

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

[held on January 17, 2023, with the Japan Securities Dealers Association]

1. Major international trends in 2023

- Japan assumed the G7 presidency in January 2023. The G7 Finance Ministers and Central Bank Governors Meeting will be held in Niigata from May 11 to 13, and the G7 Summit will be held in Hiroshima from May 19 to 21.

2. Establishment of AML/CFT/CPF framework

- The FSA published the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism in 2018 and thereby clarified AML/CFT/CPF measures required for financial institutions. The FSA set the three-year preparatory period from 2021 and is requesting all financial institutions to complete the establishment of their AML/CFT/CPF framework as required under the Guidelines by the end of March 2024.
- The FSA keeps a close eye on top managements' attitudes of financial institutions. Our on-site inspections and supervisions have revealed that the top managements of the financial institutions, whose level of achievement in AML/CFT/CPF framework establishment is high, considered AML/CFT/CPF measures as a management challenge and have taken initiative to address it.
- Given that the deadline to establish the framework is approaching around one year ahead, the FSA requests top managements to have strong sense of ownership, to accurately understand the gaps between their own framework and the requirements under the Guidelines, and to accelerate organizational efforts to ensure completion of the framework establishment by the end of March 2024.

3. Ideal collaboration between banks and securities companies in selling financial instruments

○ Since October 2022, the FSA has conducted verification of a number of regional banks' internal control systems for the selling financial products, such as structured bonds, and has had dialogues with them, through which the FSA has found problems concerning collaboration between banks and securities companies.

○ For example, it is often the case that a regional bank that holds a securities company within the same group sets up a policy to provide group-wide support in an integrated manner for customers' asset management in its mid-term business plan, etc. However, there were cases where a bank that has introduced its customers to a group securities company does not sufficiently ascertain financial instruments purchased by those customers or the status of their gains and losses.

Some of those banks and securities companies have failed to sufficiently make efforts necessary for sharing information on the customer's asset portfolio of their common customers until recently.

Such unfavorable cases have been also observed for banks collaborating with large securities companies, etc., not only with group securities companies.

○ In order to seek customers' best interest, which banks and securities companies generally set up in their policies, it is important for them to mutually divide roles in an appropriate manner and to present customer's asset portfolio management plans from the customer's perspective, while properly sharing information.

○ Some group securities companies may face revenue declines due to a recent suspension or cut of the sale of structured bonds or the influence of market conditions. From the perspective of achieving customer-oriented business conduct, they are requested to consider and discuss how to create a sustainable business model.

4. Doubling Asset-based Income Plan

- On November 28, 2022, the Doubling Asset-based Income Plan was decided at the meeting of the Council of New Form of Capitalism Realization from the perspective of achieving a virtuous circle of growth and asset-based income, wherein the promotion of investment of cash and deposits, which account for over half of the total financial assets of Japanese households, will lead to enhance corporate value sustainably and the benefits will extend to household budgets in the form of asset-based income increases.
- The Plan includes the following measures:
 - Drastically expand the NISA program, which promotes a shift of household financial assets from savings to investment, and adopt it on a permanent basis;
 - Implement reforms of the iDeCo program, including raising the age limit for new participation;
 - Establish a system to promote the provision of neutral and credible advice to consumers;
 - Strengthen asset building efforts by employees;
 - Enhance financial and economic education to increase awareness about the importance of stable asset building;
 - Create an international financial center open to the world; and
 - Ensure customer-oriented business conduct.
- Individual financial institutions' understanding and cooperation are indispensable for realizing the Doubling Asset-based Income Plan, changing people's behavior based on correct information and financial knowledge, expanding users of the NISA program, etc. and having people achieve stable asset building. In particular, strengthening of the public-private collaboration in financial and economic education is extremely important to strategically and effectively utilize resources of individual entities and to secure the neutrality. We appreciate individual financial institutions' cooperation, which is indispensable for properly operating the Financial and Economic Education Promotion Agency (provisional) and a conference and other bodies to be established before the establishment thereof.

