The JFSA Strategic Priorities

July 2022 - June 2023

Overcoming Challenges Confronting the Financial system and Building Foundation for Sustainable Growth

金融庁
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Introduction

In the business year 2022, the Japanese Financial Service Agency (JFSA) will focus on the following three areas.

I. Support the Economy and People's Lives for Future Growth

With future prospects remaining uncertain due to the COVID-19 pandemic and the Russian invasion of Ukraine, the JFSA will support the economy and people's lives from the financial aspect and lead the economy to growth. The JFSA will also encourage financial institutions to support their clients' business and to strengthen their business bases.

II. Build the Financial System in which Economic Growth is Achieved by Resolving Social Issues and is Shared with Individuals

The JFSA will improve the financial system in order to facilitate firms to address social issues such as climate change, realizing the digital society and support for start-ups, which would lead the economy to growth. At the same time, the JFSA will promote the shift of individual's financial assets from savings to investment and realize a virtuous cycle in which the fruits of economic growth are widely shared with individuals.

III. Evolve JFSA's Financial Administration Further

Amid significant changes in the domestic and international environment, the JFSA will improve the competence of the staff, enhance data analysis, and strengthen policy communications both domestically and internationally

The JFSA 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 among: [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.

Contents

I. Support the Economy and People's Lives for Future Growth

The COVID-19 pandemic, price hikes accompanying Russia's invasion into Ukraine, the climate change issue, progress in digitalization, the declining and aging population, and other factors have greatly increased uncertainties about future domestic and foreign economies, including financial markets, and rapidly caused structural environmental changes.[1] It is important for the JFSA to respond accurately to these changes and financially support the stability of Japan's economy and national life for future growth.

To this end, the JFSA will take all possible measures to ensure financial institutions' support for companies, including appropriate, swift cash flow support, and will back up financial institutions' initiatives to support the powerful growth of Japan's national and regional economies and their later sustainable growth.

To ensure that financial institutions will perform their financial intermediary functions to support the Japanese economy, the JFSA will develop its dialogues with financial institutions to enhance their business infrastructure, secure their financial soundness and build their sustainable business models based on their customers' perspectives.

1. Support for companies and vitalization of local economies responding to social and economic situation changes

(1) Promoting support for companies further

It is important for financial institutions to provide companies more effectively with appropriate supports meeting the companies' conditions, including appropriate, swift cash flow support for companies facing cash flow difficulties, business improvement or transformation support for those required to adapt to structural economic and social changes, and business turnaround support for those plagued with increasing debt amid the COVID-19 crisis. From this perspective, the JFSA and Local Finance Bureaus will continuously ask stakeholders about financial institutions' support and companies' needs and encourage financial institutions to provide fine-tuned support friendly to companies.

The JFSA will also develop "Projects to Establish Support Systems for Businesses[2]" at the Local Finance

[1] See Column 1: Current financial and economic situation.

[2] Projects for the Local Finance Bureaus to cooperate with the Bureaus of Economy, Trade and Industry in sharing challenges and measures upon offering the support to businesses in each prefecture 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, Regional Economy Vitalization Corporation of Japan (REVIC) and tax accountants).

Bureaus. The JFSA and Local Finance Bureaus will deepen partnership and cooperation with Bureaus of Economy, Trade and Industry and local stakeholders to promote initiatives based on local conditions. The initiatives include responding to locally identified challenges such as business succession and enhanced cooperation in addressing climate change, identifying and considering measures for local areas within each prefecture, and ensuring the effectiveness of existing ecosystems for supporting businesses.

Furthermore, to promote financial institutions' support for business turnaround, the JFSA will support the formulation of business turnaround plans based on the Guidelines for Business Revitalization, etc. of Small and Medium sized Enterprises[3] and follow up on guaranteed debt consolidation based on the "Basic Perspectives of 'Guidelines for Personal Guarantee Provided by Business Owners' in the Event of the Closure of a Business".[4] In addition, the JFSA will encourage financial institutions to utilize equity funds by REVIC[5] and Organization for Small & Medium Enterprises, and cooperate with SME Revitalization Support Committee and other support organizations.

Additionally, the JFSA will encourage financial institutions to develop arrangements for responding to disasters in peacetime, considering the status of natural disasters, such as large-scale earthquakes and rainstorms in recent years. When disasters occur,[6] the JFSA will consider the actual situations in the disaster-affected areas and closely cooperate with the Local Finance Bureaus and other relevant organizations in encouraging financial institutions to identify disaster-affected people's needs quickly, accurately and sufficiently, and provide fine-tuned support for them.

(2) Improving business support capabilities towards revitalizing local economies

It is important for regional financial institutions that support local economic growth to take advantage of their local networks to fulfill their roles. The JFSA and Local Finance Bureaus need to encourage partnership and cooperation among local stakeholders engaging in support for companies and back up regional financial institutions' improvement of business support capabilities in view of structural economic and social changes.[7]

To this end, the JFSA will enhance business support capabilities of the regional financial institutions

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3 This is a voluntary guideline published in March 2022 by a study panel on business turnaround of small and medium enterprises with the secretariat at the Japanese Bankers Association. It indicates a basic concept of business turnaround and provides for voluntary liquidation procedures for business turnaround of small and medium enterprises as new quasi-regulatory voluntary liquidation procedures that may allow SMEs to launch business turnaround more swiftly.

4 The basic concept was published in March 2022 by a study panel on guidelines for personal guarantee provided by business owners with the secretariat at the Japanese Bankers Association. Focusing on the time of SME closures, it considers the securement of business discipline at SMEs and specifies the purpose of the "Guidelines for Personal Guarantee Provided by Business Owners" that provide voluntary, autonomous regulations on responses of SMEs, business owners and financial institutions to the current personal guarantee provided by business owners.

5 Regional Economy Vitalization Corporation of Japan

6 Including stages where disasters are likely in line with a Disaster Relief Act amendment that took effect in May 2021.

7 See **Column 2**: Progress report on the Efficiency of Financial Intermediation.

through encouraging them to share their know-how with each other. In addition, the JFSA will promote research on the potential utilization of AI technologies for prioritizing client companies for business improvement support according to specific challenges faced by these companies. To ensure that regional financial institutions' staff members can smoothly launch support for companies regardless of whether they have sufficient experience, the JFSA will also consider developing business support methods appropriate for respective industries, with a focus on industries where needs for business support are likely to arise, based on the knowledge of experts.

Furthermore, the JFSA will back up regional financial institutions' non-financial business support. Specifically, to promote matching between suitable management professionals and local companies, the JFSA will enhance and expand REVIC's human resources platform and implement a human resources concierge project to provide consulting services, find facts and implement communication services regarding financial institutions' matching between their client companies and management professionals. In addition, in order to back up regional financial institutions' initiatives to offer digitalization support to their client companies, the JFSA will, in collaboration with relevant government agencies, inform financial institutions of various subsidization projects. When financial institutions seek prior consultations on the utilization of the revised Banking Act for digitalization support or other purposes, the FSA and Local Finance Bureaus/Offices will quickly respond to them and give consultations in an integrated manner.

(3) Establishment of lending practices that do not depend on personal guarantee provided by business owners

The Grand Design and Action Plan for a New Form of Capitalism (Cabinet Decision on June 7, 2022) describes the fostering of startup companies as the key to promoting the Japanese economy's dynamism and growth and resolving social challenges. From this perspective, the JFSA will cooperate with relevant government agencies to promote financial institutions' startup loans free from any requirement for personal guarantee by business owners, supporting startups' fundraising in Japan.

Regarding not only startup loans but also other loans in general, the JFSA has so far promoted financial institutions' loans that do not rely on personal guarantee, by publishing data of the utilization of the "Guidelines for Personal Guarantee Provided by Business Owners," the percentage share for new loans that do not rely on personal guarantee and the percentage share of guarantee requests at the time of business succession. Given that the establishment of lending practices that do not rely on personal guarantee by business owners is an important challenge, the JFSA will take all possible measures for the establishment. If personal guarantee by business owners is required, for instance, the JFSA will request financial institutions to give detailed explanations to borrower companies on individual and specific details of the requirement for guarantee contracts and on the potential revision or cancellation of such contracts. The JFSA will also follow up on financial institutions' relevant initiatives.

(4) Institutionalizing security interests over all assets

It is important to provide a wide range of options for companies, including borrowings based on the value and the future potential of the business, to enable them to raise funds through optimum methods at different phases of their business such as starting up, business succession or business turn around. It is also important to pave the way for financial institutions to provide loans focusing on the value of the business without depending heavily on real estate collateral or personal guarantees.

To back up this initiative institutionally, the "Study Group on Lending and Business Turnaround Practices to Support Corporate Borrowers' Business Enhancement[8]" specified issues regarding the introduction of a new collateral system covering all assets in November 2021. The JFSA will further examine these issues closely and endeavor to quickly realize a scheme for companies to raise funds from financial institutions by offering security interest over all assets. The JFSA will also cooperate with financial institutions to consider the policies and procedures of underwriting and monitoring, organizational management and arrangements, and promote initiatives to foster lending practices focusing on the value and the future potential of the business in Japan.

[8] "Study Group on Lending and Business Turnaround Practices to Support Corporate Borrowers' Business Enhancement" (https://www.fsa.go.jp/singi/arikataken/index.html (Available in Japanese))

2. Monitoring policies

Even at a time when the environment surrounding financial institutions are changing, financial institutions must perform their financial intermediary functions sufficiently while maintaining their soundness. To this end, they must build sustainable business models and fundamentally enhance their business infrastructure, including their financial bases, governance, and various risk management arrangements.

Within the JFSA, teams that are well versed in individual financial institutions and financial industries will cooperate with those specialized in risks to conduct deep monitoring of financial institutions through data analysis and dialogues with financial institutions. The JFSA will also steadily promote cooperation with the Bank of Japan (BOJ), including regular meetings and joint studies on key issues.

(1) Cross-sectoral monitoring policies

(i) Strengthening business bases and ensuring soundness

Financial institutions must develop sustainable business models under management teams' leadership, based on their target pictures and the roles they are expected by citizens, markets and regions to play. Accordingly, the JFSA will review business strategies of financial institutions, hold dialogues with them on their business infrastructure, financial bases, governance and risk management arrangements at home and abroad and encourage them to enhance their business infrastructure according to their respective conditions.

At present, Japanese financial institutions generally have sufficient financial bases and Japan's financial system is stable as a whole.[9] However, the outlook of financial economic, and global situations is uncertain, requiring close attention to these trends. Against this background, the JFSA will analyze the impacts of changes in the economic environment and financial markets on financial institutions' soundness and the financial system's stability. The JFSA will also monitor financial institutions' credit risk management and support for borrowers plagued with worse business conditions, as well as their risk management for securities investment and foreign currency liquidity.

Considering that human capital supports financial institutions' sustainable value creation, the JFSA will hold dialogues with various officers and employees of financial institutions to promote their investment in and fostering of human resources. Through such dialogues, the JFSA will also check financial institutions' new business exploration, customer convenience improvement and cost reduction efforts, including the promotion of digital transformation and the utilization of advanced banking service companies.[10]

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[9] See **Column 3**: Assessment of financial institutions' soundness.
[10] See **Column 4**: Report on IT governance in the financial sector.

The JFSA proceeds with the preparation for the implementation of the Basel III standards, which were finalized in December 2017, while holding sufficient communication with stakeholders[11].

(ii) Disseminating customer-oriented financial services

(a) Customer-oriented business conduct[12]

To achieve people's stable asset building, it is indispensable to secure financial institutions' customer-oriented business conduct in the development, marketing and management of financial instruments. Nevertheless, some financial institution customers claim that financial institutions are selling financial instruments that are not suitable for customers who pursue stable asset building. Therefore, the JFSA will monitor whether financial institutions have developed arrangements to develop, market and manage instruments that can contribute to customers' asset building. In particular, it must be remembered that structured bonds are complicated and difficult for some customers to understand, and that they may fail to yield returns commensurate with relevant risks or costs. Therefore, the JFSA will monitor financial institutions that handle structured bonds, checking whether the management is aware of the unique feature of structured bonds and are considering the handling of such bonds taking that feature into account. For those institutions that continue handling structured bonds, the JFSA will check if they have examined how they could achieve providing products that meet the true needs of customers, by considering to whom they sell the products and how they explain when doing so.

The JFSA will also monitor if financial institutions' specific efforts regarding their customer-oriented business conduct are clarified in policies they have formulated and published in line with the Principles for Customer-Oriented Business Conduct or have taken hold among sales personnel.

(b) User-friendly services

To respond to rapid economic and social changes in Japan, including the aging of population and the advance of globalization, the JFSA will encourage financial institutions and trade associations to implement user-friendly business conduct so that all customers can receive convenient financial services that meet their respective needs. Regarding responses to various issues and needs for elderly customers, for instance, the JFSA will engage in dialogues with financial institutions and trade associations to support their efforts to improve customer convenience and prevent troubles concerning the handling of transactions for elderly customers with reduced cognitive abilities that are conducted by their family members. To enable disabled

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[11] Revised regulations will be implemented from the end of March 2024 for financial institutions with overseas offices (internationally active financial institutions) and those without overseas offices (non-internationally active financial institutions) that use internal model-based approaches for measuring risks, and from the end of March 2025 for non-internationally active financial institutions that do not use internal model-based approaches for measuring risks. For financial institutions that desire early implementation, it is allowed to apply the revised regulations on or after the end of March 2023.

