Tentative Translation

The Statement for Vitalizing Financial and Capital Markets

* This translation is prepared solely for information purposes. The Japanese version should be referred to for the accurate content of this statement.

June 30, 2015

Panel for Vitalizing Financial and Capital Markets

Panel for Vitalizing Financial and Capital Markets

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(July 3, 2015)

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The Panel for Vitalizing Financial and Capital Markets published its recommendations on December 13, 2013 and on June 12, 2014, which outlined the medium/long-term direction and the key policy measures that lead to vitalizing the financial and capital markets.

In the recommendations, it was pointed out that the following attitudes are essential in order to foster the growth of Japan's economy, enhance asset management business, and develop the Tokyo market into a leading international financial center by 2020.

- Japan boasts strengths such as companies with sophisticated technologies and production infrastructures, and JPY 1,700 trillion in household assets for potential utilization. These strengths should be strategically leveraged to promote the growth of Japan's economy and to propel the development of the Tokyo market. In order to create an investment flow from household assets to companies in Japan, it is essential to enhance the attractiveness of the companies as investment destinations, and thus to keep in mind that the role of institutional investors, especially investment management business companies, is crucial in such an investment flow.
- A sophisticated financial infrastructure, including measures to develop and accumulate financial human resources, should be established, with the recognition that it is a prerequisite for the successful transformation of the Tokyo market into a leading international financial center in Asia.
- As economies in Asia grow rapidly and Japanese companies plan to actively expand their business operations overseas, Japan's economy and its financial and capital markets should grow in tandem with economies in Asia.

Based on these positions, both the Government and private sector are making steady progress in the implementation of the measures specified in the recommendations, including the formulation of the Corporate Governance Code. The majority of the measures will require sustained efforts, and results are to be achieved in the medium to long term. That said, the decisive efforts made so far are notable. The recent rise in stock prices and volume of transactions demonstrates a positive cycle. This market trend also implies that the progress thus far meets the expectations of investors.

(Reference) Market trends from June 2014 onward

Nikkei 225 closed at JPY 15,162 as of June 30, 2014 versus JPY 20,563 as of May 31, 2015

Average daily trading value for the first section of the TSE

JPY 1,916.8 billion (June 2014) versus JPY 2,755.9 billion (May 2015)

In this statement, the Panel will evaluate the progress of measures in various areas of the financial and capital markets in Japan and reexamine the policies for 2020, and then provide opinions on issues that require further attention, including new issues believed to be crucial for vitalizing the financial and capital markets in Japan.

1. Progress of measures in various areas of the financial and capital markets

(1) Enhancing the competitiveness of Japanese companies and their attractiveness to domestic and foreign investors

From the standpoint of further leveraging one of Japan's strengths, such as companies with sophisticated technologies and production infrastructures, it is vital to boost the investment appeal of Japanese companies among domestic and foreign investors. To this end, it is essential that globally-competing companies change their mindset to place emphasis on profitability and shareholder returns, and improve their profitability and ROE to levels comparable to global benchmarks. Companies need to identify the strengths and weaknesses of each of their businesses, improve management structures, and focus on businesses with growth prospects as appropriate.

The following measures are being undertaken to promote these changes.

① Formulation and implementation of the Corporate Governance Code

Pursuant to the Japan Revitalization Strategy (Revised in 2014), the Council of Experts Concerning the Corporate Governance Code, for which the Financial Service Agency (FSA) and the Tokyo Stock Exchange (TSE) served as joint secretariat, had been engaged in discussions since August 2014 on the formulation of the Corporate Governance Code. Accordingly, the Corporate Governance Code [Final Proposal] was put together in March 2015 and the TSE formulated the Corporate Governance Code in May, employing the same content as the proposal. The code was implemented on June 1, 2015. The Corporate Governance Code does not place excessive emphasis on avoiding and limiting risk or the prevention of corporate scandals. Rather its primary focus is on achieving "growth-oriented corporate governance" through appropriately ensuring suitable accountability and promoting healthy risk-taking.

② Formulation of the Stewardship Code; participation by a large number of institutional investors

Pursuant to the Japan Revitalization Strategy 2013, the Council of Experts Concerning the Japanese Version of the Stewardship Code, for which the FSA served as the secretariat, formulated and announced Japan' Stewardship Code in February 2014. The Stewardship Code is a set of principles for institutional investors on promoting the sustainable growth of investee companies through constructive dialogue with such companies, given their responsibility to manage the capital of the ultimate beneficiaries (private individuals, pensioners, and insurance policyholders). To promote and expand the implementation of the code, the FSA has been releasing a list of institutional investors that have announced their acceptance of the code (revised every three months). As of the end of May 2015, 191 institutional investors, which include most of Japan's major institutional investors, have announced their acceptance of the code.

These initiatives should provide guidelines for listed companies and investors in engaging in constructive dialogue. Moving forward, constructive dialogue between listed companies and investors is expected to be promoted in accordance with these two codes.

③ Introduction and promotion of JPX-Nikkei Index 400

JPX-Nikkei Index 400 was developed as a new stock index consisting of component companies attractive to investors meeting global investment requirements, such as the efficient use of capital, investor-focused management perspectives, and the adoption of IFRS. The TSE commenced computation of this new index in January 2014.

The new index is receiving high praise from institutional investors in Japan and abroad. Since the TSE began calculating this index, the listing of ETFs (exchange-traded funds) and index-linked public investment trusts was offered to meet the strong transaction need of these institutional investors. At present, five ETFs are listed on the TSE and more than 30 public investment funds are being managed. Even abroad, Japanese ETFs were listed on the London Stock Exchange in September 2014. Currently, Japanese ETFs are listed on exchanges in four countries. Moreover, the Osaka Securities Exchange began trading JPX-Nikkei Index 400 futures in November 2014.

