

Summary Points from
Strategic Directions and Priorities
2017-2018



Financial Services Agency

November 2017

The JFSA's annual *Strategic Directions and Priorities*

- The Financial Service Agency (JFSA) annually publishes the *Strategic Directions and Priorities* to clarify its policy goals for each program year since 2015.
- The JFSA is committed to continuous enhancement of the quality of regulation and supervision through the PDCA cycle. The *Strategic Directions and Priorities* corresponds to the “Plan” stage, and, after the completion of each program year, the JFSA reviews the progress made and identifies the remaining tasks and emerging issues. The findings are summarized in the *Progress and Assessment of the Strategic Directions and Priorities* in the “Check” stage.
- The JFSA published the *Progress and Assessment of the Strategic Directions and Priorities 2016-2017* in October 2017. For the program year 2017, the JFSA issued the “*Strategic Directions and Priorities 2017-2018*” in November 2017, marking the start of another round of the Plan-Do-Check-Act cycle. The following pages present the JFSA's key policy goals for the program year 2017.

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I. Mission and reforms

- The JFSA's mission is to contribute to the national welfare by securing sustainable growth of national economy and wealth through achieving the following three sets of goals :
 - i. Financial stability and effective financial intermediation;
 - ii. Consumer protection and consumer benefit; and
 - iii. Market integrity and market vigor.

- For the JFSA staff to accomplish its mission above, the JFSA will reform its :
 - i. Culture;
 - ii. Governance;
 - iii. Organizational structure; and
 - iv. Supervisory approaches.

II-1. Reform of the JFSA

Cultural reform : JFSA staff's proactive contribution to the national welfare

- Reform performance review to encourage staff's proactive contribution to the national welfare.
- Foster a new generation of leaders through merit-based promotion rather than seniority-based one.
- Develop high degrees of expertise for the JFSA staff and recruit more expertise.

Governance reform : Open to suggestions and criticisms from the outside

- Improve JFSA's policies and their evaluation reflecting advice of the Expert Panel on Policy Evaluation. The panel serves the function as an advisory board of the JFSA.
- Evaluation of financial regulation and supervision by a consulting firm.
- Shape a system to hear suggestions and criticisms from the outside.
- Enhance transparency of the JFSA through providing more information and bringing up issues.

Reform of organizational structure : Resilient to new challenges

- Enhanced strategy development with holistic perspectives.
- Development of regulatory framework in line with IT and other innovation.
- Continuous monitoring of regulated entities through off-site and on-site.

II-2. New supervisory approaches

- Realize a new supervisory approaches of “substance”, “Forward-looking” and “Holistic view”.

From *the Form* to *the Substance*

Focusing on whether minimum standards being formally met



Focusing on whether high-quality financial services (best practices) are being provided

