The JFSA Strategic Priorities
July 2021-June 2022

Overcoming COVID-19 and
Building the Financial System for Greater Vibrancy

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金融庁
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Introduction

In the business year 2021, Japanese Financial Services Agency (JFSA) will focus on the following three areas.

I. Overcoming the challenges of COVID-19 and bringing about a robust economic recovery

First, JFSA will take all necessary actions to ensure that financial institutions continue to perform their financial intermediary function and firmly support the economy and society, which have been seriously affected by COVID-19. In addition, with the aim of achieving a post-COVID-19 economy, JFSA will encourage businesses and individuals to support management improvement and revitalization and conversion of businesses.

II. Development of the financial system that achieves a vibrant economy and society

Second, viewing changes in economy, society, and industry in and outside Japan as opportunities for growth, JFSA will promote a shift to vibrant economic and social structures by achieving a smooth circulation of funds and developing a financial system that enables vigorous and creative financial services.

III. Further develop JFSA's financial policy

Third, JFSA will enhance its capability as a financial authority by (i) enhancing monitoring capability through sophisticated data analysis, and by (ii) fostering professional human resources to contribute to the economy and society in and outside Japan as the agency supporting financial services.

We will focus on these priority issues and continue our effort to increase the welfare of the people through sustainable growth of businesses and the economy as well as stable asset formation by striking a balance between each of: [1] stabilizing the financial system and having financial institutions fully perform their financial intermediary function; [2] ensuring user protection and enhancing user convenience; and [3] securing fairness and transparency over, and invigorating, the market.

* JFSA is always open to receiving opinions concerning “JFSA Priorities for July 2021-June 2022,” which we will take into consideration for the future. To give an opinion, please visit our website <https://www.fsa.go.jp/en/contact.html>.

Contents

I. Overcoming the challenges of COVID-19 and bringing about a robust economic recovery

Financial institutions need to offer cash flow support appropriately and swiftly to companies facing difficulties in raising funds due to the impact of the COVID-19 infection (hereinafter referred to as "COVID-19"). JFSA has collaborated with relevant ministries and agencies and has encouraged financial institutions to offer support in accordance with individual companies' needs, such as through revising the terms and conditions of the outstanding loans, and utilizing financial institutions' proprietary loans,[1] loans guaranteed by Credit Guarantee Corporations (CGCs), effectively interest-free and unsecured loans provided by government financial institutions, and subordinated loans recognizable as capital.

JFSA will continuously monitor financial institutions' cash flow support for companies, and will also carry out measures to encourage their efforts for revitalizing the economy to support a robust economic recovery toward the post-COVID era.

Also, JFSA will endeavor to accurately grasp the current situations of financial institutions and the financial system as a whole and continue dialogues to encourage financial institutions to develop their sustainable business models so that they will strengthen their business foundations and surely contribute to a robust recovery and growth of the Japanese economy.

1. Financial institutions' cash flow support for companies

Given that the impact of COVID-19 has been prolonged, JFSA put the highest priority on making sure that financial institutions understand the business conditions of companies on a daily basis and offer them cash flow support in an appropriate way. From this perspective, JFSA has repeatedly requested financial institutions to offer cash flow support as flexibly as possible in order to back companies by such means as actively providing new loans, including those for necessary funds until the public support is delivered, and persistently proposing long-term extensions of repayment terms or deferment terms.

JFSA will continuously request financial institutions to make all possible efforts to provide cash flow support for companies, and will monitor whether cash flow support is being offered appropriately as a whole through hearing from stakeholders about consultations from

[1] Loans not utilizing Credit Guarantee Corporations' guarantee

businesses and changes in fund needs. Additionally, based on the content of consultations received at JFSA's Financial Services User Consultation Desk, including the Consultation Hotline Related to COVID-19, JFSA will ask for appropriate responses to individual financial institutions as necessary, and will carry out public relations activities to disseminate cash flow support in collaboration with Credit Guarantee Corporations, government financial institutions, relevant ministries and agencies, etc. Also with regard to corporate financial reporting and audit, JFSA will keep an eye on the impact of COVID-19 and make appropriate collaborations among related parties.

Considering the occurrences of large-scale earthquakes, heavy rains and other natural disasters in recent years, JFSA will proceed with the development of readiness to respond to natural disasters from normal times. In the event of a disaster,[2] such as heavy rain in multiple areas this summer, JFSA will closely cooperate with relevant organizations to offer support to disaster victims promptly and appropriately in accordance with the circumstances of disaster-affected areas.

On that occasion, JFSA will request financial institutions to adopt prompt and adequate financial measures and to provide other fine-tuned support to affected people based on a full understanding of their needs.

With respect to individuals and sole proprietors who face difficulty in repaying their housing or other loans due to a natural disaster or COVID-19, JFSA will encourage them to rebuild their livelihood and/or business through getting their debts consolidated based on the "Guidelines for Debt Consolidation after a Natural Disaster" (including special provisions when applying the Guidelines to COVID-19-related cases). JFSA will provide assistance with regard to expenses required for "registration support experts (lawyers, etc.)" as support for debt consolidation procedures.

[2] Including the stages of possible disaster risks covered by the partial amendment of the Disaster Relief Act, etc. that was put into effect in May 2021

2. Efforts for revitalizing local economies

(1) Promotion of support for business improvement, business turnaround, and business transformation, and building of systems therefor

While economic activities are expected to be revitalized gradually thanks to progress in vaccination and other factors, the impact of COVID-19 and the way to recover sales differ by each company. For companies facing business challenges not limited to financing, in particular, it is necessary that financial institutions based in individual local communities take the initiative in offering supports for business improvement, business turnaround, business transformation, in consideration of the characteristics of respective local communities, local industry sectors, and business types.

Therefore, JFSA will integrally and comprehensively promote efforts to provide this support through building and strengthening local support systems in collaboration and cooperation with local stakeholders (including, but not limited to, financial institutions, Credit Guarantee Corporations, business associations, local governments, SME Revitalization Support Committee, Organization for Small & Medium Enterprises and Regional Innovation, Regional Economy Vitalization Corporation of Japan (REVIC), and tax accountants). More specifically, Local Finance Bureaus will, in collaboration with Bureaus of Economy, Trade and Industry, propel "Projects to Establish Support Systems for Businesses," where the aforementioned local stakeholders discuss and share challenges and measures upon offering the support to businesses in each prefecture. Local Finance Bureaus will, as necessary, identify organizations that play a central role in collaborations and make sure that support systems have been developed to enable individual companies to receive support from appropriate local organizations.

(2) Environmental improvement to ensure support for business improvement, business turnaround, business transformation

In order to ensure support for companies' management improvement and revitalization and transformation of businesses, JFSA will endeavor to improve the environment so that financial institutions can get involved in companies' rebuilding of their business models and improvement of their financial bases toward the post-COVID era in collaboration with support organizations.[3] For example, in collaboration with relevant organizations, JFSA will study the formulation of guidelines for private arrangements (out-of-court workouts) for business

[3] Credit Guarantee Corporations, SME Revitalization Support Committee, REVIC, etc.

revitalization based on the actual situation of SMEs and review "Guidelines for Personal Guarantee Provided by Business Owners."

With regard to categories of loans upon revision of conditions, such as deferment of payments, if a borrower formulates a certain management improvement plan (a highly feasible fundamental reconstruction plan), its loans may be treated as ordinary loans. JFSA will clarify the rules for this treatment in light of the fact that the entirety of the impact of COVID-19 is hard to forecast and JFSA has repeatedly issued requests for cooperation for cash flow support.

In addition, from the perspective of examining the possibility of effectively utilizing debt collection companies (servicers), which also have a function to support business reconstruction not limited to factoring and debt-collection, as one player in business reconstruction in respective local areas, JFSA will make efforts to understand the actual situations, including the collection of examples of successful business reconstruction supported by servicers.

(3) Encouragement toward vitalization of local economies

JFSA and Local Finance Bureaus need to understand the actual situations of ecosystems of local economies, such as through creation of networks with local companies and support organizations, etc. and collection of examples of financial institutions' support for local companies, and to positively encourage related parties to work for vitalization of local economies as a whole.

Specifically, in order to help local companies that intend to expand or transform their business secure management personnel toward the post-COVID era, JFSA will expand the list of large companies' human resources, which is to be managed by REVIC, to include about 10,000 human resources at an early stage and promote services of regional financial institutions, etc. to match professionals and local companies.

Moreover, JFSA will support the initiatives of financial institutions and Credit Guarantee Corporations, etc. to have their staff members share knowhow to support companies across regions, organizations, and business types. JFSA will also promote multiple jobs and side jobs of staff members of financial institutions to enable them to engage in activities to support local companies' efforts to improve productivity and vitalize local communities.[4]

Officials of JFSA and Local Finance Bureaus who gathered on a voluntary basis have been involved in solutions for specific local problems from the standpoint as persons in charge of financial administration through having contact with local intellectuals in the fields of government, industry, academia, and finances, while creating networks with local related parties, thereby further deepening knowledge on approaches to the sustainable growth of local economies.

(4) Review of legal systems to have them contribute to sustainable growth of local companies and economies

There are many venture companies and companies under reconstruction whose financial conditions are not necessarily favorable at present but have future potential. It is necessary to develop an environment under which these companies, even without real estate or any other tangible assets, can raise funds without depending on business owners' personal guarantee, and financial institutions can offer support without worries to these companies for their management improvement while assisting with their business continuation and development. For that purpose, JFSA will consider the establishment of business growth collateral (provisional) as a new collateral system covering the business as a whole in reference to overseas systems and practices, with due consideration given to how to secure convenience and protection of other creditors.

In April 2021, the Subcommittee on Collateral Legal Systems of the Legislative Council of the Ministry of Justice commenced deliberations on legal systems for collateral, including the aforementioned business growth collateral (provisional). JFSA will contribute to these deliberations and will also deliberate specific legal systems and practical handling of the systems by financial institutions and supervisory authorities at the Study Group on Lending and Business Turnaround Practices to Support Corporate Borrowers' Business Enhancement.[5]

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4 On June 23, 2021, JFSA issued the document titled "Dissemination and Promotion of Side Jobs and Multiple Jobs Based on the 'Basic Policy on Economic and Fiscal Management and Reform 2021' and the 'Action Plan of the Growth Strategy and Follow-up on the Growth Strategy" to trade associations. (https://www.fsa.go.jp/news/r2/sonota/20210623.html) (Available in Japanese)

5 A study group established in JFSA in November 2020 for the purpose of deliberating collateral legal systems that will appropriately motivate financial institutions to support companies' business continuation and development

3. Monitoring policies

(1) Current economic and financial conditions and cross-industry problems

COVID-19 is continuously exerting a significant impact on the global economy. Individual national governments have been taking various fiscal and monetary policies, and economic forecasts are improving mainly in developed countries. However, while accommodative monetary policies have been maintained globally, companies' debts are increasing and it is necessary to pay attention to possible influence on the world and Japanese financial systems that may be exerted by future environmental changes.

Under such circumstances, financial institutions in Japan generally have strong financial bases at this point and the overall financial system remains stable.[6] Economic activities have been supported continuously thanks to policies of the national government and the Bank of Japan. On the other hand, amid continuing uncertainties arising from COVID-19, it is important to continuously check the status of how financial institutions perform their financial intermediary function and to accurately ascertain impacts exerted by potential risks, such as possible future credit costs on the soundness of financial institutions.

Under an accommodative monetary environment, some financial institutions are increasing investment in highly risky products or in credit assets or other foreign products to search for yields. JFSA needs to understand risks due to market fluctuations in a cross-sectoral manner in light of increasing uncertainties in the market and utilize that knowledge in political responses and information provision as necessary, not only in dialogues with individual financial institutions.

(2) Monitoring policies by business type

[i] Major banks, etc.

JFSA will first ascertain actual situations mainly focusing on the business types and companies that have been most seriously affected by COVID-19 with increasing loans, amid continuing uncertainties in businesses due to the impact of the infection. Then, JFSA will check the status of support for companies offered by financial institutions, such as cash flow support and provision of quasi-capital loans.

Furthermore, JFSA will strengthen initiatives to ascertain and verify the risk management systems of individual financial institutions cross-sectorally. JFSA will continue having

6 See Column 1 Viewpoint on soundness of financial institutions.

dialogues with financial institutions regarding the effectiveness of their internal ratings and processes for depreciation and provisions in consideration of possible changes in the domestic and international economic environment, including expected increases in bad loans in the future. Additionally, JFSA will grasp individual financial institutions' investment and funding policies on a timely basis, analyze influences of financial market fluctuations on their financial soundness and the financial system as a whole, and encourage them to enhance their systems for managing risks relating to markets and foreign currency liquidity. Also with regard to cross-shareholdings, JFSA will continue having dialogues on such themes as the examination of its purpose and rationality and the progress of reduction plans.

At the same time, JFSA will further promote dialogues concerning financial institutions' governance. In particular, their governance structures are becoming more and more complicated due to business acquisitions and expansion of business bases overseas, including emerging countries, and highly risky transactions are being conducted via securities subsidiaries. In light of these circumstances, JFSA will consider the preferable use of IT and ideal systems and accounting procedures to support global business operations, and will check the effectiveness of frameworks for group-wide and global risk management of individual financial institutions. Also in consideration of the increasing weight of nonbanking operations among earnings of banking groups and progress in the utilization of IT and digital technologies, JFSA will check the effectiveness of supervision of business execution by boards of directors, etc. and the processes of fostering and appointing management professionals with regard to ideal business execution and governance, including those in fields requiring highly advanced expertise.

[ii] Regional financial institutions

Regional financial institutions (regional banks and cooperative financial institutions) have talent, trust from communities, and local networks, and are expected to play key roles in supporting local economies in the post-COVID era. However, the business environment surrounding them[7] is becoming severer due to the impact of COVID-19, in addition to continuing low interest rates and aging and shrinking population. Under such circumstances, JFSA has taken various measures, including the enactment of the Act on Special Measures for the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (the "Anti-

[7] See Column 2 Business conditions of regional banks.

Monopoly Act"), which exempts the application of the Anti-Monopoly Act for mergers, etc. of regional banks that satisfy certain requirements, and the establishment of a scheme to grant funds for regional banks that will drastically improve their business efficiency through measures such as mergers and the establishment of a joint holding company. Furthermore, from the perspective of assisting efforts by financial institutions to broadly contribute to creating a sustainable society through digitalization and regional revitalization, JFSA revised regulations on the scope of services and on investments. Each regional financial institution needs to plan and implement its own measures for creating a sustainable business model based on its regional environment and securing financial soundness into the future, through utilizing the aforementioned public support as necessary.[8]

To assist with their efforts, JFSA will have deep dialogues with regional financial institutions on their efforts to strengthen their business foundations, and with those planning to diversify and enhance their businesses portfolio, thereby encouraging them to ensure corporate governance over the entire group.

Then, JFSA will intensively monitor regional financial institutions' efforts to offer cash flow support and support for business improvement, business turnaround, and business transformation.[9] In addition, in light of various trends in the economy and markets in and outside Japan, JFSA will monitor how they manage credit risks, including those involving large exposure borrowers and manage securities investment, utilizing inspections as needed. Regarding regional financial institutions with an issue in their profitability or financial soundness in terms of sustainability, JFSA will have a deep dialogue based on an early warning system etc., and encourage them to plan and implement effective measures for strengthening their business foundations.

In order to facilitate regional financial institutions' efforts to ascertain credit risks more accurately based on borrowers' portfolios, JFSA will continue collecting best practices, including those relating to processes for estimating reserves and information disclosure.

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8 Establishment of the Act on Special Measures for the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (put into effect on November 27, 2020; with a time limit of 10 years), establishment of a scheme for granting funds based on the amendment of the Act on Special Measures for Strengthening Financial Functions (put into effect on July 21, 2021; with a time limit of 5 years), amendment of the Banking Act, etc. including review of regulations on the scope of services and on investments (to be put into effect within 6 months after promulgation of the Act (May 26, 2021), establishment of the Support Desk for Regional Financial Institutions Mainly in Terms of Business Consolidation and Restructuring, and the Bank of Japan's introduction of the Special Deposit Facility to Enhance the Resilience of the Regional Financial System (commenced on March 1, 2021; with a time limit of 3 years), etc.

9 See Column 3 Efforts to ascertain current situations toward proper performance of financial intermediary functions.

With regard to implementation of Basel III framework, for which the final agreement was reached in December 2017, JFSA will make preparations through sufficient dialogues with related parties.

For cooperative financial institutions, JFSA will continue dialogues with regard to the status of their performance of the financial intermediary function with the aim of having them achieve sustainable business management while offering solid support in accordance with the needs of SMEs and micro businesses under the spirit of mutual aid. JFSA will analyze the influences exerted by credit risks and market risks on cooperative financial institutions' soundness amid the COVID-19 epidemic and recommend each cooperative financial institution to take pre-emptive measures, looking ahead to the future. JFSA will have dialogues with central organizations to encourage them to play a role to offer management support and operation support to cooperative financial institutions.

[iii] Securities firms

At the stage of building the post-COVID economy and society, it is also important to ensure that a capital market fulfills its functions appropriately from the perspective of supporting asset building of individuals and fund procurement of companies with growth potential. In that process, securities firms, which function as financial intermediaries in the investment chain, are expected to perform their functions to the extent possible in accordance with the business modes and characteristics of large, online, and regional securities firms, etc.

For that purpose, individual companies must endeavor to create sustainable business models through developing a system for customer-oriented business conduct, establishing an appropriate compliance system, and fulfilling governance functions. From such a viewpoint, JFSA will continue in-depth dialogues.

For major securities firms actively expanding business overseas, JFSA will conduct monitoring of their businesses, with keeping an eye on the status of their systems for global governance and risk management. For securities firms conducting transactions online, in light of various problems concerning system risk management, JFSA will continue monitoring the status of how they have developed their management systems.

[iv] Insurance companies

Insurance companies need to respond to the changing business environment, such as decreasing population, continuing low interest rates, the increasing severe and frequent natural disasters, the shrinkage of the auto insurance market, the further progress of digitalization, while also preparing for the post-COVID society.

In response to these changes in the business environment, it is important to build sustainable business models and to develop insurance products that meet the changing customer needs. In addition, as the demand for non-face-to-face and efficient business operations increases, insurance companies need to develop a workforce that is capable of dealing with digitalization.

Furthermore, as more insurance companies are expanding overseas, it is important to enhance their group-wide governance systems. In order to support their efforts, JFSA will hold dialogues with insurance companies in coordination with the overseas supervisors.

In response to natural disasters, under the severe environment where reinsurance premiums are soaring, the urgent challenge for insurance companies is to manage risk at the management level, balancing the company's capital, risk and return. JFSA will continue to monitor the efforts of the insurance companies. In addition, JFSA will also hold dialogues with non-life insurance companies regarding appropriate and prompt payment of insurance claims and appropriate premium rates for fire insurance.

At the same time, in response to these environmental changes, JFSA will steadily prepare for appropriate protection for policyholders, a smooth transition to a prudential policy based on economic value-based solvency regulation, and will also constantly review the financial indicators and regulations for necessary updates.

[v] Japan Post

JFSA will hold dialogues with Japan Post Bank and Japan Post Insurance on their efforts regarding customer-oriented business conduct and ideal products and services based on customer needs, etc., in addition to the improvement of risk management toward deepening market operations. JFSA will also hold dialogues with Japan Post regarding its group-wide efforts to secure medium- to long-term revenue bases for stably providing universal services by fully utilizing the postal network.

II. Development of a financial system that achieves a vibrant economy and society

While the impact of COVID-19 has been prolonged, people are looking for new working styles and lifestyles, while companies are reviewing their business models. As symbolized by the digitalization of society as a whole, including the financial sector, it can be said that these moves are further accelerating changes in social structure, which have so far been progressing moderately. Increased interest in the global environment and other global issues, geopolitical changes, and social trends, such as the aging society with fewer children, have been exerting significant influences on the future directions of a new economy, society and industry.