This index not only satisfies investor needs but also plays a vital role in promoting the achievement of various requirements set by global investment standards, including the effective use of capital by Japanese companies. In addition, the spread of products such as ETFs linked to this index is expected to be beneficial in triggering a positive cycle in which growth capital is absorbed into companies with high investment appeal among investors.

④ Steady increase in companies voluntarily adopting IFRS

The Japan Revitalization Strategy (2014 revised version) explicitly declared “promotion of an increase in the number of companies voluntarily adopting IFRS” as a target for the first time in a decision by the Cabinet. In addition, it stated the following. “In addition to the measures already taken, the Government will conduct a fact-finding survey and interviews to ascertain how companies that have voluntarily adopted IFRS overcame any challenges they faced during their transition to IFRS, as well as the advantages brought about by their shift to IFRS. It will then publish its findings from the above in the form of an 'IFRS Adoption Report (tentative name)' to serve as a useful reference for companies considering adopting IFRS." In accordance with the Cabinet decision, the FSA conducted a fact-finding survey and interviews with companies that are voluntarily adopting IFRS, and published the "IFRS Adoption Report" in April 2015. The report indicated that the adoption of IFRS not only improved comparability with the competitors but also contributed to the sophistication of business management.

The number of companies voluntarily adopting IFRS in Japan is steadily increasing. At present, 90 companies are adopting IFRS (as of June 16, 2015). Of these 90 companies, 87 are listed companies with a combined market capitalization of around JPY 121 trillion. This represents around 20% of the total market capitalization of all listed companies. It is essential to continue to take measures that promote an increase in the number of companies voluntarily adopting IFRS.

(2) Smooth supply of funds to support the growth of private companies enhancing financial intermediary functions

In order to sustain the positive cycle under "Abenomics" and to foster the growth of Japan's economy, it is essential to enhance financial intermediary functions that satisfy diverse financing needs. In particular, enhancement of (i) market intermediary functions supplying the funding for growing businesses and (ii) financial intermediary functions via indirect financing based on customers' business potential is important.

① Enhancing market intermediary functions

In Japan, there has been a shortage of growth capital necessary to realize the commercialization of an entrepreneur's technologies or ideas. This has resulted in the so-called “valley of death,” a situation in which the commercialization of R&D is hindered due to insufficient financing. In light of this, it is essential that further steps be taken to ensure the smooth flow of capital into growth areas, including venture capitals. At present, the following measures are underway.

i Establishment of an investment crowdfunding system

Owing to revisions to the Financial Instrument and Exchange Act in 2014, the system for investment crowdfunding—investment via the Internet for non-listed shares and partnership-type funds—was established to strengthen the supply of growth capital, both from the perspective of relaxing entry requirements and of protecting investors.

ii Establishment of a system related to funds for professional investors

There has been a sharp rise in losses and damages to investors due to funds for professional investors. Revisions to the Financial Instrument and Exchange Act were passed in May 2015 to ensure the smooth supply of growth capital while also protecting investors. Comprehensive measures to establish this system include the introduction of reasons for disqualification, expansion of regulations governing practices, and administrative actions against offenders. The government plans to issue a Cabinet order and Cabinet Office Ordinance, among other things, in order to put this system into effect.

These measures should create an energetic market that is both fair and transparent. The “valley of death” is also expected to be overcome with the expansion of the supply of growth capital. Going forward, as the market moves into the stage where projects are developed by using these measures, it will be particularly important to take concrete actions, including matching seeds and funds.

In the next stage of development after overcoming the “valley of death,” venture capital funds and private equity funds are likely to supply growth capital. Accordingly, from the viewpoint of the investors that provide capital to these funds, it is vital that an environment be established in which these funds can properly function.

② Enhancing financial intermediary functions via indirect financing

Globally-competing Japanese companies need to sustain and enhance their international competitiveness. Meanwhile, local (regional) companies and industries need to improve their efficiency and productivity, and thus contribute to improving employment and wages in their regions. Given the awareness of this issue, it is important that financial institutions support the growth of companies and industries by implementing evaluation of customers' business potentials.

The role of regional financial institutions is especially important. These financial institutions should further strengthen the support they offer to companies at various stages in the business lifecycle. This includes assistance to improve the management, productivity, and corporate structure of a sustainable company through the use of regional economy vitalization funds, lending based on customers' business potentials, and providing appropriate consulting services.

To this end, the following measures are underway.

i Creation and use of regional economy vitalization funds and other support provided by the REVIC

In October 2014, the Act on Regional Economy Vitalization Corporation of Japan was revised to more effectively move forward with support by the Regional Economy Vitalization Corporation of Japan (REVIC) for projects for regional economy vitalization and business rehabilitation. The revision added an LP (limited partnership) investment function for regional economy vitalization and business rehabilitation funds. Full use is being made of this function. Through alliances between REVIC and regional financial institutions, regional economy vitalization and business rehabilitation funds are being created and utilized to support regional healthcare industries, a goal in the Comprehensive Strategy for Vitalization of Towns, People, and Jobs, as well as to revitalize local tourism and urban development, vitalize regional core companies, and for restoration and growth projects in areas devastated by the Great East Japan Earthquake.

ii Promotion of financing based on evaluation of customers' business potentials

In accordance with its Financial Monitoring Policy, which was announced in September 2014, the FSA has been confirming actions by financial institutions to promote lending based on customers' business potentials through inspections and monitoring. The FSA has also been actively promoting initiatives by deepening mutual dialogue in addition to promoting the use of the "Guidelines for Personal Guarantee Provided by Business Owners" and the REVIC's function to dispatch specialists to support evaluation of customers' business potentials.