5. Results of requests for FY2023 tax reforms

- For FY2023 tax reform, the FSA made requests regarding the Doubling Asset-Based Income Plan, including fundamental expansion of the NISA program, environmental development concerning cross-border transactions, insurance, and crypto-assets.
- As a result, fundamental expansion and perpetuation of the NISA program was incorporated in the Tax Reform Outline compiled by the ruling parties, which was publicized on December 16, 2022. More specifically, the following are included:
 - To unify the various NISA types, and create an " Accumulation-type , " which takes over from Tsumitate NISA (installment-type NISA) , and a "Growth-type , " which takes over from general NISA, both of which may be used at the same time; and
 - To increase Annual investment limit to 1.2 million yen for the Accumulation-type and to 2.4 million yen for the Growth-type.

In total, up to 3.6 million yen per year may be invested through the NISA program, a higher level than the upper limit of the ISA of the United Kingdom.

- Additionally, the upper limit of 18 million yen will be set on the total value of tax-exempt holding (the upper limit on Growth-type , which is part of the overall upper limit, will be set at 12 million yen), and the period of tax exemption for profits earned from financial products will be made indefinite.
- The new NISA program system after the fundamental expansion is scheduled to be put into effect in April 2024, but tax exemption will be applicable to products in which investment has been made through the existing general NISA and Tsumitate NISA (installment-type NISA) before the end of 2023 outside the framework of the new program. The burden on financial institutions related to computer system development is expected to be reduced because it will be unnecessary to transfer investment assets held under the existing program to the new program. We appreciate individual financial institutions' cooperation for smooth implementation of the new program.

- The Doubling of Asset-based Income Plan aims to double the number of NISA accounts, from the current 17 million to 34 million, and also double the value of purchases made through NISA, from the current 28 trillion yen to 56 trillion yen, over the next five years.
- For achieving households' stable asset building, the following are also important, in addition to the fundamental expansion and perpetuation of the NISA program:
 - To enhance financial and economic education; and
 - To ensure customer-oriented business conduct by financial institutions, etc.Your cooperation is also indispensable regarding these points.
- The latest reform is for fundamental expansion of the NISA program and is attracting people's attention. In order to further facilitate people's stable asset building, not only the government's initiative but responses and cooperation of financial institutions, which directly make contact with users, are very important. Please offer cooperation in order for the development of Japanese financial markets and financial sector.
- In addition to the above, the following major items related to the FSA are also included in the tax reform outline:
 - Extension of tax exemption related to "gensaki" bond transactions (repo transactions) with foreign investment funds (three years);
 - Extension of the suspension of levying of the corporate tax on the reserves of retiring pension funds, etc. (three years); and
 - Extension of the preferential tax measures related to infrastructure funds (three years).It is important to implement these in an effective manner, and we ask for your cooperation.
- Regarding the unification of taxation on income earned from financial instruments (expansion of the scope of aggregation of profits and losses), the tax reform outline states that "the national government will conduct deliberations comprehensively based on the outcome of the past deliberations regarding measures to prevent intentional tax evasion." We will take measures required for achieving the unification.

- As a whole, the latest tax reform outline incorporates many of the FSA's requests and is epoch-making. We would like to extend our gratitude to you for your cooperation in the process of compiling our tax reform requests.

6. Future monitoring in light of the Doubling Asset-based Income Plan, etc.

- As major pillars of the Doubling Asset-based Income Plan, the ensuring of customer-oriented business conduct is included in addition to the fundamental expansion and perpetuation of the NISA program.
- Plans for the fundamental expansion of the NISA program have mostly been decided based on deliberations by the ruling parties, but their tax reform outline states that "the supervisory agency should revise the Comprehensive Guidelines for Supervision and strengthen supervision and monitoring of financial institutions so as to regulate their inappropriate acts, such as forcibly recommending churning to customers by the use of the 'growth investment quota'." Therefore, the FSA will make responses appropriately.
- We have repeatedly stated that taxation reform and other institutional measures alone are not sufficient for facilitating a shift of household financial assets from savings to investment but that it is extremely important for each participant in the process of investment (investment chain) to thoroughly ensure customer-oriented business conduct. In particular, securities companies are expected to ensure their operations for the sale of and solicitation for financial instruments in accordance with customers' best interest. We would like to continue in-depth dialogues with them.