Under those circumstances, the financial system is expected to support companies that take on risks and open a path to new growth in order to achieve sustainable growth and shift to a more vibrant economy and society. JFSA will create a virtuous cycle of funds in and outside Japan and build a financial system to enable the active development of financial services by financial institutions, thereby supporting companies' efforts to improve productivity and user convenience and to solve social challenges and promote a shift to vibrant economic and social structures.

1. Promotion of digital innovation

Amid the accelerating digitalization of economy and society as a whole, private business operators are increasingly providing diverse financial products and services using innovative technologies, such as block chains and AIs, and open APIs. Some countries, mainly emerging ones, are promoting financial inclusion through digital financial services from the viewpoint of promoting economic growth. Central banks are activating their R&D on Central Bank Digital Currencies (CBDCs). It is important to further promote digital innovations in the financial sector in order to improve companies' productivity and user convenience, while ensuring the protection of users.

(1) Consideration of policy frameworks which support the digitalization of means of payments and securities products

In Japan, the use of digital payments is growing and considerations on the digitalization of corporate bonds and other securities products and the development of a platform for such securities are also underway with the aim of enabling active transactions at lower cost. International discussions on the potential use of new financial technologies and how to respond to their risks are also underway, including how to handle global stablecoins, with the aim of enhancing cross-border payments. In light of these moves, the Study Group on Digital and Decentralized Finance, which was established by JFSA in July 2021, intends to seek optimal ways for financial institutions to adapt to the shift toward the digitalization of payment measures, securities products, and others from the perspective of promoting innovation in the private sector and ensuring appropriate user protection for financial services.

With regard to CBDCs, the Bank of Japan is conducting proof of concept on their basic functions and will continuously conduct proof of concept on their peripheral functions by the end of FY2022. JFSA will continue making contributions to these activities in cooperation with the Ministry of Finance.

(2) Enhancement and efficiency improvement of payment infrastructure and development of new financial services

JFSA will proceed with the reform of payment infrastructure in light of the shift to cashless payment and the diversification of payment services providers. As a result of the efforts made so far,[10] the review of interbank transaction charges has led to gradual reduction of user cost regarding bank transfers. Going forward, in order to ensure interoperability and promote competition between payment services, JFSA will proceed with its study on the expansion of the scope of eligibility for participation in the interbank payment system to include funds transfer service providers. It will also promote a study on how to make frequent and small-amount payments more convenient. Additionally, from the viewpoint of ensuring payment security, JFSA will take necessary measures, such as considering how to conduct monitoring of business operators to be newly connected to the interbank payment system.

With regard to FinTech-related businesses, which are starting to serve as infrastructure for the people's lives, including payment, new market entries and business expansion and diversification of existing business operators are expected. From the viewpoint of enhancing user convenience and developing services that contribute to the resolution of social challenges through digital innovation, JFSA will strengthen communication with and provide integrated support to home and oversea business operators by taking advantage of the

[10] See Column 4 Enhancement and efficiency improvement of payment infrastructure.

functions of the FinTech Innovation Hub (FIH).[11]

In particular, regarding the payment sector, where the pace of change in the business environment is fast, JFSA will engage in close exchanges of opinions with business operators and industry associations in order to grasp business needs and identify and resolve challenges, including those in API connection that should be addressed by the authorities and industry associations in cooperation with business operators.

With regard to financial service intermediary businesses, which are expected to enhance user convenience as a result of being allowed to provide intermediary service in all of the banking, securities and insurance sectors through a single registration, JFSA will proceed with the approval of self-regulatory organizations and registration examination from the viewpoint of the sound development of the businesses and the protection of users.

(3) Digitalization of business processes and procedures in the financial sector

JFSA will promote digitalization through cooperation between the public and private sectors in order to enhance the convenience of business processes and procedures and improve operational efficiency in the financial sector and to establish a foundation for sustainable growth in a post-COVID-19 era.

Specifically, JFSA will promote digitalization concerning inter-company payment in cooperation with relevant ministries and agencies from the viewpoint of improving the efficiency of administrative work at companies and financial institutions and enabling the use of data in business management and expansion. As the government as a whole is promoting digitalization and data-linkage regarding inter-company transactions, from order placement/receipt to payment, in addition to disseminating electronic invoicing, JFSA will promote the use of financial electronic data interchange (EDI). In addition, JFSA will support steady progress in the implementation of a voluntary action plan announced by the financial industry in July 2021 in preparation for the full digitalization of the functions of bills and checks. In order to promote these activities, it is important for corporate internet banking to spread and take hold, and therefore, JFSA will engage in dialogue with relevant parties about

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[11] Established in July 2018 within JFSA in order to deepen understanding about the latest business and technological trends related to FinTech for better policy making. FIH identifies challenges faced by business operators and provides integrated support to them through its functions, including FinTech Support Desk, which provides one-stop services in response to business operators' requests for consultation, and a FinTech PoC (Proof of Concept) hub that supports eliminating the hesitation and concern that FinTech firms and financial institutions are inclined to have in conducting unprecedented tests. FIH also contributes to discussions for solving the global issues that a decentralized financial system could bring about at the Blockchain Governance Initiative Network (BGIN) to achieve both increased user convenience through innovation and user protection.

making this service more convenient.

Until now, JFSA has revised laws and regulations that require papers, seals and face-to-face procedures and promoted computer system improvements to enable online applications and filings. JFSA will continue activities that improve convenience of administrative services, including computer system updates that enable wider use of electronic payment of fees, etc. It will also encourage further revision of industry practices predicated on the use of papers, seals, and face-to-face procedures by conducting a follow-up review of activities based on the discussions by the Study Group on Review of Use of Papers, Seals, and Face-to-Face Procedures in the Financial Industry. Through these efforts, JFSA will further support digitalization in the private sector.

Moreover, in light of the Digital Transformation Promotion Laws enacted in the ordinary Diet session in 2021, JFSA will cooperate with relevant ministries and agencies, Deposit Insurance Corporation of Japan and industry associations in order to facilitate preparations related to listing My Number on bank and savings accounts and registering accounts for the transfer of public moneys linked with My Number.

(4) Enhancement of IT governance at financial institutions[12]

As a result of the advance of digitalization, it is important for financial institutions to have IT governance in place so as to realize creation of corporate value through integration between IT and business strategy. In this regard, financial institutions are expected to provide advanced services that enhance customer experience and improve efficiency of their own business management by making active use of IT and digital technology and promoting the use of data. JFSA will hold in-depth dialogue with financial institutions about such activities.

In addition, JFSA will support financial institutions which are considering initiatives that use advanced technologies, such as the development of an enterprise system with the use of new technologies, including cloud services and micro services,[13] by holding discussions with these financial institutions at an early stage and on a continuous basis from the viewpoints of IT governance and risk management through the Enterprise System and Frontrunner Support-Hub. Furthermore, with respect to projects for the transition to a next-generation system and the development of a highly-sophisticated system, JFSA will also hold

[12] See Column 5 IT governance report in the financial sector.

[13] Micro service refers to an architecture whereby a system's functions are divided into small groups of services and are used as loosely combined groups.

in-depth discussions at the stage of project planning and on a continuous basis and conduct monitoring activity with an emphasis on encouraging voluntary improvement efforts by financial institutions.

JFSA will encourage financial institutions to enhance IT governance by analyzing useful practices that are observed through dialogues with financial institutions and publishing the results (IT system failures, etc. will be mentioned later in II.6. (3)).

2. Expanding Japan's role as an international financial center[14]

(1) Promotion of government-wide activities

Japan's efforts to expand its role as an international financial center are expected not only to contribute to creating jobs and industries and strengthening economic potential, but also to make contributions internationally by enhancing Asian and global financial markets' resilience against disaster and other risks through risk diversification. As Japan also has a large real economy and stock market, and around 1,900 trillion yen's worth of household financial assets, there is huge potential for asset management businesses.

In order to expand Japan's role as an international financial center by taking advantage of its strengths like these, JFSA has been striving to make the Japanese market more attractive for foreign asset management firms. In addition to making institutional improvements to establish simplified entry procedures, JFSA has set up the Financial Market Entry Office, through which English communication has been made available for foreign asset management firms with respect to pre-application consultation, registration examination and supervisory processes. There are multiple cases in which registration was completed in a short period of time. Moreover, JFSA has promoted these activities in a comprehensive manner, for example by cooperating with relevant ministries and agencies about tax system measures and easing of status of residence requirements.

(2) Further strengthening of the activities

Going forward, JFSA will not only steadily conduct the abovementioned activities but also further strengthen them. Specifically, JFSA will expand the scope of foreign firms for which English communication is made available to include foreign securities firms and banks that mainly deal with customers in English. To that end, JFSA will make necessary organizational and staffing

[14] See Column 6 Measures relating to the International Financial Center.

improvements.

At the same time, JFSA will strengthen support for the establishment of corporations in Japan by foreign financial institutions and everyday life support for highly skilled foreign financial professionals. To that end, JFSA will establish the Financial Startup Support Program, through which national and local governments and private business operators work together, by using a model project that provides one-stop English support for foreign asset management firms seeking entry into the Japanese market. JFSA will also create a favorable environment for realizing a green international financial center where green bonds are actively traded (to be mentioned later in II.3.(2)).

As it is important that those activities be widely recognized and shared, JFSA will actively promote them in cooperation with relevant organizations, for example by opening dedicated websites and holding seminars. At the same time, JFSA will continue exchanges of opinions with various relevant organizations in and outside Japan in order to collect inputs regarding the needs and challenges from far and wide and will thereby evolve its activities constantly in order to expand Japan's role as an international financial center.

3. Promoting sustainable finance[15]

As the world moves toward building a sustainable society, the importance of finance that could facilitate industrial and social transition is increasing. In particular, recognizing that the global trend is accelerated toward decarbonization, it is urgent to develop, in cooperation with market participants, a favorable environment for promoting sustainable finance that could attract capital for growth from home and abroad to the efforts of Japanese companies. In doing so, the JFSA will promote measures to ensure that corporate efforts are appropriately evaluated, including the efforts for transition in industry to achieve carbon neutrality.

(1) Enhancement of corporate disclosure, both in quality and quantity

The JFSA will encourage companies listed on the Prime Market segment of the Tokyo Stock Exchange, which will open in April 2022, to enhance the quality and quantity of disclosure based on the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) or an equivalent framework based on the revision of the Corporate Governance Code in June 2021. In addition, in the Disclosure Working Group under the Financial System Council, the JFSA will discuss how listed companies and other companies that submit securities reports should appropriately disclose their sustainability-related initiatives to make Japanese market more attractive as an investment destination in the global context.

Both the public and private sectors will actively participate in the initiative to develop a comparable and consistent disclosure framework for sustainability, including climate change, by International Financial Reporting Standards (IFRS) Foundation.

(2) Demonstration of market functions

In order to realize a "Green International Financial Center," it is essential to create an environment in which various domestic and foreign investors can easily and appropriately make investment decisions contributing to decarbonization.

To this end, in coordination with issuers and a wide range of other stakeholders, and based on the practices of institutional investors and other market participants, the JFSA works to develop standards related to the use of proceeds and other elements, and aims to establish a framework for objectively confirming the eligibility of green bonds, etc. Furthermore, in

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[15] Sustainable finance: a type of finance intended to realize a sustainable society.
See Column 7 Trends concerning sustainable finance.

cooperation with the Japan Exchange Group (JPX) etc., the JFSA will establish an information platform to broadly consolidate information on the confirmed green bonds etc., as well as the issuers' management and policies regarding ESG (Environmental, Social, and Governance).

The role of ESG rating organizations and data providers, as a bridge between enterprises and investors, is also important. In order to build an ecosystem where evaluations and data are used in a trustworthy manner, the JFSA plans to develop a code of conduct expected of ESG rating organizations and data providers regarding issues such as the transparency and comparability of evaluation methodologies as well as governance, with the aim of ensuring the independence and objectivity of evaluations. To this end, the JFSA will invite experts and other stakeholders to a panel for discussion, bearing in mind clarification of the roles to be played by enterprises and investors.

In addition, from the viewpoint of investor protection, the JFSA will monitor asset management companies and distributors regarding ESG-related investment trusts for individual investors, which are rapidly growing.

With regard to social bonds,[16] based on the new guidelines,[17] the JFSA will consider formulating a document that provides specific examples of indicators regarding the social benefits of social projects in cooperation with relevant ministries and agencies.

(3) Financial Institutions' support for the borrowers and investees, and climate change risk management

Financial institutions are expected to be actively engaged with investment and loan recipients and to provide them with expertise and other support, so that they can address climate change. From the perspective of steadily promoting such efforts by financial institutions, the JFSA will further work on sharing information and knowledge for regional financial institutions to effectively engage in local companies' decarbonization.

It is also important for financial institutions to recognize that how to respond to climate change is a management challenge and to establish an appropriate preparedness for addressing it. Specifically, financial institutions are expected to establish a governance system for climate-related risks, develop business models and strategies that take into account the risks and opportunities of climate change, establish a process for recognizing,

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[16] Social bonds are bonds issued in order to raise funds for projects that contribute to the resolution of social challenges.

[17] See Column 8 Social Bond Guidelines.

assessing and managing climate-related risks, and utilize scenario analysis.

From these perspectives, in this business year, the JFSA, in collaboration with the Bank of Japan, will conduct a pilot exercise of scenario analysis using NGFS scenarios as common scenarios for three megabanks and three major non-life insurance groups. At the same time, the JFSA will clarify the monitoring viewpoints with regard to financial institutions' efforts to engage with investment and loan recipients and manage climate-related risks. The JFSA will develop those viewpoints for depository financial institutions and insurance companies as a first step.

(4) Active participation in international discussions

Taking into account that COP26 (The 26th United Nations Climate Change Conference of the Parties) will be held in November 2021, the JFSA will play a leading role in international sustainability-related discussions on such matters as disclosure, smooth private capital mobilization, enhancement of capital market functions, and climate-related risk management. The JFSA will also accumulate knowledge on how considerations on data, metrics, and sustainability-related issues beyond climate change are evolving internationally in order to contribute to the domestic policy development.

In addition, the JFSA will keep abreast of discussions on international initiatives by the private financial sector in a timely manner, and consider frameworks to support financial institutions participating in such initiatives, while cooperating with such initiatives and utilizing the results of such discussions.

4. Stimulating capital markets and smooth capital provision to growing businesses

If the Japanese capital market is to strongly support innovation and change in industrial structures on an economy-wide basis and realize sustainable growth, it is essential to enhance the market functions and financial intermediary functions from users' point of view. Promoting this activity amid international competition between markets contributes to making the Japanese market more attractive. Doing so is also important from the viewpoint of establishing Japan's position as an international financial center by attracting domestic and foreign investment funds and foreign asset management firms and financial institutions, as mentioned in II.2. above.[18]

In light of the fact that existing activities to enhance the functions of direct finance and market-based indirect finance have not necessarily changed the macro-level fund cycle, JFSA will conduct a bird's eye examination of the capital market with respect to the exercise of the market functions and financial intermediary functions while looking at the situations of users, market intermediaries, institutional investors and exchanges. In doing so, JFSA will promote activities to enhance the functions of the whole investment chain while ensuring investor protection.

(1) Check/review the policy measures and conventional market practices for better market function

Facilitating provision of capital for growth will be the key to encouraging innovation by start-ups. Therefore, while giving due consideration to the protection of investors, JFSA will conduct a review on approaches to providing funds that contribute to a start-up ecosystem, including reforming Initial Public Offering (IPO) pricing processes, considering the introduction of regulations to allow the listing of SPACs (Special Purpose Acquisition Companies), and improving regulations to activate private placement financing, in addition to the amendments of regulations to facilitate provision of capital by professional investors.

With regard to the firewall regulation that separates banks and securities firms, in order to ensure the provision of user-oriented services, JFSA will develop institutional systems regarding provision and receipt of customer information of listed companies, enhance the effectiveness of monitoring, and continue necessary studies.

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[18] See Column 9 Deliberations for facilitating provision of capital for growth and review of firewall regulations separating banks and securities firms.

Regarding the secondary stock market, JFSA will help to realize the Tokyo Stock Exchange's market structure reform[19] and also conduct a study on measures to enhance the market functions, such as promoting appropriate competition between proprietary trading systems (PTS) and financial product exchanges.[20]

(2) Promoting corporate governance reform

In light of the revision of the Corporate Governance Code in June 2021, JFSA will encourage activities such as exercising the board functions and ensuring the diversity of core human resources. In order to ensure the provision of governance information that contributes to constructive dialogues between companies and investors towards increasing mid-to long-term corporate value, JFSA will also conduct a study on disclosure regarding such matters as the status of activities of the board and investment in human capital at the Disclosure Working Group of the Financial System Council.

Exercising "defensive governance" as well as "offensive governance" is also important. Therefore, in light of the revised Corporate Governance Code, JFSA will encourage appropriate coordination between the internal audit department, directors and *kansayaku* and also study measures to secure the reliability of corporate audits and the effectiveness of internal controls.

(3) Enhancing asset management business

Until now, JFSA has paid attention to the important role performed by asset management firms in the investment chain and engaged in a series of dialogues with the firms, including their management teams and parent companies in the same financial conglomerate groups, about activities to enhance their investment capabilities, such as product development, fund management, and governance structure to prioritise customers' interests.[21] At the same time, JFSA has promoted activities to encourage sound competition among asset management firms by increasing the visibility of investment performance. As the firms' awareness about the need to strengthen investment capabilities is growing, some progress has been made in those activities, but it is necessary to further increase the effectiveness of the efforts.

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[19] See Column 10 Tokyo Stock Exchange's listed stock market structure reform.

[20] See Column 11 Deliberations on financial instruments business operators' best execution policies.

[21] See Column 12 Progress Report on Enhancing the Asset Management Business 2021.

In order to ensure that the activities to enhance investment capabilities by asset management firms and their groups lead to actual results, such as the supply of products to prioritise customers' interests, favorable fund returns, and expansion of the group's assets under managements, JFSA will engage in a series of dialogues with the firms. In addition, JFSA will make efforts to increase the visibility of the performance of publicly offered investment trusts on a routine basis and also promote similar efforts regarding discretionary investment management, including fund wraps, from the viewpoint of enhancing the investment chain as a whole. Moreover, JFSA will conduct wide-ranging research on service providers, e.g., system vendors, which support the asset management industry. JFSA will publish a progress report on enhancing the asset management business, reflecting the results of those activities, in the summer of 2022.

(4) Securing trust in the market

In order to ensure the integrity and transparency of the market and the protection of investors, the Securities and Exchange Surveillance Commission, based on the "Strategy & Policy 2020-2022" for the 10th term (from December 2019 to December 2022), aims to realize comprehensive, flexible, and in-depth market oversight (holistic, timely, and in-depth market oversight). To that end, as an organization responsible for enforcement based on law and evidence, the SESC will continue to conduct substantially meaningful market oversight in accordance with laws and regulations, including the Financial Instruments and Exchange Act.

With regard to market misconduct and disclosure violations, in addition to proactively and flexibly conducting investigations and inspections with a view to possible recommendations for administrative monetary penalty payment orders, the SESC will take rigorous enforcement actions, including pursuing criminal prosecutions, against serious cases as appropriate. As for the monitoring of financial instruments business operators, the SESC will conduct checks on how deeply customer-oriented business operation has taken hold, on changes in their business models and in the market due to the advance of digitalization, and on their development of internal control systems to deal with those changes. At the same time, regarding unregistered business operators, the SESC will proactively use its investigative power regarding the filing of cases with courts. In addition, the SESC will strive to strengthen market discipline through activities such as disseminating easy-to-understand information, including various collections of example cases related to corporate information disclosure, monitoring of financial instruments business operators, and market misconduct.

Moreover, from the viewpoint of enhancing trust in corporate information in the capital markets, audit firms are required to further improve the quality of external audits as a gatekeeper in the markets, in addition to activities conducted by the SESC and efforts made by companies themselves, such as governance reform, etc. Given these trajectories, by the end of 2021, the quality management standards for audit firms will be revised. In addition, the Certified Public Accountants and Auditing Oversight Board will review audit firms' governance systems, group audit, and Key Audit Matters (KAM). Moreover, given the economic and social developments, in this fall, the Advisory Council on the Systems of Accounting and Auditing will commence comprehensive contemplation on various challenges related to accounting audit, such as the desirable future of audit firms as the entities responsible for serving as auditors of listed companies and the development of a favorable environment enabling certified public accounts to enhance their skill-set and explore their capabilities.