iii Utilizing short-term loans that are continuously renewed by the lender to leverage capability to assess business performance

The FSA implemented the clarification of its financial inspection manual in January 2015 and has been providing presentations for financial institutions and other related parties to thoroughly explain about the revision of the inspection manual. This was carried out to encourage financial institutions not to rely on collateral or guarantees but to leverage their capability to assess business performance and smoothly provide working capital based on the needs of the SMEs (small and medium-sized enterprises).

iv Development Bank of Japan implementing limited-time strengthening in order to promote the supply of growth capital

Concurrent with the development of the market and indirect financing environment, in the medium/long term the private sector will be encouraged to supply growth capital to fill the urgent demand companies have for capital. One necessary strategy for the time being is to expand the supply of capital by utilizing the functions of government-affiliated financial institutions while being careful to avoid moral hazards (overdependence on public funds) and unnecessary pressure on private enterprises. From this standpoint, the Development Bank of Japan plans to strengthen its lending of growth capital for a limited time to help Japanese companies strengthen their productivity and earnings power in the global competitive environment. Through 2020, the DBJ will focus on supplying growth capital which is necessary for actively taking steps to achieve corporate growth. These steps include the development of new businesses, in part by carrying out cross-industry partnerships, and also by launching businesses to make use of dormant technologies.

This measure aims to stimulate the private sector to help promote the supply of private-sector capital. It is important to implement these measures to help the private sector accumulate knowledge on supplying growth capital. From a similar perspective, it is crucial that this measure be reviewed and revised in a timely fashion depending on conditions for private-sector financing. In the medium/long term, the supply of growth capital should be promoted through the creation of funds led by the private sector, including trading firms and institutional investors. It is also vital that support be given to aggressive growth initiatives, such as large-scale restructuring aimed at improving profit margins and M&A.

(3) Establishing a positive cycle in which abundant financial assets held by households and public pension funds are allocated to funding for growing businesses

Household financial assets in Japan have reached JPY 1,700 trillion. More than half of this is put away in deposits. As of the end of March 2014, about 13.7% of these total household financial assets were invested into risk assets such as investment trusts and equities. This is even lower than in the years prior to Japan's bubble economy (18.3% at the end of March 1986). This level is extremely low compared with global standards.

In a deflationary economy the relative value of cash and deposits tends to rise. In this sense, there was reason to keep a substantial portion of assets in the form of cash and deposits. This seems reasonable to a certain extent. However, under "Abenomics", which aims to end the deflation, it is reasonable to promote asset management practices which generate risk-appropriate returns in the medium to long term by investing in risky assets to a certain extent. In order to establish a positive cycle in which abundant household financial assets are allocated to funding for growing businesses, the following measures are underway.

① Introduction of NISA and Junior NISA

NISA was launched in 2014. Until the end of March 2015, 8.79 million NISA accounts had been opened and the total amount of investments had reached more than JPY 4 trillion. In the FY2015 Tax Reform, the maximum amount of the annual investment in NISA accounts was raised from ¥1 million to ¥1.2 million. Moreover, Junior NISA was created in the FY2015 Tax Reform. Junior NISA enables people less than 20 years old to open a NISA account with the maximum amount of the annual investment set at ¥800,000. It also allows the tax exemption of dividend incomes and capital gains from listed equities to account holders in Junior NISA as well as NISA. In addition, simplification of the procedures to open a NISA account is a subject of future consideration. The proposed simplifications include the omission of the submission of residence certificates as a necessity to open a NISA account. Such measures are expected to make NISA more accessible and popular.

GPIF reforms

② GPIF reforms

Regarding the reforms of the Government Pension Investment Fund (GPIF), the Panel for Sophisticating the Management of Public/Quasi-public Funds compiled the Final Report in November 2013. Reflecting the recommendations of the Final Report, the Japan Revitalization Strategy (revised in 2014) expects that the GPIF will appropriately revise its policy asset mix and that initiatives for strengthening the governance structure of the GPIF will be promoted, including the improvement of its Board structure. In light of these factors, the GPIF revised its medium-term plan in October 2014, and announced that it would shift from a portfolio heavily invested in Japanese Government Bonds to a more diversified investment portfolio and that it would strive to reinforce the governance structure, including the establishment of the Governance Council.

The GPIF needs to move forward on its reforms, including the examination of the necessity of revising laws. Besides this, the GPIF as an institutional investor needs to contribute to fostering the investee companies' corporate value and sustainable growth, and to fulfil its fiduciary responsibility based on Japan's Stewardship Code, of which the GPIF announced its acceptance in May 2014. The Investment Principles of the GPIF specify that it should invest solely for the benefit of pension recipients. At the same time, it is expected that such investment eventually contributes to increased investment in growing businesses and thus to the invigoration of the Japanese economy, realizing a positive cycle of the economy.

③ Promoting financial literacy (announcement of financial literacy map, etc.)

It is essential that financial literacy be steadily promoted going forward so that Japan reaches a level that is on a par with international levels. In June 2014, the Committee for the Promotion of Financial Education, which is composed of the FSA and other related organizations, announced the Financial Literacy Map. The map systematically outlines in detail the minimum level of financial literacy a person should have by age and item. With the development of the Map various activities are being undertaken, including university lectures and seminars.

2. Issues requiring further action to vitalize the financial and capital markets

(1) Strengthening corporate competitiveness by improving corporate value

To strengthen the competitiveness of a company, it is vital to improve corporate value sustained by, especially for global companies, enhanced corporate governance with proper attention to the capital cost.

