used for exchange transactions by unregistered business operators

- It is prohibited to conduct exchange transactions in the course of trade without obtaining a banking license under the Banking Act or without registering for the funds transfer services under the Payment Services Act.
- However, there are cases where unregistered business operators who have not obtained a banking license or have not registered for the funds transfer services get involved in remittances to business operators who operate illegal websites, such as so-called online casino websites. Additionally, there are cases where accounts of financial institutions opened by unregistered business operators are used for those unregistered business operators' exchange transactions.
- In light of such situation, the FSA revised the Guideline for Supervision of Funds Transfer Service Providers dated May 17, 2024. The revised guideline clearly states that when the authority obtains information on an account used for bank transfers for an online casino or other transaction by a malign unregistered business operator, the authority will provide the financial institution where the relevant account was opened with information on misuse of the bank account.
- In response, industry associations issued a notice dated June 28, 2024. Individual financial institutions that received the provision of information on misuse of an

account are requested to take required measures, such as the performance of obligations under the Act on Prevention of Transfer of Criminal Proceeds and the reduction of risks based on the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism.

15. Publication of a Report on the Current Status and Challenges Regarding Anti-Money Laundering and Counter Financing of Terrorism in Japan (as of June 2024)

- The deadline for the development of risk management systems based on the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism expired at the end of March 2024. From now it is necessary to shift our focus from responses to what were pointed out in the FATF Fourth Round of AML/CFT Mutual Evaluations to the enhancement of the effectiveness toward the Fifth Round.
- Additionally, the immediate top priority is to cope with rapid increases in phone fraud, etc. and misuse of financial services in those fraud cases.
- With such awareness, the FSA compiled the latest version of a Report on the Current Status and Challenges Regarding Anti-Money Laundering and Counter Financing of Terrorism in Japan (as of June 2024), commonly called "Report on AML/CFT Measures," and published it on June 28, 2024.
- The report contains examples that will serve as reference for financial institutions when they verify the effectiveness of their risk management systems for the purpose of further enhancing them after the expiration of the deadline at the end of March 2024, as well as pioneering initiatives combating misuse of accounts, which is now increasing rapidly. Financial institutions are expected to make efforts to strengthen and enhance their own AML/CFT measures by making reference to the report.

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

Failures"

- On June 26, 2024, 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 FY2023.
- The report categorizes cases with the focus placed on timings of failures and analyzes the causes and problems. Additionally, the report incorporates best practices for incident response, such as smooth responses to customers in the event of suspension of ATM services and smooth restoration of computer systems in line with a contingency plan, as a reference for financial institutions in strengthening their IT resilience.
- In addition, this report contains columns titled "Best practices and challenges regarding financial institutions' Threat-Led Penetration Testing (TLPT)" and "Outline of dialogues with financial institutions concerning operational resilience."
- Financial institutions are expected to further strengthen their system risk management for ensuring stable provision of services by making reference to the report.

17. Publication of the FSA Analytical Notes on Real Estate Loans

- On July 2 and 9, 2024, the FSA published the "FSA Analytical Notes (2024.7)." This compiles the FSA's data analyses as part of its initiatives for enhancing data utilization.

(Reference) <https://www.fsa.go.jp/en/news/2023/20230929-2/index.html>

- This report presents four analyses, including the " Analysis of Trends of Real Estate Loans by Regional Banks and Study on Credit Ratings using Machine Learning," by utilizing various data including the transaction-level loan data collected at the Common Data Platform.^(*)

Due to restrictions on available data, the analysis covers only regional banks, but the FSA intends to continue careful monitoring of banks' lending to the real estate industry, not limited to lending by regional banks, in consideration of the recent trends of the real estate market.

* In addition to the analysis regarding lending to the real estate industry, the " Analysis of Corporate Transaction Network," the "Analysis of Corporate Bankruptcies arising from Human Resource Shortage amid the Changing Working Environment," and the "Analysis of Impact of the High-Speed Trading Activity on Market Liquidity and Magnitude of Market Fluctuations" were also published.

- The FSA would like to continue efforts for ascertaining the nature and mechanism of economies and financial systems in a multifaceted manner by using granular data, aiming to further enhance data-driven monitoring.

18. Reference material concerning the NISA program for general users

- On June 26, reference material concerning the NISA program for general users was published on the FSA's dedicated website. The material introduces frequently asked questions, points to pay careful attention to, and case examples regarding the NISA program in an easy-to-understand manner so that beginners and general users can appropriately utilize the program amid market fluctuations.
- As has been mentioned so far, it is important to carry out PR activities in public-private collaboration now, when the NISA program is attracting increasing attention of the general public, in order to ensure that the program is utilized appropriately.
- Financial institutions are also requested to utilize the reference material when providing explanations to users. If you notice any points for improvement in the details, please send us your opinions.

(Reference) Reference material concerning the NISA program for general users

https://www.fsa.go.jp/policy/nisa2/about/nisa2024/slide_202406.pdf (Available in Japanese)