Furthermore, JFSA will continue to support the secretariat of the International Forum of Independent Audit Regulators (IFIAR), which is the only international financial organization that has its secretariat in Tokyo, and contribute to improving audit quality globally as the Vice Chair organization of the IFIAR.

5. Disseminating user-oriented financial services

JFSA will promote stable personal asset building by disseminating user-oriented financial services and also strive to ensure customer relations friendly to all users, including the elderly, and to resolve social challenges, including the multiple debt problem.

(1) Customer-Oriented Business Conduct[22]

In order to achieve stable personal asset building, it is desirable to create a mechanism whereby financial services providers proactively exercise their ingenuity to compete to provide better financial products and services and those engaging in better practices are selected by customers. From that viewpoint, JFSA will examine the status of utilization of the "Key Information Sheet," which briefly describes the fees and commissions and investment risks, as well as possible conflicts of interest, and other points in order to make it easier to

[22] See Column 13 Financial services providers' efforts regarding customer-oriented business conduct.

compare various products across the boundaries of various business laws, including various activities to propose products best suited to customers, such as the product selection process, sales and proposal process and performance evaluation systems of sales personnel, and whether those activities have enabled financial services providers to secure their own customer bases and profitability.

JFSA will also publish the status of activities related to financial services providers' customer-oriented business conduct in a comparable manner (increasing the visibility of activities) and strengthen information dissemination, for example by showing examples of good practices. In addition, JFSA will engage in dialogue with financial services providers, mainly about whether their policies indicate their understanding of the purpose and spirit of the principles of customer-oriented business conduct and the specific actions that should be taken by sales personnel.

Moreover, with regard to the "comparable common KPIs for investment trust sales companies" (e.g., customers' shares by investment performance level), JFSA will encourage financial services providers to formulate and publish KPIs concerning foreign currency-denominated insurance based on similar standards.

(2) Promoting stable household asset building and enhancing financial literacy[23]

If individuals are to lead an affluent life throughout their lifetime amid the ongoing aging of society and diversification of lifestyles, including working styles, it is important for them to consider life plans, starting at a young age, and strive to secure funds necessary for various life stages. To that end, efforts toward stable asset building are becoming more and more important.

In addition, when individuals strive for stable asset building, it becomes necessary to select products and services suited to their respective life plans, and therefore, activities to enhance financial literacy are important. While such activities must be implemented for people in a broad range of age groups, the importance of financial education for young generations in particular is becoming increasingly important in view of the forthcoming lowering of the age of adulthood in April 2022.

Therefore, JFSA will promote financial literacy activities mainly for young generations in cooperation with relevant ministries and agencies and other organizations while making use

[23] See Column 14 Financial and economic education.

of ICT, including web-based teaching materials. Specifically, JFSA will conduct a study on more effective methods of financial and economic education while promoting online lessons at senior high schools and universities and holding seminars for schoolteachers based on the new Course of Study for senior high schools, which are scheduled to come into force in April 2022.

In addition, in order to support stable asset building on the taxation side, JFSA is promoting the dissemination of the NISA (Nippon Individual Savings Account) program, introduced in January 2014 and the installment-type NISA program,[24] introduced in August 2018. The number of NISA accounts as of the end of March 2021 was 15.80 million, with assets totaling 23 trillion yen in purchase value (including around 3.6 million installment-type NISA accounts with assets totaling 900 billion yen). In order to further promote stable personal asset building, JFSA will encourage local governments and economic associations to ensure that information on asset building using installment-type NISA and other means is widely provided, for example in workplaces.

(3) Careful customer relations friendly to all users

JFSA will encourage financial services providers to respond to rapid economic and social changes in Japan, including the aging of society and the advance of globalization, and to implement careful customers' relations management so that all users can receive highly convenient financial services that suit their respective needs.

Specifically, regarding the handling of elderly customers in sales of financial products, JFSA will promote the development of appropriate industry-wide rules that ensure flexible customer relations suited to investors' skills and circumstances. JFSA will also engage in dialogue with the industry about the handling of transactions conducted by family members on behalf of elderly customers with reduced cognitive abilities from the viewpoint of promoting efforts to increase convenience for customers and prevent problems.

With regard to the use of financial services by foreign residents, JFSA will provide useful information and raise awareness about matters requiring attention among users and other relevant people in order to ensure smooth account opening. At the same time, JFSA will further promote financial services providers' activities to increase convenience, such as facilitating and improving the efficiency of procedures.

[24] See Column 15 Spread of NISA.

In order to enable people with disabilities to use safe and highly convenient financial services over the counter and through ATMs, JFSA will further encourage financial services providers' activities to remove social barriers, such as developing facilities and making sure that frontline employees appropriately deal with such people through employee training.

(4) Handling of the multiple debt problem

With regard to the handling of the multiple debt problem, JFSA will strengthen cooperation with relevant organizations (the National Police Agency, the Consumer Affairs Agency, prefectural governments, industry associations, etc.) in order to promote efforts to call for attention to and raise awareness about risks.

Regarding various types of transactions that have become common due to the effects of the COVID-19 epidemic, including SNS-based individual-to-individual loans,[25] JFSA will further promote efforts to call for attention about risks.

In addition, in light of the lowering of the age of adulthood, JFSA will check the status of compliance with laws and regulations by money lending business operators in order to prevent young people from being made to take on excessive debt. It will also encourage the industry to ensure that money lending business operators continue voluntary efforts to prevent such a situation when providing loans to young people.

6. Preparing for potential risks

Amid the rapid advance of digitalization and globalization, it is essential to proactively be prepared for various risks if a resilient financial system is to be developed.

(1) Reinforcing the measures for anti-money laundering and, counter financing of terrorism and counter-proliferation financing (AML/CFT/CPF)

As the diversification of payment methods and the globalization of transactions with technological advances make financial transactions more and more complex, globally, financial institutions, etc. are required to continuously enhance their risk management

[25] Transactions under which money is lent and borrowed via SNS and transactions under which money is provided in exchange for the purchase of individuals' wage receivables with the funds to be recovered later through those individuals.

framework in response to changes in risks. In other countries, for example, some financial institutions had to change their senior management and pay heavy fines, and vulnerabilities in the control framework of anti-money laundering, and counter terrorist financing and counter-proliferation financing (AML/CFT/CPF) are having an increasingly large impact on the management of financial institutions.

Under such circumstances, in light of the results of the 4th round of Mutual Evaluations by the FATF (Financial Action Task Force), JFSA will continue to cooperate with relevant ministries, agencies and industry associations to steadily implement measures to enhance the AML/CFT/CPF control framework established by financial institutions, etc. in Japan as well as requesting financial institutions to promote providing thorough explanation to customers when conducting on-going Customer Due Diligence and to improve customers' level of understanding on AML/CFT/CPF. Specifically, JFSA will strengthen its inspection and supervision framework by obtaining inspection staff and conducting risk-based inspection and supervision by prioritizing sectors that are considered to be of high risk.

Also, in order to enhance and improve the efficiency of AML/CFT/CPF measures, JFSA will continue to consider and implement a plan to develop a shared system by several financial institutions, etc.

JFSA is committed to playing a leading role in international discussions at the FATF and other forum, especially at FATF's Virtual Asset, Contact Group (VACG),[26] where JFSA serves as co-chair and leads its work, such as updating"FATF Guidance for a risk-based approach to Virtual Assets and Virtual Asset Service Providers.''

(2) Ensuring cybersecurity and operational resilience

Under the circumstances where new services, such as cloud services serving as a new infrastructure for ICT systems and payment services provided by financial institutions in collaboration with FinTech companies, are widely used, it is increasingly important to effectively manage all business processes, including outsourced services and services provided through collaboration with third parties, and ensure operational resilience.

With regard to cybersecurity, the scope of business processes for which financial institutions need to enhance risk management is expanding, as indicated by the incidents in which customer and business data was stolen or destroyed by cyberattacks against

[26] The group has been leading work related to virtual assets at the FATF since the adoption of the FATF Standard on virtual assets and VASP in 2019.

outsourcing service providers, or in which vulnerabilities of services provided through collaboration with external entities were abused to steal customer assets.

JFSA will, therefore, examine the effectiveness of information security, particularly cybersecurity, at financial institutions that are considered to face high risk by conducting an inspection and other means. In addition, JFSA will also encourage financial institutions, through an expanded cybersecurity exercise and other means, to strengthen their abilities to respond to an incident and recover their operations when a cybersecurity breach occurs.

In addition, JFSA will support the enhancement of the level of cybersecurity at individual institutions by developing items to conduct a more detailed assessment of cybersecurity management systems, by analyzing self-assessment results of financial institutions' self-assessments based on these items, and by providing feedback on their positions compared to other financial institutions and on matters that require improvements.

Moreover, as a result of the emergence of globally active major cloud service providers, concentration risk has arisen. A new regulatory and supervisory approach concerning operational resilience may be needed. JFSA will conduct a more in-depth study on how to address these emerging issues, including issues related to cross-border cloud services by participating in international discussions on third-party outsourcing.

(3) Strengthening IT risk management[27]

As there have been cases in which the occurrence of incidents, such as large-scale IT system failures and illegal access to IT systems at financial institutions and exchanges have affected users, it is important not only to prevent IT system failure but also to reduce and mitigate the impact of operational disruptions and restore business operations quickly at regulated entities including financial institutions. When a system failure occurs, JFSA will monitor the incident and actions taken by financial institutions, such as causes of the incident and improvement measures. Moreover, where a serious damage is caused to customers or where a problem is identified in the IT risk management of a financial institution, JFSA will conduct an intensive examination, including an inspection. In addition, JFSA will promote the enhancement of IT risk management by publishing a report that summarizes trends in system failures at financial institutions and their causes and countermeasures.

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[27] See Column 16 Analysis report on IT system failures in the financial sector.

(4) Response to permanent cessation of LIBOR publication

London Interbank Offered Rate (LIBOR) is an important interest rate benchmark used by diverse users, including financial institutions, non-financial corporations, and institutional investors. However, it has been decided that the publication of LIBOR will be ceased at the end of December 2021, except for certain US dollar LIBOR settings.

JFSA, as a supervisory authority, will strongly bear in mind the limited time left before the cessation of LIBOR publication and conduct monitoring as to whether financial institutions' activities related to the transition from LIBOR, including careful customer relations management, are making steady progress based on Japan's transition plan, studied jointly by the public and private sectors, and it will require them to make sure to take actions in accordance with the progress. JFSA will also encourage users other than financial institutions to take necessary actions.

Moreover, with regard to transactions referring to foreign currency-denominated LIBOR other than yen-denominated LIBOR, JFSA will require actions that are in accordance with guidelines presented by the home country authorities or deliberative bodies of the foreign currencies.

(5) The approach to economic security

The financial industry is not only the main infrastructure industry that supports national economic activities but also an industry that holds large amounts of personal and corporate information. From the viewpoint of economic security, it is important to enhance financial services while ensuring safety and reliability concerning the maintenance of the infrastructure function. Therefore, in light of discussions on economic security, JFSA will cooperate with relevant organizations with regard to the use of equipment and systems, business partnerships, outsourcing and other matters, as well as appropriate management of information held by the financial industry.

III. Further develop JFSA's financial policy

Amid significant changes in the financial environment, the expected roles and functions of JFSA are also changing drastically. JFSA has conducted reform not only for its administrative methods but also its governance and organizational culture. In order to make a contribution to the economy and society domestically and internationally as the agency supporting financial services, JFSA needs to continue to expand these efforts and constantly evolve financial policy.

From this perspective, JFSA will continue taking measures this business year as well reinforcing its ability as an organ in charge of financial policy by improving its monitoring capability through the sophisticated data analysis, etc. and strengthening of international networks, and by increasing the motivation and capacity of all JFSA staff members to the extent possible.

1. Sophisticating monitoring operations

(1) Sophisticating data analysis

While the business environment and earnings structure of financial institutions are changing, it is important to better utilize data and improve the effectiveness and efficiency of monitoring in order to understand economic and market trends and accurately comprehend the business status of each financial institution and the resilience and vulnerability of the overall financial system.

Therefore, JFSA will enhance data utilization, including through analyzing the data obtained from financial institutions in combination with macroeconomic and financial data and firm-level data. More specifically, JFSA will analyze the impact of COVID-19 on companies to assess financial institutions' financial soundness and deliberations on how financial institutions should support companies' recovery in the post-COVID era.

When considering that data storage and processing capacity are being enhanced thanks to technological innovation and that big data are increasingly utilized by foreign authorities, JFSA also needs to more positively utilize data that are more granular than conventional template-based aggregate data collected from financial institutions. Accordingly, as a data strategy from a mid-to-long term perspective, JFSA will deliberate on how to better utilize granular data, including firm-level, loan-level, and transaction-level data, in monitoring and policy planning and research effective and efficient frameworks for collection and management of such data in light of the trend of digitalization in the financial industry.

In addition, JFSA will continue its endeavor to improve its data analysis projects quantitatively and qualitatively with the aim of enhancing its analytical capability and promoting data utilization.[28]

(2) Enhancement of monitoring capability

When conducting inspections, etc., JFSA will flexibly employ direct dialogues upon on-site inspections and a new monitoring style using remote technologies, depending on the situation of verification and dialogue and the required level. On that occasion, JFSA will select means for ensuring communication and appropriate sharing of awareness with financial institutions through sufficient dialogues, while giving due consideration to the alleviation of the burden of financial institutions. For that purpose, JFSA will accumulate practices and constantly make improvements through a PDCA cycle to effectively employ remote means.

Also for alleviating the burden of financial institutions and ensuring high-quality monitoring, JFSA will steadily strengthen collaboration with the Bank of Japan, while taking into account the opinions of financial institutions, through making adjustments in inspection and investigation targets, centrally managing regulatory reports, conducting joint surveys on major issues, etc.

At the same time, it is also important to reinforce networks to share information and make collaboration with other countries appropriately on a timely basis. From the perspective of enhancing the effectiveness of global monitoring, JFSA will hold a supervisory college meeting concerning major Japanese financial groups that are conducting business globally, with the participation of relevant supervisory authorities, and will maintain close collaboration with overseas authorities on a regular basis. Additionally, JFSA will build and reinforce networks with Asian countries and emerging countries through the Global Financial Partnership Center (GLOPAC) and opportunities of bilateral financial cooperation, and will endeavor to enhance the monitoring capability of Japan through jointly accumulating knowledge and lessons and

[28] Under the initiative of the JFSA Chief Data Officer (CDO), the Macroprudential Policy and Data Strategy Office commenced efforts to integrate and support data analysis projects that have been newly commenced by respective departments and officials for the purpose of policy planning and monitoring. Last business year, the Office held a meeting to report analysis results with the attendance of academic experts as commentators or otherwise made efforts for the sharing and accumulation of knowledge on data analysis.

sharing best practices with other countries.

2. Improvement of organizational capability as the financial authority

(1) Fostering professional human resources

For the evolution of financial administration, experts with advanced expertise in respective fields are indispensable. Accordingly, JFSA will check required areas of expertise and endeavor to foster professional human resources from a mid-to-long term perspective through carrying out initiatives to have knowledge in respective areas shared among JFSA as a whole.

In particular, in order to introduce data-based analysis in the process of decision making, JFSA will increase the participants of data analysis projects within the agency and provide various types of training, aiming to enhance staff members' skills in cross-sectoral data science. Additionally, JFSA will provide staff members engaging in duties relating to the monitoring of financial institutions and markets with diverse opportunities for experimental practices, and will create a mechanism to increase their ability to deal with new types of businesses and conduct monitoring of the management of risks, such as credit risks and market risks. Furthermore, by having staff members experience secretarial duties, including Diet affairs, budgetary affairs, personnel affairs and coordinating operations, JFSA will foster officials with the ability to manage organizations, which is indispensable in implementing policies and operating JFSA.

JFSA will also actively dispatch its officials to international organizations, foreign authorities, local governments, and private companies, etc., not to mention Local Financial Bureaus, which jointly take charge of financial administration, with the aim of positively incorporating wide-ranging knowledge and experience in financial administration. Additionally, JFSA will continue cooperation with and recruitment of external human resources with cutting-edge knowledge.

(2) Placing priority on self-motivated initiatives

An organizational culture to encourage staff members to voluntarily make proposals and take on challenges based on their own ideas is indispensable for the evolution of financial administration. Therefore, JFSA has developed a framework of the Open Policy Lab[29] to encourage staff members with certain ideas to present policies voluntarily, irrespective of their affiliation, and a framework to organizationally support staff members who voluntarily study problems of financial administration and publish the outcomes as research papers.[30] JFSA will continue improving the environment so that these frameworks are positively utilized by a larger number of staff members.

(3) Promotion of further collaboration and cooperation with Local Finance Bureaus

Roles of financial institutions that support people's living and economy of local communities are very important in broadly disseminating high-quality financial services and achieving the development of local economies. It is indispensable that JFSA closely collaborates and cooperates with Local Finance Bureaus, which play significant roles in regional financial administration. JFSA has promoted close and timely collaboration with Local Finance Bureaus through actively holding online meetings among officers and among working-level officials, and will continue to expand these efforts. Additionally, JFSA will further strengthen collaboration and cooperation with Local Finance Bureaus by such means as preparing opportunities for officials of Local Finance Bureaus, including young officials, to positively present their opinions on financial administration. When receiving prior consultations or requests for permission or approval for new businesses or inquiries concerning laws and regulations from financial institutions, JFSA and Local Finance Bureaus will jointly conduct interviews and enhance efficiency in supervision, thereby assisting local financial institutions with their challenging initiatives.

(4) Development of an environment where every personnel can demonstrate their abilities

Efforts are being made to ensure that all staff members can adopt flexible working styles depending on their circumstances, respectively, thereby improving the quality of their lives and also improving the quality of their work performance. While COVID-19 has been accelerating the digitalization of society as a whole, JFSA has enabled all staff members to work remotely from home and has improved its environment for online conferences with

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[29] See Column 17 Major past "Open Policy Lab" activities.

[30] See Column 18 Overview of research papers by JFSA officials.

external organizations. In order to firmly establish these new working styles in the post-COVID-19 era, JFSA will continue to promote remote work, and will further facilitate the streamlining of operations and enhancement of efficiency, through identifying works that can be outsourced, further utilization of Robotic Process Automation (RPA), and enhancement of convenience of monitoring systems, so as to develop a working environment where all staff members can concentrate on their responsible duties.

It is also important to put the right people in the right place depending on individuals' capacity and motivation in order to have all staff members work actively and achieve growth. Accordingly, JFSA will allocate personnel based on their capacity and aptitude irrespective of their employment category and will publicly recruit personnel within and outside the agency.

(5) Enhancement of executive officials' management capability

Business operations based on appropriate management are required for maximizing the functions of an organization. In particular at JFSA, which consists of staff members with diverse backgrounds, including those from private companies well-versed in financial business operations and those with qualifications as lawyers or accountants, executive officials need to have the high-quality management capability to maximize the capacity of all those staff members. Therefore, top management and directors make their management policies visible to their subordinates, and meticulous organizational operations are to be promoted with modest-sized groups led by leaders who are expected to play leading roles. JFSA will continuously provide 360-degree feedback and management training for executive officials to constantly enhance their management capability. Furthermore, JFSA will continue satisfaction surveys on the workplace environment targeting all staff members, constantly provide feedback on survey results and take measures organizationally based thereon, thereby endeavoring to develop a workplace environment where all staff members can exercise their abilities as much as possible.