7. To achieve wage increases for creating a virtuous cycle of growth and distribution

- The Kishida administration has been taking measures for creating a virtuous cycle of growth and distribution with the final goal of realizing a new form of capitalism. Wage increases and expansion of other human investment are the core challenges therefor.

- At present, a positive attitude toward human investment and human resources development directly leads to a company's competitiveness. Wage increases commensurate with individual workers' abilities are significant as management challenges under such circumstances. Please consider the expansion of human investment, including wage increases.

8. Efforts for sustainable finance

- It is estimated that investment of a total of 150 trillion yen in the public and private sectors is required in the coming ten years in Japan in order to achieve carbon neutrality by 2050.
- Regarding the utilization of private financing, the FSA, the Ministry of Economy, Trade and Industry (METI), and the Ministry of the Environment (MOE) had discussions on five occasions at the Study Group on Financing for Achieving GX of the Industry, and compiled the content of the discussions as a policy package on December 13, 2022.
- The policy package includes the following:
 - (i) Environmental development for making investments in the fields of green, transition, and innovation, and development and establishment of blended finance;
 - (ii) Financing for regional companies and SMEs to promote GX investment;
 - (iii) Development of market environment to promote GX investment; and
 - (iv) Creation of a new evaluation axis for companies making efforts for GX and measures to guide funds to climate change-related sectors on a macro level.
- In particular, with regard to the problem of temporary increases of financed emissions in cases where financial institutions and investors make investment or provide loans in support of transition activities of high-emission companies, a working group will be established under the Taskforce on Preparation of the Environment for Transition Finance, jointly held by the FSA, METI and MOE, and the concepts and the methods for international information provision will be compiled. Additionally, the FSA will

continuously hold the Working Group on Financial Institutions' Efforts towards the Decarbonization of the Economy, which it established in October 2022, and will formulate guidance for dialogues between financial institutions and companies by June 2023. We would like to continue close collaboration with financial institutions.

- With regard to ESG evaluation and data providers that evaluate companies' ESG-related initiatives, including those concerning GX, ensuring transparency and fairness of their evaluation means and governance for preventing conflict of interests, etc. are recognized as challenges. In order to cope with them, the FSA finalized the Code of Conduct for ESG Evaluation and Data Providers on December 15, 2022. The FSA is intending to publish the status of financial institutions that have accepted the Code of Conduct by around the middle of this year.
- Communications between ESG evaluation and data providers and companies and investors, which are the subjects for evaluation, are important in order to ensure the utilization of ESG evaluation and data with trust. Therefore, the Code of Conduct also includes recommendations to companies and investors, such as recommending investors to disclose how they utilize ESG evaluations. We hope that financial institutions will also refer to the Code of Conduct.
- Furthermore, among ESG-related data as a whole, the significance of the provision and utilization of data related to climate change is increasing and it is important for data providers and data users to mutually exchange information and opinions on their needs and challenges. Accordingly, the FSA, the Ministry of Education, Culture, Sports, Science and Technology, the Ministry of Land, Infrastructure, Transport and Tourism, and the Ministry of the Environment jointly established the Panel among Scenario/Data-related Organizations for Evaluation of Climate-related Risks and Opportunities, which consists of members from the industrial arena and the financial sector. Its first meeting was held on December 22, 2022. The Panel plans to discuss future directions of required measures. Financial institutions are expected to refer to the discussions of the Panel for better utilizing data in making climate-related disclosure or on other occasions.
- Not limited to these, the FSA will specify policies in detail for achieving the four

pillars in the policy package mentioned above in close collaboration with relevant ministries and agencies. Our final goal is to create a mechanism to smoothly and constantly secure funds, including private funds, necessary for achieving carbon neutrality, and we consider it important to implement effective measures in light of the actual status of and needs for financing services as well as of the operating policies of individual financial institutions. In that sense, dialogues with financial institutions will become more and more important. We appreciate your cooperation in close exchanges of information and opinions.