From *the Past* to *the Future*

Focusing on checking soundness at times in the past



Focusing on whether sustainability of soundness are ensured in the long run

From *Element by element analysis* to *Holistic analysis*

Focusing on responding to specific individual problems

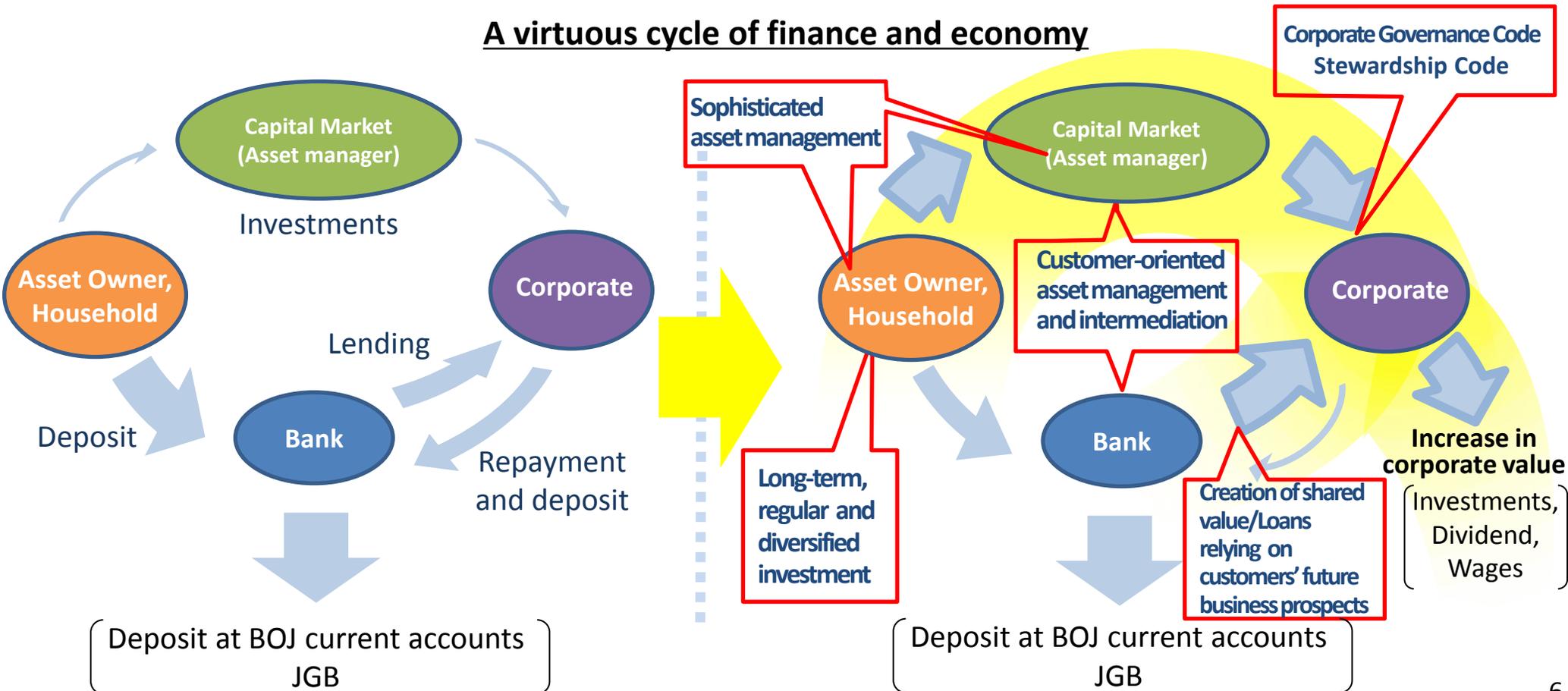


Focusing on whether responses to truly important problems are successful from the whole business point of view

- The JFSA published “JFSA’s supervisory approaches –Replacing checklists with engagements –” in December 2017. The main points in the report are:
 - ✓ Striking the right balance between rule-based and principle-based supervision;
 - ✓ Promoting financial institutions to pursue best practices;
 - ✓ Encouraging financial institutions to provide more information on their initiatives to consumers;
 - ✓ Shifting from static regulation to dynamic supervision; and
 - ✓ Developing good governance that is open to suggestions and criticisms from outsiders.
- The JFSA and the Local Finance Bureaus will pursue more efficient, speedy, and transparent registration processes.

III. Holistic approach for contemplating better financial flow

- It is vital for the JFSA to timely address new challenges to emerge.
 - The JFSA will analyze policy issues to present policy options, examining (a) whether the flow of funds is at the optimum throughout the economy, and (b) how to achieve better equilibrium.
 - The JFSA will, in a holistic and forward-looking manner, examine the financial flow through discussions in various advisory groups and reflecting opinions of experts.



IV-1. Financial institutions and households

(a) Customer-oriented asset management and intermediation

- The JFSA published the Customer-Oriented Business Conduct Principles in March 2017. To encourage financial institutions to adhere to the Principles, the information on each financial institution's initiatives will be publicly shared.

The JFSA will:

- Publish KPIs comparable across financial institutions (e.g., whether respective financial institutions provide financial products that yield reasonable return proportional to risks and fees in the long term);
- Monitor and publish overall trends and best practices of financial institutions' initiatives; and
- Attempt business analysis on whether financial institutions' business model with so many sales persons aggressively searching for commissions from customers is compatible with the customer-oriented business conducts .