It is expected that the Stewardship Code, which was formulated and published in February 2014, and the Corporate Governance Code, which was implemented on June 2015, are to function in tandem to realize dual virtuous cycles, namely sustainable corporate growth and an increase in investor returns.

Although the recent initiatives to improve corporate governance in Japan are warmly welcomed by both domestic and foreign investors, the following measures are essential in order to make these actions embedded in our corporate norm.

It is necessary to work with international organizations, such as the OECD, to widely propagate the Corporate Governance Code’s value of achieving “growth-oriented governance.” In addition, the implementation of the Stewardship Code based on a full understanding of the aim and spirit of said code should be promoted through monitoring and updating a list of institutional investors who accept the code

Following the implementation of the Corporate Governance Code, some companies have already announced their basic policies to abolish cross-shareholdings unless justified by recognizable significance or have published their standards on exercising voting rights in light of contributing to corporate value in the mid to long term. These actions have been well received by market participants. Companies are requested to sincerely carry out accountability in this area. For example, once the board of directors of a company examines the economic rationale of cross-shareholdings, including the degree to which such shareholdings contribute to the improvement of corporate value, the company should provide an explanation to its shareholders and other stakeholders on its cross-shareholding policies which reflects the outcome of the examination. Additionally, it is advisable for banks to further strengthen their equity risk management so that their financial intermediation functions could be stably and properly executed even under market turmoil.

(2) Drastic strengthening of asset management business

In order to foster growth of Japan's economy and to develop the Tokyo market as a leading international financial center, it is crucial to vitalize its financial and capital markets and establish a positive cycle in which abundant financial assets held by households and public pensions are allocated more towards funding for growing businesses. In this regard, the drastic strengthening of Japan's asset management business is also crucial.

In order to strengthen Japan's asset management business, it is important that they establish superior governance and compensation systems based on highly independent fiduciary duties in order to attract capital from around the world and diverse and highly-skilled financial professionals. Moreover, to accelerate the establishment of a positive cycle where the nation's abundant personal financial assets and other assets are used for growth capital, the industry must promote the use of investment trusts. However, at present there are various issues that must first be dealt with.

Currently, in contrast with the US and Europe, the outstanding balance for investment trusts in Japan is comparatively low. The level of investment in investment trusts is low, and although there are a number of investment trusts, each is small in scale. Consequently, for asset management companies, management and clerical costs are high. Meanwhile, for the customer, it is difficult to find a product that suits their personal needs.

Furthermore, investment trusts with complex mechanisms are increasing. This is triggering an annual rise in sales commission on investment trusts. Also, as has been the case in the past, these investment trusts do not always generate profit for the customer. This results in the sale of the trust after a short period of time in order to switch to a different investment. This trend is believed to be diminishing the appeal of investment trusts to investors.

The majority of management at investment management companies in Japan originally worked at an affiliated sales unit. Consequently there is a strong tie with the sales unit of the management company. This makes it difficult to develop products from the viewpoint of the investor. Some of the sales units do in fact offer recommendations for diversified investments and provide reliable consulting. However, in most cases, the majority of popular financial products consist mainly of high-risk products, and sales units generally do not offer recommendations on diversifying investments.

In addition, there is the issue of a lack of professionals in the field who are actually handling investment management. Securing these professionals and training employees to become specialists in this field is an urgent issue that must be dealt with. It is crucial that asset management companies review hiring methods, performance evaluations, compensation systems, and other areas to see if there is room for improvement. In addition, creating assets management opportunities to train young employees is also believed to be beneficial. Companies should examine these and other areas.

Though there are quite a few issues to overcome in strengthening Japan’s asset management business, the following improvements are underway.

① Improving disclosure effectiveness in the prospectus and other materials (risk, etc.)

The final report by the "Working Group on Review of Investment Trust and Investment Corporation Regulation" of the Financial System Council, which was released in December 2012, recommended that easy-to-understand disclosure for the purpose of quantitative risk assessment and comparison should be carried out so that investors could make an appropriate investment decision. As a result, explanations with charts and other indicators are now required in the investment risk section of the securities registration statement and in the prospectus related to domestic and foreign investment trust beneficiary certificates, in order to enable a reasonable comparison of risks between the fund and other assets of equal class.

② Improving performance transparency (notification system for total returns)

In accordance with Japan Securities Dealers' Association regulations, asset management companies must notify investors of the total return on the investment trust so that the investor can easily understand the cumulative profits/losses, including dividends, for the entire investment period.

③ Improving efficiency of asset management business (revision to Cabinet orders on investment trust mergers, etc.)

Investment trust mergers contribute to the expansion in scale of an investment trust. However, owing to a revision to the Investment Trust Law, a written resolution is not required in the event of minimal impact to a beneficiary's profits due to an investment trust merger. Accompanying this, the Cabinet Office issued an order requiring that "minimal impact" be defined in detail, including a statement that the basic nature of the product remains the same before and after the merger.

④ Clarification of supervision responsibilities

In March 2014, guidelines on supervision were revised. The revised guidelines state that evaluations of sales staff performance should not focus heavily on revenues, such as sales commissions, and that proper evaluation should given for a sales employee's contribution to expansion of the customer base. The guidelines on supervision were revised again in September 2014. This time, under points of concern, management companies were required to state whether a sales person clearly explained sales commission rates and amounts and other costs (investment trust fees, etc.) at the time of solicitation. Another item that has to be clearly stated is whether efforts were made to explain in an easy-to-understand manner the conditions of the investment trust management system, including items related to the person in charge of managing the investment trust (number of years of experience in a position of responsibility for managing assets, career, profile of management team, etc.).