[12] See Column 5: Sales companies' efforts regarding customer-oriented business conduct.

people to use safe and convenient financial services, the JFSA will promote financial institutions' and trade associations' further efforts to remove social barriers, including developing facilities friendly to people with disabilities and holding seminars for frontline employees about how to utilize a telephone relay services and so on.

In an effort to promote women's empowerment, the JFSA has so far cooperated with other government agencies to encourage financial institutions to accept women's opening of accounts in their birth names or original family name (as opposed to using their married names). Considering the results of the fact-finding survey about such responses by financial institutions, the JFSA would encourage them to make more positive responses. While the number of foreign nationals in Japan is expected to increase, the JFSA will provide foreign nationals with useful information and precautions in order to ensure their smooth use of financial service such as opening an account. The JFSA will also encourage financial institutions and trade associations to further promote convenience improvement efforts, such as facilitating and streamlining procedures. The JFSA has requested and will prompt financial institutions to courteously respond to Ukrainian refugees who have come to Japan and want account opening and other financial services.

(c) Handling multiple debts

As multiple debts remarkably hinder the daily life of debtors, the JFSA will cooperate with relevant agencies to issue warnings about multiple debts and encourage financial institutions to prevent young people aged 18 or 19 from becoming insolvent debtors after the adulthood age was lowered from 20 to 18 in April 2022. Furthermore, the JFSA will focus monitoring on lenders' compliance with trade associations' voluntary guidelines and their loans to young people.

The JFSA will also enhance warnings about new loan shark methods, such as lending disguised as a sale, and cooperate with law enforcement authorities to strictly punish such methods.

(iii) Handling various risks based on global situations

(a) Enhancing measures for anti-money laundering, counter financing of terrorism and counter-proliferation financing (AML/CFT/CPF)[13]

Based on current global situations and the results of the FATF[14] 4th Mutual Evaluation of Japan, Japanese financial institutions are internationally required to enhance their AML/CFT/CPF measures to the levels required by the FATF. Therefore, the JFSA will focus on monitoring encouraging financial institutions to complete measures required by the "Guidelines for Anti-Money Laundering and Combating the Financing

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13 See Column 6: Initiatives to enhance AML/CFT/CPF measures.

14 Financial Action Task Force

of Terrorism" by the end of March 2024. Towards the FATF 5th Mutual Evaluation expected to be conducted in or after 2025, the JFSA will also consider approaches in order to achieve higher-quality inspections and supervision. Furthermore, the JFSA, in cooperation with industry associations, will publicize the necessity and importance of AML/CFT/CPF measures to improve the level of understanding on these measures among customers of financial institutions through the government public relations etc.

As for the Funds Transfer Transactions Analysis Services that is entrusted by banks, etc. and provides monitoring services and other operations on banks' money transfer transactions, the JFSA will prepare for implementing a framework for such service. In this regard, the JFSA will support the Japanese Bankers Association's consideration of a shared system and encourage some banks' efforts to qualitatively improve their current initiative to develop a shared system.

From the international context, enhancing AML/CFT/CPF measures regarding virtual assets has become one of the challenges. The JFSA will keep contributing to discussions on strengthening these measures, taking advantage of positions as a co-chair of the FATF's Virtual Asset Contact Group, which deals with virtual asset-related matters and its upper positioned working group, "Policy Development Group" respectively.

Japan has been cooperating with its Group of Seven (G7) partners to impose economic sanctions including asset freezing against Russia for its invasion of Ukraine. Financial institutions are required to act in line with domestic and foreign laws and regulations, including Japan's Foreign Exchange and Foreign Trade Act. The JFSA will encourage them to adequately implement relevant measures.

(b) Enhancing cybersecurity

Cyberattacks have become even more sophisticated in recent years. In addition, it has become even more difficult for financial institutions to control the vulnerability of IT systems because they have increasingly outsourced system development and operations to third parties and locations of third party providers of components of IT systems and software have become diversified. Given such circumstances, cyber risk is one of the key business challenges for financial institutions.[15] The JFSA will monitor whether or not financial institutions have developed effective risk controls and management over cybersecurity.

The JFSA, jointly with the BOJ and the Center for Financial Industry Information Systems, developed a self-assessment tool on the maturity of controls and management over cybersecurity. The JFSA and BOJ will ask regional financial institutions to conduct their self-assessment, compile and analyze the self-assessment results, and provide feedback for the regional financial institutions to encourage them to enhance

[15] See World Economic Forum (https://jp.weforum.org/press/2022/01/jp-climate-failure-and-social-crisis-top-global-risks-2022), G7 Elmau Summit (https://www.mofa.go.jp/mofaj/ecm/ec/page4_005632.html), etc.

their cybersecurity. Moreover, the JFSA will consider applying the self-assessment tool to insurers and securities companies with necessary changes that take into account the business characteristics of each sector.

Furthermore, the JFSA will conduct the Financial Industry-Wide Cybersecurity Exercise under scenarios that take into account the current cyberattack threats and new cyberattack cases to further enhance financial institutions' cybersecurity.

(c) Enhancing IT risk management[16]

In the past few years, there were cases where errors and failures in IT systems of financial institutions caused suspension of automated teller machines and online services. It took longer than expected for the troubled financial institutions to recover these operations and services that affected a number of customers. Some incidents originated from failures in IT systems of third party service providers. Financial institutions should not be too complacent with the current controls and management over risks in IT systems, but, under the leadership of the board and senior management, they should continuously review and improve their controls and management, including risks stemming from third party providers, taking into account the latest trends in errors and failures in IT systems. The JFSA will urge financial institutions to improve their risk controls and management over IT systems by examining the root causes of errors and failures in IT systems of financial institutions and the effectiveness of remedial measures taken by financial institutions to improve their risk controls and management. The JFSA will also pay close attention in examining or inspecting large-scale, difficult projects on integration or renewal of IT systems to make sure that stable operations of IT systems after the integrated or renewed IT systems go live.

The JFSA will further investigate the current practices on risk controls and management over IT systems in financial institutions, particularly challenges in IT asset management, vulnerability controls and data management, including those of third-party providers, and will hold dialogues with outsourcing service providers on these issues as necessary.

(d) Operational resilience

As technology failures, pandemics, natural disasters and other events may disrupt critical functions required for the maintenance of the financial system, such as settlement and financial services frequently used by customers, even if preventive measures are taken to forestall such disruptions, financial institutions should secure frameworks to mitigate the impacts of disruptions by ensuring the early recovery of such functions or providing alternative measures. In line with international trends, including the principles

[16] See Column 7: Analysis report on system failures at financial institutions.

developed by the BCBS[17] in March 2021 and discussions at the FSB,[18] the JFSA will publish a discussion paper to hold dialogue with financial institutions and experts, and will pursue best practices along with financial institutions to address issues, such as the mapping of interconnections and the assignment of necessary business resources, in order to secure effective operational resilience.

(e) Economic security responses

In May 2022, the Economic Security Promotion Act was enacted to establish systems to secure the stable provision of key infrastructure services. Given that the financial industry is included in key infrastructure to support the people's economic activities and owns massive personal and corporate information, it is important to sophisticate financial services while securing safety and reliability regarding the maintenance of infrastructure functions. From this perspective, the JFSA will promote cooperation with relevant organizations and careful dialogues with business operators towards the smooth implementation of the Economic Security Promotion Act.

(2) Monitoring policies by business type

(i) Major banks, etc.

Major banks have great presence on Japan's economy and are expected to stably provide quality financial services that contribute to economic growth and people's well-being. The JFSA will monitor if they have put in place a framework for each item in (1) with the level of sophistication commensurate with the scale and complexity of their services.

Regarding credit risks, the JFSA will engage with major banks on their internal ratings, processes for loan charge-offs and provisions, and lending practices for business turnaround and other products in robust demand, and consider necessary actions. As for market and liquidity risks, the JFSA will review their investment and funding strategies, with greater focus on risk management regarding securities investment and foreign currency liquidity, including overall asset-liability management, and encourage them to sophisticate these practices. Regarding foreign currency liquidity, particularly, the JFSA takes note of the fact that Japanese financial institutions depend on the market for foreign currency funding and consequently have vulnerability to rapid market changes. Besides, the JFSA will conduct, jointly with the BOJ, a stress testing exercise based on common scenarios, and in doing so encourage banks to improve stress testing methodologies. The JFSA will also examine the purposes and rationality of their cross-shareholdings and track progress of their reduction plans.

As major banks pursue cross-border and cross-sectoral business expansion, such as overseas acquisitions

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[17] Basel Committee on Banking Supervision

[18] Financial Stability Board

and greater global footprints, the JFSA will engage with the banks on their strategies and encourage them to sophisticate their group and global governance. Particular focus will be on strategies and risk management frameworks regarding transactions with overseas funds and less creditworthy borrowers, and IT and accounting infrastructure to support global operations. As for domestic operations, the JFSA will review preventing measures for the abuse of a dominant bargaining position in light of the recently relaxed regulation on firewalls between banks and securities companies, leveraging information provided to a contact point that has been newly set up exclusively for preventing such abuses.

The JFSA will encourage the Japan Post group to promote measures for customer-oriented business conduct in consideration of new services and products. The JFSA will also hold dialogues with the group on initiatives to secure medium to long-term earnings infrastructure for the entire group from the perspective of providing stable universal services through the post office network.

(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 support local economic growth in the post-COVID era. For meeting those expectations while the business environment[19] surrounding regional financial institutions is changing, they need to strengthen their business foundations. From this perspective, the JFSA has taken various measures[20] and some regional financial institutions have taken actions such as founding regional trading companies and investment subsidiaries for regional revitalization, establishing sophisticated banking service companies for digitalization and regional revitalization, and implementing comprehensive business alliances and business consolidation.

As some of the measures are temporary, regional banks need to discern and implement necessary measures to further promote their business reforms with the time limits in mind. Therefore, the JFSA and Local Finance Bureaus will have dialogues with regional banks' top management leaders to encourage their business reform efforts. In addition, regional banks' governance is key to their business foundations. Therefore, the JFSA and Local Finance Bureaus will promote regional banks' business reform efforts through dialogues with their top leaders, executives, employees and external directors on the performance of governance by their shareholders and boards of directors. As for regional banks that make efforts to take advantage of bank holding companies to sophisticate business management functions for enhancing and

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[19] See Column 8: Business conditions of regional banks.

[20] The measures include the 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), the 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) and the amendment of the Banking Act, etc. including review of regulations on the scope of services and on investment (put into effect on November 22, 2021, with no specific time limits).

diversifying their business portfolio, the JFSA and Local Finance Bureaus will monitor their efforts and progress.

Furthermore, regarding risk-involving financial instruments sales, the JFSA will hold dialogues with regional banks on the meaning of such sales in their business strategies, as well as customer-oriented business conduct, with the analysis of complaints given to the JFSA about their services and of their segment-wise earnings.[21] Regional banks are required to sophisticate their risk management according to their risk-taking conditions. Therefore, the JFSA will monitor the management of credit risks, including those regarding large-lot borrowers, of securities investment, including response to short-term market fluctuations and of risks accompanying new measures that regional banks tackle proactively,[22] utilizing inspections as necessary.

With cooperative financial institutions, the JFSA will continue dialogues on their performance of the financial intermediary function so that they will contribute to resolving regional challenges and achieve sustainable business management through their support meeting various needs of SMEs and micro businesses under the spirit of mutual aid. The JFSA will encourage them to take advantage of new services and support from their central organizations to strengthen their business foundations. As economic and market environments change due to the prolonged impacts of COVID-19, the JFSA will also urge cooperative financial institutions to make precautionary efforts in anticipation of projected credit and market risks' impacts on their profitability and soundness. Through dialogues with their central organizations, the JFSA will encourage them to serve as contacts between cooperative financial institutions and with other support organizations to support cooperative financial institutions' initiatives contributing to resolving regional challenges.

In case regional financial institutions apply for special measures regarding COVID-19 under the Act on Special Measures for Strengthening Financial Functions, which serve as a framework for government capital participation in order to support businesses affected by COVID-19, the JFSA will appropriately give a response in consideration of the purpose of the act.

(iii) Securities companies

Securities companies are required to make proactive contributions to securing market fairness as a market gatekeeper and support households' stable asset building and fundraising by companies with growth potential through the sufficient performance of the financial intermediary function.

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[21] See Column 9: Sustainability of regional banks' retail businesses including financial instruments sales.

[22] In recent years, some regional banks have activated lending in large cities outside their traditional business territories, proactively provided loans accompanied by complex risks (marketable loans, leveraged loans, etc.) or expanded investment in securities (including foreign bonds and multi-asset investment trusts).

Through dialogues with securities companies, the JFSA will encourage them to deepen their customer-oriented business conduct initiatives and continue efforts for grasping customers' true needs under their management teams' strong leadership to perform the function.