IV-1. Financial institutions and households

(b) Long-term, regular and diversified investment for households

- From January 2018, a new tax incentive scheme (Dollar-Cost Averaging NISA) will be introduced. To promote the new NISA, the JFSA will :
 - Focus on workplaces as an initial foothold for those who have not engaged in regular investment (*Introduction of Workplace Dollar-Cost Averaging NISA*), and, in parallel, ensure that this initiative would widely be practiced by other ministries, local governments, and private enterprises
 - Enhance financial literacy of employees, in the initiative above; and
 - Utilize new information channels including internet blogs and SNS.

(c) Financial services for retired generation

- Approximately 60% of household financial assets are held by those age 60 and older.
 - The JFSA will consider how the retired generation manage financial assets to live a quality life and how financial industry can contribute to that.

IV-2. Institutional investors and market surveillance

(a) Boosting further corporate governance reform

- Corporate governance reform has been progressed, with the two established codes: the Stewardship Code in February 2014 (and revised in May 2017) and the Corporate Governance Code in 2015.
- Meanwhile, it has been pointed out that resolute management decisions being conscious of capital cost are rarely found and retained earnings are piled up.

To breakthrough such a situation, the JFSA will:

- Draft a guidance for communication between institutional investors and investee companies, aiming at encouraging governance and management for increase in corporate value in the long term; and
- Consider measures to enhance expertise of asset owners.

IV-2. Institutional investors and market surveillance

(b) Enhancing market surveillance

- Financial market structure is changing rapidly. New types of financial instruments and trading are emerging one after another, and FinTech is advancing.

Given these environmental changes, the Securities Exchange Surveillance Committee will:

- Engage in market surveillance with a forward-looking approach based on timely market data collection and analysis from a macro viewpoint to detect and prevent problems at early stage;
- Carefully monitor and address what is happening in the market so as not to leave any room uncovered in market surveillance;
- In reaction to illegal behaviors, understand the whole picture of the problems and point out their root causes, for recurrence prevention; and
- Consider introduction of a new market surveillance system equipped with AI data analysis.

V-1. Regional banks

(a) Are the business models of regional banks sustainable?

The JFSA will :

- Conduct on-site monitoring of those regional banks with serious challenges on the sustainability of their business models, and urge them to take actions promptly;
- Publish comparable KPIs across banks which indicate each bank's effort for better financial intermediation. The KPIs will facilitate competition among banks in terms of creating shared value;
- Enhance the function of the REVIC* and the JHR** to support regional banks in terms of human resources and expertise. This will enable the banks to provide further value-added services for the client companies;
- Discuss whether to relax some regulations on the scope of businesses of the regional banks;
- Assess the current conditions regarding the competition between banks and government-run financial institutions and consider their desirable relationship; and
- While obtaining advice from experts, conduct a review of the necessary competition among banks to attain both financial soundness and financial intermediation in the long run. Similarly, consider whether there is a room for revising financial regulation and supervision that currently work for the maintenance of banks' financial function and smoothing banks' exit from the market.

* REVIC : Regional Economy Vitalization Corporation of Japan

** JHR : Japan Human Resources Co., Ltd.

V-1. Regional banks

(b) Addressing changes in global economy and market environment

- The JFSA will continue dialogue for improving banks' risk management in order to maintain their financial soundness in both scenarios of continued low interest rate environment and rise of interest rate.

(c) Improving governance resilient to changes in business environment

- Some banks are too optimistic on their business prospects while some others do not implement a necessary reform despite serious concerns on the sustainability of their business models without effective checks by outside directors and shareholders. Therefore, the JFSA will check and understand the actual situation of their governance and hold dialogues for their reform.

V-2. Three megabank groups

- As three megabank groups expand their overseas business, they are getting more affected by changes in global economy and financial market environment.
- It is vital for the three megabank groups to develop high-quality governance to swiftly address environmental changes, such as technological innovation which alters the traditional sources of competitive power into legacy assets.

(a) Addressing changes in global economy and market environment

The JFSA will promote:

- Risk management promptly responding to the changes through utilizing stress tests;
- Securing stable foreign currency funding and enhancing foreign currency liquidity management;
- Appropriate screening and managing the risks of hybrid finance and real estate loans that have expanded in the low interest rate environment; and
- Addressing the control of their equity risk swiftly through, for example, reducing their shareholding.