The JFSA Strategic Priorities
July 2021-June 2022

Column

Contents

Ⅰ. Overcoming the challenges of COVID-19 and bringing about a robust economic recovery

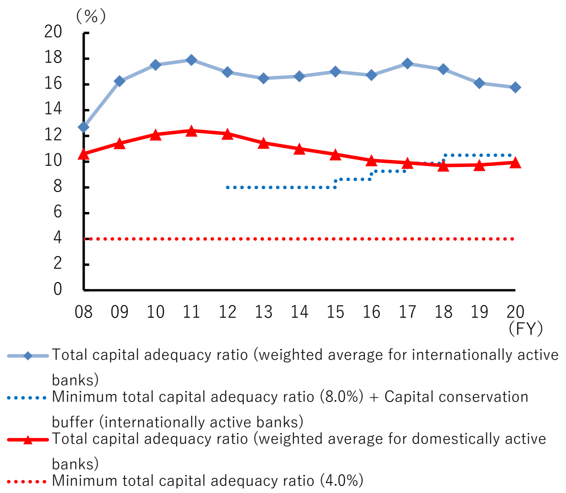
Column 1: Viewpoint on soundness of financial institutions[1]

Capital adequacy ratios for banks as the center of Japan's financial system have remained well above regulatory minimum levels (Figure 1). Their non-performing loan ratios have stayed low. In this way, Japan's financial system is generally stable and robust.

In the year to March 2021, the credit cost ratio increased from recent years (Figure 2). Thanks to policy support by the national government and the Bank of Japan, however, credit cost ratios have been held down to lower levels than seen during the past crises. Under such circumstances, some financial institutions have taken advantage of future information to book reserves.

For the future, financial institutions' soundness should be checked from a forward-looking viewpoint amid continued economic and market uncertainties under the COVID-19.

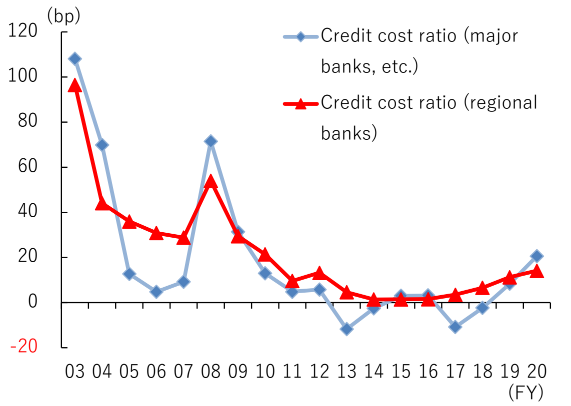
(Figure 1) Capital adequacy ratio trend



(Note) Capital adequacy ratios are calculated on a non-consolidated basis.

(Source) FSA

(Figure 2) Credit cost ratio trend



(Note1) SURUGA Bank is excluded for FY2018. Excluding merged bank's data.

(Note2) Credit cost ratio = Credit cost / average balance of outstanding loans)

(Source) FSA

[1] See the main text in I., 3. Monitoring policies (1) Current economic and financial conditions and cross-industry problems.

(1) Risk of rising credit costs

As for domestic credits, JFSA analyzes the impact that the emerging risk of business deterioration for a wide range of debtors in industries affected by COVID-19 and for large debtors would exert on the soundness of financial institutions.

Regarding Japanese financial institutions' overseas credits that have continued increasing, JFSA analyzes the impact of COVID-19 and other factors mainly in sectors and countries where Japanese financial institutions have expanded risk taking (Figure 3).

As noted above, credit costs in recent years are less than amid the past crises. JFSA verifies credit risk management arrangements from a forward-looking viewpoint in anticipation of domestic and overseas economic environment changes, such as a potential increase in loan losses, and encourages financial institutions through dialogue to upgrade such arrangements.

(2) Market operation and investment risks

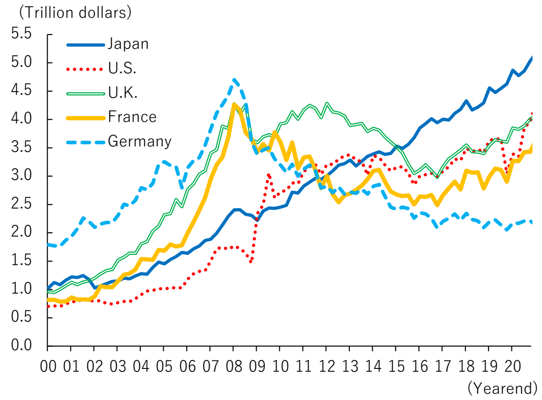
While keeping close watch on domestic and overseas market trends, JFSA encourages financial institutions through dialogue to upgrade their risk management arrangements to keep their soundness even during market fluctuations.

Major banks' investment in overseas credit markets expanded in recent years before remaining at high levels (Figure 4). Japanese financial institutions' high exposure to some markets or products and a sharp increase or decrease in such exposure may affect the stability of the financial system. To analyze such impact, JFSA exchanges views with a wide range of financial institutions on their market operation policies to understand such policies in a timely manner.

(3) Liquidity risks regarding foreign currency fundraising

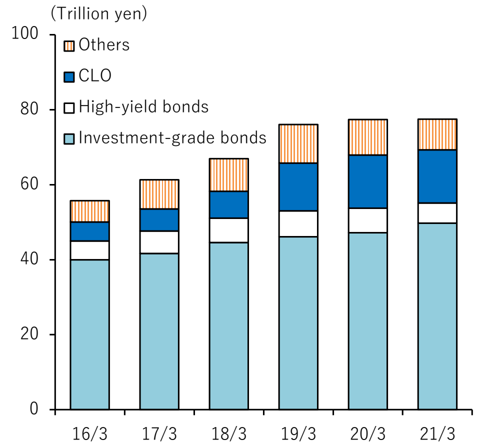
Japanese financial institutions' foreign currency fundraising depends on market-based procurement to some extent, being vulnerable to sudden market fluctuations. While the liquidity of foreign currencies is maintained at present thanks to the policies of relevant foreign central banks (Figure 5), JFSA talks with financial institutions about how to upgrade their management of foreign currency liquidity risks to make them ready to respond to rapid market fluctuations.

(Figure 3) Overseas credits trend



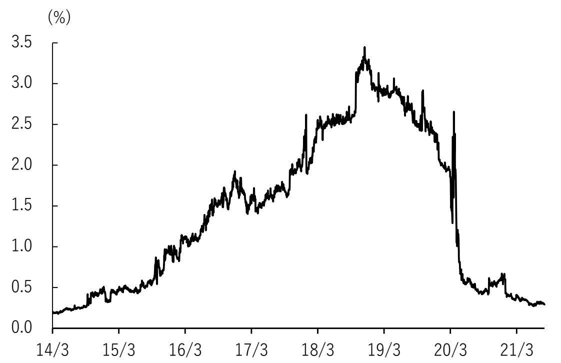
(Source) Prepared by JFSA from BIS

(Figure 4) Major banks' overseas credit investment trend



(Source) JFSA

(Figure 5) Market dollar fundraising cost



(Note1) Dollar fundraising cost = 3-month U.S. LIBOR – 3-month yen LIBOR – Dollar-yen basis
(Note2) Latest data are for the end of July 2021.
(Source) Bloomberg

Column 2: Business conditions of regional banks[2]

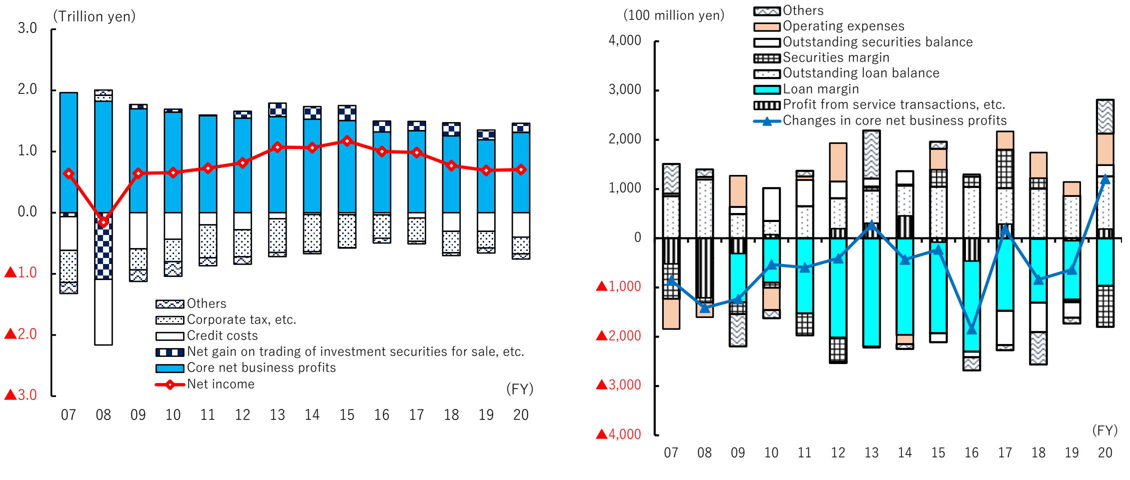
The business environment for regional banks has become tougher due to the continued low interest rate environment, and declining and aging population. Even in such environment, it is important for regional banks to secure their stable earnings and future soundness and fully achieve their financial intermediary functions. JFSA will closely watch economic and financial market trends, analyze and identify potential risks of financial system quickly and take appropriate measures to secure financial system stability.

Regional banks' financial results show that their core net business profits, which indicate basic profitability, have followed a downtrend while their credit costs have continued an uptrend in recent years. In FY2020, however, their core net business profits increased due to operating expense cuts, etc. (Figure 1).

Their capital adequacy ratio, which indicates capacity to absorb losses, has remained well above the regulatory capital requirements (Figure 2).

Among their assets, loans have followed an uptrend. Securities peaked in FY2014 and continued a downtrend due to investment difficulties after domestic bond redemptions, before turning up in FY2020. Their loans in FY2020 increased as they positively supported business operators in view of the COVID-19 impact (the outstanding balance of their domestic loans at the end of June 2021 increased about 8 trillion yen or 2.6% year on year to 292 trillion yen) (Figure 3).

(Figure 1) Net income trend and factors behind changes in core net business profits



(Note 1) Data for regional financial institutions that failed to survive mergers during each fiscal year are excluded.

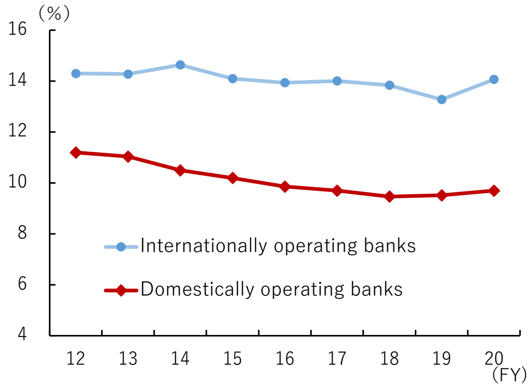
(Note 2) Net gain on trading of investment securities for sale, etc. = Net gain on equity securities + Net gain on bonds

(Note 3) Credit costs = (Provision for general reserve for possible loan losses + Provision for specific reserve for possible loan losses + Provision for loan loss reserve for specific overseas countries + Write-off of loans) – (Gains on reversal of reserve for possible loan losses + Recoveries of written-off claims)

(Source) JFSA

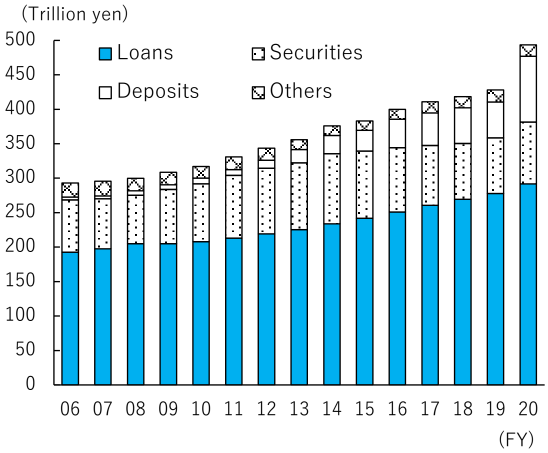
[2] See the main text in I., 3. Monitoring policies (2) Monitoring policies by business type [ii] Regional financial institutions.

(Figure 2) Capital adequacy ratio trend



(Source) JFSA

(Figure 3) Details of assets



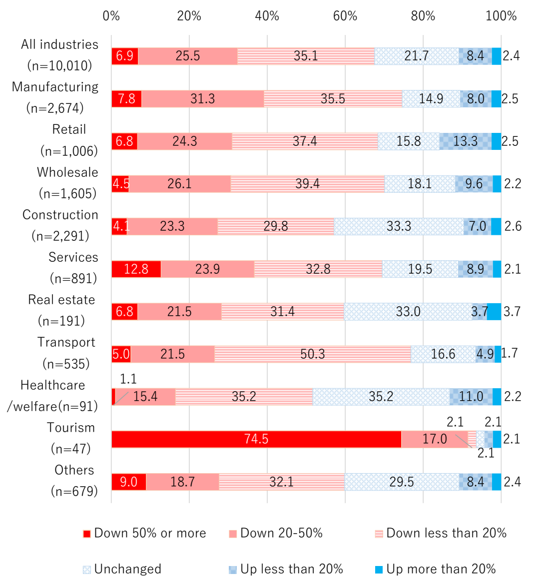
(Source) JFSA

Column 3: Efforts to ascertain current situations toward proper performance of financial intermediary functions[3]

As many business operators face sales drops, difficult cash flow conditions and future uncertainties under the expanding impacts of the COVID-19, financial institutions' consistent efforts for business feasibility evaluation and close-following support are being tested along with their financial intermediary functions.

JFSA has conducted a business questionnaire survey since FY2015 to check customers' evaluation of regional financial institutions' financial intermediary process. In the FY2020 survey, JFSA checked the impacts of the COVID-19 on businesses and regional financial institutions' support. Nearly 70% of businesses have suffered sales drops due to the impacts (Figure 1). As regional financial institutions provided businesses with cash flow support, the number of survey respondents seeing more stable cash flow than just after the COVID-19 outbreak increased in the April 2021 survey (Figure 2).

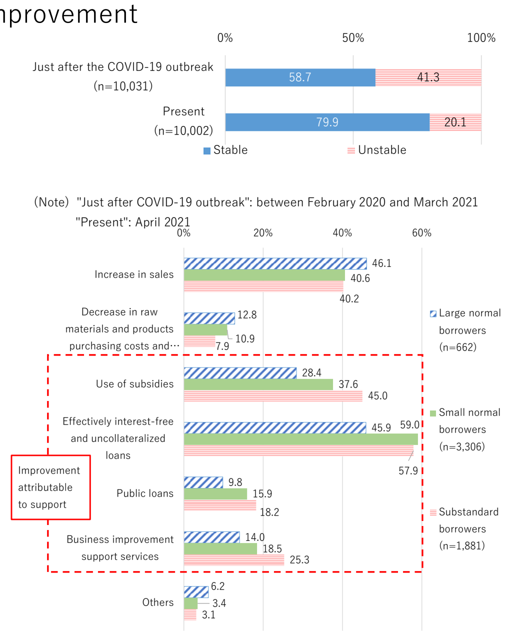
(Figure 1) Impact of COVID-19 on sales



(Note) It must be noted that sales in the tourism industry fluctuate widely depending on respondents as the number of survey targets or effective respondents in the industry is less than in other industries.

(Source) JFSA

(Figure 2) Cash flow status and reasons for improvement



(Source) JFSA

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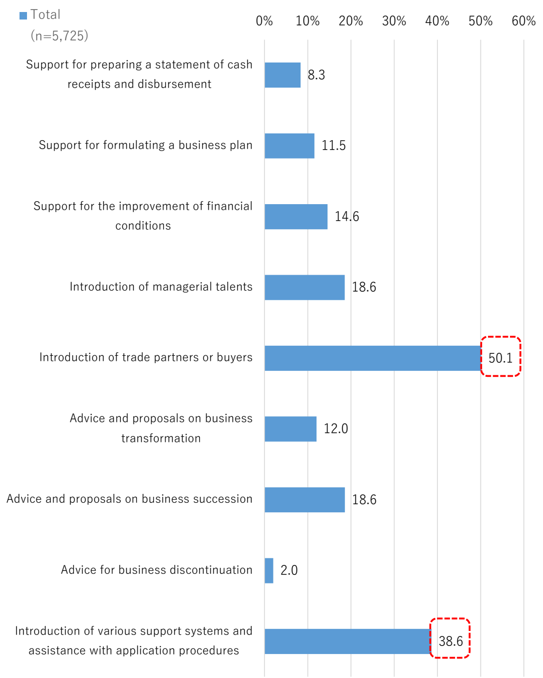
[3] Initiatives to achieve specific functions are compiled into PY2021 Progress Report on the Efficiency of Financial Intermediation, published in July 2021.
(https://www.fsa.go.jp/news/r2/ginkou/20210708/20210708.html)

See the main text in I., 3. Monitoring policies (2) Monitoring policies by business type [ii] Regional financial institutions.

The survey asked questions not only about the impacts of the COVID-19 but also about business improvement support services that businesses hope to receive from financial institutions in the future. Among such services, the "introduction of trade partners or buyers" was cited by 50% of respondents and the "introduction of various support systems and assistance with application procedures," by nearly 40%. Nearly 50% of respondents agreed to pay fees for the "introduction of managerial talents" and a little more than 40% agreed to do so for "advice or proposals on business transformation" (Figure 3).

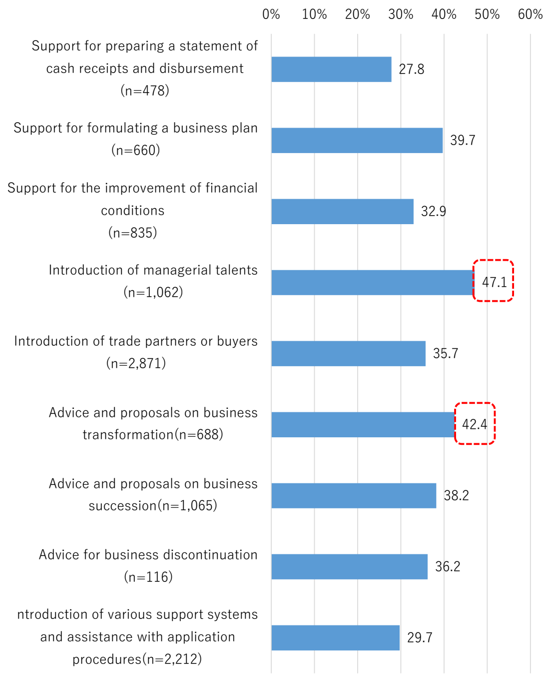
(Figure 3) Services that businesses want to receive from financial institutions and financial institution services for which businesses agreed to pay fees

〔Wanted services〕



(Source) JFSA

〔Services for which businesses agree to pay fees〕



(Source) JFSA

It is hoped that regional financial institutions will continue to expend all possible means for cash flow support and achieve their financial intermediary functions to back up regional economies' powerful post COVID-19 recovery by providing businesses with sufficient support meeting their needs.

II. Development of a financial system that achieves a vibrant economy and society

Column 4: Enhancement and efficiency improvement of payment infrastructure[4]

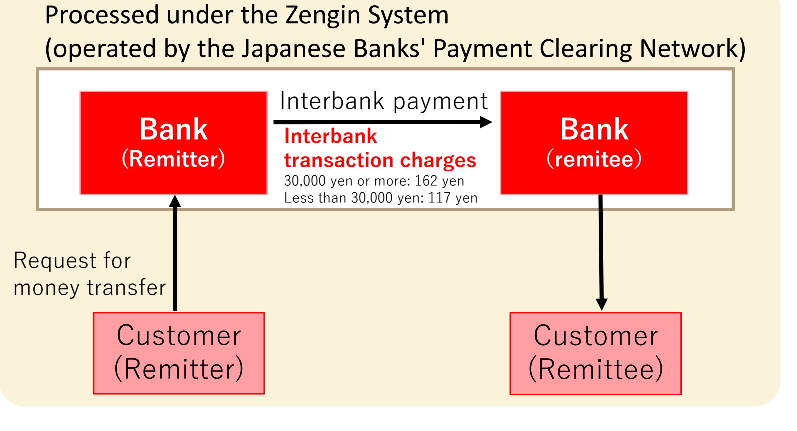
The national government's Growth Strategy published in July 2020 incorporates "reduction of interbank transaction charges," "creation of a system for frequent and small-amount payment," and "superior non-banks' participation in the Zengin System (interbank payment system) (*)" as measures relating to the development of payment infrastructure in light of expected progress in cashless payments. Under such policies, JFSA has been carrying out measures therefor in collaboration with related parties.