With major securities companies that operate globally, the JFSA will hold dialogues on overseas business strategies to monitor their effective governance and risk management arrangements meeting their business strategies, including whether they are ready to secure smooth communications among stakeholders, including those at overseas offices, and make agile responses if risk events occur. With regard to securities companies that conduct online trading, the JFSA will monitor if they can sufficiently respond to system risk challenges commensurate with their respective business sizes.

(iv) Insurance companies

Insurance companies are required to conduct efficient business operations utilizing digitalization, build sustainable business models and develop products meeting changes in customer needs in consideration of medium to long-term business environment changes, including falling birthrates, aging population, severer natural disasters and the shrinking auto insurance market. As insurance companies are expanding their overseas operations, they must clarify strategies in order to benefit from overseas economic growth and strengthen their governance on a global basis. In cooperation with foreign authorities, the JFSA will encourage insurance companies through dialogues to make steady progress in relevant efforts.

Due to the increase in insurance money payments amid frequent natural disasters in recent years, property insurance premiums have followed an uptrend. As interest is growing in severer flood disaster risks, the JFSA will hold dialogues with stakeholders on the subdivision of flood insurance premiums according to risks and cooperate with them in disseminating risk information towards the diffusion of flood disaster compensation and in countering financial fraud taking advantage of disasters. Towards a smooth transition to a new policy to secure insurance companies' soundness based on the economic value-based solvency regulation to respond to such business environment changes, the JFSA will consider details of the regulation while monitoring the development of relevant arrangements at insurance companies.

To prevent insurance companies from developing or offering insurance products designed mainly for avoiding tax and other products that deviate from genuine insurance purposes, the JFSA will enhance cooperation with the National Tax Agency to effectively examine products and monitor insurance solicitation. Considering that misconducts involving insurance salespersons have continued to occur, the JFSA also encourages insurance companies to develop effective salesperson management system.

The JFSA will cooperate with Local Financial Bureaus to hold dialogues with stakeholders on the promotion of insurance solicitation given the public insurance systems and the sophistication of establishment of a control environment for insurance agencies to secure the appropriate provision of insurance services that meet various customer needs.

As for small-amount and short-term insurers, the JFSA will cooperate with Local Finance Bureaus to review monitoring methods, quickly identify problems regarding financial soundness and business adequacy, and initiate appropriate measures.

II. Build the Financial System in which Economic Growth is Achieved by Resolving Social Issues and is Shared with Individuals

At present, Japan needs to deal with various social issues including climate change, digital society realization, and startup support. The JFSA will financially develop an environment to have such social issue resolution bring about new economic growth and achieve a "virtuous circle of growth and distribution" in which the fruit of growth will be passed on to people widely and will lead to people's asset formation and a further increase in consumption and investment.

1. Facilitating people's stable asset formation and stimulating capital markets

The JFSA will facilitate people's stable asset formation through promoting sustainable growth of the Japanese economy and achieving a virtuous circle of funds in which corporate value will be enhanced and earnings will be shared by people broadly.

For that purpose, it is necessary for all participants in the investment chain,[23] which supports people's asset formation, to fulfill their roles sufficiently as expected. Specifically, in order to enable individuals to build portfolios with optimal financial assets that meet their needs, the JFSA will endeavor to enhance the financial literacy of people and ensure customer-oriented business conduct by financial institutions, and will also encourage pension funds and other asset owners and asset management firms to sophisticate their asset management for stable higher investment returns. Additionally, in order to facilitate smooth funds supply to startups and other growing companies, the JFSA will take measures to strengthen the functions of capital markets and enhance companies' disclosure of non-financial information, such as that on human capital, which serves as the basis for their sustainable value creation.

(1) Promoting people's stable asset formation

(i) From savings to investment[24]

Over 50% of the overall household financial assets in Japan (approximately 2,000 trillion yen[25]) are cash

[23] The investment chain refers to a flow in which investment by customers and beneficiaries in companies enhance their corporate value and the dividends therefrom are returned to households.

[24] See Column 10: Shift from savings to investment (promotion of financial and economic education, spread of NISA).

[25] The balance of household financial assets as of the end of 2021 was approximately 2,023 trillion yen. (Source: Japan's Flow of Funds Accounts (BOJ))

and deposits. In the meantime, assets directly or indirectly held in the forms of shares and investment trusts account for around 20% at the largest, which is much lower than in the US or in the UK.[26,27] In order to increase the financial assets of households, assets that are currently held as deposits need to be invested to create a virtuous circle in which the results of the sustainable enhancement of corporate value will be passed on to households. Under such idea, the "Grand Design and Action Plan for a New Form of Capitalism" and the "Basic Policy on Economic and Fiscal Management and Reform 2022" stated that a comprehensive "Doubling Asset-Based Income Plan" will be devised at the end of 2022. The JFSA will deliberate on and promote related measures in close collaboration with relevant ministries and agencies.

So far, the JFSA has endeavored to disseminate and promote the use of NISA, encouraging people to make stable asset formation through long-term, regular, and diversified investment by tax incentives. As of the end of March 2022, the number of accounts for ordinary NISA and regular investment NISA (*Tsumitate* NISA) has grown to about 17 million, but further increase is important. In order to facilitate a shift of individuals' financial assets from savings to investment in all age groups, the JFSA will discuss means to expand the NISA program fundamentally. In order to expand the user base of NISA, it is essential that the system is simple and easy-to-understand, and enables people to start asset formation with a small amount of money and to continue stably on a long-term basis. With the aging population and declining birthrate and diversified lifestyles, NISA should become more convenient, catering to individuals across different age groups and varied lifestyles.

(ii) Enhancement of financial literacy

In order to enable individuals to select appropriate financial instruments and services that suit their needs and life plans and to achieve stable asset formation through diversified investment, it is important to enhance people's financial literacy. For that purpose, financial and economic education should be provided to a wide range of generations. Schools and workplaces have so far provided opportunities for financial and economic education, including that on asset formation, but they have been limited.

While further efforts are being required to educate young people in response to the lowering of the legal age of adulthood from 20 to 18 in April 2022, the curriculum guidelines for senior high schools were revised to improve course programs on asset formation in financial education. The JFSA and Local Finance Bureaus are cooperating with schools, providing classes for students using teaching materials and videos, and training teachers, to support the smooth provision of lectures in line with the revised guidelines. In

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[26] Japan: approx. 19%; US: approx. 55%; UK: approx. 42% (as of the end of 2021; Compiled by the JFSA based on data of BOJ, FRB and BOE)

[27] According to the results of the questionnaire survey conducted in the Financial Literacy Survey (in 2022, by the Public Relations Department, Financial Central Committee), out of 30,000 sampled survey targets, approximately 17,000 responded that they do not make investments in any of the three (shares, investment trusts, and foreign currency deposits, etc.).

addition, financial institutions and industry associations are also providing information on asset formation and financial education in diverse ways. The JFSA will follow these initiatives in the private sector, and while effectively cooperating with the private sector, consider a framework for promoting efforts for providing educational opportunities concerning asset formation on a national level and from a neutral standpoint.

(iii) Customer-oriented business conduct

In order for households to build appropriate portfolios suited to their individual life plans and risk tolerance, and formulate assets stably, it is vital to ensure customer-oriented business conduct of financial services providers that sell financial instruments, give advice, develop financial instruments, manage and invest assets. Furthermore, an ideal mechanism would be that the financial industry keeps innovating and competing to offer better services and products, and through this financial services providers that continue efforts to improve their services are chosen by customers.

In order to enhance the effectiveness of these initiatives, the JFSA should take required measures in light of the appropriate division of roles in a principle-based approach under the "Principles for Customer-Oriented Business Conduct" and a rule-based approach. As a principle-based approach, the JFSA will review the "Principles for Customer-Oriented Business Conduct" for promoting product governance of asset management firms etc.[28] and for strengthening governance for securing the former. As a rule-based approach, the JFSA will consider an institutional framework to ensure that appropriate solicitation and consulting services are provided from the perspective of customer-oriented business conduct, thereby encouraging sound development of the consulting and advisory businesses for assisting customers' asset formation, and will also consider a system for improved information provision to customers by the use of digital tools to improve services provided by financial services providers. (Regarding monitoring of financial services providers, see the main text in I. 2.(1)(ii)(a) above, and regarding the enhancement of the asset management business, see the main text in II.1.(2) below.)

(2) Enhancing asset management business

So far, focusing on the significant roles of asset management firms, which should play a central role in the investment chain, the JFSA has continued dialogues with them on their individual product governance, such as their structuring and provision of instruments and fund management putting customer interest first, and has encouraged them to further strengthen their efforts.[29] The JFSA will engage in dialogue focusing

[28] Product governance means to clarify targeted customers and structure financial instruments that meet the interests of such customers, provide necessary information to financial services providers so that those instruments are surely provided to targeted customers with necessary information, and evaluate and verify all these processes.

[29] See **Column 11**: Progress Report on Enhancing Asset Management Business 2022.

on asset management firms' specific measures and outcomes regarding their product governance systems, as to whether they are making efforts for securing the effectiveness under the initiative of the top management while looking to the best interests of customers.

In addition, it is also required for life insurance companies, pension funds and other asset owners to present their basic policies on investment and contribute to enhancing the corporate value of investment destinations through their own actions or via the actions of the asset management firms to which they entrust business. Asset owners include diverse entities and their business statuses vary, but the JFSA will collaborate with asset management firms, relevant ministries and agencies, academia, intellectuals, and international organizations, etc., in addition to asset owners, and discuss operational problems and other matters to achieve long-term and sustainable increases of assets held and deposited, so that functions expected commonly for their investment in diverse assets, including their consideration of ESG[30] elements, are sufficiently fulfilled.

The JFSA will publish a report, etc. on the progress and challenges regarding the enhancement of the asset management business, including the outcomes of these efforts mentioned above.

(3) Strengthening the functions of capital markets to encourage the growth of startups, etc.[31]

In order to foster growth of businesses and industries that will support Japan's sustainable economic development, it is important to strengthen capital markets to ensure appropriate distribution of diverse securities.[32]

From such perspective, the JFSA will encourage domestic pension funds and other asset owners to expand the funding to venture capital funds,[33] and will develop a framework for incorporating unlisted stocks into investment trusts, for the purpose of increasing the provision of growth capital to startups and other entrepreneurs.

Regarding listing processes, the JFSA, the Japan Securities Dealers Association, the Tokyo Stock Exchange, etc. will promote review of the IPO[34] pricing processes so that startups can achieve further growth. Additionally, the Tokyo Stock Exchange will realize appropriate listing examination on the companies in newly established industries based on the characteristics of their businesses, by utilizing third-party evaluations. It will also diversify listing methods by developing an environment for facilitating the use

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30 ESG refers to Environment, Social, and Governance.

31 See Column 12: Interim Report of Working Group on Capital Market Regulations of the Financial System Council.

32 For support for startups through indirect financing, see the main text in I. 1. (3) and I. 1. (4).

33 Venture capital funds refer to funds that make investment in startups, etc.

34 Initial Public Offering

of direct listing.[35] It is also important for the Tokyo Stock Exchange to carry out follow-ups concerning its review of market segments and promote initiatives for stimulating markets, such as the extension of market hours.

To facilitate secondary transactions of unlisted stocks, the JFSA will enable PTSs[36] to handle securities traded by limited investors. Further, the JFSA will examine specific schemes for trading listed stocks at PTSs, such as easing the upper limit for transactions by auction. Regarding unlisted securities, the JFSA will strive for flexible and swift processes for authorization depending on the type of financial instruments such as unlisted stocks, security tokens, and foreign stocks.

Deliberations on the firewall regulations will also be continued, including the necessity of the review thereof, taking into consideration the perspective of whether they contribute to the fundraising of startups and other small and medium-sized enterprises.

(4) Enhancing corporate governance reform and disclosure of non-financial information, such as that on human capital

For companies' sustainable growth and increasing corporate value over the mid- to long-term, the JFSA has promoted corporate governance reform based on constructive dialogues between investors and companies by formulating and revising the Stewardship Code and the Corporate Governance Code. Currently, progress has been made in appointing independent outside directors and establishing a nominating committee and a remuneration committee, but companies are expected to make substantial effort in line with the purpose of the reform through exercising the board functions and enhancing the effectiveness of constructive dialogues with investors, not limited to the pro forma measures.

From such perspective, the JFSA will follow up the status of companies' and investors' efforts, and will endeavor to develop an environment to make corporate governance reform more substantial by organizing issues of related systems, not necessarily tied to the three year periodic review cycle of the Stewardship Code. As part of such action, the JFSA will organize issues to discuss regarding the large shareholding reporting system and other systems, including what the regulations on "act of making important suggestions" should be, with the aim of promoting dialogues between investors and companies.

With regard to internal controls, which are indispensable for companies' governance, the JFSA will sort out problems in the current internal control reporting system and deliberate means to enhance the effectiveness of internal controls, taking into consideration international discussions on companies' internal controls and risk management.

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[35] Direct listing is a method of directly becoming listed without going through underwriting by securities companies.