Owing to these revisions, the focus of performance evaluations at banks and securities companies which handle sales has shifted from sales revenues (sales commission revenues) to the expansion of assets held and customer base. There has also been progress in disclosing information about the people in charge of handling asset management.

As discussed above, a certain degree of progress has been made in the use of investment trusts in Japan. At the same time, a major issue is the further promotion and use of investment trusts to pave the way for establishing systems such as NISA and defined contribution pensions. Consequently, the following points are impeding the increased usage of investment trusts.

First is the number of funds. A large amount of funds means a rise in management cost for the investment management company, a rise in clerical costs for the sales unit, and a rise in sales commissions to customers to reflect the rise in cost for the investment management and sales companies. This reduces the investment appeal for the investor. Furthermore, another problem that arises is that it becomes difficult for investors to find a fund that suits their individual needs. Investment management companies should aim to strategically nurture large-scale, long-life funds. This creates a positive cycle, as it will boost management efficiency and reduce costs for the sales company, and ultimately reduce the cost burden shouldered by the customer.

Moreover, it is essential that the investment management company's management be independent from that of the sales company. The management of the investment management company should not be former employees of the affiliated sales company. Personnel that have specialized knowledge of asset management operations should be placed in the position of management. Another effective method is to place independent outside directors in the board room. Furthermore, it is important that asset management business companies establish superior governance and compensation systems based on highly independent fiduciary duties in order to attract capital from around the world and diverse and highly-skilled financial professionals.

Sales commissions for investment trusts in the US are lower than in Japan and are declining annually. This reflects the business model being employed for investment trust sales. Focus is not placed on sales commissions. Emphasis is placed instead on outstanding balance and performance. For instance, in a US asset management company, a major source of revenue is advisory fees and investment management fees, not sales commissions. The investment management industry in Japan needs to switch over to this type of business model.

Furthermore, in order to ensure stable asset-building for customers, sales companies should provide easy-to-understand explanations to investors about the products they recommend, taking into account factors such as the customer's life stage and the nature of the risk involved. Moreover, it is vital that financial institutions engaging in product development, sales, and asset management fulfill their role responsibilities (fiduciary duties) in order to carry out optimal asset management that will satisfy the needs of the customer and generate profit.

Fund appraisal companies sort each investment fund according to the investment objectives and policy of the fund and then apprise and/or rate its investment performance objectively. Such data is effective in understanding the earning power and risk degree of each product from a relative and objective point of view. It is desirable for customers to actively utilize appraisals by fund appraisal companies and /or ratings to help retail investors choose their best products and/or services.

In addition, although there are systems and business practices particular to Japan, discussing broadly about mutual recognition and the establishment of overseas offices so that foreign funds would be dealt in Japan and Japanese funds dealt in foreign markets would provide for the asset formation of citizens and the smooth supply of funding for growing businesses.

Regarding the flow of money through asset management businesses, there are many cases where funds were raised in Japan and then invested in foreign bonds. However, by taking a comprehensive approach as stated above, under appropriate governance the pervasion of long-term diversified investment including Japanese stocks would lead the Japanese market, in which foreign investors currently make up a high proportion of trading participants, to develop into an attractive market in which various investors, including Japanese investors, could participate.

(3) Wealth accumulation among the working generation and the importance of financial education

Under the “Abenomics” initiative aiming to end deflation, it is essential to promote asset management practices which generate risk-appropriate returns in the medium/long term by investing in risky assets to a certain extent, and thus to establish a positive cycle which facilitates the smooth supply of funding for growing businesses. To this end, it is important to provide an environment in which households can accumulate wealth aligned with their lifecycle stages. Furthermore, in a country that faces population decline and hyper-aging, it is necessary for the working and younger generations to accumulate wealth over the medium/long term, accompanied by reforms of the social security system.

Although the market acceptance of NISA is steadily increasing, more than half of its users are still elderly people. It is necessary to foster investment among young people and the working generation through additional measures, including the application of Junior NISA as created in the FY2015 Tax Reform.

Moreover, consideration should be given to enhancing the acceptance of the defined contribution pension plan in order to help increase the number of working people who go into comfortable retirement by means of medium/long-term asset management based on their own choices.

In order to ensure that younger people and the working generation properly accumulate wealth, high-quality financial education is critical. As mentioned earlier, the Financial Literacy Map is currently being used in lectures at universities and those open to the public, and these efforts should be continued and expanded. Besides that, investment education offered by providers of defined contribution pension plans to their customers is also helpful for the working generation in acquiring the financial literacy necessary for their wealth accumulation.

In addition, a broader range of university students, regardless of their majors, is expected to acquire financial literacy. This will be a milestone in the sound wealth accumulation of the broader general public.

Furthermore, developing an environment for interdisciplinary studies and research is desirable in attracting highly-skilled financial professionals to Japan.

(4) Enhancing corporate competitiveness, upgrading to a settlement system that contributes to user convenience, and examining how financial groups should work

① Initiatives for enhancing settlement and other operations

In recent years, rapid advances in information technology (IT) have brought about changes in the financial industry. In addition, given further progress in globalization, the way companies are conducting transactions is also changing. Consequently, the environment surrounding accounts/transaction settlements is undergoing a drastic transformation. Amid this backdrop, requests for more sophisticated settlement methods are rapidly increasing. In light of this, and given the Japan Revitalization Strategy (2014 revised version), the Financial System Council’s Study Group on Payments and Transaction Banking convened and announced its interim revisions in April 2015. Going forward, the study group is scheduled to establish an action plan based on its interim revisions, and will likely conduct further examination of the system should it be necessary.