9. Participation in the Sanriku Joban Mono Network

- METI launched a framework to communicate the attractions of specialties in the Sanriku and Joban regions and expand consumption toward full-fledged reconstruction of Fukushima and other disaster-affected areas.
- The Sanriku Joban Mono Network is an integral initiative by government organs and the industrial arena, aiming to assist full recovery of the fisheries industry, etc. in the Sanriku and Joban regions and achieve sustainable development of the fisheries industry, etc. into the future.
- Please consider participating in the Network and actively join in the activities.

10. Publication of the Q&A on the Handling of Carbon Credits

- Financial institutions are permitted to deal with the carbon dioxide equivalent quotas and equivalents thereto under the regulations on business scopes specified in laws concerning individual businesses. Through the public comment process in 2008, it was clarified that whether relevant carbon credits fall under the "equivalents" or not is to be judged on a case-by-case basis from the viewpoint of ensuring strictness in procedures for examinations and approval and the clarity of attribution.
- In recent years, carbon credits led by the private sector have become dominant, and the FSA considers it important to ensure that financial institutions themselves can

clearly determine the conformity to the "equivalents" and can deal with those carbon credits more actively.

- Accordingly, the FSA compiled and published the Q&A on the Handling of Carbon Credits on December 26, 2022. The Q&A clarifies the following:
 - J-Credits and JCM-Credits, out of carbon credits led by the national government, fall under the "equivalents"; and
 - Even in the case of carbon credits led by the private sector, if the attribution is clear enough and an organization having a certain level of examination and verification abilities is involved in the process of their issuance, such carbon credits may be judged to fall under the "equivalents."
- Financial institutions are expected to refer to this Q&A when intending to deal with carbon credits, and further promote initiatives for achieving carbon neutrality.

11. Progress in Transition Away from LIBOR

- The publication of LIBOR was ceased at end-December 2021, except for certain USD LIBOR settings. Synthetic JPY/GBP LIBOR for certain tenors calculated using market data had been temporarily published since January 2022, out of which the publication of synthetic JPY LIBOR was ceased at end-December 2022. Regarding the remaining synthetic GBP LIBOR, the publication for 1- and 6-month settings will be ceased at end-March 2023. Based on our monitoring, we assess that the progress in transition away from synthetic LIBOR settings continues to progress smoothly. Financial institutions that still have exposure to contracts referencing synthetic LIBOR are required to continue to take necessary actions.
- With regard to USD LIBOR, for which the publication will be ceased at end-June 2023, we have not identified any major obstacles in financial institutions' transition arrangements at this point. Having said that, we would like them to make sure to progress necessary actions for the transition, with the timeframe until the cessation of USD LIBOR in mind.

- The FSA will continue to monitor the progress in transition arrangements of financial institutions, cooperating with the Bank of Japan, and require them to take necessary actions depending on their respective situations.

12. Matching by regional financial institutions

- In the project to match workers with management skills with local companies, which the FSA has been promoting to further enhance regional financial institutions' function of mediating human resources to companies, some financial institutions have registered a number of their employees with the REVICareer. The system has been thus utilized positively and employment contracts have been concluded in some cases, including those covered by public benefits. These are the outcomes of cooperation of financial institutions that have registered their employees with the REVICareer. We would like to extend our gratitude.
- As part of the PR activities, the FSA has held events mainly targeting workers of large companies in urban areas to deepen their understanding concerning the meaning of working for regional companies and the worth thereof. Videos of the events are scheduled to be made available online on February 11 onward. Please view them.