[36] Proprietary Trading System

Furthermore from the perspective of promoting constructive dialogues between investors and companies and supporting corporate governance reform, it is also important to make efforts to enhance disclosure of corporate information.[37] In particular, as investors' needs for information on human capital are increasing, efforts should be made to enhance the disclosure of non-financial information in financial reports, such as companies' human resource development policies, policies on improving workplace environment, gender pay gap, and ratio of women in management positions. This is because it is essential that companies and investors share a consensus that human capital serves as the basis for companies' sustainable value creation. Additionally, from the perspective of enhancing the efficiency in disclosure, the Financial System Council's Working Group on Corporate Disclosure has been deliberating specific measures for abolishing quarterly securities reports under the Financial Instrument and Exchange Act and consolidating them into quarterly earnings reports under the Exchange Rules and will submit related draft laws during the next ordinary Diet session.

The review of the G20/OECD[38] Principles of Corporate Governance is supposed to be finalized by the end of 2023. The JFSA will continue to actively contribute to the discussion by leveraging its experience.

(5) Securing trust in the market

(i) Initiatives concerning market oversight

The Securities and Exchange Surveillance Commission (SESC) will continue market oversight that is truly meaningful in order to ensure the integrity and transparency of the market and the protection of investors.

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 securities business monitoring, the SESC will verify that the business operators have internal control environments with a focus on appropriate investment solicitations based on the principle of suitability, and that they are selling financial products based on customer-oriented business conduct (in particular, sales of financial products with complex risk structures, such as structured bonds). At the same time, regarding unregistered business operators, the SESC will proactively exercise its investigative authority to file petitions to courts.

Additionally, the SESC is steadily promoting digitalization of its operations, including deposits and savings inquiries for investigations and inspections, by utilizing existing services in the private sector.

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37 See Column 13: Deliberations concerning disclosure of corporate information.

38 Organisation for Economic Co-operation and Development

The SESC will formulate "Strategy & Policy 2023-2025" for its 11th term (covering three years from December 2022) and implement measures based on that strategy and policy.

(ii) Institutional development for securing trust in accounting audit

In order to ensure audit quality at all audit firms, including small and medium-sized ones, that conduct audits of listed companies and to encourage certified public accountants to bring out and cultivate CPAs' abilities, the Certified Public Accountants Act was amended to introduce a registration system for auditors of listed companies and to modify restrictions on audit firm employees based on their marital relationships. The JFSA will develop relevant Cabinet Orders and Cabinet Office Orders for smooth enforcement of the amended Act. Additionally, the Principles for Organizational Operations of Audit Firms (The Audit Firm Governance Code) will be revised so as to require audit firms to enforce discipline effectively depending on their size, etc.

The Certified Public Accountants and Auditing Oversight Board will perform monitoring with a focus on the inspection for small and medium-sized audit firms, whose roles in audits for listed companies are increasing. As the host country of the International Forum of Independent Audit Regulators (IFIAR),[39] which is the only international organization in the financial sector whose secretariat is located in Tokyo, the JFSA will continue offering support to the secretariat and contribute to enhancing audit quality globally, in light of the increasing interest in non-financial information and the progress in technological innovation, while taking advantage of Japan's position as the Vice Chair country of IFIAR.

2. Promoting sustainable finance[40]

With the increasing importance of societal issues, such as climate change as well as declining birthrate and aging population, it has become indispensable to promote sustainable finance to facilitate a transition to new industrial and social structures and to realize a sustainable society.

In particular, regarding climate change, a significant amount of long-term investments are needed for smoothly facilitating economic and social transition to achieve the goal of carbon neutrality by 2050, and the JFSA will proceed with the development of a favorable environment for promoting transition finance to support such transition.[41]

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39 IFIAR was established in 2006 with the mission to serve the public interest, including investors by enhancing audit oversight globally. In April 2017, its secretariat was established in Tokyo, making IFIAR the first international organization in the financial sector to have a secretariat in Japan. IFIAR comprises independent audit regulators from 54 jurisdictions as of July 2022.

40 See Column 14: JFSA's initiatives for sustainable finance.

41 See Column 15: Initiatives for transition finance in Japan.

(1) Enhancing companies' disclosure of sustainability-related information

For companies, it is indispensable to consider possible risks and opportunities in their business activities that may be brought about by problems relating to the sustainability of the economy and society, and to develop strategies therefor in order to improve and maintain their corporate value over the medium to long term. Companies listed on the Prime Market of the Tokyo Stock Exchange, which started in April 2022, are now required to enhance, quantitatively and qualitatively, climate-related disclosure based on the TCFD[42] recommendations or other equivalent international framework, following the revision of the Corporate Governance Code. Furthermore, from the perspective of providing sustainability-related information, not limited to climate change-related information, that is necessary for making investment decisions, a new column will be created in annual securities reports to provide such information in an integrated manner.

While the disclosure of sustainability-related information is rapidly advancing in individual countries, it is important to secure international comparability of information. Accordingly, Japan will actively participate in international discussions for developing international standards to have Japan's opinions reflected therein.

Specifically, in response to developments to establish the sustainability disclosure standards by the ISSB,[43] the public and private sectors work together to disseminate opinions internationally along with the SSBJ[44] which plays a leading role in gathering domestic opinions, and actively participate and make contribution also in terms of human resources and funds.

In order to ensure that the SSBJ can play its roles actively in deliberating the details of sustainability-related information to be disclosed in Japan, the Financial System Council's Working Group on Corporate Disclosure will discuss the legal positioning, etc. of the SSBJ.

(2) Demonstrating capital market functions

For sound development of the sustainable finance market, it is important for investors, asset managers, ESG evaluation organizations and other players to respectively fulfill their expected roles to have the financial and capital markets function properly. For this purpose, the JFSA will, in close collaboration with asset owners, relevant ministries and agencies, international organizations and other stakeholders, ascertain what issues asset owners, such as life insurance companies and pension funds may face in balancing sustainable growth of their own assets under management and the growth of portfolio companies through due consideration to ESG factors based on their own investment policies, in close collaboration with other asset owners, relevant ministries and agencies, and international organizations (see the main text in II. 1.(2)

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42 Task Force on Climate-related Financial Disclosures
43 International Sustainability Standards Board
44 Sustainability Standards Board of Japan

above). In response to increasing expectations for asset management firms that deal with ESG funds[45] and in light of international trends, etc., the JFSA will also revise the Comprehensive Supervisory Guidelines for Financial Instruments Business Operators, etc. by around the end of FY2022 with the aim of facilitating asset management firms' development of their appropriate systems and enhancing their disclosure. Furthermore, from the perspective of ensuring transparency in ESG evaluation, the JFSA will formulate a Code of Conduct for ESG Evaluation and Data Providers, call for endorsement of the Code, and publish the status of support and endorsement of it from domestic and foreign evaluation providers that provide services in Japan by the end of FY2022.

Efforts will be also made to promote the expansion of the ESG-related information platform of the Japan Exchange Group. by integrating corporate data and expanding covered financial instruments so that the platform forms the foundation of Japan's ESG investments.

For the issue of climate change, out of various ESG issues, it is particularly important to promote transition finance that supports a steady transition of companies and financial institutions for achieving a decarbonized society. Therefore, the JFSA will actively contribute to the formulation of a 10-year roadmap for investing toward GX, including GX Economic Transition Bonds (provisional name),[46] and the operation of the GX League.[47] For the development of carbon credit markets, the roles that financial institutions can play are also discussed from the perspective of ensuring appropriate pricing of transactions.

(3) Roles of financial institutions

It is important for financial institutions and companies to cooperatively promote effective efforts for achieving a sustainable society, thereby enhancing the sustainability of their own businesses respectively and contributing to the growth of Japan's economy.

Regarding countermeasures against climate change in particular, the JFSA is to establish the new working group to formulate, in cooperation with relevant ministries and agencies, a guidance for dialogues and practices among companies and financial institutions so as to make contribution to the formulation and steady implementation of a transition plan that is to be made consistent with the goal of carbon neutrality by 2050 based on scientific grounds. For that purpose, the JFSA will deepen discussions on a credible

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45 The Progress Report on Enhancing Asset Management Business 2022, which was published on May 27, 2022, describes initiatives, etc. expected for asset management firms that used such expressions as "considering ESG elements" for explaining the characteristics of the ESG funds they offer and their asset management processes.

46 GX Economic Transition Bonds (tentative name) are bonds whose introduction is being considered as a means for procuring funds for achieving GX (green transformation). It is planned to procure funds for the government to lead investments in the public and private sectors (over 150 trillion yen) that are required for the decarbonization in the coming 10 years, in advance, while securing sufficient funds for the future.

47 The GX League is a platform presented in the "GX League Concept" published in February 2022, where companies actively working on GX discuss transformation of the economic and social system as a whole and conduct practices to create a new market in collaboration with the public, academia and financial sectors. As of the end of March 2022, 440 companies have agreed with this concept and they are preparing for the full-fledged operation of the league in April 2023 onward.

transition plan with domestic and foreign financial institutions and investors who are endeavoring to materialize a trajectory for the reduction of greenhouse gas emissions, while taking into account outcomes of the G20 Sustainable Finance Working Group, and will also examine and analyze preceding cases from overseas.

For facilitating regional financial institutions' support for local companies, the JFSA, relevant ministries and agencies, and local bureaus will jointly map their challenges to support measures depending on, such as, companies' business types, sizes, and energy consumption in an easy-to-understand manner, and disseminate it to stakeholders in regions. Additionally, the JFSA will compile concrete examples of financial institutions' support for companies and challenges that occur on site in order to take area-wide measures.

Based on international discussions, the JFSA will proceed with deliberations on practical problems concerning data and indicators necessary for financial institutions for their management of climate-related risks and on means to better utilize such data and indicators. Regarding climate-related data, in collaboration with relevant ministries and agencies and with the cooperation of research institutes, companies, and practitioners in the financial sector, the JFSA will have discussions for compiling an appropriate data set that can be used to practically assess the impact of climate change on businesses, as well as utilization methods and matters to note therefor. In addition, considering that the importance of expanding the roles of insurance in response to natural disaster risks is often pointed out, the JFSA will promote discussions with other national supervisory authorities on how to respond to this.

(4) Evaluating the impact of investment

It is important to attract diverse investors to have them make impact investment and thereby encourage companies to make efforts for improving their sustainability, through accurate measurement and evaluation of the social and environmental impact of investment Accordingly, the JFSA will establish a new working group, further developing a study group on impact investment, which it has cohosted together with the GSG[48]-National Advisory Board Japan since June 2020. The working group will promote discussions on how to materialize a practical measurement method for the impact of investment and compile a report by the end of FY2022. Regarding impact evaluation relating to climate change in particular, the JFSA will deepen collaboration with relevant ministries and agencies for formulating a framework to assess the potential reduction of greenhouse gas emissions. Through these initiatives, the JFSA aims to facilitate investment to start ups in the climate-related field (namely, Climate Tech companies).

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[48] Global Steering Group for Impact Investment

(5) Developing skilled professionals

In collaboration with related parties such as finance-related associations the JFSA will support the development of a sustainability-related qualification examination, clarify knowledge and skills required for ESG investments and means to obtain such knowledge and skills as skill maps to broadly disseminate them to the public. Also in collaboration with related parties such as finance-related associations, the JFSA will consider, for example, providing courses and teaching materials on sustainable finance for finance-related courses at universities.

Regarding natural capital, including biodiversity, as well, the JFSA will consider its influence on finance and the expected roles of finance through participating in international discussions in the NGFS,[49] etc. and by studying trends in the private sector.

3. Realizing a digital society[50]

Financial services utilizing smartphones, APIs,[51] AI and other new technologies have come to play a significant role as key infrastructure in our living, such as for making payments, and are expected to further expand in tandem with the digitalization of society. In order to further facilitate these moves, the JFSA reorganized its structure to integrate the department responsible for promoting financial innovation and that in charge of monitoring FinTech firms, achieving integrated operation thereby strengthening their collaboration. Under this new structure, the JFSA will strengthen support for businesses so that new financial services do not undermine customer protection and the safety of the financial system, as they bring about innovative functions to our society, and expanding sustainably to contribute to economic growth.

The JFSA will also exchange opinions closely with diverse ventures firms, financial institutions, business companies, and industry groups and will identify what it can do to promote innovation and new financial services while ensuring user protection and the safety of the financial system.

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[49] Network for Greening the Financial System

[50] See **Column 16**: Development and dissemination of new financial services.

[51] Application Programming Interface: API refers to Application Programming Interface, generally meaning an interface that enables users to easily use applications provided by external software, etc.

(1) Carrying out measures relating to digital money and crypto-assets for promoting Web3.0, etc.

Recently, moves toward further development of the internet, such as Web3.0[52] and the metaverse[53], are expanding globally. In order to facilitate these moves also in Japan, the JFSA will carry out the following measures in terms of financial policy. First, in response to the enactment of the amended Payment Services Act in June 2022, systems relating to so-called stablecoins will be properly enforced and fully implemented. The JFSA will also facilitate the streamlining of prior examinations by self-regulatory associations regarding crypto-assets to be dealt with by crypto-asset service providers and the clarification of interpretations regarding whether items and contents issued on blockchains fall under the category of crypto-assets. Additionally, the JFSA will develop systems to cope with a problem concerning taxation on portions of crypto-assets (including so-called governance tokens)[54] held by issuers, and to enable trust banks to accept crypto-assets as trust property (custody services). The JFSA will also develop an environment concerning transactions of security tokens under the PTS, continue deliberations on issues such as decentralized finance, follow the latest technological trends, and strengthen information provision targeting the whole world.