In the retail banking sector, FinTech, the integration of finance and IT, is a growing trend. Furthermore, starting with transaction settlements (payments), non-bank players are starting to take on banking operations as a part of their business with the goal of becoming a more comprehensive financial service provider. In this manner, the unbundling of the banking operations, mainly transaction settlements, is occurring. This structural change is likely to have a substantial impact on the future composition of banks. US and European banks view this changing environment as a potential risk and are therefore forming alliances and cooperating with non-bank players. These actions are more strategic than those being taken by Japanese banks.

In Japan, banks primarily are planning a transition away from their closed structure. However, as a diverse range of players enter the race, a key issue will be promoting innovations to develop competitive settlement services. At the same time, some financial institutions are building business models that emphasize open innovation. It is essential that banks strategically incorporate advanced IT. Through this it will be possible for them to analyze Big Data on customer needs and behavior and develop optimal and tailor-made products for customers. Moving forward it will be necessary to prepare an environment that will facilitate these types of developments.

Meanwhile, in wholesale banking, a crucial element that determines the competitive strength of a bank is its cash and debt management capabilities. In particular, it has been pointed out that US and European banks are far ahead of Japanese banks in systems and services for cash management.

In light of these factors, the positioning of CMS management strategies at Japanese banks, particularly major banks, is a key point. At the same time, more flexible business development is also important. This should be carried out with the strategic expansion of IT investments by teaming up with IT venture companies, or in the case of overseas units local conditions should be taken into account. Banks should examine what it will take to establish the environment necessary to carry this out. Moreover, in other countries, some banks provide advanced CMS services with ICT technologies in cooperation with companies other than banks. Furthermore, system issues related to the transfer of capital within a corporate group or internationally, the electronically recorded monetary claim system, and CMS provided by banks, including foreign banks, should also be examined.

In addition to this, reforms to the settlement infrastructure are also an urgent issue. In the US, Europe, and major emerging economies, banks are rapidly moving forward with the strategic sophistication of their banking transaction systems, including bank-to-bank networks, as a means of boosting their competitive strength.

In December 2014, the Japanese Bankers Association (JBA) decided on and announced plans to develop a payment environment where the 24/7 operation of the Zengin System can be realized by 2018. While this is progress, compared with the initiatives of other countries, the speed of the reforms to the settlement infrastructure is expected to accelerate.

Concretely, looking at the future of banking operations and given factors such as the ongoing integration of finance and IT, the banking transaction infrastructure must become seamless worldwide. The banking system needs to take factors such as international account trends and future needs into consideration. It also needs to adopt international standards for wire transfer formats, provide low-value international wire transfers, and the limit for wire transfers using the interbank payment system should be raised. The interbank payment system should also be designed to handle yen-denominated wire transfers by non-Japanese residents. A single system should be made to handle all of these functions. It is also important to increase involvement in the building of a banking transaction infrastructure in Asia, including APN, mainly for banking circles. At the same time, another key issue will be the expansion and enhancement of banking transaction infrastructure functions by making a full transition to XML documents, which boast superior functions, including an end-date setting, and new uses for the interbank payment system; and through a review of the interbank payment system’s operation system; to contribute to speedy and strategic decision-making.

② Examining the ideal structure for the financial group system

Currently, the environment surrounding financial groups is undergoing a drastic change.

Advances in innovation for financial services, including the banking transactions discussed above, are likely to have a huge impact on the state of financial services going forward. US and European financial institutions are briskly taking strategic action to deal with these changes in the market environment. For Japanese financial groups to compete, they will have to enhance banking transaction operations and make more aggressive and strategic IT investments that will support their operations.

Looking at Japanese major financial groups, including the three megabanks, the percentage of the group's total revenues from non-bank and overseas subsidiaries is increasing. Looking at regional activities, financial groups are making use of their holding companies to implement management integration that extends over prefectural borders. Consequently, while financial groups deal with changes in global and local economic and financial market environments, new developments are also unfolding.

Recent international debate on financial groups suggests that the responsibility for the health and soundness of a financial group headed by a holding company lies with the regulatory authorities of the financial group's country of origin. From the perspective of boosting the overall competitive strength of a financial group, the holding company should take on a broader central role, not only developing strategic management policies for the overall group but also implementing stronger management of the entire group.

Given these factors, the ideal structure of business and legal systems should be examined in order to enable a financial group to carry out advanced and flexible operations and to expand and strengthen the efficiency of governance and risk management functions, which would increase benefits from synergies and cost reductions to provide optimal services to customers.

When the FSA examines the settlement methods and legal systems of financial groups, the FSA is advised to collaborate and communicate with professionals relating to financial industries, such as lawyers and accountants. In addition, the panel recommends that the FSA hire new professional human resources, such as IT engineers.

(5) Regional revitalization

① Contribution by regional financial institutions

Japan is faced with structural issues in the form of population decline and hyper-aging. The rate of decline in working-age population by prefecture during the 2012-2025 period illustrates that most of the prefectures will experience a decline rate greater than 10%. In addition, given that the firm exit rate is higher than firm entry rate, financial institutions are likely to face a very difficult business environment in which their number of customers is decreasing.