(*) The Zengin System is operated by the Japanese Banks' Payment Clearing Network, which connects financial institutions in Japan by a network for domestic exchange settlements.

(1) Reviews of interbank transaction charges

Interbank transaction charges are charges to be paid from a remitter to a remittee upon a bank transfer. They are costs taken into account when each financial institution sets transfer fees (Figure 1).

(Figure 1) Mechanism of interbank transaction charges



(Source) JFSA

[4] See the main text in II., 1. Promotion of digital innovation (2) Enhancement and efficiency improvement of payment infrastructure and development of new financial services.

Uniform interbank transaction charges have been maintained over 40 years, but the national government's Growth Strategy presented a policy for review to lower interbank transaction charges to reasonable levels appropriately reflecting costs under a unified mechanism established by the Japanese Banks' Payment Clearing Network, while making cost structures more visible.

As a result of deliberations based on this policy, a transition to a new mechanism operated by the Japanese Banks' Payment Clearing Network (a mechanism of fund transfer operational costs) was decided in March 2021. The outline of the new mechanism is as follows.

At present (interbank transaction charges)	After review (fund transfer operational costs)
➢ Individual banks set charges among themselves. ➢ 162 yen (over 30,000 yen) or 117 yen (less than 30,000 yen) per money transfer * With exceptions, such as free money transfers for salaries and public funds ➢ No review substantially	➢ Charges are decided based on the average cost required for processing by the Japanese Banks' Payment Clearing Network. ➢ 62 yen per money transfer (free money transfer only for salaries and bonuses) ➢ Review once every five years

* To be commenced in October 2021 (or in October 2024 only for public funds)

(2) Superior non-banks' participation in the Zengin System and creation of a system for frequent and small-amount payment

Regarding the topics, "superior non-banks' participation in the Zengin System" and "improvement of convenience in frequent and small-amount payments," discussions were held by the Task Force for the Next-Generation Payment Systems, which consists of related businesses, experts, JFSA, Bank of Japan, etc. Since June 2020, the Task Force had discussions based on the results of interviews with non-banks and system vendors, and compiled a report presenting the future direction in January 2021.

Key points of the report by the Task Force for the Next-Generation Payment Systems

[i] Participants of the Zengin System, which are limited to banks, etc. at present, are to be expanded to include funds transfer service providers in around FY2022.

Requirement	➢ From the perspective of ensuring the stability of the payment system, the same requirements as those for banks now participating in the Zengin System are to be applied to newly participating funds transfer service providers. ➢ Regarding the monitoring of newly participating funds transfer service providers, the Japanese Banks' Payment Clearing Network, JFSA, the Bank of Japan need to closely collaborate with each other and have deliberations appropriately.
Form of participation	➢ From the perspective of ensuring fair access to the payment system, participation as "clearing participants" settling funds directly using the BOJ's current account is expected to be secured, but for clearing participants, stricter measures are required in terms of their financial bases and risk management. ➢ Regarding indirect participation (entrusting settlement using the BOJ's current account to a bank), the terms and conditions to be included in the agency agreement are expected to be standardized when a clearing participant accepts the settlement from the entrustor.
Connection methods	➢ In the short term, participation on the premise of the current system is to be deliberated, and in the medium to long term, it is preferable to consider concrete connection methods utilizing API that are expected to be beneficial both for funds transfer service providers and existing participating banks. ➢ Also in consideration of the possibility of fundamentally improving the efficiency of the Zengin System, the utilization of new technologies should be taken into account from a mid- to long-term perspective.

[ii] As temporary measures for improving convenience in frequent and small-amount payments, the *Cotra* Project, led by five city banks, will be commenced early FY2022.

Five city banks are aiming to build a new infrastructure for small amount payments, called *Cotra*, under which financial institutions and non-banks can individually offer payment services easier at lower cost in a sustainable manner that is also inexpensive and convenient for users.

The Task Force's report also states that it is preferable to continue deliberations concerning better methods and challenges in tandem with the *Cotra* Project, bearing in mind the next renewal of the Zengin System from a mid- to long-term perspective.

Column 5: IT governance report in the financial sector[5]

On June 30, 2021, JFSA published the Report on the Results of a Survey on IT Governance at Financial Institutions, which compiles the current status and challenges ascertained through the survey conducted in program year 2020 with the aim of facilitating financial institutions' efforts to strengthen their IT governance. In PY2020, JFSA also conducted a questionnaire survey for shinkin banks, in addition to regional banks, and compared collected data.

As a result, it was found that the indicator, "system expenditure/amount of deposits,"[6] shows better cost effectiveness of shinkin banks' systems, in the same manner as in the IT governance report in PY2019 (Figure 1).

(Figure 1) System expenditure / Amount of deposits by business category

	PY2019		PY2020	
	Regional banks (104 banks)	**Shinkin banks (estimate)**	**Regional banks (103 banks)**	**Shinkin banks (254 banks)**
BS Amount of deposits (average)	3.3trillion yen	554.0 billion yen	3.4trillion yen	571.9 billion yen
P/L System expenditure (average)	4.7 billion yen	0.66 billion yen	4.9 billion yen	0.61 billion yen
index System expenditure / Amount of deposits	0.18%	0.12%	**0.17%**	**0.11%**

(Source) JFSA

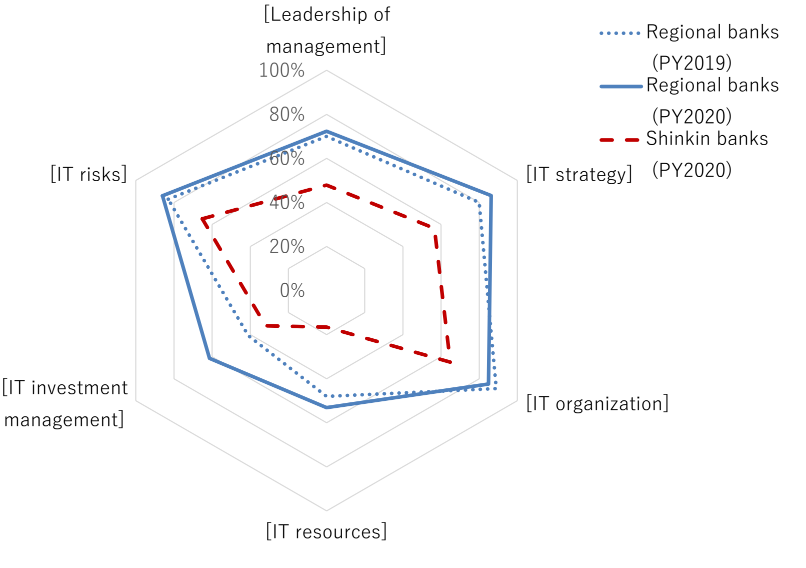
As a background for such cost structure, the following factor is presumed: regional banks' systems for their basic functions regarding exchange and deposit operations, etc. (nonstrategic field) and for other functions regarding management assistance, etc. (strategic field) are tightly coupled and have become too complicated and bloated, and this increases cost for additional development and maintenance. However, some regional banks have already solved the problem of complicated and bloated systems and have started deliberations for developing a next-generation accounting system to enable flexible responses to digitalization. JFSA established the "Enterprise System and Frontrunner Support-Hub" in March 2020 to support such pioneering efforts, and has been encouraging financial institutions to utilize this Support-Hub from an early stage.

5 See the main text in II., 1. Promotion of digital innovation (4) Enhancement of IT governance at financial institutions.

6 The amount of data and throughput increase in accordance with the increase in the amount of deposit (financial institution's size) and cause increases in IT cost. Therefore, the efficiency and appropriateness of IT cost are evaluated using "system expenditure/amount of deposit" as the indicator

Additionally, JFSA conducts a comparison of the responses to the questionnaire survey regarding how financial institutions have been making efforts for the "Six Approaches and Viewpoints Relating to IT Governance."[7] In the sector of "IT resources," the percentage of those responding "Yes" (= making efforts) was the lowest, both for regional banks and shinkin banks, and it was found that they have problems especially with regard to the securing and fostering of human resources and are required to take measures more strategically (Figure 2).

(Figure 2) Percentages of those responding "Yes" to questions regarding six approaches and viewpoints relating to IT governance



(Source) JFSA

Regarding the Six Approaches and Viewpoints Relating to IT Governance, JFSA has also had dialogues with targeted financial institutions to ascertain their implementation status, in addition to conducting the questionnaire survey, and has published a compilation of concrete examples obtained through those dialogues since PY2019. JFSA will incorporate valuable information obtained through dialogues with financial institutions and experts into the relevant compilation and disseminate and deepen understanding broadly through opinion exchanges or on other opportunities, while encouraging financial institutions to utilize the information to strengthen their IT governance.

[7] [i] Leadership of management; [ii] IT strategy that matches management strategy; [iii] IT organization that consistently implements the IT strategy; [iv] Optimized IT resources (resource management); [v] IT investment management processes that results in the creation of corporate value; and [vi] Properly managed IT risks

Column 6: Measures relating to the International Financial Center[8]

Taking advantage of household financial assets totaling 1,900 trillion yen, JFSA has been endeavoring to reform Japan's financial and capital markets into more attractive ones and develop an environment to attract foreign businesses and highly-skilled professionals. Three representative measures are introduced below.

(1) Financial administration in English

In January 2021, JFSA and Local Finance Bureaus jointly established the "Financial Market Entry Office," where all procedures for newly entering foreign financial institutions, from prior consultations, registration procedures and supervision after commencing business, are undertaken in English. Through efficient communication on a real-time basis by the use of web conference systems and other means, efforts have been made to reduce cost for entering Japanese markets and achieve registration in a shorter time for foreign financial businesses. Regarding four cases for which registration has been completed by August 2021, relevant procedures were undertaken as speedily as in other countries.

In June 2021, for better convenience, JFSA relocated the Financial Market Entry Office to Kabutocho, Nihonbashi, where the Tokyo Stock Exchange is located and other related businesses, including start-up asset management companies, have business offices. This is expected to ease access to JFSA and facilitate smooth consultations and registration procedures.

Additionally, in April 2021, AI multilingual translation services (speech/text translation) were introduced. At present, the services are mainly used for rough translation, but are expected to achieve higher accuracy through the development of a financial search engine, for which efforts are being made simultaneously. It is expected that the services will make it possible for us to have communications with foreign financial businesses more promptly and effectively in multiple languages, not limited to English.

(Figure 1) Sign for the new office

(Source) JFSA

(Figure 2) Front of the building where the new office has relocated

(Source) JFSA

[8] See the main text in II., 2. Expanding Japan's role as an international financial center.

(2) International Financial Center Webpage

In March 2021, JFSA opened the International Financial Center Webpage with the aim of providing foreign financial businesses that are considering newly entering Japanese markets with information on registration procedures for commencing asset management business in Japan, the taxation system and statuses of residence or other related government policies, and information helpful for start-ups or everyday life in Japan, in a comprehensive manner.

(3) Trial business project to develop a "financial entrepreneurship support network"

When a foreign financial company or individual intends to open a business base in Japan, various procedures are required, such as establishing a corporation, obtaining a status of residence, and preparing for starting life in Japan, not only obtaining a license to engage in a financial business. As services to offer support for these procedures comprehensively have yet to be fully established in Japan, [9] JFSA is conducting a trial business project to develop a "financial entrepreneurship support network" to offer support as a single point of contact.[10]

(Figure 3) International Financial Center Website

(Source) JFSA

(Figure 4) Financial entrepreneurship support network

(Source) Tricor Japan K.K.

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[9] In Hong Kong, approximately 7,000 companies are registered as companies offering one-stop support services for procedures necessary for commencing a business (for establishing a corporation, acquiring a status of residence and a license to engage in a financial business, and commencing a new life, etc.).

[10] Website dedicated to the trial business project of Tricor Japan K.K., which was consigned with the project: https://www.tricorglobal.com/tricor-japan-financial-services-agency-start-up-support-program

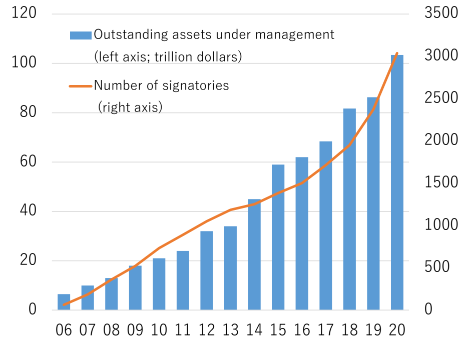
Column 7: Trends concerning sustainable finance[11]

In recent years, private financial institutions and institutional investors have been expanding their voluntary efforts for sustainable finance (finance for achieving a sustainable society). The number of signatories to the Principles for Responsible Investment (PRI), which provides for the principles concerning ESG (environment, society and governance) investment, is steadily increasing (Figure 1).

Additionally, markets for ESG-related bonds, such as green and social bonds, are expanding globally. ESG-related bond markets are also expanding in Japan, but market sizes are still smaller compared to other countries (Figures 2 and 3).

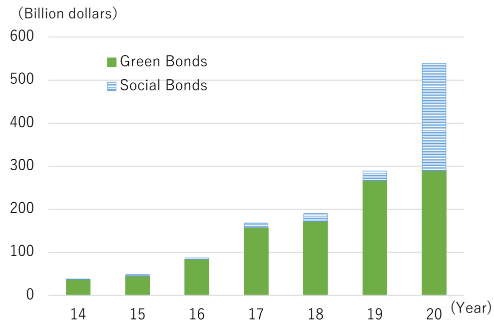
Under such circumstances, in October 2020, the Japanese government declared the national goal of achieving carbon neutrality by 2050, and in April 2021, the greenhouse gas (GHG) reduction target as of FY2030 was raised. Bringing about a virtuous cycle between the environment and economy through this challenge is the government-wide goal to be achieved (Figure 4).

(Figure 1) Changes in the number of signatories to the PRI and outstanding assets under management



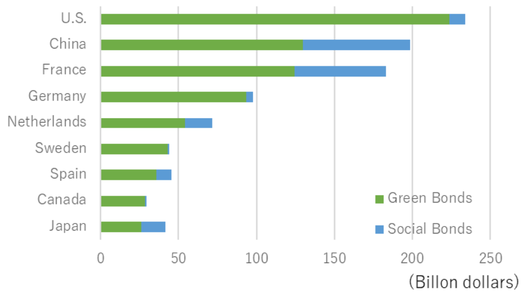
(Source) Prepared by JFSA based on materials of the PRI

(Figure 2) Changes in the amounts of ESG bonds issued globally



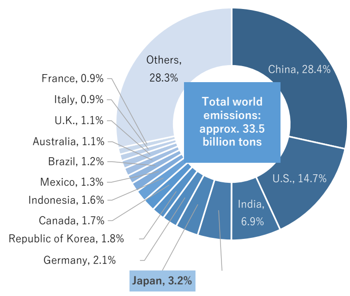
(Source) Prepared by JFSA based on materials of the Climate Bonds Initiative

(Figure 3) Cumulative amounts of issued ESG-related bonds by country (- 2020)



(Source) Prepared by JFSA based on materials of the Climate Bonds Initiative

(Figure 4) World CO_2 emissions (2018)



(Source) Prepared by JFSA based on materials of the Japan Center for Climate Change Actions

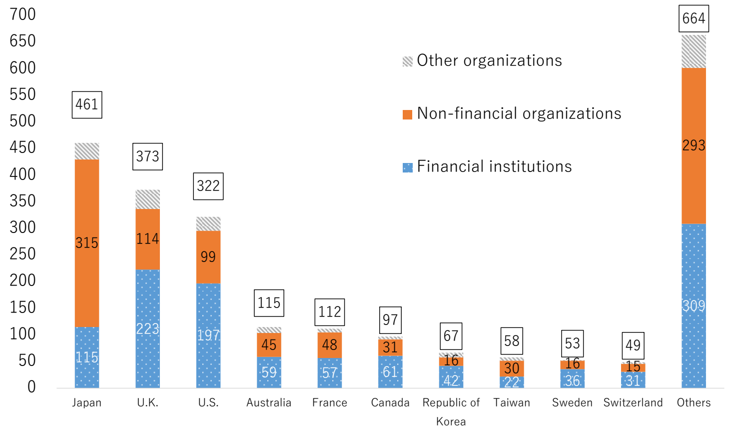
[11] See the main text in II., 3. Promoting sustainable finance.

A vast amount of money is required for achieving carbon neutrality. The International Energy Agency (IEA) estimates the required amount of energy-related investments until 2040 to achieve the goals of the Paris Agreement as approx. 54.4 trillion dollars to 67.8 trillion dollars (approx. 5,930 trillion yen to 7,390 trillion yen) for the whole world. Japanese companies have advanced technologies and the potential to contribute to achieving a decarbonized society. It is important that financial institutions and the financial capital market of Japan properly fulfil their functions to attract ESG investment funds, which are said to amount to 35 trillion dollars (approx. 3,740 trillion yen), from overseas so that domestic and international funds for company growth will surely be utilized for related initiatives of Japanese companies.

From such perspective, the Expert Panel on Sustainable Finance (chaired by Dr. MIZUGUCHI Takeshi, President of Takasaki City University of Economics) was established in JFSA in December 2020 to have it discuss various related issues. The Expert Panel published a report presenting the following three pillars of recommendations in June 2021.

Enhancing corporate disclosure: In order for companies to promote constructive dialogues with investors and financial institutions for maintaining and improving their corporate value over the mid to long term, appropriate corporate disclosure regarding sustainability is the key. In Japan, around 460 companies (as of the end of July 2021) have announced their support for the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), meaning that Japan has the largest number of supporting companies in the world, but further efforts are required to enhance the quality and quantity of disclosure based on the revised Corporate Governance Code (June 2021), and to continuously deliberate ideal disclosure of sustainability-related information (Figure 5).

(Figure 5) Number of organizations announcing their support for the TCFD recommendations (as of the end of July 2021)



(Source) Prepared by JFSA based on materials of the Task Force on Climate-related Financial Disclosures (TCFD)

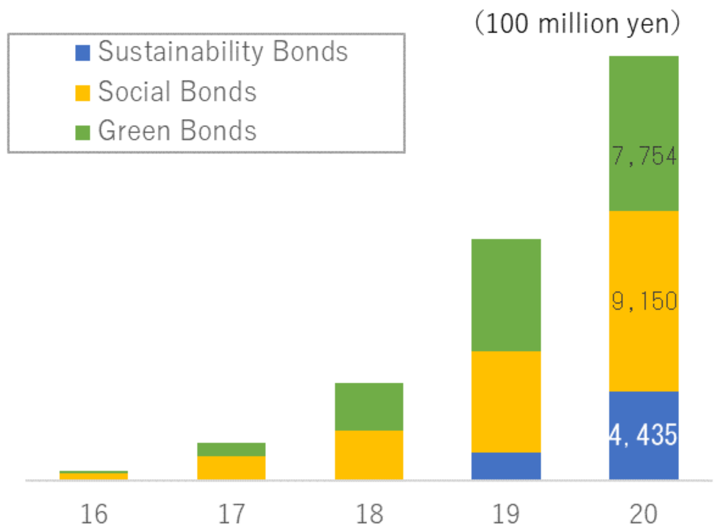
Demonstrate capital market functions: It is important for major market players, such as institutional investors, exchanges, and ESG rating and data providers, to play their expected roles appropriately with the aim of vitalizing the sustainable finance market, thereby having the capital market demonstrate its functions of efficiently allocating capital through ensuring high liquidity and the pricing function.

Financial institutions' support for borrowers and investees, and risk management: In Japan, where the ratio of indirect financing is high, banks and other financial institutions need to incorporate a perspective of sustainability and promote borrowers' efforts for decarbonization, thereby facilitating a transition of the real economy and develop their own risk management systems.