There has been the global turmoil in crypto-asset markets. The JFSA will continue to contribute to international policy discussion on crypto-assets by leveraging its experience as a global forerunner in the regulation and monitoring of crypto-asset activities and markets.

With regard to CBDCs,[55] the BOJ completed proof of concept on their basic functions in March 2022, and has shifted to the phase of proof of concept on their peripheral functions since April 2022. In light of the progress of the BOJ's proof of concept, the JFSA will continue making contributions to these activities in cooperation with the Ministry of Finance in terms of the impact of CBDCs on financial institutions.

(2) Promoting enhancement and efficiency improvement of payment infrastructure

Considering socioeconomic and technological changes in the environment surrounding payments, the JFSA will promote enhancement and efficiency in funds settlement, actively cooperating with relevant private bodies and ministries and agencies.

Regarding the next Zengin System (interbank payment system), the JFSA will participate in deliberations by a wide range of related parties so that safety, flexibility and convenience are secured for its development

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[52] Web3.0 is a concept that is attracting attention as the next-generation internet, representing a world that has escaped from the control of large platforms and has become decentralized, wherein individuals are connected with each other. This is a concept following Web1.0 centered on emails and websites and Web2.0 characterized by smartphones and SNSs. (Source: Basic Policy on Economic and Fiscal Management and Reform 2022 (June 7, 2022))

[53] "Metaverse" refers to a three-dimensional virtual space apart from the real world that was created in computers or computer networks, and services provided therein. (Source: Basic Policy on Economic and Fiscal Management and Reform 2022 (June 7, 2022))

[54] A governance token generally refers to a token with voting rights pertaining to a community's decision making. (Source: Research on Technological Risks in Trust Chains of Decentralized Financial Systems (a report of the commissioned research by QUNIE Corporation published on June 16, 2022))

[55] Central Bank Digital Currency

policy. After taking measures necessary for securing safety of payment, the JFSA will expand the scope of eligibility for participation in the Zengin System to include funds transfer service providers by the end of FY2022, and will follow up moves to improve convenience in frequent and small-amount payments, including a new infrastructure for money transfers between individuals that is planned to commence operation within 2022.

Additionally, with regard to internet banking for corporate customers, which has significance in promoting the digitalization of inter-company payments, the JFSA will collaborate with relevant ministries and agencies to promote and disseminate it in consideration of the current status of use thereof by businesses. As a QR code payment system is introduced for local taxes for FY2023 onward, the JFSA will also encourage financial institutions to take necessary measures therefor. Furthermore, toward the full digitalization of the functions of bills and checks, the JFSA will support steady progress in the implementation of a voluntary action plan[56] announced by the financial industry. Given that the government as a whole is promoting digitalization and data-linkage for inter-company transactions, that is, throughout an entire transaction from order placement/receipt to payment, in addition to disseminating electronic invoicing, the JFSA will support related businesses' efforts for promoting the use of financial electronic data interchange (EDI).[57]

4. Building foundation to further develop as international financial center[58]

Japan's strengths lie in its stable judicial system backed by democracy and the rule of law, peace and good order in society, and its favorable living environment, and life in Japan is becoming more and more attractive compared with some foreign countries where prices, including rent, are surging rapidly. It has a large real economy and a big stock market, and with household financial assets of around 2,000 trillion yen, Japan has considerable potential for asset management businesses.

The JFSA will promote deliberations on the Doubling Asset-Based Income Plan, facilitate the provision of capital for growth, including foreign funds, promote FinTech, and develop business and the living

56 The voluntary action plan was formulated by the Panel on "Full Digitalization" of the Functions of Bills and Checks (secretariat: Japanese Bankers Association) in July 2021 (revised in June 2022). In this plan, to completely eliminate exchange of bills and checks at clearing houses nationwide by the end of FY2026 is set up as the final goal.

57 The Task Force for the Next-Generation Payment Systems and the Working Group for Promoting Use of ZEDI established by the Japanese Banks' Payment Clearing Network (Zengin-Net) deliberate about the promotion of the use of Zengin EDI System (ZEDI System) and means for data-linkage between financial institutions and companies that place and receive orders.

58 See Column 17: Measures relating to the international financial center.

environment to benefit foreign asset managers and highly skilled professionals, with the aim of further enhancing the attractiveness of Japan as an international financial center in order to attract domestic and foreign funds to fields of growth and create a truly attractive market that would lead sustainable economic growth. As there is growing interest in achieving a sustainable economy and society, such as through decarbonization, in particular, the JFSA will promote sustainable finance in the form of the Green International Financial Center where domestic and foreign funds are integrated to be invested in initiatives relating to sustainability (see the main text in II. 2. above).

(1) Developing an environment for promoting the market participation of foreign asset management firms

Backed by Japan's strengths and potential, the government as a whole has endeavored to develop an environment to promote foreign asset management firms and other financial institutions. The target for one-stop services in English for pre-application consultation, registration check and supervisory processes via the Financial Market Entry Office was expanded from investment managers and investment advisory and agency businesses to include some securities companies in March 2022.[59] The coverage of services in English will be further expanded based on the needs of related parties, and make institutional changes as needed.

(2) Strengthening direct approach to foreign asset management firms

As it is important not only to enhance, but also to disseminate and promote, various measures, the JFSA has actively been conducting PR activities on the website of the international financial center and through online seminars.

In addition to information on the potential and attractiveness of Japan's markets, the JFSA will provide detailed information in accordance with the content of businesses of individual companies. The JFSA will also strengthen dialogues with domestic and foreign asset management firms. In so doing, the JFSA will encourage transactions at Japan's financial and capital markets and supply of funds to Japanese companies, and will identify the broad needs and challenges for foreign asset management firms intending to enter Japanese markets or expand business in Japan, which will be utilized for improving its future activities.

[59] During the period from January 2021, when the Financial Market Entry Office was established, to the end of August 2022, registration was completed for a total of 11 cases (of which, 2 cases were for securities companies).

III. Evolve JFSA's Financial Administration Further

As people's needs have diversified amid significant changes in the domestic and international financial environments, the roles and functions that the JFSA is required to fulfill have changed from time to time. The JFSA has so far continued to reform itself, but it will have to evolve its financial administration further to make greater contributions to Japan's sustainable growth.

From this viewpoint, the JFSA in BY2022 will attempt to improve all its staff members' capacity, quality and motivation to enhance its capabilities as a financial administration organization. The JFSA will also upgrade data utilization and enhance capabilities to advocate its policies at home and abroad.

1. Enhancing organizational capabilities as the financial authority

(1) Enhancing staff members' capacity and quality

To continuously evolve financial administration in line with financial environment changes, the JFSA must attempt to enhance the capacity and quality of all its staff members irrespective of their employment category. Therefore, the JFSA will improve the environment for enhancing their expertise by providing training programs in accordance with their desired fields. The JFSA will also identify the skills and knowledge that it lacks now or will require in the future, and then consider how its staff members should acquire them. As a basis of enhancing the expertise of staff members, the JFSA will fundamentally revise its training programs to allow junior staff members undertaking future financial administration to systematically learn the basics for governmental officials of JFSA.

To enhance data collection and analysis capabilities required for financial administration and promote data utilization, the JFSA will steadily upgrade relevant arrangements and skills of its staff members by qualitatively enhancing its data analysis projects through measures such as training and experts' support.[60]

(2) Placing priority on self-motivated initiatives

The JFSA will place priority on its staff members' independence and autonomy and seek to develop a workplace where they can engage in free and vigorous discussion. Specifically, the JFSA will encourage its staff members to proactively participate in the Open Policy Lab, a framework fostering voluntary policy proposals by staff members irrespective of their job specifications, and also encourage its staff members to use a framework to support them in their efforts to independently and voluntarily undertake study and

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[60] See Column 18: Data analysis project.

publish academic papers and columns.[61]

The JFSA will also implement proactive initiatives and contribute to policy planning, including organizing lectures and study meetings to get useful input from people outside, such as financial institutions and experts.

Furthermore, the JFSA will accept applications for specific posts from its staff members so that they can autonomously choose their career paths.

(3) Creating a workplace where everyone can work actively

From the viewpoint that a workplace where everyone can work actively to maximize performance will contribute to maximizing organizational functions, the JFSA will implement various initiatives to develop such workplace. Specifically, the JFSA will promote an initiative to support staff members' smooth comeback to their jobs after taking pregnancy and childcare leave, enhance an environment where telework and online conferences are easy to conduct, consider reforming the JFSA network system for safe and efficient business operations. Furthermore, the JFSA will outsource formulaic operations, and promote robotic process automation. These initiatives are designed to strongly back up flexible and efficient ways of working.

High-quality management capabilities are required to maximize the capacity of all JFSA staff members with diverse backgrounds. In this respect, the JFSA will visualize top management and directors' management policies to their subordinates and conduct a 360-degree evaluation and satisfaction surveys. In addition, the JFSA will enhance the management capabilities of its staff members by sharing each JFSA bureaus' initiatives to vitalize the entire organization within the JFSA on an ongoing basis, and providing management officials with management clues.

The JFSA will also promote internal and external dialogues on how to develop a workplace where young and other JFSA staff members feel more satisfied with their jobs and more motivated to work and how a desirable organizational culture should be, continuing to reform itself into an organization where staff members can work satisfactorily and produce better achievements.

(4) Promoting cooperation and collaboration with Local Finance Bureaus

It is indispensable for the JFSA and Local Finance Bureaus to cooperate and collaborate with each other to realize financial administration policies. Therefore, the two sides will continue good parts of their communications and collaboration in planning and executing policies and consider reforming other parts and streamlining the process. The JFSA will solicit financial administration policy proposals from young

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[61] See **Column 19**: Major "Open Policy Lab" activities.

staff members of the JFSA and Local Finance Bureaus, and utilize online meetings between their executive and working-level officials to share information in a timely manner.

Based on the revised Comprehensive Guidelines for Supervision of Regional Financial Institutions (implemented from August 20, 2021), the JFSA and Local Finance Bureaus will be united to deal with prior consultation and approval requests from regional financial institutions on their new services, as well as their inquiries about laws and regulations, in an effort to streamline the supervision of regional financial institutions. Furthermore, the JFSA and Local Finance Bureaus will attempt to qualitatively improve all supervisory authorities by promoting the sharing of knowledge and achievements gained through dialogues with regional financial institutions. The JFSA will also deepen cooperation and collaboration in securities business monitoring and market surveillance to realize effective administration.

2. Sophisticating data utilization in financial administration

(1) Multifaceted understanding of realities by data utilization

At a time when the business environment and earnings structure for financial institutions are changing, it is important to understand economic and market trends, and to accurately identify the resilience and/or vulnerabilities of individual financial institutions' business conditions and the entire financial system.

From this perspective, the JFSA will sophisticate data utilization for a multifaceted understanding of realities by combining and analyzing data obtained from financial institutions, macroeconomic and financial data, individual company- data, and geographical data. Data obtained from financial institutions include granular data of which the collection is considered in section (2) below. Specifically, the JFSA will identify details of companies' financial conditions and financial institutions' lending trends and the dynamics and quantitative impacts of economic and market trend changes on financial institutions as well as analyzing new challenges, including climate change. Through the visualization and utilization of data, the JFSA will use data for considering how financial institutions should support companies and how the monitoring of financial institutions should be sophisticated.

The JFSA will also operate, in an integrated manner, divisions for dealing with inquiries from financial service users, for designating and supervising financial ADR[62] organizations, and for implementing cross-sectoral research and analysis on conduct[63] risks to deepen their cooperation. In this way, the JFSA will

[62] Alternative Dispute Resolution

[63] Conduct represents social norms, business practices, market practices, expectations by users and other stakeholders, and others that are not written as law but should be respected, and those close to them.

implement the multifaceted analysis of information on troubles involving financial service users and the identification of relevant realities, and utilize their results for monitoring financial institutions in a timely manner.

(2) Improving data collection and management frameworks

Given the improvement of data storage and process capacity through technological innovation and foreign authorities' utilization of big data, it is important for the JFSA to proactively utilize more granular data than data collected traditionally from financial institutions. From this perspective, the JFSA will cooperate with the BOJ in conducting PoC(Proof of Concept) on a new data collection and management framework (so-called shared data platform) and considering developing an effective, efficient data collection and management framework towards the regular collection of granular data, including details of loans to companies.

3. Strengthening the ability to advocate JFSA's policies as well as public relations at home and abroad

As the global economic and political situation and domestic financial conditions are changing, it has become more important for the JFSA to build international networks to appropriately share information and cooperate with foreign countries in a timely manner. It is also important for the JFSA to communicate its initiatives appropriately to national citizens and stakeholders at home and abroad to deepen their interest in and understanding of Japan's financial administration.