Amid this backdrop, regional financial institutions need to strengthen initiatives to realize a positive cycle in which they support regional economic and industrial activities while concurrently growing and expanding with the region. In specific, it is vital that regional financial institutions properly evaluate the content of the businesses of companies that are in different life stages, provide solutions to these companies, and extend necessary support. This will contribute to an improvement in productivity and also enable the financial institution to stably secure revenues and sustain and improve its financial soundness. From this standpoint, regional financial institutions need to further review their business models so that they can actively and continuously fulfill the roles required of them by the region. The following are vital measures.

i Active contribution to regional development by regional financial institutions

Regional financial institutions are being asked to actively contribute to regional development. The Comprehensive Strategy for Vitalization of Towns, People, and Jobs calls for teamwork between the public and private sector to support voluntary initiatives for providing solutions to companies in various life stages in order to improve the productivity and efficiency of regional companies. This includes the implementation of a regional company support package backed by regional financial institutions. In addition, it is crucial that regional financial institutions participate in plans for the creation of regional versions of the comprehensive strategy to be carried out by municipalities, and also be involved in the individual projects included in the strategy.

ii Promoting alliances and cooperation between regional financial institutions and government-affiliated financial institutions in order to enhance financial functions in regional areas

The Comprehensive Strategy for Vitalization of Towns, People, and Jobs plans to develop sophisticated financial functions in regional areas through alliances between private-sector financial institutions and government-affiliated financial institutions. To ensure that the diverse problems being faced in each region are handled in detail, it is vital that the creation of an environment for supporting regional vitalization strategies is supported from a financial standpoint, including promoting the appropriate functioning of government-affiliated financial institutions and providing opportunities for regional financial institutions and government-affiliated financial institutions to exchange opinions in order to create joint projects and share know-how.

iii Additional support for regional business rehabilitation and vitalization of regional economies

In working with regional financial institutions, REVIC must utilize the (previously mentioned) regional vitalization and business rehabilitation fund in order to continue to smoothly supply capital and management know-how to regional companies. In addition, in order to improve productivity at regional companies, a subsidiary of REVIC should be used to match personnel with jobs and promote the positioning of management personnel who have a wide range of experience at regional companies. These are essential steps to vitalizing regional economies.

iv Regional financial institutions working together and taking advantage of systems established by the financial group

Regional financial institutions should examine business development that is realized by leveraging the benefits from cost reductions and mutual synergies between regional financial institutions by using systems established by the financial group, which will be discussed later. This will be effective in building a sustainable business model later on.

② Smooth supply of funds to growing businesses by utilizing a variety of funding methods

As discussed earlier, progress is being made in enhancing the market intermediary functions which are to increase the supply of funds to growing businesses. Going forward, more focus should be given to measures to match specific needs with appropriate funding. In particular, in order to ensure a smooth supply of funds to growing businesses and overcome the “valley of death,” clusters of networks consisting of a wide variety of venture firms and their related parties are essential.

Based on these understandings, the following measures should be taken.

i Promote use of various types of crowdfunding (including investment crowdfunding)

To grasp the need for capital and promote the supply of growth capital in regional economies, the use of various types of crowdfunding, including investment crowdfunding, should be promoted (the system was put in place in May 2015) in cooperation with groups such as the Council on Hometown Investments.

ii Establish new trading system for non-listed shares

To support companies whose businesses are deeply-rooted in the local community but have not publicly listed their shares, the shareholder community system should be used to help these companies procure capital.

Going forward, by using the forum, which will be discussed later, regional companies and residents can increase their knowledge of the system and thereby promote its use.

iii Supply capital via funds that support regional vitalization and business rehabilitation

Companies in their infant stage are expected to receive growth capital via regional vitalization funds, including venture capital and private equity funds. Regional financial institutions and REVIC should work together to promote the further use of funds designed to support regional vitalization and business rehabilitation, and of PE funds created to spark growth and increase the value of companies.

iv Hold forum with regional economic circles and capital market participants to promote the supply of growth capital to regional economies

To promote the supply of growth capital while taking into account conditions in the regional economy, all parties related to the region should meet together. This includes management from regional companies that recently listed their shares, as well as regional venture companies, stock exchanges, securities companies, regional financial institutions, venture capitals, and regulatory authorities. Opinions should be exchanged on current conditions and issues surrounding the capital market. In addition, a forum on promoting the supply of growth capital to the region should be held to present examples and share know-how on supplying growth capital to the region. These initiatives should be further promoted as a part of efforts to establish an environment that supports venture companies and other startups.

(6) Promoting cooperation with Asian countries and the rest of the world and establishing a leading position as an international financial center

Thus far the FSA has contributed to the development of Asian countries and supported the activities of Japanese companies and financial institutions in Asia through technical assistance for developing financial infrastructures and through human resource exchanges using its Asian Financial Partnership Center (AFPAC). It is commendable that these efforts have helped Japanese companies and financial institutions enter overseas markets. It will be critical to further strengthen assistance in the financial field in order for Japanese companies and financial institutions to expand business abroad.

In order to develop the Tokyo market into an international financial center, it will be necessary to articulate the attractiveness of Japan's financial and capital markets.

Transforming the Tokyo market into an international financial center that attracts people, goods, and capital from around the world is also crucial to invigorating the Japanese economy. To accomplish this, it is critical to foster a better business and living environment for highly-skilled professionals, including improved English-language proficiency among the population.

From these standpoints, the consideration and the implementation of the following measures are essential.

① Supporting Japanese companies and financial institutions entering oversea markets

With a view to further strengthening support to Japanese companies and financial institutions entering oversea markets, it will be necessary to make it easier for these companies to access necessary financial services (financial consulting, accounting and legal services, etc.) when they expand their business to Asian countries and other emerging economies. To ensure easy access to these services, Japanese specialists engaging in these financial services should be encouraged to work actively in Asia. It will be necessary, working with relevant organizations, including the regulatory authorities of other countries, to provide information to companies in cooperation with Japanese financial experts, to hold and expand various seminars and training programs, and to set up a contact point at the FSA for gathering various information, including information on such seminars, thereby disseminating information to both domestic and foreign audiences. Seminars and training programs for the human resource development of overseas regulatory authorities' staff, etc., should be systematically implemented as well. Furthermore, there is a fundamental issue in the fact that there are not sufficient lawyers and accountants working actively abroad. Both the public and private sectors should cooperate to train experts with deep knowledge on and qualifications for international work.