Column 8: Social Bond Guidelines[12]

Social bonds are bonds that limit the use of proceeds to social projects (projects that contribute to solving social issues and bringing about positive social effects). In response to the spread of the COVID-19 infection, the issuance of social bonds for supporting countermeasures against the infection is increasing significantly worldwide. In this manner, the importance of investment in the social sector, in addition to the environmental sector, out of overall ESG investment, is becoming broadly recognized and is attracting attention domestically and internationally (Figure 1).

(Figure 1) Trends in SDGs Bonds in Japan



(Source) Prepared by the Japan Securities Dealers Association (covering public issues in Japan between 2016 and 2020)

Also in Japan, the issuance of social bonds is rapidly increasing, but most of them are issued by the public sector, and general private companies have just started to issue social bonds. The further promotion of social projects through social bonds issued by general private companies is required.

Regarding social bonds, the Social Bond Principles formulated by the International Capital Market Association (ICMA) (hereinafter referred to as the "ICMA Social Bond Principles") were the sole international standards, but in December 2020, a request for early formulation of practical guidelines

[12] See the main text in II., 3. Promoting sustainable finance (2) Demonstration of market functions.

commensurate with the characteristics of Japanese society was made by the Japan Federation of Economic Organizations and other bodies. In response, the Working Group on Social Bonds was established with JFSA serving as the secretariat in March 2021, and JFSA compiled the Social Bond Guidelines (draft) in July 2021 through discussions among academic experts and persons with practical experience at the Working Group.

The Social Bond Guidelines (draft) present examples of concrete measures in accordance with the circumstances of Japan, which faces various problems as an industrialized country, while paying attention to the consistency with the ICMA Social Bond Principles, thereby aiming to secure the credibility of social bonds and reduce burden of issuers at the same time and encourage Japanese private companies to issue more social bonds.

Specifically, the Social Bond Guidelines (draft) show what are expected for social bonds and specific measures for each of the four core components ([i] use of proceeds, [ii] process for project evaluation and selection, [iii] management of proceeds, and [iv] reporting) and for each of the two key recommendations for improving the transparency of social bonds ([i] social bond frameworks and [ii] external reviews), which the ICMA Social Bond Principles emphasize.

The guidelines, which also introduce examples of social projects (specific use of proceeds) based on social issues in Japan (including social projects pertaining to response to aged society, regional revitalization, response to natural disasters and infections, promotion of women's empowerment, etc.), are practical to be utilized by Japanese private companies that are considering issuing social bonds and by investors who are considering making investments in social bonds.

Based on the results of the public comments, JFSA will finalize the details of the guidelines and facilitate further discussions among related parties to specifically present indicators for the social benefits of social projects.

Column 9: Deliberations for facilitating provision of capital for growth and review of firewall regulations separating banks and securities firms[13]

From the perspective of recovering the economy and achieving sustainable growth through the better-functioning of the Japanese capital market in light of the emergence of the post-COVID society and economy, the Working Group on Capital Market Regulations, the Financial System Council, has had deliberations on such themes as facilitating provision of capital for growth, facilitating the entry of overseas financial institutions, etc., and sharing clients' information between securities firms and banks since October 2020. As a result, the following two reports were compiled.

(1) First Report - Regulatory Policy: Toward an International Financial Hub (December 2020)

[i] Facilitating the entry of overseas investment managers

A pressing issue in establishing international financial hub functions in Japan is further expediting the development of the environment for promoting the entry of overseas financial institutions, especially investment managers, and such efforts must be undertaken promptly. However, the following problems have been pointed out: the current regulatory framework under the Financial Instruments and Exchange Act does not necessarily take into account overseas investment managers mainly managing foreign funds; and neither overseas track records nor the ongoing supervision by foreign authorities is considered upon the entry and in the subsequent supervision of overseas investment managers managing only foreign funds.

Based on the above-mentioned issues, as simplified entry schemes (notification required), the Working Group recommended to establish [i] a special scheme for fund management businesses mainly targeting overseas qualified investors (foreign corporations and individual residents overseas with a certain level of assets) (permanent system), and [ii] a special scheme for investment managers (managing only foreign funds) who have certain overseas track records and have authorization by foreign authorities in specified foreign countries (temporary system) (Figure 1).

Based on these recommendations, a draft of the amendment of the Financial Instruments and Exchange Act for establishing special systems for specially permitted fund management businesses for overseas qualified investors, which corresponds to [i] above, and for specially permitted asset management businesses for the transition period, which corresponds to [ii] above, was submitted to the ordinary session of the Diet in 2021 and was approved in May 2021. The draft of the amendment has already been promulgated and procedures for public comments have also been commenced for draft amendments of other relevant Cabinet Office Orders. The amended Financial Instruments and Exchange Act will be put into effect by November 2021.

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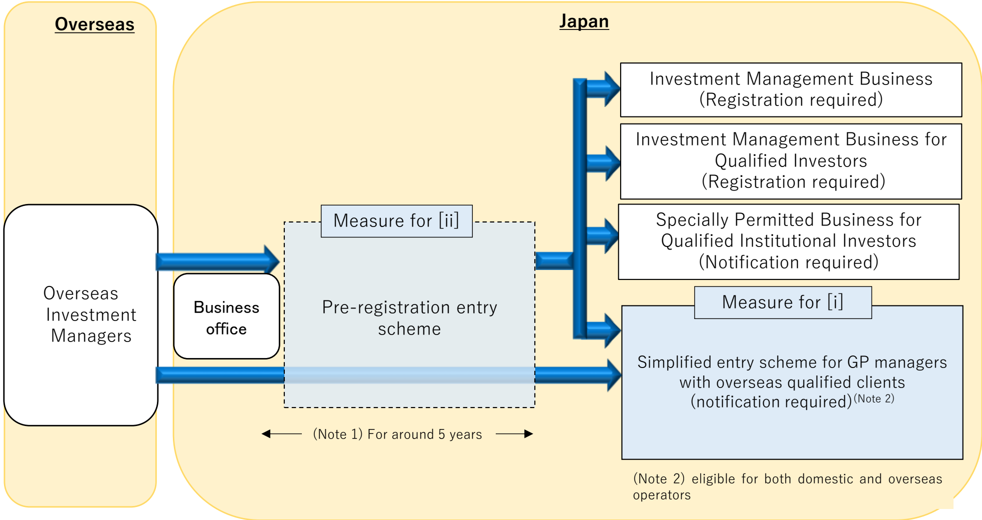
[13] See the main text in II., 4. Stimulating capital markets and smooth capital provision to growing businesses.

(Figure 1) Development of systems to facilitate the entry of overseas investment managers

Create new entry schemes through simplified procedures (notification required) for

[i] investment managers of funds mainly targeting foreign professional investors (foreign corporations and individuals with certain assets who reside overseas), and

[ii] investment managers (only managing foreign funds) who have obtained a license from foreign authorities and have certain overseas track records (temporary measures for [ii] [for around 3 to 5 years])



(Source) JFSA

[ii] Revising firewall regulations concerning overseas corporate clients (regulations on information exchanges)

The firewall regulations prohibit the sharing of clients' material non-public information between banks and securities firms within the same financial group without customer consent. The regulations were introduced in 1993, when the prohibition of banks' and securities firms' mutual entry to the banking and securities business was lifted, for such purposes as preventing abuse of undue influence of "main banks," ensuring proper management of conflict of interest, and robustly protecting clients' information. Thereafter, several reforms have been implemented, while weighing the purposes and the means of regulations, in consideration of the trend of after-the-fact reviews and changes in regulatory developments in other jurisdictions.

Regarding the firewall regulations, the following have been pointed out: Obtaining written consent from companies located in countries without similar regulations has proven difficult, putting Japanese financial institutions at a competitive disadvantage vis-à-vis overseas financial institutions that are not subject to the regulations; the regulations would limit corporate clients' access to holistic proposals from Japanese financial institutions as a group; the regulations should be reviewed from the perspective of improving the attractiveness of Japan's financial and capital markets.

Based on these opinions, the Working Group suggested that it would be appropriate to lift the restriction on the sharing of clients' non-public information concerning overseas corporate clients with the aim of ensuring regulatory equivalence with global standards and strengthening international competitiveness vis-à-vis overseas financial institutions, etc. Accordingly, relevant Cabinet Office Orders were amended and promulgated and enforced in June 2021.

(2) Second Report - To Create an Attractive Capital Market toward the Post-COVID Era (June 2021)

[i] Ideal provision of capital for growth

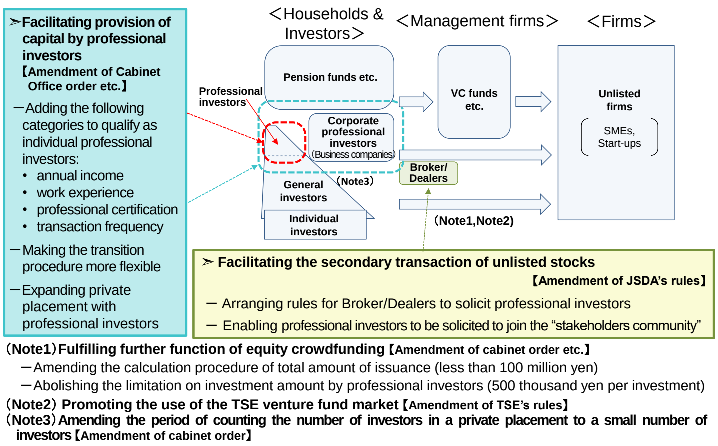
In order to cope with discontinuous changes in society and economy and industrial structure in the post-COVID era, it is becoming even more important to secure funds recognizable as capital that support innovation by start-up companies and restructuring and reorganization of existing businesses.

When providing capital for growth to unlisted companies, including start-up companies, it is necessary to facilitate and diversify flows of funds recognizable as capital. The following recommendations were made from the perspective of developing an environment to make it easier for professional investors to take risks, while thoroughly protecting general investors (Figure 2).

・Creating a system to facilitate provision of capital by professional investors
・Facilitating the secondary transaction of unlisted stocks
・Fulfilling further function of equity crowdfunding, through which general investors can also invest
・Promoting the use of the TSE venture fund market
・Amending the period of counting the number of investors in a private placement to a small number of investors so that companies can procure funds more flexibly

Based on these recommendations, JFSA plans to amend relevant Cabinet Orders and Cabinet Office Orders, etc.

(Figure 2) Facilitating Provision of Capital for Growth



(Source) JFSA

[ii] Revising firewall regulations concerning domestic customers

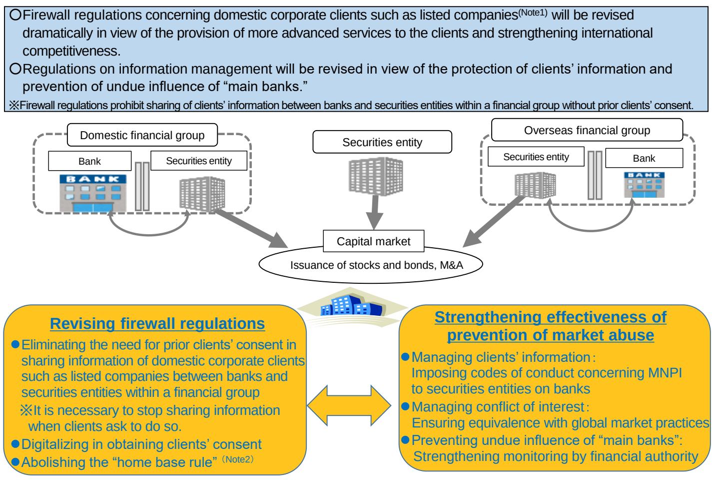
Through a significant review of the firewall regulations in 2008, the opt-out system for corporate customers was introduced for the sharing of customers' non-public information. Amid dramatic changes in the environment surrounding the financial industry, the following problems are pointed out regarding the firewall regulations: banks and securities firms do not fully utilize the opt-out system on such grounds that, due to the need to provide customers with explanations on a large number of matters, the opt-out system is not so advantageous compared with the opt-in system in consideration of the burden and convenience; regulations to prohibit information sharing unique in Japan are recognized as being excessive and this undermines the efforts to enhance Japan's attractiveness as an international financial hub; the firewall regulations interfere with business activities to propose and provide comprehensive financial services to customers and are imposing a heavy burden both on customers and financial institutions.

Based on these opinions, the Working Group recommended to review the firewall regulations from the perspective of effectively ensuring their purport (robust protection of clients' information, management of conflict of interest, and prevention of undue influence of "main banks") while giving due consideration to the necessity to have Japan's capital market further fulfil its function, improve the attractiveness of Japan's market as an international financial hub, provide customers with more advanced financial services, strengthen the international competitiveness of domestic financial institutions, and enhance customer convenience, etc.

More specifically, the Working Group recommended to fundamentally review the regulations to eliminate the need for prior clients' consent in sharing information of domestic corporate clients, such as listed companies, within a financial group, while mentioning the need to suspend information sharing upon an individual company's request, and to endeavor to strengthen effectiveness of measures to prevent market abuse (Figure 3).

Based on these recommendations, JFSA plans to amend relevant Cabinet Office Orders and Comprehensive Guidelines for Supervision, etc.

(Figure 3) Revising Firewall Regulations



(Note 1) Considering that SMEs are susceptible to undue influence of "main banks," revising regulations concerning them will continue to be considered.
(Note 2) "Home base rule" prohibits people who belong to both the bank and the securities entity from accessing non-public information of both entities.

(Source) JFSA

Column 10: Tokyo Stock Exchange's listed stock market structure reform[14]

(1) The Tokyo Stock Exchange conducted the following reforms in November 2020 for the purpose of supporting the sustainable growth of listed companies and medium to long-term improvement of their corporate value and offering an attractive spot market that will be highly approved by various domestic and foreign investors:

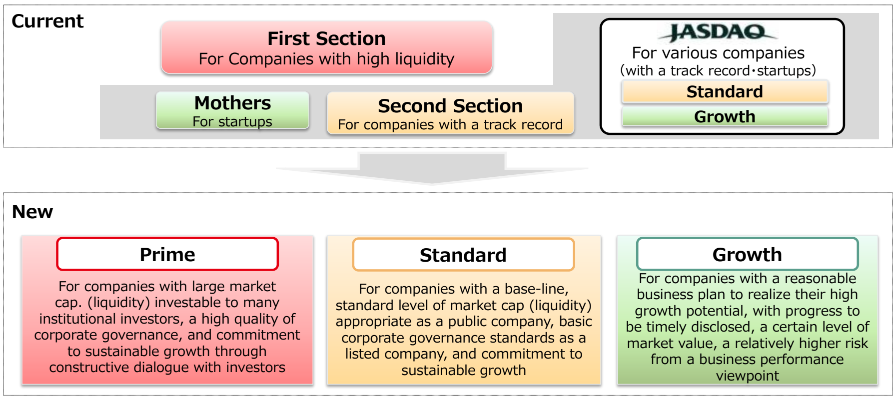
[i] Unifying the requirement for listing on the First Section to companies with a market capitalization of 25 billion yen (abolishing the requirement of having a market capitalization of 4 billion yen for companies listed on Mothers)

[ii] Easing the requirement for listing on the First Section with regard to loss-making companies (including loss-making companies with sales of 10 billion yen or more and a market capitalization of 100 billion yen or more, and checking companies' substantial revenue bases, etc. irrespective of their short-term business performances)

[iii] Reviewing the criteria for delisting due to debts exceeding the assets (excluding companies with a market capitalization of 100 billion yen or more from subjects for delisting or a transfer from the First Section to the Second Section)

(2) The Tokyo Stock Exchange plans to restructure its current five market segments into three: Prime Market, Standard Market and Growth Market, in April 2022 (Figure 1).

(Figure 1) Outline of market restructuring



(Source) Japan Exchange Group

(3) In particular, for the Prime Market, the criteria regarding market capitalizations, liquidity and governance are to be made stricter than those for the First section as follows:

[14] See the main text in II., 4. Stimulating capital markets and smooth capital provision to growing businesses (1) Check/review the policy measures and conventional market practices for better market function.

[i] The requirement for initial listing and the requirement for continued listing will both be set as the total market value of all outstanding shares being 10 billion yen or more.

[ii] The scope of tradable shares will be reviewed, such as excluding shares with low liquidity held by shareholders, and the requirement for initial listing and the requirement for continued listing will both be set as a tradable share ratio being 35% or more.

[iii] In the Corporate Governance Code, which was revised in June 2021, a stricter governance level (comply or explain) will be applied to the Prime Market.

(Note) Companies listed on the First Section that do not satisfy the criteria [i] and [ii] may be listed on the Prime Market for the time being on condition of disclosing a written plan for satisfying the aforementioned criteria.

	First Section	Prime Market
Criteria on market capitalizations	Market capitalization of 25 billion yen (directly listed on the First Section) Market capitalization of 2 billion yen (transfer to the Second Section)	Total market value of all outstanding shares of 10 billion yen (both upon listing and for continued listing)
Definition of tradable shares	Exclude equities of shareholders that account for 10% or more of the total from tradable shares	Exclude equities of domestic banks, insurance companies, and industrial corporations from tradable shares even if they account for less than 10% of the total
Tradable share ratio	35% (only upon listing)	35% (upon listing and for continued listing)
Corporate governance code	All principles	All principles (including stricter ones for the Prime Market)

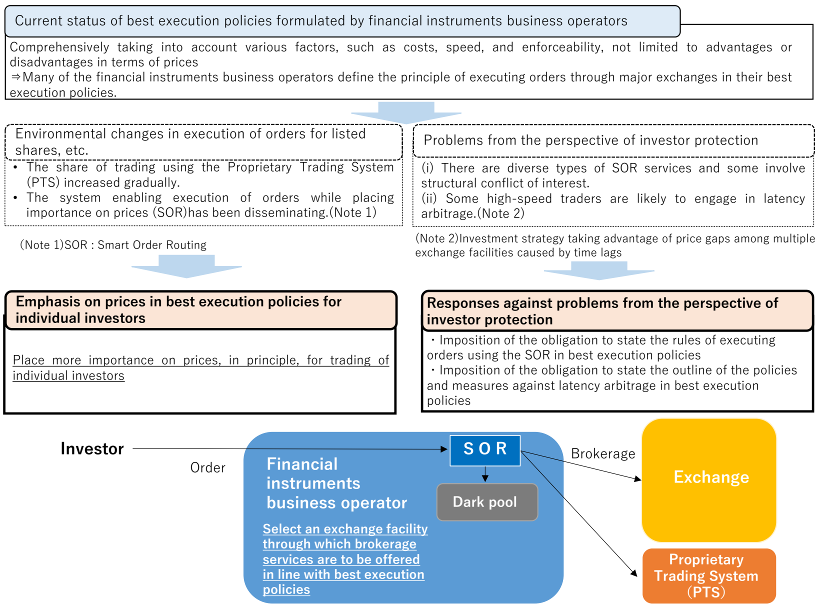
The Tokyo Stock Exchange will also review TOPIX to place more importance on market capitalization levels and the floating share ratio.

	Current TOPIX	Future TOPIX
Market capitalization level	None (all issues listed on the First Section)	Total market value of all outstanding shares of 10 billion yen or more (Issues totaling less than 10 billion yen will be excluded by the end of January 2025.)
Floating share ratio	Cross-held shares are included as floating shares when calculating a weighting in the index.	Cross-held shares are excluded from floating shares when calculating a weighting in the index.

(4) After listed companies undergo procedures for selecting new market segments and their new market segments are determined and published (scheduled in January 2022), the current market segments are scheduled to be replaced with the aforementioned new market segments on April 4, 2022.

Column 11: Deliberations on financial instruments business operators' best execution policies[15]

(Figure 1) Outline of the Report by the Task Force to Discuss Optimal Ways to Ensure Best Execution



(Source) JFSA

When there are multiple exchange facilities, a financial instruments business operator needs to consider through which of those exchange facilities a customer's order should be executed in order to maximize interest of the customer. In 1998, the on-exchange trading requirement was abolished and an approval system for operating the Proprietary Trading System (PTS) as securities businesses was introduced. In 2005, the principle that securities companies must execute trading on an exchange unless a customer clearly selects off-exchange trading (the principle of on-exchange trading) was reviewed and a new obligation was introduced from the perspective of investor protection to require securities companies to establish their best execution policies, which are policies and methods for executing customers' orders for securities trading under the best terms and conditions, and to actually execute orders based on those policies.