(1) Enhancing international networks

Japan will chair the Group of Seven (G7) and ASEAN Plus 3 (Japan-China-Republic of Korea) meetings in 2023. Taking this opportunity, the JFSA will communicate the significance of Japan's major policy measures to foreign countries. The JFSA will also steadily prepare for the 2023 IAIS[64] Annual General Meeting in Tokyo, taking into account that it will be as an opportunity to enhance the presence of Japan's financial markets and lead discussions at the IAIS.[65]

With the objective of further enhancing international networks, the JFSA will resume in-person meetings

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[64] International Association of Insurance Supervisors

[65] A follow-up to the Grand Design and Action Plan for a New Form of Capitalism (Cabinet Decision on June 7, 2022) states, "To enhance the international presence of Japan's financial administration and financial markets, Japan will host the 2023 Annual General Meeting of the International Association of Insurance Supervisors (IAIS), and will actively lead international discussions on regulatory and supervisory issues, including those related to climate related risk, natural disaster risk and technological innovation."

for the GLOPAC[66] programs and bilateral international cooperation, while considering both the needs for visiting Japan and COVID-19 impacts.

(2) Timely, effective and efficient policy communication

The JFSA has proactively developed various information communication tools, including websites and social networking services. We will make effective use of these tools to strategically disseminate policy information in a timely, effective and efficient manner. Specifically, the JFSA will improve its staff members' knowledge about public relations activities and relevant arrangements and enhance contents for major policy areas. It will also proactively use automatic translation tools to increase English language information on its website in order to enhance information dissemination capabilities.

[66] Global Financial Partnership Center

Column

Contents

I. Support the Economy and People's Lives for Future Growth

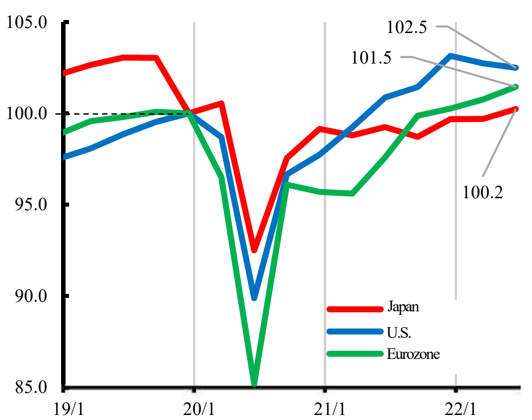
Column 1: Current financial and economic situation[1]

According to current economic indicators, the global economy has shown signs of recovery in demand from the decline under the impact of COVID-19 (Figure 1), mainly in developed countries, and inflationary trends that have arisen from supply constraints and resources price spikes triggered by Russia's invasion into Ukraine and lockdowns in China (Figures 2 and 3). In response, central banks have rapidly tightened monetary policy. As inflation levels still remain high, stagflation fears and uncertainties about the future global economy have been increasing.

In such situation, financial markets have destabilized. In the stock market, major U.S. and European stock indexes hit record highs in early 2022 and weakened towards the middle of the year (Figure 4). Interest rates have been increasing globally against the backdrop of major countries' monetary policy turnaround (Figure 5). In the currency market, the Japanese yen has depreciated against the dollar and euro since early 2022 (Figure 6).

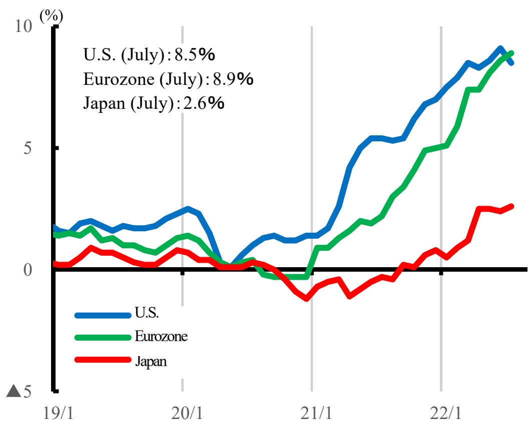
While the monthly number of corporate bankruptcies in Japan has remained lower than usual since the COVID-19 outbreak (Figure 7), some companies have lagged behind others in recovering from the COVID-19 disaster, with downside economic risks still lingering due to supply constraints and resources price spikes. In such situation, we should watch the impact of economic changes such as price hikes on economic activities and people's lives while ascertaining and analyzing the impact of financial market fluctuations on financial systems and institutions.

(Figure 1) Real GDP trends



(Note) 100 for October-December 2019
(Source) Prepared by the JFSA from Bloomberg.

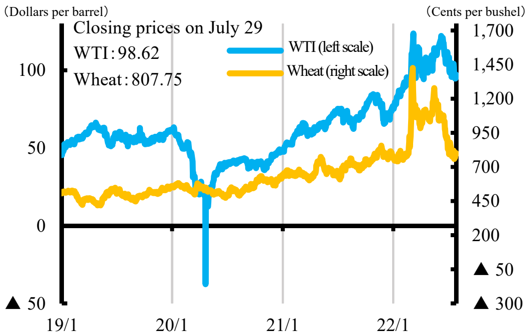
(Figure 2) Consumer price index trends



(Note) Year-on-year change
(Source) Prepared by the JFSA from Bloomberg.

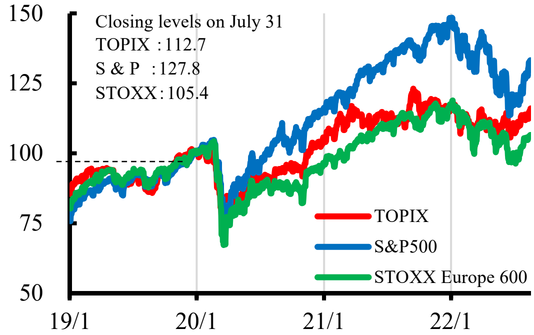
[1] See the main text in I. Support the Economy and People's Lives for Future Growth.

(Figure 3) Commodity market trends



(Source) Prepared by the JFSA from Bloomberg.

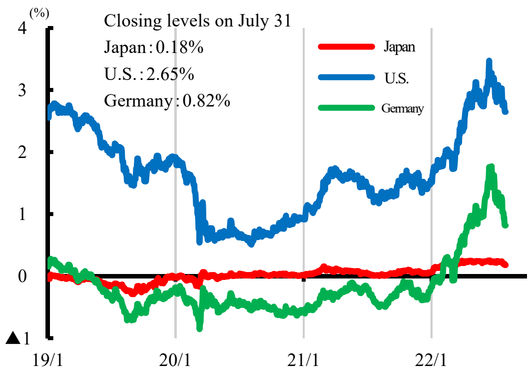
(Figure 4) Stock index trends in developed countries



(Note) 100 for January 1, 2020

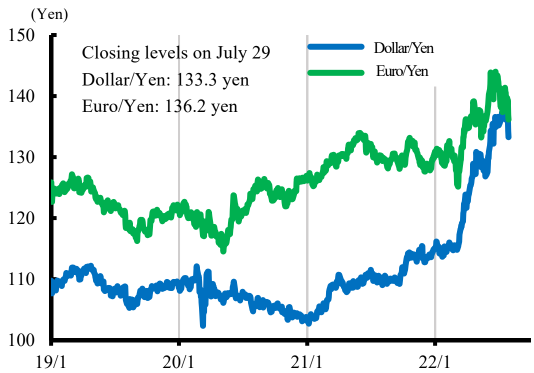
(Source) Prepared by the JFSA from Bloomberg.

(Figure 5) 10-year government bonds yield trends



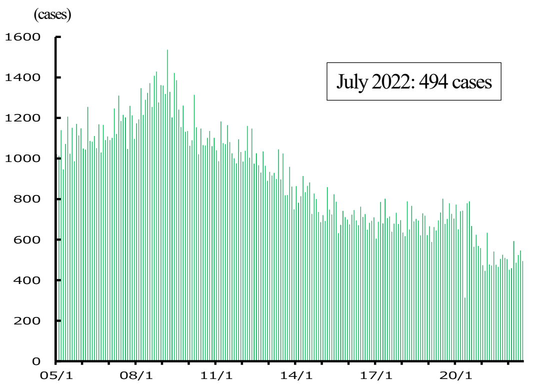
(Source) Prepared by the JFSA from Bloomberg.

(Figure 6) Foreign exchange market trends



(Source) Prepared by the JFSA from Bloomberg.

(Figure 7) Bankruptcy trends



(Source) Prepared by the JFSA from Tokyo Shoko Research "Corporate bankruptcies nationwide"

Column 2: Progress Report on the Efficiency of Financial Intermediation[2]

The JFSA has published the annual Progress Report on the Efficiency of Financial Intermediation since BY2019.

(1) Initiatives for COVID-19 responses and supporting companies

At a time when COVID-19 continues to exert impacts on regional economies, it is important for financial institutions and other regional stakeholders to cooperate in promoting initiatives to support companies integrally. To this end, the Local Financial Bureaus have cooperated with the Regional Bureaus of Economy, Trade and Industry in promoting "Projects to Establish Support Systems for Businesses" to share challenges and solutions regarding support for companies in each prefecture, implementing workshops and other initiatives to enhance cooperation between working-level officials.

The JFSA will promote the development of relations and cooperation between financial institutions and other business support organizations to settle voluntary and autonomous business support arrangements among regional stakeholders in each region.

(2) Expansion of financial intermediation and authorities' response

(i) Hopes on local companies – Corporate survey –

The JFSA has conducted a corporate survey since BY2015 to check customers' evaluation of regional financial institutions' financial intermediary process, covering micro, small and medium-sized companies that deal with regional financial institutions as their main finance banks.

According to the BY2021 survey, the "introduction of trade partners or buyers" and the "introduction of various support systems and assistance with application procedures" were cited by a large share of respondents as services that companies hope to receive from financial institutions, representing services that are directly linked to the improvement of earnings. Among services for which companies agreed to pay fees, the "introduction of managerial talents" was cited by nearly 50% of respondents, becoming the most frequently cited service (Figure 1).

(Figure 1) 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

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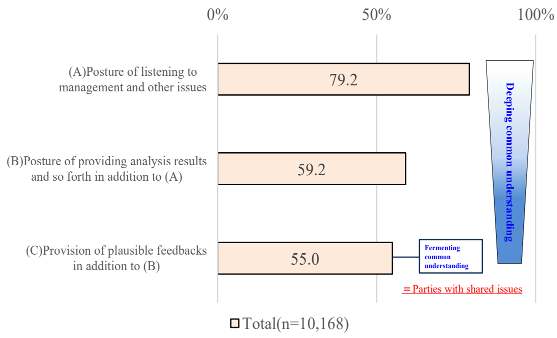
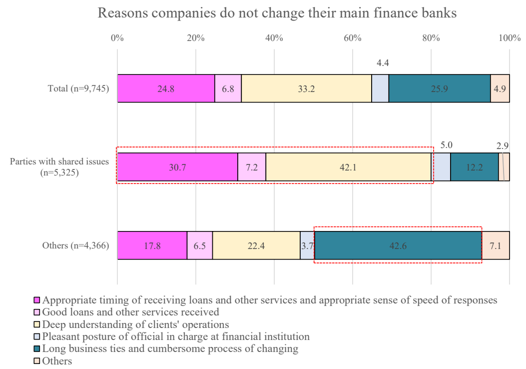
[2] See the main text in I. 1 (2) Improving business support capabilities towards revitalizing local economies.

Regarding reasons companies do not change their main finance banks, respondents positively rated services and understanding of financial institutions that share challenges with client companies. As for other financial institutions, more than 40% of respondents cited a negative reason that it is cumbersome to change a main financing bank (Figure 2).

(Figure 2) Possibility of ensuring stable customer base by fermenting common understanding of client firms' problems



(Source) JFSA

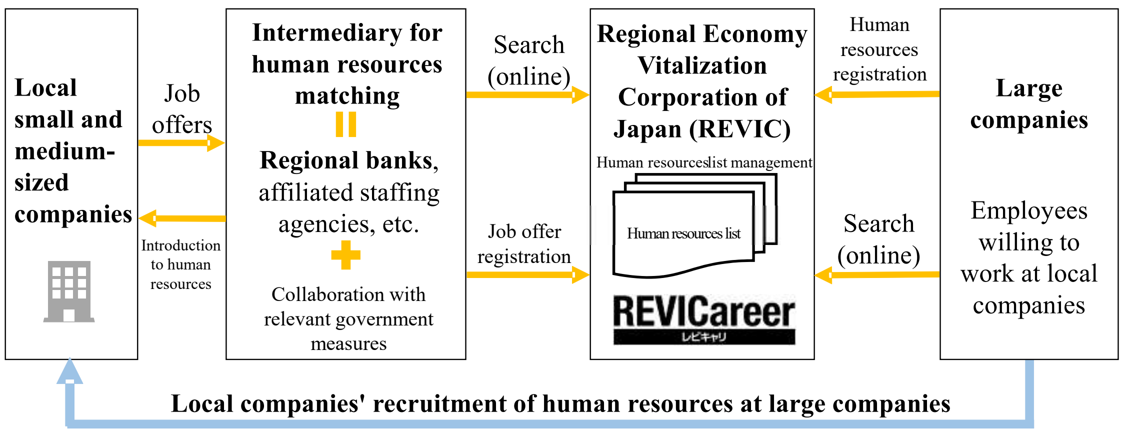


(Source) JFSA

(ii) Promoting matching between suitable management professionals and local companies

The JFSA launched a project to promote matching between suitable management professionals and local companies in FY2020. Under the project, the JFSA has developed the "REVICareer" human resources platform to connect human resources at large companies to local companies and implemented training sessions and workshops for large companies' human resources registered with the "REVICareer" platform (Figure 3).