② In parallel with the above measures, the Japan Bank for International Cooperation (JBIC), a public financial institution which supports Japanese companies in expanding their businesses overseas, is expected to strengthen its function of providing growth capital, along with mobilizing private resources and know-how. With such a measure, JBIC will become better able to provide loans and investments to projects where Japanese technologies and know-how are expected to be utilized, including projects with a relatively higher risk profile.

The Global Financial Partnership Center (tentative name)

The Asia Financial Partnership Center, which was established by the FSA in 2014, should change its name to the Global Financial Partnership Center (tentative name) and consider widening its scope from Asia, which has been its sole focus since its establishment, to emerging economies in other regions such as the Middle East, Africa, and Latin America, thereby expanding its technical assistance system.

In addition, the Global Financial Partnership Center (tentative name) should serve to convey the appeal of Japan's financial and capital markets to other parts of the world. It should strategically implement overseas IR in major financial and capital markets around the world.

③ Developing the Tokyo market into an international financial center

Regarding the business environment in Tokyo, the Tokyo Global Financial Center Promotion Council held its first meeting, hosted by the Tokyo Metropolitan Government, in September 2014, and its sub-committees have since continued discussion. At present, redevelopment is proceeding in the Daimaruyu, Nihonbashi-Ginza, Roppongi-Toranomon, and Kabuto-cho areas as a part of efforts to foster a better business environment. Going forward, utilizing the platform instigated by the Tokyo Metropolitan Government and promoting cooperation among the aforementioned areas, Tokyo as a whole needs to work toward establishing a position as an international financial center.

In addition, in order to attract highly-skilled professionals from around the world, it will be necessary to adopt a more flexible immigration control system. The points-based system has allowed preferential immigration treatment for highly-skilled foreign professionals at the management level in financial institutions. Expanding the scope of the system to include younger professionals and those looking to start financial businesses in Japan is one of the measures to consider.

Moreover, as many conferences and meetings related to international finance as possible should be hosted or invited to be hosted in Tokyo. Also, the FSA and Certified Public Accountants and Auditing Oversight Board (CPAAOB) should continue its efforts to nominate Tokyo to be the Permanent Secretariat for the International Forum of Independent Audit Regulators (IFIAR).

(7) Improving the convenience of financial and capital markets and other initiatives for vitalization

In overseas financial centers, there is fierce competition between international markets. To establish and improve the Tokyo market so that it will become an international financial center that ranks among overseas markets, a variety of funds, derivatives, and other financial products should be traded on Tokyo’s financial product exchange. In addition, settlement functions in the market should be strengthened. To improve the convenience of and vitalize the financial and capital markets, it is essential to aggressively advance the following initiatives.

① Comprehensive exchange

Given that major exchanges in foreign markets are planning to expand their derivative products, the promotion of initiatives to create a comprehensive exchange for financial instruments as quickly as possible should continue to be carried out. Exchanges in Japan should also consider listing a diverse range of derivative products, including commodity derivatives.

② Infra funds and healthcare REIT

The promotion of the development, investments in, and listing of infra funds and healthcare REITs should be carried out to ensure the smooth flow of capital to improve quality of life. Infra funds will make it easier for investors to invest in infrastructure assets. Extensive information will be made available to investors so they can make their own investment decisions, and opinion exchanges between related parties will be held. It will obviously be necessary to establish an environment that facilitates the creation and listing of these funds. To promote the development and listing of healthcare REITs, financial institutions are expected to team up with related organizations and give presentations to healthcare companies to promote and enlighten them on these funds.

③ Vitalization of the bond market (including promoting issuance of foreign bonds in the Tokyo market)

To get the Japanese bond market to play a central role in Asia's bond market, it will be necessary to promote initiatives including the vitalization of the bond market, vitalization of the Tokyo Pro-Bond Market in which both domestic and foreign traders participate, and the introduction of a system that provides reports and announcements of information on corporate bond transactions. In addition, the issuance and distribution in Japan of bonds denominated in foreign currencies should be taken under consideration.

④ Strengthening functions of clearing and settlement houses

Taking into account trends at overseas clearing and settlement houses, the strengthening of functions, including the expansion of clearing and settlement house services in Japan, should be taken into consideration to improve convenience for market participants.

⑤ Shortening settlement period for JGBs, equities, and other financial instruments

Given the settlement period in other major developed countries, the settlement cycle for JGBs should be shortened (T+1), and the transaction period for equities and other securities should be switched to a T+2 cycle as soon as possible.

⑥ Cross-border bond issuances and smooth settlement in Asia

Under the Asian Bond Markets Initiative (ABMI), it is necessary to give much consideration to the standardization of bond issuance documentation and procedures, as well as to linkages of securities and payment settlement systems with a view to promoting the development of efficient and liquid bond markets in the ASEAN+3 region.

3. Conclusion

Following the publication of the two Recommendations in December 13, 2013 and June 12, 2014, development of rules and systems in the financial and capital markets in Japan has been making steady progress, and has been highly recognized by foreign investors. It could be said that the rudder of the ship of reforms for 2020 has now been turned, such as with the formulation of the Corporate Governance Code and the commencement of its application. However, it often takes time for such a large ship to change its direction. Although rules and systems have improved to a certain extent, it is vital to patiently endeavor until all the stakeholders in the Japanese financial system understand the essence of such rules and systems, and then to take actions. It is crucial to keep a close watch on the reforms to ensure that such improvements continue without slowing.