On that occasion, it was provided that the best terms and conditions should be decided by comprehensively taking into account various factors, such as costs, speed, and enforceability, not limited to prices, in light of the market infrastructure, etc. at that time, and that executing trading on the most liquid market should be considered as one of the means of best execution. Accordingly, best execution

[15] See the main text in II., 4. Stimulating capital markets and smooth capital provision to growing businesses (1) Check/review the policy measures and conventional market practices for better market function.

policies currently adopted by many of the financial instruments business operators define the principle of executing orders through major exchanges in consideration of the liquidity, possibility of execution, trading speed, and other factors.

Thereafter, the share of PTS trading increased and the Smart Order Routing (SOR: a system to execute orders by searching an exchange facility presenting the best price from among multiple facilities) came to be utilized widely, and an environment to enable execution of orders through comparison of prices on multiple exchange facilities has been thus developed.

On the contrary, the following problems are pointed out:

・ There is a structural conflict of interest incidental to the SOR between customers and financial instruments business operators or exchange facilities affiliated with or being in a friendly relationship therewith.
・ Although the registration system for high-speed traders was introduced in 2018, some of them seem to adopt an investment strategy taking advantage of price gaps among multiple exchange facilities caused by time lags (latency arbitrage).

In light of these environmental changes and problems after the introduction of the current system, the Task Force to Discuss Optimal Ways to Ensure Best Execution, the Financial System Council, had deliberations and reviewed regulations on financial instruments business operators' best execution policies, and published a report recommending the following in June 2021 (Figure 1).

(1) With regard to best execution policies for individual investors, the following obligations should be imposed from the perspective of placing emphasis on prices:
・ when mainly considering the customer's interest other than prices, the obligation to state the reason therefor in best execution policies; and
・ when using dark pools, the obligation to state the reason therefor in best execution policies.

(2) As responses against problems from the perspective of investor protection, the following obligations should be imposed:
・ the obligation to state the rules of executing orders using the SOR in best execution policies;
・ the obligation to state the status of improvements in prices in written explanations of best execution (a document explaining that the order was executed in line with best execution policies); and
・ the obligation to state the outline of the policies and measures against latency arbitrage in best execution policies.

Incidentally, with regard to the Payment for Order Flow (PFOF), as no cases involving the PFOF have been found in Japan and deliberations are underway in the United States regarding the review of the relevant regulations, it was decided to take measures appropriately and flexibly, including the imposition of legal regulations, as necessary in accordance with the future trend and changes in the circumstance.

Based on the ideas presented in the Report, JFSA will make preparations for system introduction, including the development of related government orders, etc.

Column 12: Progress Report on Enhancing the Asset Management Business 2021[16]

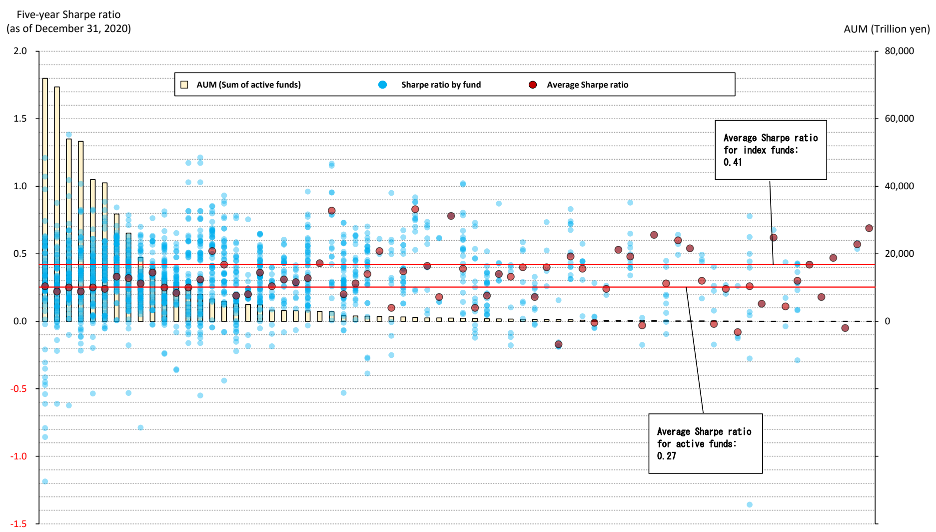
In order to create a virtuous cycle of capital and render the fruit of enhanced corporate value and profit to households, it is important for all participants of the investment chain, including distributors, etc., not limited to asset management firms, to sufficiently fulfil their roles and enhance the asset management business.

Accordingly, in June 2021, JFSA published the Progress Report on Enhancing the Asset Management Business 2021, which compiles the results of dialogues with asset management firms and future directions. The Report points out that asset management firms' efforts can be observed for developing a governance structure to prioritize customers' interests, establishing a management structure that enables long-term-investment-value-oriented business conduct, and clarifying the corporate vision, but also suggests the need to have those efforts actually bear fruit, such as an increase in returns and expansion of assets under management. Additionally, the Report picks up the following issues regarding investment performance and cost.

(1) Performances of asset management firms' publicly offered active funds[17]

Some other asset management firms with a large number of funds and large AUM have many funds with Sharpe ratios[17] lower than the average of index funds.[18]

(Figure 1) AUM and fund performance by asset management firm
(arranged from left to right in descending order of the AUM)



(Source) Prepared by JFSA based on QUICK data

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[16] See the main text in II., 4. Stimulating capital markets and smooth capital provision to growing businesses (3) Enhancing asset management business.

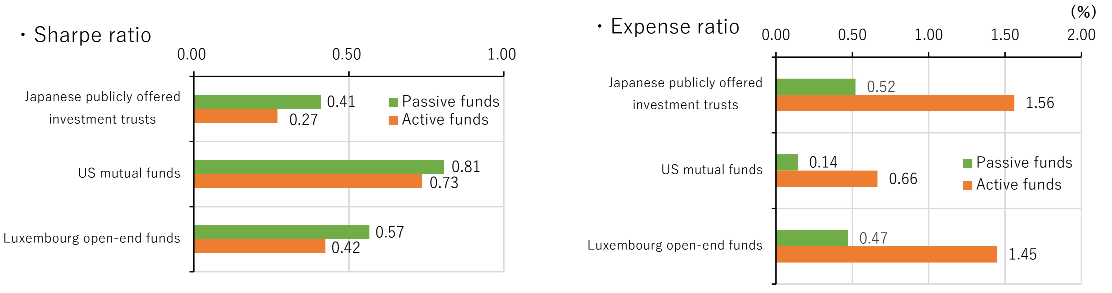
[17] An index fund is also called a passive fund, for which passive investing is conducted by selecting issues that move on with a specific share price index. An active fund is a fund aiming to gain a return exceeding an index through discretionally selecting issues (active investing)

[18] An indicator to measure a return of an investment per unit of risk (standard deviation) during a specific period of time

(2) International comparison of funds' performance cost

In international comparison, US mutual funds have an advantage in terms of both the Sharpe ratio and the expense ratio[19], irrespective of being passive funds or active funds.

(Figure 2) Comparison between passive and active funds

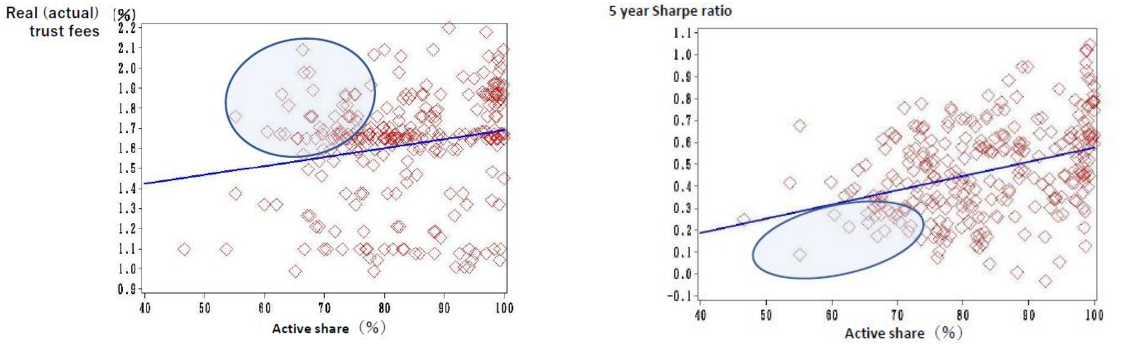


(Source) Prepared by JFSA based on data provided by QUICK and Ibbotson Associates Japan

(3) Product governance: problem of closet trackers

It has been pointed out that there are problems of closet trackers that advocate policies of active investing and collect high trust fees but actually managed in almost the same manner as index funds. Trust fees are high for the funds with low active shares[20] and there are some funds with relatively low Sharpe ratios (parts circled with blue lines in Figure 3).

(Figure 3) Closet tracker issues - a discrepancy between investment policy and actual portfolio management



(Note) Data based on funds with a five year performance track record as of the end of 2020 among domestic publicly offered investment trusts investing in Japanese equities (275 funds in total) Benchmark: TOPIX

(Source) QUICK

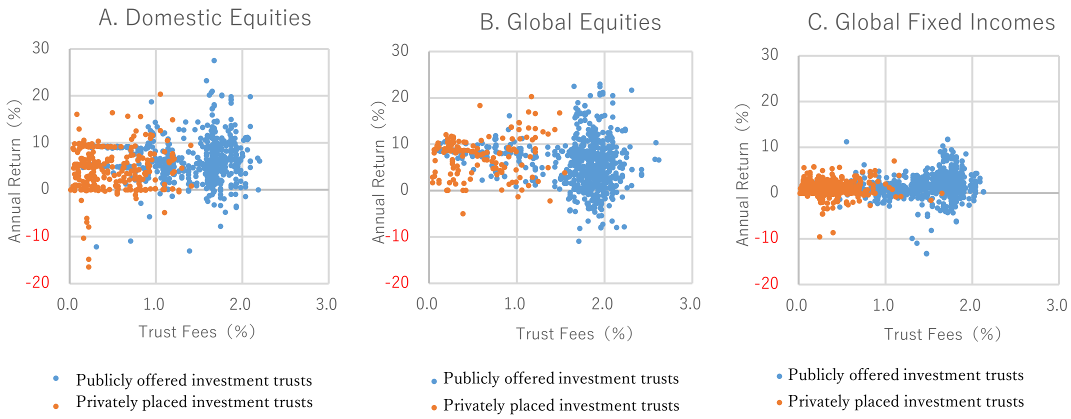
19 An indicator to measure the ratio of management fees and other expenses against the average total assets of investment trusts (funds)

20 An indicator to show the disparity from the index (benchmark) of actual management of issues held by a fund and their weights; An active share is low for investing in line with the index (passive investing) (0% in the case of completely same portfolio constituents and individual stock weights.), and an active share becomes larger for discretionary investing (active investing) further apart from the index.

(4) Comparison between publicly offered investment trusts and privately placed investment trusts

Per a comparison of publicly offered investment trusts and privately placed investment trusts, the trust fees of privately placed investment trusts are generally lower, and their annual returns vary less than those of publicly offered investment trusts. Efforts for improving fund performance for publicly offered investment trusts are required, by improving investment efficiency and controlling costs.

(Figure 4) Performance comparison between publicly offered investment trusts and privately placed investment trusts

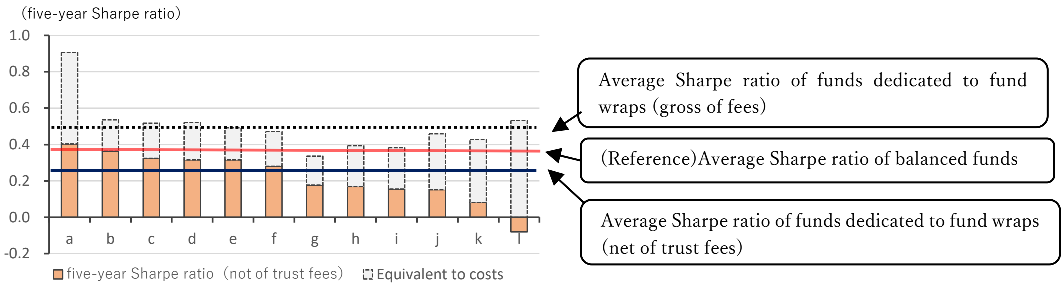


(Source) QUICK, Prepared by JFSA based on documents submitted by major asset management firms with larger AUMs of private placement investment trusts

(5) Fund wraps

In addition to fund wrap fees the costs charged to fund wrap customers include the fees for discretionary contracts and also trust fees for underlying investment trusts to invest in. Overall, the average performance after deducting these fees is inferior to that of balanced funds.

(Figure 5) Five-year Sharpe ratio for funds dedicated to fund wraps



(Source) Japan Investment Advisors Association , Prepared by JFSA based on Quick Data

Column 13: Financial services providers' efforts regarding customer-oriented business conduct[21]

JFSA developed and published the "Principles for Customer-Oriented Business Conduct" with the aim of providing better financial instruments and services for achieving people's stable asset building, and has had dialogues with financial services providers, conducted surveys, and broadly provided information. As distributors have come to be aware of the necessity of customer-oriented business conduct, customers purchasing investment trusts, mainly installment investment trusts, are increasing and the focus in the performance evaluation system has been shifting from revenues at the time of sales to outstanding assets on deposit (Figure 1).

However, it seems that customers do not necessarily recognize such changes in financial services providers' policies, and distributors' outstanding assets on deposit as a whole have remained unchanged, which suggests that financial services providers' efforts have yet to bear fruit (Figure 2). Additionally, as mentioned in the Report by the Working Group on Financial Markets, Financial System Council, which was published in August 2020, there is room for improvement in individual financial services providers' policies for achieving the Principles. JFSA also conducted a customer survey to check the awareness and behavior of financial services providers' customers in their asset management. As a result, it was suggested that if financial services providers offer regular follow-up services, not limited to services at the time of selling financial instruments, this may create an opportunity for customers to understand the significance and effect of long-term investment and may also lead to better services to support customers' investments in line with their ideas and needs.

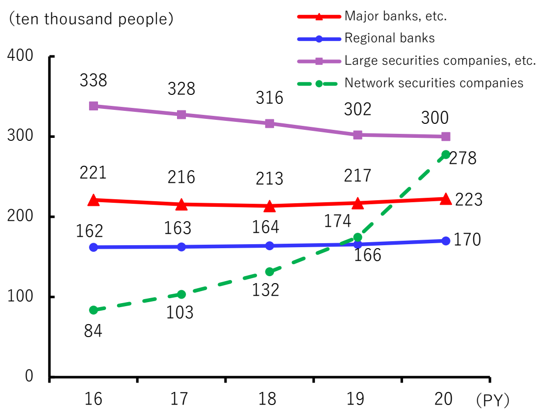
JFSA compiled the following four key points for future monitoring based on dialogues with distributors and analysis of data in PY2020.

The first is how individual financial services providers will materialize their policies and progress in KPIs that they have disclosed in a manner beneficial to customers based on the Principles. The second is whether important information and sales processes are disclosed to customers based on individual financial services providers' policies. The third is how to evaluate the performance of sales personnel in a manner to motivate them to perform customer-oriented business conduct. The fourth is the importance of reviewing business strategies to balance customer-oriented business conduct and operational sustainability.

[21] See the main text in II., 5. Disseminating user-oriented financial services (1) Customer-Oriented Business Conduct.

JFSA considers it significant to ascertain financial services providers' provision of services from a macro perspective and what financial instruments and services they will provide to what types of customers (to wealthier customers and to customers who are building their assets, for example) as a result of the adoption of those business strategies.

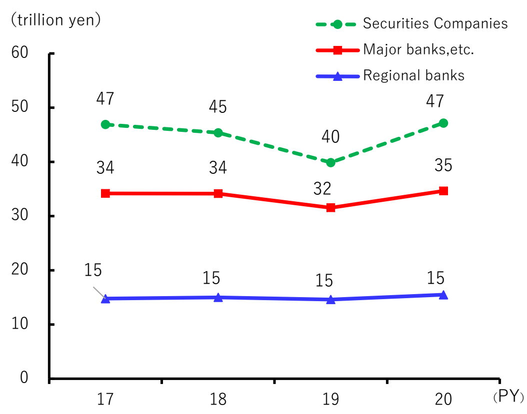
(Figure 1) Changes in the number of customers holding investment trusts



(Note 1) Data from 9 major banks, etc., 26 regional banks, 8 large securities companies, etc. (7 large securities companies, etc. due to a business merger for PY2020), and 4 network securities companies was aggregated.
(Note 2) For the number of customers holding investment trusts for banks, on the basis of their own sales
(Note 3) Individual customers with assets on deposit as of the end of each program year are covered.

(Source) JFSA

(Figure 2) Outstanding assets on deposit for risk-involving financial instruments



(Note 1) Aggregated data from 8 major banks, etc. 21 regional banks, and 7 securities companies (6 securities companies due to a business merger for PY2020), from which valid responses were obtained
(Note 2) For banks, on a combined basis of their own sales, sales through brokers, and referral sales
(Note 3) Risk-involving financial instruments refer to single premium policies, investment trusts, fund wraps and bonds.

(Source) JFSA

Column 14: Financial and economic education[22]

JFSA has promoted the provision of digital contents and other financial and economic education initiatives using ICT for a wide range of age classes as the COVID-19 has brought about constraints on JFSA officials' face-to-face school classes. Introduced here are three contents JFSA created in BY2020.

(1) "Unko Money Drill" content for elementary school students (Figure 1)

JFSA officials have so far visited universities and senior high schools to give lectures. In a bid to lead younger students to become interested in financial matters, JFSA cooperated with the Unko Drill series,[23] which is known for its high popularity among children, to develop "Unko Money Drill (Life)" (Unko Drill × JFSA), content to help elementary school children enjoy learning about money on the Internet, publishing the content in March 2021. In developing the content, relevant JFSA officials chose money-related everyday life events that elementary school children are likely to experience and set up interesting choices suitable for the playful Unko Drill, including wrong choices inducing laughter. They accumulated talks to devise the content for enjoying learning. In the current business year, JFSA plans to publish "Unko Money Drill (Society)" as the second content for elementary school children.

(2) Videos for senior high school students and teachers (Figure 2)

Anticipating the lowering of the age of adulthood and the implementation of new school curriculum guidelines including expanded descriptions on finance in April 2022, JFSA developed and distributed class videos for senior high school students and commentary videos for teachers. In class videos for senior high school students, six topics are explained in 10 minutes each, including family budget management, asset building and financial troubles.

(3) "JFSA Tell Me Series" video for younger people (Figure 3)

University professors and other experts created commentary videos for the "JFSA Tell Me Series" made available on the JFSA website and the JFSA YouTube channel. Experts provide 10-minute easy-to-understand explanations about how to deal with money or build assets for the future from their respective viewpoints.

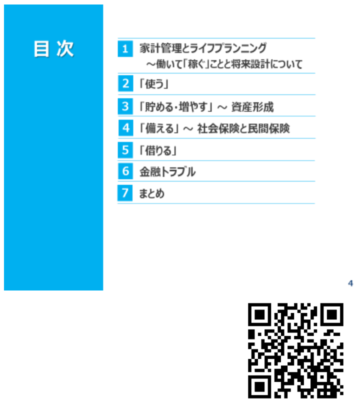
[22] See the main text in II., 5. Disseminating user-oriented financial services (2) Promoting stable household asset building and enhancing financial literacy.

[23] "Unko Drill" is a series of learning drills including "unko" ("poop") in all questions, published by Bunkyosha Japan. The series includes Japanese language, numbers and English drills for elementary school children as well as preschoolers. The series has sold 8.2 million copies.