(b) Improving governance resilient to changes of business environment

The JFSA will:

- Promote establishing good governance for concentration on core competence in pursue of capital efficiency;
- Promote ensuring the customer-oriented business conducts, with the initiative of the groups' holding companies (e.g., managing group companies' conflicts of interests and preventing the abuse of superior bargaining position);
- Hold dialogues for bold and timely reactions to the technological innovation; and
- Hold dialogues for strengthening information collection and analysis capability, for their organizational reforms and for securing their human resources, given globalization and sophistication of their businesses.

V-3. Insurance companies and securities companies

Insurance companies

- Anticipating shrink of traditional domestic insurance market, it is vital for insurance companies to respond appropriately to longevity and technological innovation.

The JFSA will:

- Hold dialogues with insurance companies over sustainability of their business models and their business strategies, focusing on their critical management issues;
- Respond constructively to new insurance products and services which are developed in response to newly emerging risks;
- Hold dialogues with life insurance companies for enhancing asset management and risk management, and encourage those companies to fulfill their “Stewardship Responsibility”; and
- Hold in-depth dialogues with insurance companies whose governance is ineffective, and monitor large insurance companies about overseas business strategies in the context of their overall management strategies.

Securities companies

- Securities companies need to secure stable revenue base and fiscal soundness, and to address the changes in their business environment.
- Existing business model without proper consideration for customer benefit might be unsustainable.
 - The JFSA will monitor securities companies’ initiatives to establish their customer-oriented and sustainable business models.

V-4. Global regulatory reforms and building global network

Global regulatory reform

- The JFSA has advocated that the global regulatory reform efforts should aim to attain both growth and stability.
 - Based on this principle, the JFSA will contribute to finalization of the Basel III framework in an appropriate and timely manner and to evaluation of the regulatory reform's effects.
- Japanese financial institutions are facing challenges to establish their sustainable business models in the most aging society in the world. Many countries would face similar issues.
 - The JFSA will collaborate with other foreign authorities and share its experience and knowledge, and contribute to overcoming the challenges.

Global network and cross-border cooperation

The JFSA will:

- Work with the UK and European authorities so that Japanese financial institutions will be able to smoothly adjust to Brexit; and
- Expand its technical support to emerging countries in accordance with needs of each country to develop their financial regulatory systems and their expertise, and strengthen the JFSA's global network with foreign regulatory authorities through the Global Financial Partnership Center (GLOPAC) program.

VI-1. Function-based financial system and FinTech

Function-based financial system

- Changes in the circumstances surrounding the financial system:
 - ✓ Unbundling and rebundling of financial services by the development of information technology (IT)
 - ✓ Expansion of shadow banking sector including investment funds
 - ✓ Necessity for the financial system which does not impede the reconstructing of financial institutions' business models
 - ✓ Possible drastic changes to the financial system in the future, triggered by digital currencies

Current financial regulations:

- (a) Similar services but subject to different regulations in each sector
- (b) No common fundamental concepts or rules in the financial field
- (c) Sector-specific rules with provisions not reflecting the development of IT



Points to consider:

- (a) Identical functions and risks subject to the same regulation
- (b) Cross-sectoral common fundamental concepts and rules in the financial field
- (c) Cross-sectoral review of the financial regulations to accommodate changes



The Financial System Council starts the study.

FinTech

The JFSA will:

- Enhance the user convenience and corporate sector's productivity through introducing information technologies to companies' whole process of payment and settlement;
- Promote innovation by both financial institutions and FinTech companies; and
- Strengthen an international cooperation network on FinTech.

VI-2. Cyber security and virtual currencies

Cyber security

- Given the growing risk of cyber attacks, it is an urgent issue for the financial system as a whole to ensure the cyber security.

The JFSA will:

- Through a more inclusive industry-wide exercise (Delta Wall II), upgrade capability of small and medium-sized financial institutions; and
- Encourage large financial institutions to utilize more sophisticated evaluation methods in order to further improve their capability to address cyber security risks.

Virtual currencies

- Recently, split of a virtual currency and high price volatility has been observed in virtual currency markets.

The JFSA will:

- Examine whether virtual currency exchange service providers are equipped with appropriate business operations systems (including IT system risk management), while taking appropriate balance between innovation and consumer protection;
- Monitor virtual currency markets; and
- Closely monitor ICO (Initial Coin Offering) activities and issue necessary warnings for user protection.