

Administrative Action in the Financial Sector

Basic Administrative Approach

- Strict enforcement of transparent and fair financial supervision based on clear rules.
- Development and proper implementation of financial rules giving consideration to ensuring customer protection and market fairness.

Basic Principles

- Based on the basic administrative approach, the Financial Services Agency (FSA) has been undertaking administrative action when it establishes, in light of relevant laws and regulations, that customer protection and market fairness is being harmed. The size, nationality, and type of business of the financial institutions involved do not affect FSA decisions.

Ensuring Fairness and Transparency in Administrative Action

1. Clear Indication of Regulatory Guidelines and Interpretation in Advance

- The FSA's Supervision Guidelines and Inspection Manuals are made publicly available, which include inspection and supervisory perspectives and workflow of administrative actions.

(case.1) The Guidelines for Major Bank Supervision already specified, in the paragraph entitled "Information Provision and Consultation for Customer Protection," clear supervisory checkpoints relating to cases of mis-selling when it was found that certain banks mis-sold financial products, including deposits, failing to explain their risks and provide important information to customers.

(case.2) The Guidelines for Insurance Companies Supervision already specified, in the paragraphs entitled “management system for insurance payment operation” and “system for insurance solicitation,” clear supervisory checkpoints when it was found that certain insurance companies conducted improper non-payments.

- In the so-called No Action Letter system, when private companies are about to launch new businesses, dealings in concrete terms, we receive and respond to inquiries about whether such concrete activities are subject to unfavorable dispositions.
- Moreover, to complement the No Action Letter system which deals with the legality of individual cases, we have introduced “written inquiry procedures for general legal interpretation,” allowing for inquiries about general and abstract legal interpretation.

(note 1) As of March 31, 2008, the FSA’s No Action Letter system have received 28 requests since its introduction in July 2001. Among them, five requests concern the Securities and Exchange Act (currently the Financial Instruments and Exchange Act) and the cabinet orders for the enforcement of the Act.

(note 2) Additional elements of “written inquiry procedures for general legal interpretation,” when compared to the No Action Letter system, include the following:

- i enabling inquiries about general and abstract legal interpretations besides inquiries about individual cases.
- ii enabling business associations to inquire by themselves, in addition to individual corporations.
- iii enabling people other than the professions with special knowledge about the inquiry matter such as lawyers and certified public accountant to become deputies.

2. Observance of Due Process

- Before taking administrative action, we conduct a hearing with financial institutions concerned in accordance with the Administrative Procedure Law.
- Moreover, as a preliminary step toward the above-mentioned procedures set forth in the Administrative Procedure Law, we have proceedings for the exchange of opinions upon the request of financial institutions (opinion-exchanging system).

(note) In addition, administrative appeal based on Article 6 of the Administrative Tribunals Examination Law and judicial appeal based on Article 8 of the Law on Suits against the government are available.

3. Ensuring Transparency

- In order to improve predictability in other financial institutions and to prevent similar incidents from arising, we announce all administrative actions to the public, except in cases where such announcement might hinder managerial improvement in the targeted financial institution, including the announcement of an unfavorable disposition relating to financial soundness.

When announcing such actions to the public, we strive to improve predictability by clearly stating the underlying facts and supporting laws, regulations and provisions.

- We also compile and publish, on a quarter basis, a collection of cases in which administrative action has been taken.
- We respond to many requests for disclosure of information each year, based on the application of the Law Concerning Access to Information held by Administrative Organs.

Criteria for Administrative Action

1. Prior to taking administrative action, the FSA, as a first step, considers the following aspects, so as to identify the appropriate measures to take.

- i **Seriousness and Maliciousness of the Conduct**

The extent of the damage to public interests

Whether the financial institution is substantially undermining public interest, such as undermining confidence in the financial market by

developing and providing products that are severely inappropriate in view of proper disclosure of a customer's financial position.

The extent of damage to customers' interests

Whether numerous customers have incurred damages on a wide scale, and to what extent each individual customer has incurred damages.

Maliciousness of the conduct

Whether the financial institution's act was malicious — for example, whether it continued to sell similar products despite receiving many complaints from customers.

Length and frequency of conduct

Whether the act was performed over a long or short period of time, and whether it was performed repeatedly/continuously, or rather a one-off event.

Existence of intention

Whether the act was performed intentionally with awareness of its illegality and inappropriateness, or due to negligence.

Organized involvement

Whether the act was performed based on a personal decision by the sales staff on the floor, or whether a manager was involved as well; whether the top management was involved therein.

Concealment of conduct

Whether there were any attempts to cover up the problem after it was recognized; and if so, whether it was organized.

Involvement with antisocial forces

Whether there was any involvement with antisocial forces, and if so, the extent of their involvement.

ii Appropriateness of Governance Systems and Operational Control Systems causing or contributing to the violation

Whether presidents and the board of directors fully recognize the importance of compliance and take necessary initiatives to ensure compliance

Whether internal audit structures are adequately established and whether they work in a reliable manner

Whether compliance and risk management structures are well organized and function effectively

Whether operational staff recognize the importance of compliance and whether internal education programs are adequately provided to employees

iii Mitigating Factors

In addition to the above, whether there are any mitigating factors, such as, whether the financial institution is itself making necessary efforts to protect customers in a voluntary fashion prior to administrative

responses.

In particular, in cases where the financial institution is making voluntary efforts in an appropriate manner based on the principles that have been shared with the authorities, this fact will be taken into consideration as a mitigating factor.

2. In consideration of the factors referred to in 1. above and after looking into whether there are any other factors that should be taken into account, we ultimately decide on administrative action by examining the following :
 - (1) Whether it is appropriate to let the financial institutions concerned make voluntary efforts to achieve the necessary improvements in their business operations.
 - (2) Whether considerable efforts are required in terms of the business improvement and whether it is necessary to have the financial institution concentrate intensively on implementation of business improvements for a certain period of time.
 - (3) Whether it is appropriate to allow the financial institution to continue its business operations.

Checking Framework

- When considering administrative action, we not only review precedents, but also carefully conduct checks in multiple sections to ensure fairness.
- Inside the FSA, we have established an independent office consisting mainly of lawyers that investigates compliance of the FSA (staff), as well as a desk for receiving information related to the compliance of the FSA (staff).
- We have established the “Principles of Financial Supervision and Rules for Supervision Division Staff (Code of Conduct)”.

Follow-Up

- The principal objective of taking administrative action is to ensure financial soundness and operational appropriateness of the financial institutions; action itself is not a goal.
- The submission of a business improvement plan is required in response to administrative action, because the financial institutions are expected to make substantial improvements to their systems of their own accord with respect to governance, risk management and compliance, and the effects thereof are expected to henceforth be demonstrated continuously.
- From this perspective, the FSA focuses on following up on and encouraging the business improvement efforts implemented by the financial institutions.