(Figure 3) Scheme for the project for promoting matching between suitable management professionals and local companies



(Source) JFSA

(3) Solutions led by local players

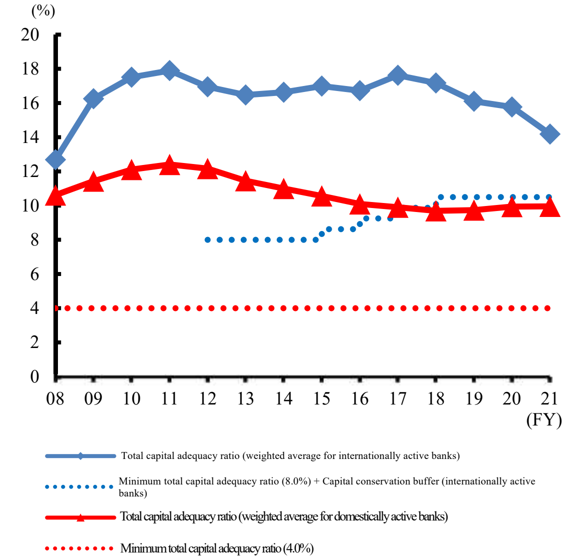
Since FY2018, JFSA officials have sustained their voluntary efforts to resolve local challenges. They have considered specific solutions to local challenges along with local industrial, academic and government stakeholders and introduced experts and professionals as necessary. In March 2021, the JFSA launched cooperation with the Ministry of the Environment to support the development of relevant human resources networks.

Column 3: Assessment of financial institutions' soundness[3]

Capital adequacy ratios for banks -the center of Japan's financial system- have remained well above regulatory minimum levels (Figure 1). In addition, their non-performing loan ratios have stayed low (Figure 2). As indicated, Japan's financial system is generally stable and robust.

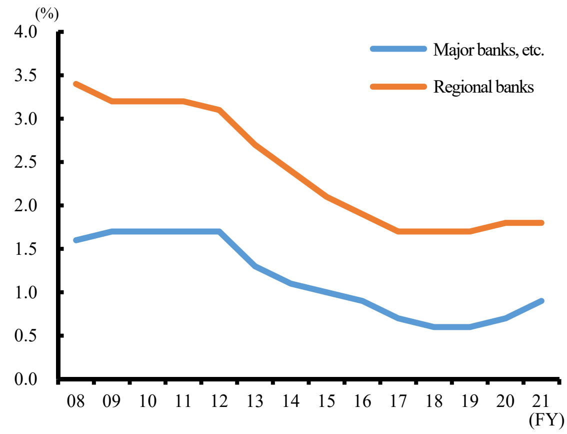
Since the outlook of financial, economic, and global situations is uncertain, there is a strong need for the JFSA to assess risks that may have an impact on the soundness of financial institutions.

(Figure 1) Capital adequacy ratio trend



(Note) Capital adequacy ratios are calculated on a nonconsolidated basis.
(Source) JFSA

(Figure 2) Non-performing loan ratio trend



(Source) JFSA

(1) Market operation and funding risk

Global interest rate hikes have led to mark-to-market losses and losses on sales of bonds held by financial institutions (Figure 3). As for the foreign currency funding environment, rising funding costs (Figure 4) and widening basis spreads[4] in the medium to long-term zone indicate changes in the supply-demand balance. Attention must be paid to the possibility that future monetary policy actions and the trend of U.S. banks and other foreign currency suppliers could have an impact on financial institutions' market-based fundraising.

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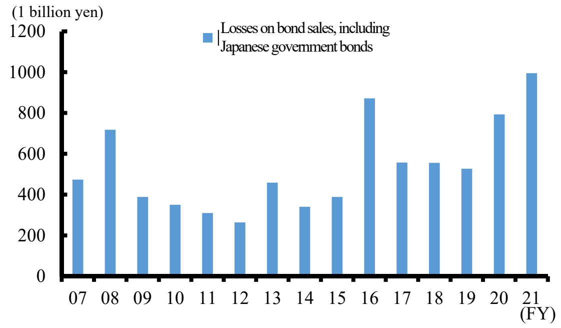
3 See the main text in 1.2. (1) (i) Strengthening business bases and ensuring soundness.

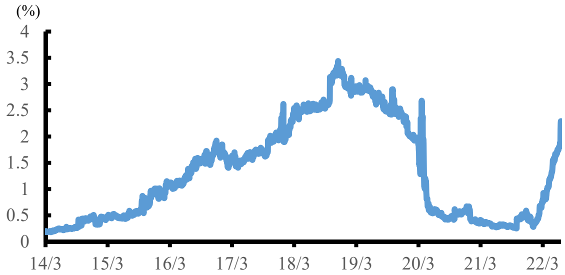
4 "Cross-currency basis spread" refers to a premium to cover an interest rate gap in a cross-currency principal swap transaction. The spread fluctuates in line with a cross-currency supply-demand gap. When the market plunges into U.S. dollar shortages or demand for U.S. dollars is strong, for instance, the U.S. dollar-yen basis spread tends to expand in the negative direction.

(Figure 3) Realized losses at Japanese financial istitutions



(Note) Covered are major banks, etc. and regional banks.
(Source) Prepared by the JFSA from Bloomberg.

(Figure 4) 3-month dollar fundraising cost trend

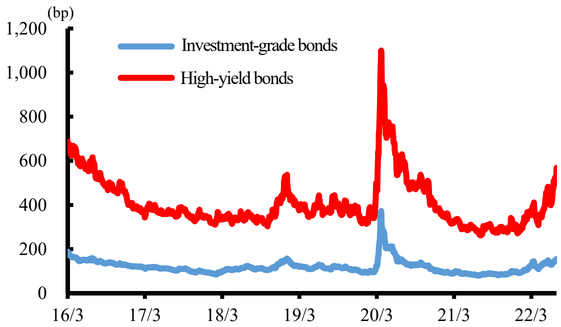


(Note 1) Due to the termination of Libor, the cost since January 2022 is computed on a risk-free rate basis.
(Note 2) The latest cost is for June 15, 2022.
(Source) Prepared by the JFSA from Bloomberg.

Credit spreads are also widening (Figure 5), with collateralized loan obligation and leveraged loan prices falling (Figure 6). While major banks' investment in overseas credit markets is slightly decreasing at present (Figure 7), some financial institutions have investment portfolios dominated by overseas credit investment or promote strategies for active credit and private equity investment in addition to traditional security investment to earn net interest income. When credit risks grow, the expansion of credit valuation adjustment (CVA)[5] of over-the-counter derivatives transactions may have some impact on financial institutions' financial performance (Figure 8).

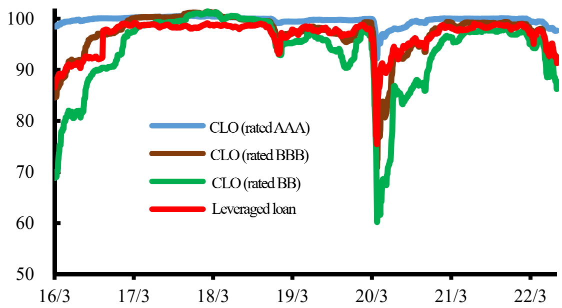
The JFSA will accurately identify the impacts of the strains in financial market on financial institutions' soundness and foreign currency funding through data analysis and hold dialogues with various types of financial institutions about their market investment and funding policies and risk management. Where necessary, the JFSA will encourage them to sophisticate risk management arrangements.

(Figure 5) U.S. corporate bond spread



(Note) Latest data are for the end of June 2022.
(Source) Prepared by the JFSA from Bloomberg.

(Figure 6) CLO (collateralized loan obligation) and leveraged loan prices



(Note) Latest data are for the end of June 2022.
(Source) Prepared by the JFSA from Bloomberg.

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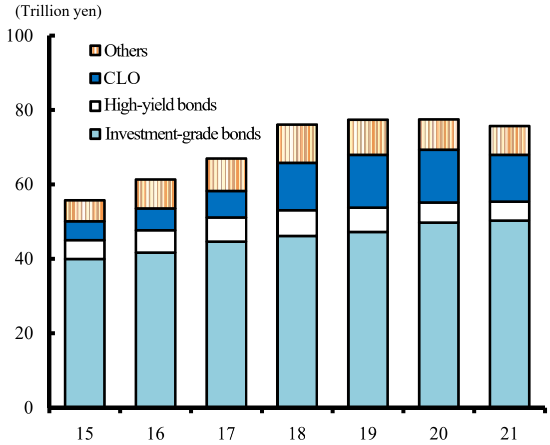
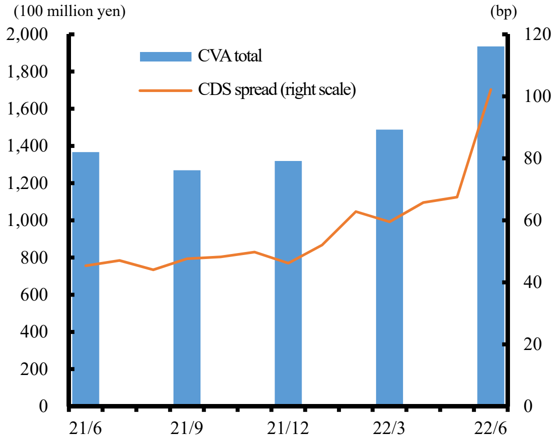
5 CVA is the adjustment to prices of derivative transactions to reflect the creditworthiness of the counterparties. Like loan-loss provisions, CVA is determined by the exposure at default (EAD), the probability of default (PD) and the loss given default (LGD) for a derivatives transaction. Unlike for loan-loss provisions, exposures in CVA calculation fluctuates driven by market factors (such as interest rates, exchange rates), and the PD for CVA must be estimated from credit default swap and other spreads.

(Figure 7) Major banks' overseas credit investment trend



(Source) JFSA

(Figure 8) CVA balance and CDS (credit default swap) spread trends at large financial institutions (3 megabanks and large securities companies)

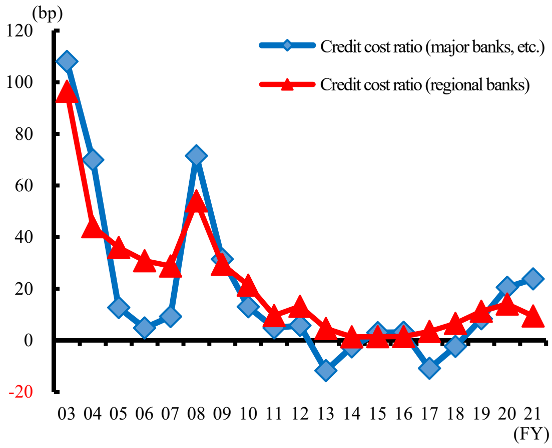


(Source) JFSA

(2) Risk of rising credit costs

Credit cost ratios have been smaller than the long-term average as defaults in Japan have been limited to low levels (Figure 9). On the other hand, defaults at some large debtors and provisions involving credits to Russia exert some impacts on earnings at financial institutions (Figure 10).

(Figure 9) Credit cost ratio trend



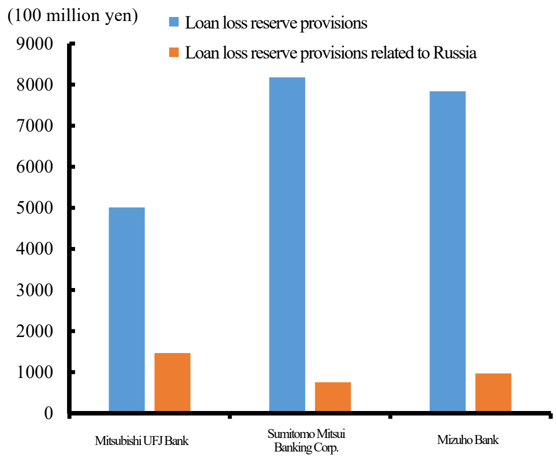
(Note 1) SURUGA Bank is excluded for FY2018. Data are excluded for financial institutions that failed to survive mergers in each fiscal year.