(Figure 1)
Unko Money Drill

(Source) JFSA

(Figure 2)
Videos for senior high school students and teachers



(Source) JFSA

(Figure 3)
JFSA Tell Me Series

(Source) JFSA

Column 15: Spread of NISA[24]

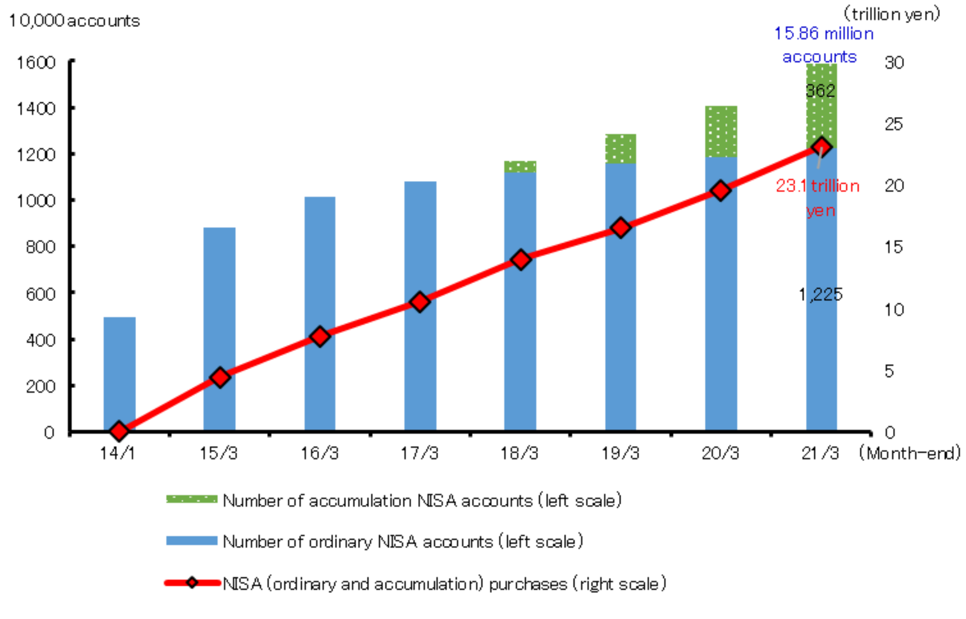
In Japan, cash and deposits have continuously accounted for the majority of household assets, with household asset growth limited to low levels. An effective way to promote the stable building of household assets is to encourage people to accumulate diverse investments over a long term. To support the stable building of household assets, JFSA has tried to diffuse and promote the Nippon Individual Savings Account (NISA) tax incentive system, particularly the accumulation NISA.

According to a questionnaire survey, the recognition rate for the accumulation NISA system rose by 3.9 percentage points year on year to 64.6%. The recognition rate for details of the system came to 23.2%, up 4.3 points.

At the end of March 2021, the number of ordinary and accumulation NISA accounts came to about 15.86 million, with purchases totaling about 23.1 trillion yen, indicating a steady diffusion (Figure 1).

(Figure 1)

Trends in the number of NISA (accumulation and ordinary) accounts and purchases



(Note) The number of accounts and purchases from the end of March 2018 cover ordinary and accumulation NISA accounts after the accumulation NISA was launched in January 2018.

(Source) JFSA

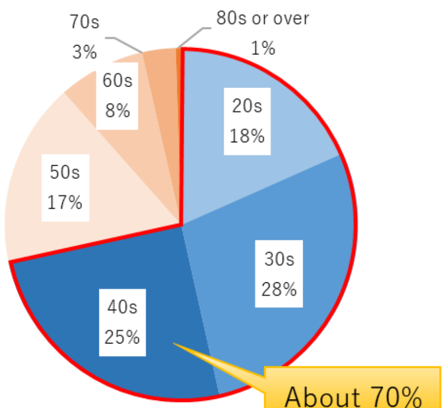
[24] See the main text in II., 5. Disseminating user-oriented financial services (2) Promoting stable household asset building and enhancing financial literacy.

Between January 2018 and March 2021, about 3.62 million accumulation NISA accounts were opened with purchases totaling about 901.2 billion yen. A total of 4.69 million ordinary and accumulation NISA accounts were opened during the period. Opened in the year to March 2021 were about 380,000 ordinary NISA accounts (representing an increase of 3.3%) and about 1.42 million accumulation NISA accounts (an increase of 64.6%). The accumulation NISA system made such great contributions to an increase in the total number of NISA accounts.

A breakdown of NISA account holders by age bracket indicates that those in their 20s to 40s accounted for about 30% of ordinary NISA accounts and for about 70% of accumulation NISA accounts at the end of March 2021 (Figure 2). People in their 30s posted the largest growth in the number of accumulation NISA accounts, suggesting that a new layer of investors including young people has been expanding through the accumulation NISA system (Figure 3).

(Figure 2)

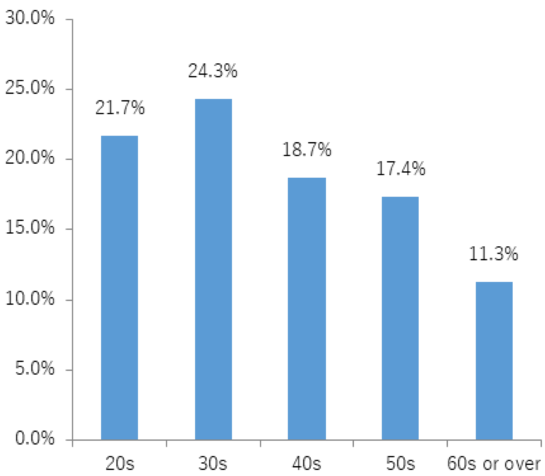
Accumulation NISA account holders (by age bracket)



(Source) JFSA

(Figure 3)

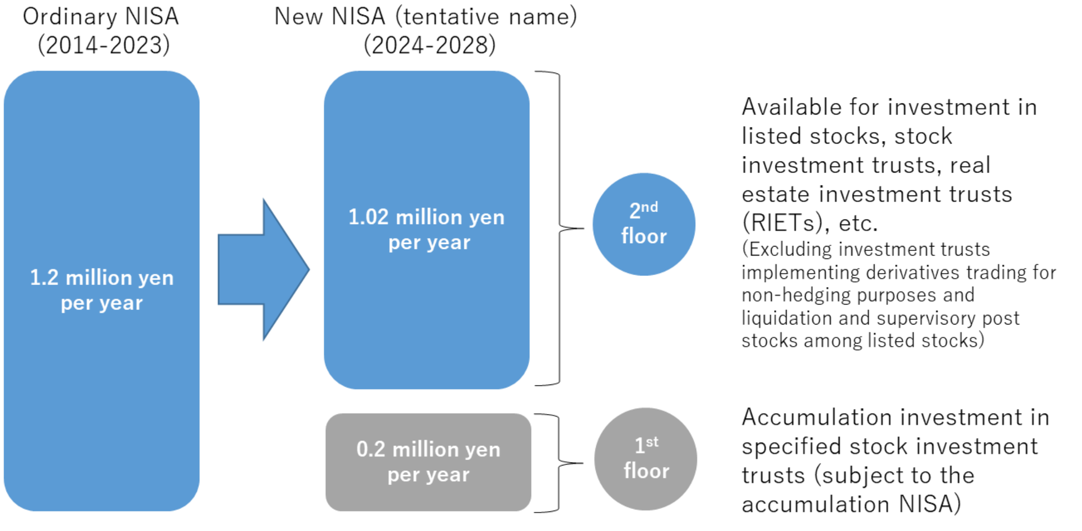
Accumulation NISA account growth rate by age bracket (from December end 2020 to March end 2021)



(Source) JFSA

The FY2020 tax reform included the extension of the accumulation NISA system and a measure to revise the ordinary NISA system into a two-floor system to allow tax-free investment on the second floor for investors using the accumulation NISA system on the first floor from 2024 in order to encourage more people to experience accumulated and diverse investments. Investment targets for the first floor will be the same as for the accumulation NISA. Targets for the second floor will exclude the following from ordinary NISA accounts (i) investment trusts implementing derivatives trading for non-hedging purposes and (ii) liquidation and supervisory post stocks among listed stocks (Figure 4). The FY2021 tax reform includes a measure to simplify NISA procedures. JFSA will continue to promote the diffusion of the NISA system.

(Figure 4)Overview of new NISA system



(Source) JFSA

Column 16: Analysis report on IT system failures in the financial sector[25]

In June 2021, JFSA published "Analysis report on IT system failures in the financial sector,"[26] which compiles causes and countermeasures for characteristic IT system failures accompanying digitalization.

The report is designed to be used by financial institutions for strengthening IT risk management from the viewpoints of financial system stabilization and customer protection.

The report analyzes causes for and lessons from IT system failures reported between April 2020 and March 2021, focusing on when system failures had occurred (Figure 1).

(1) IT system failures accompanying system integration or renewal

Under large-scale projects for integrating or renewing core banking systems and transitioning to cloud services, system failures have occurred due to a lack of understanding about specifications for older systems. Lessons from these failures include the development of information technology assets, such as system specifications and work procedure manuals, as well as the cultivation of information technology personnel.

(2) IT system failures arising from program update or unusual special operations

Numerous IT system failures arising from unusual special operations, such as system changes, were seen. One of the lessons from these failures is that system operators failed to anticipate potential failures, falling short of identifying risks sufficiently.

(3) IT system failures occurring during routine operations and maintenance

There were multiple system failures in which redundancy configuration prepared for hardware breakdowns, etc. failed to work as intended. Lessons from these failures include the preparation of measures responding to a failure to switch to a subsystem and the acceleration of system failure detections and responses to ensure the continuation of key business operations.

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[25] See the main text in II., 6. Preparing for potential risks (3) Strengthening IT risk management.

[26] Based on the Comprehensive Guidelines for Supervision, etc., JFSA receives reports on actual system failures from financial institutions, checks the status of recovery from such failures at these institutions, interviews them and takes their reports on causes of failures and improvement measures that they analyzed and considered.

(4) Intentional conduct including cyberattacks and fraudulent access

There were numerous cases in which offenders conducted illegal transactions by taking advantage of personal identification systems to link bank and cashless payment service accounts.

Offenders also made illegal access to online transactions mainly at financial instruments business operators.

To prevent illegal transactions, financial institutions are required to introduce effective personal identification measures, such as multifactor authentication, in line with specific services and risk characteristics and to develop arrangements for the preparation and implementation of compensation policies and faithful consultations with customers to secure the protection of customers in the event of illegal transactions.

(Figure 1) Overview of IT system failure trends and lessons

Timing of incidence	Characterization of failures	Lessons, responses, etc.
(1) Accompanying system integration/update	Falling short of understanding specifications of old systems	✓ Resolving human resource shortages arising from aging of legacy system experts ➢ Developing IT assets and human resources
(2) Arising from program update and unusual special operations	(i) Falling short of considering effects of operations (ii) Setting and operational misses	✓ Improving work quality ➢ Implementing reviews attended by experts who can overview the entire system ➢ Enhancing work procedure manuals anticipating various situations
(3) Occurring during routine operations and maintenance	(i) Third party-provided services, etc. (ii) Failures in which redundancy configuration fails to work	✓ Improving effectiveness of BCP/CP (business continuity plan/contingency plan) ➢ Securing alternative means anticipating system failures and maintaining information cooperation with third parties ➢ Preparing measures to continue key business operations and accelerating failure detections and responses
(4) Intentional conduct, including cyberattacks and fraudulent access	(i) Incidents involving personal identification systems	✓ Illegal conduct prevention measures, including introduction of effective personal identification systems ✓ Securing safety using multifactor authentication and other measures meeting details and risk characteristics of services
	(ii) Incidents involving security of services provided by cloud service providers	✓ Improving measures to counter illegal access for cloud services ➢ Developing arrangements to acquire knowledge about cloud service specifications and update information and collect information

(Source) JFSA

III. Further develop JFSA's financial policy

Column 17: Major past "Open Policy Lab" activities[27]

In the BY2020 Open Policy Lab, 13 teams covering a total of more than 100 officials participated. The following introduces major projects:

(1) Regional Solutions Support Team

The Regional Solutions Support Team identifies regional facts and problems through networks such as Regional Finance Meeting, a club for exchanges between national and regional public servants and financial institution officials, accumulates dialogue with regional stakeholders and works out specific policy measures to solve problems. Regional dialogue has produced specific policy measures, including the computerization of special guarantee certification and other processes for COVID-19 loan procedures in Yamagata and Ishikawa Prefectures and cooperation between local governments and financial institutions in utilizing side-job workers in Fukushima Prefecture.

In order to link the team's activities to the development of regional economic eco-systems and networks, JFSA created the Regional Solutions Support Office[28] in July 2019 to accumulate and publish collected information and knowhow and reflect them in policy measures.

❶Regional Finance Meeting

・Voluntary public servants and financial institution officials are permanently linked to each other through social networking services and meet several times annually for their exchange.

(Source) JFSA

❷Regional dialogue meeting

・Small regional groups of stakeholders with common awareness meet for discussion.

・Industry, academia and government stakeholders consider how to resolve specific regional issues.

(Source) JFSA

❸Planning/scheme consideration

・As specific policy measures are drafted through regional dialogue meetings, JFSA officials and dialogue stakeholders work on relevant organizations to realize the draft measures.

(Source) JFSA

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[27] See the main text in III., 2. Improvement of organizational capability as the financial authority (2) Placing priority on self-motivated initiatives.

[28] Renamed "Better Regional Finance Office" in July 2021.

(2) Oral History of Financial Administration

In July 2020, JFSA marked its 20th anniversary. During the two decades, JFSA addressed various challenges, including the domestic financial crisis, the global financial crisis, the Great East Japan Earthquake, the sustainment of the low interest environment, falling birthrates and aging population, and digitalization. In order to learn lessons from experiences with these challenges, JFSA has interviewed its former officials who faced and tackled these challenges, publishing their remarks as the Oral History of Financial Administration. Such interviews will be continuously conducted and added to our website, the Oral History.

Column 18: Overview of research papers by JFSA officials[29]

JFSA has encouraged its officials to voluntarily study and write papers on issues facing financial administration. In BY2020, the following research papers were authored and published.

(1) An analysis of the transaction network in the Japanese OTC derivatives markets

G20 Leaders, at the 2009 Pittsburgh Summit, agreed that over-the-counter (hereinafter referred to as OTC) derivatives trade (transactions) contracts should be reported to trade repositories. JFSA implemented OTC derivatives trade (transactions) reporting requirements in 2013, mandating market participants, including financial instruments business operators and central counterparty clearing houses, to report their OTC derivatives transactions.

The authors aim to clarify market features of the OTC derivatives in Japan by analyzing transaction networks based on reported data using metrics in graph theory.

They found that the OTC derivatives markets in Japan have small-world features[30] and a sparse network structure[31] in common with all product markets. However, in the OTC derivatives market where foreign exchange is the underlying asset, the core players who act as the hub of market transactions have higher clustering coefficients[32] than the average of the entire market, indicating that the core players' involvement in the market may differ relatively depending on the product category of the underlying asset.

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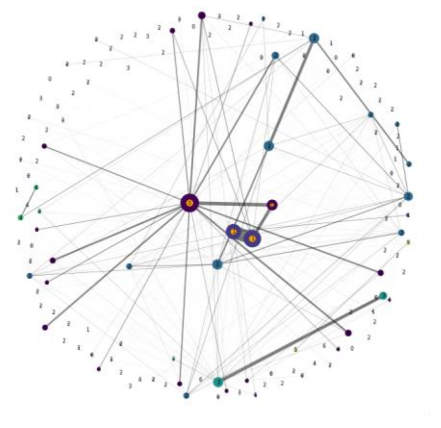
[29] See the main text in III., 2. Improvement of organizational capability as the financial authority (2) Placing priority on self-motivated initiatives.

[30] The small world characteristics are seen in real world complex networks (including friendship, the Internet and joint authorship), indicating that the average node distance is far smaller than the number of nodes for a network.

[31] The sparse network structure means that a trading network structure based on a network density (showing the extent to which market participants are linked to each other in a trading network) is sparse.

[32] The clustering coefficient indicates how closely market participants are linked to each other locally within a network.

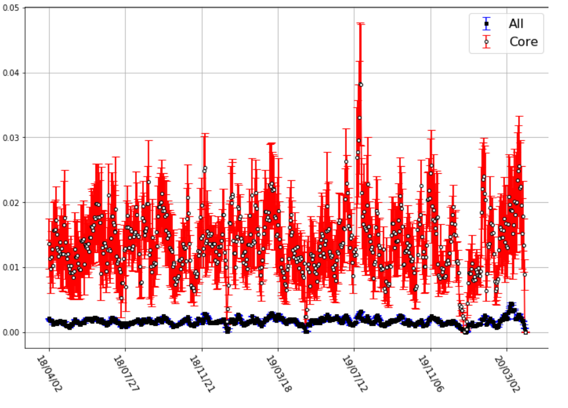
(Figure 1) Trading network structure regarding OTC credit market



Node sizes are proportionate to the sum of assumed principals for trading participants, edge widths reflect the sum of assumed principals of transactions between market participants. Vertices with an orange inner circle indicate core players, while the color of each vertex, or the outer color surrounding an orange circle in the case of a core player indicates the community to which each vertex belongs.

(Source) Paper (1)

(Figure 2) Betweenness centrality of trading network regarding OTC credit market



The red line indicates the average for core players, while the blue line shows the average for all market participants.

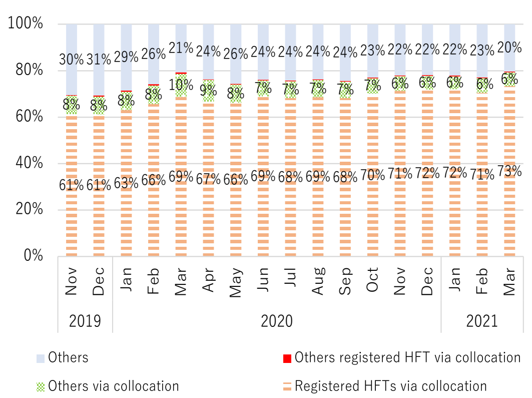
(Source) Paper (1)

(2) Analysis of high frequency trading characteristics

The author analyzed the characteristics of high-speed trading by market participants registered as high frequency traders (HFTs) under the Financial Instruments and Exchange Act, using cash trading data for some 4,000 issues on 343 market days between November 2019 and the end of March 2021.

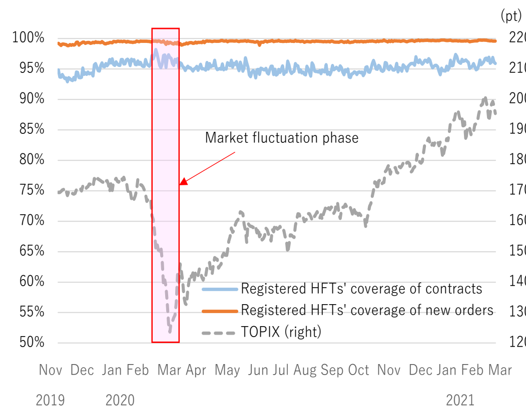
The analysis indicated [1] that registered HFTs use high frequency trading for most high-speed trading while limiting market orders, [2] that registered HFTs' high-speed trading accounted for about 70% of trading orders, about 40% of trading value and more than 80% of immediate or cancel (IOC) orders (with instructions to immediately fill part or all of each order at limited or more favorable prices and cancel any part failing to be filled) on the Tokyo Stock Exchange during the analysis period, and [3] that registered HFTs' high-speed trading did not differ by market conditions but covered as much as 98% of all issues even during a major change (a global stock market decline under the serious impact of COVID-19 in March 2020), providing spread liquidity (contributing to narrowing quotation spreads).

(Figure 3) Number of orders via collocation and registered HFTs



(Source) Paper (2)

(Figure 4) Registered HFT coverage (contracts, new orders) and TOPIX trend



(Source) Paper (2)

* For details of the papers, see: https://www.fsa.go.jp/frtc/report/index.html.
* The papers represent personal views of authors rather than official views of JFSA or the JFSA Financial Research Center.