(Note 2) Credit cost ratio = Credit cost / average balance of outstanding loans

(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

(Figure 10) Loan loss reserve provisions and those related to Russia (FY2021)



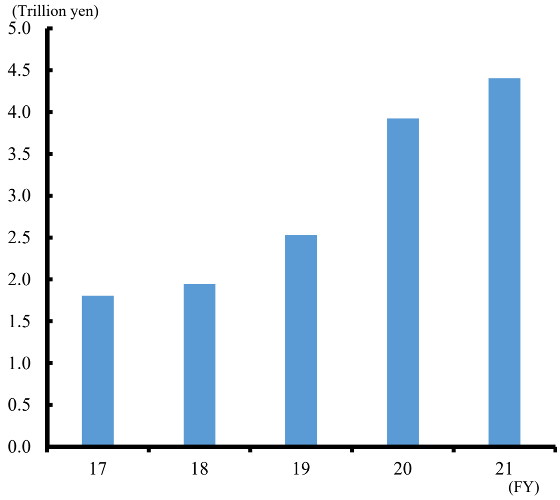
(Source) JFSA

A closer look at the different types of products shows that, major banks have been proactively providing leveraged buyout (LBO) loans, reflecting growing demand for funds for business turnaround in Japan (Figure 11). However, the portfolio has shown deterioration and tends to be larger loans than in overseas market.

Recently, major banks have also focused on loans to U.S. and other non-IG companies with great growth potential, amid the declining profitability of loans to foreign investment-grade (IG) companies in the continued low-interest environment, which had been dominant earlier. Leveraged loans to non-IG companies have increased also on a global level (Figure 12). In promoting business to these borrowers with lower credit quality, affiliate banks and securities companies are attempting to take various opportunities over a long term through their cooperation, which makes it important for financial institutions to manage earnings and risks on a group-wide basis.

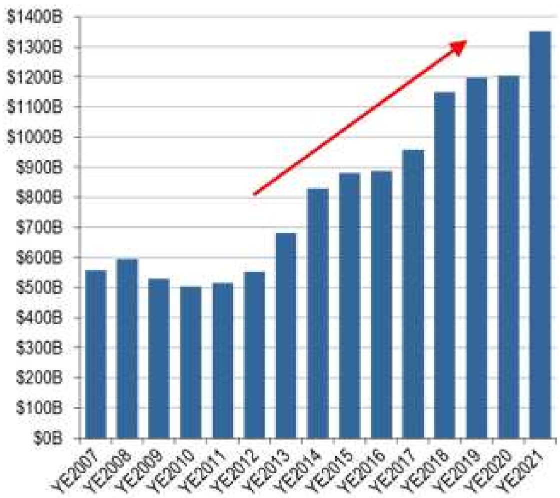
While watching the impacts of financial, economic and global environments on companies' earnings, fund demand and debt repayments regarding financial institutions' domestic and overseas credits, the JFSA will engage with these financial institutions on their credit risk management and group-wide arrangements and encourage them to sophisticate such arrangements as necessary.

(Figure 11) Large banks' domestic leveraged buyout loan balance



(Source) JFSA

(Figure 12) Leveraged loan balance (global)



(Note) S&P defines loans rated BB or below as leveraged loans in principle.
(Source) S&P

Column 4: Report on IT governance in the financial sector[6]

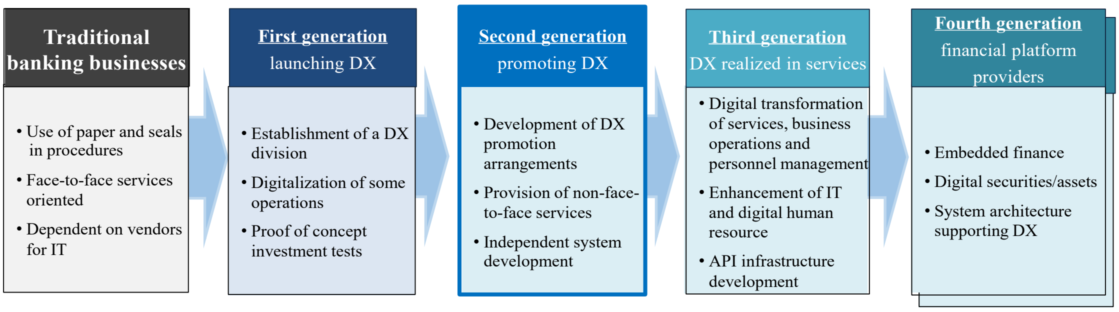
To maintain sustainable business models, financial institutions need to develop and improve IT systems that liaise IT strategy and business strategies to benefit from digital transformation (DX)and better meet customer needs. IT governance[7] refers to framework in which financial institutions utilize IT to create enterprise values under the leadership of board and senior management.

In BY2021, the JFSA conducted a fact-finding survey and analysis on the following IT governance issues, based on the BY2020 survey results and progress in digital transformation at financial institutions.[8]

(1) DX status

The JFSA divided financial institutions by DX status into generations. For example, the JFSA categorized a group that have just launched DX as the first generation (Figure 1). DX-leading regional banks and megabanks are reaching the third generation. Financial institutions in the second and third generations have implemented strategic investment based on medium to long-term DX strategies and organizational reform for DX. At present, however, they have not necessarily taken advantage of digital technologies to expand their businesses. They are still exploring what they should specifically pursue, such as being a provider of financial platforms.

(Figure 1) Digital shift in financial institutions



(Source) JFSA

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6 See the main text in 1.2. (1) (i) Strengthening business bases and ensuring soundness.

7 JFSA, "Discussion Paper on Dialogues and Practices Regarding Financial Institutions' IT Governance" (June 2019) https://www.fsa.go.jp/news/30/20190621-3.html (Available in Japanese)

8 JFSA, "Research Report Regarding IT Governance of Financial Institutions" (June 2022) https://www.fsa.go.jp/news/r3/20220630/20220630.html (Available in Japanese)

(2) Retaining and developing IT human resources

In the answers to the questionnaire to financial institutions on initiatives for the personal acquisition and development of IT human resources, the item that the most regional and shinkin banks answered "yes" to was the question on whether or not they took initiatives on the improvement of IT and digital literacy of their staff. The portion of regional and shinkin banks that answered "yes" to this item increased from BY2020. With respect to other questions (see the questions below in the table), the portion of the answer, "yes", however did not reach the level of 50% in the half of all the questions in regional banks, and did not reach the level of 10% in some questions in shinkin banks. This result indicates that retaining and developing IT human resources still remains a challenge for these regional financial institutions (Figure 2).

(Figure 2) A survey result on IT human resources (the numbers show the percentage of respondents answering "yes" to the questions listed below)

Questions	Regional banks		Shinkin banks	
	BY2020 (%)	BY2021 (%)	BY2020 (%)	BY2021 (%)
(i) Have you formulated a medium to long-term plan to secure and develop IT human resources?	53.4	58.0	20.5	19.3
(ii) Have you formulated a career path for IT human resources?	42.7	48.0	4.3	5.9
(iii) Have you developed standards and methods for assessing the skills of IT human resources?	45.6	47.0	8.3	9.8
(iv) Have you established a training system to develop IT human resources?	43.7	46.0	7.9	7.9
(v) Have you established any recruitment system to secure IT human resources?	55.3	60.0	16.1	18.5
(vi) Have you established any system to encourage employees to acquire IT-related qualifications?	89.3	– (No survey)	35.4	– (No survey)
(vii) Have you implemented measures to all staff to improve their IT and digital literacy?	59.2	79.0	28.0	36.2
(viii) Have you implemented any other initiatives to secure and develop IT human resources?	35.9	47.0	12.2	13.4

(Source) JFSA

When the JFSA interviewed financial institutions about effective ways to promote the securement and development of IT human resources, some answered that given that long-term continuous initiatives are required to secure and develop IT human resources, management team members' engagement and organization-wide efforts are important for such initiatives.

(3) Next-generation joint system center scheme

Questioned about the next-generation joint system center for regional banks, they indicated that they are trying to improve system cost efficiency by developing a more open, slim system center to cut costs and prevent complication and bloating.

Column 5: Sales companies' efforts regarding customer-oriented business conduct[9]

In June 2022, the JFSA published the Results of Monitoring Customer-Oriented Business Conduct of Investment Trust Distributors, summarizing the monitoring results regarding the status of customer-oriented business conduct at distributors of risk-involving financial instruments and the disclosure of policies they formulated and published based on the "Principles for Customer-Oriented Business Conduct" as follows.

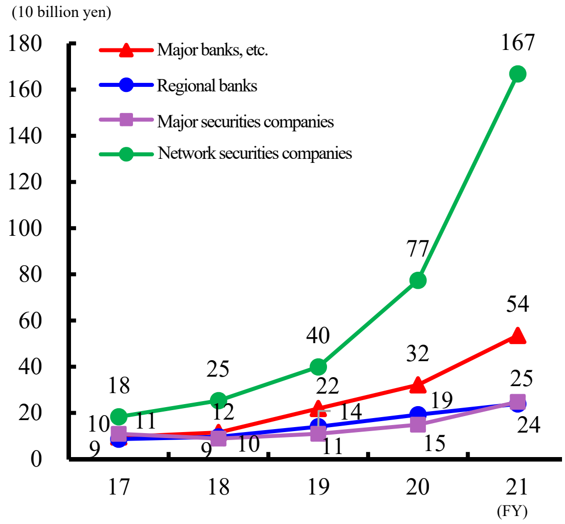
Many distributors have been considering or implementing measures to secure their stable earnings while realizing customers' best interests, paying attention to customer segments. For instance, distributors, including network securities companies, have taken advantage of such measures to remarkably increase accumulation-type investment trust sales (Figure 1) and investment trust holders (Figure 2), indicating that a mechanism for customers to select investment trusts has begun to be realized.

Meanwhile, some regional financial institutions have problems regarding sales arrangements and the visualization of their sales policies. For instance, regional financial institutions have (i) formed comprehensive alliances with large securities companies to hand over customer accounts and unify products for handling, (ii) opened joint branches with network securities companies to introduce customers to them and (iii) enhanced sales mediation and customer introduction for their securities business affiliates. However, follow-up operations after the introduction of customers have been undertaken by securities companies. Regional banks have failed to know specific sales results after the introduction of customers, leaving securities companies to sell mainly theme funds and structured bonds. As for the evaluation of employees' performance, some financial institutions have given lower weights to deposit balance data while vowing to emphasize stock earnings and deposit balances in the evaluation. Their evaluation of employees' performance has thus deviated from their business policies or strategies.

Given these points, the JFSA will focus monitoring on (i) whether management teams at distributors of risk-involving financial instruments have considered sustainable business strategies and clarified them in business policies, (ii) policies that meet business strategies have been established among salespersons and produced achievements at these distributors and (iii) arrangements have been developed at these distributors to develop, sell and manage financial instruments that contribute to customers' asset building, based on the characteristics of structured bonds and sales system problems.

[9] See the main text in 1.2. (1) (ii)(a) Customer-oriented business conduct.

(Figure 1) Changes in sales amounts of installment investment trusts

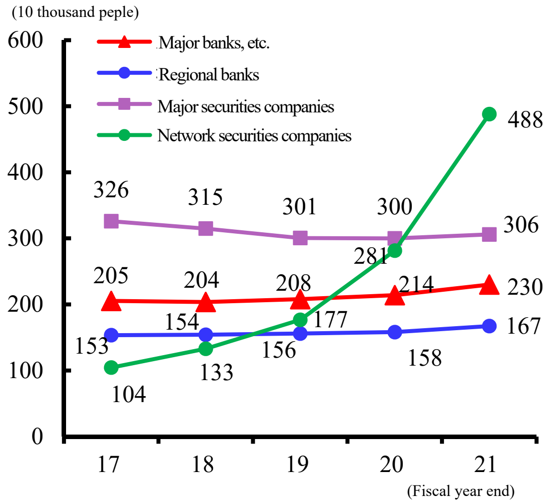


(Note 1) Aggregated data from 7 major banks, etc., 22 regional banks, 7 securities companies, and 5 network securities companies, from which valid responses were obtained

(Note 2) The amount of annual reserves is calculated from the following formula: "(the amount in September of the relevant program year + the amount in March of the same program year) × 6"

(Source) JFSA

(Figure 2) Changes in Number of Customers Holding Investment Trusts



(Note 1) Data from 8 major banks, etc., 23 regional banks, 7 large securities companies, etc. and 5 network securities companies was aggregated.

(Note 2) Investment trusts for banks cover their own sales.

(Note 3) Individual customers with assets on deposit as of the end of each fiscal year are covered.

(Source) JFSA

Column 6: Initiatives to enhance AML/CFT/CPF measures[10]

The JFSA has been working to enhance risk-based AML/CFT/CPF measures at financial institutions since 2018. The FATF 4th Mutual Evaluation Report of Japan (Report) published in August 2021 recognizes achievements regarding Japan's efforts to enhance AML/CFT/CPF measures. On the other hand, the Report points out that Japan needs to promote financial institutions' understanding on those risks and strengthen supervision further preferentially in terms of such measures.

Taking into account the points raised in the Report, the JFSA has been trying to further enhance AML/CFT/CPF measures since BY2021 by conducting inspections focusing on such measures primarily at deposit-taking financial institutions, fund transfer service providers, and crypto-asset exchange service providers, as well as holding joint public-private study meetings.

To provide information on AML/CFT/CPF risks and challenges surrounding Japan's financial industry to financial institutions as a feedback, the JFSA in April 2022 published a report " "Anti-Money Laundering, Counter Financing of Terrorism, and Counter-Proliferation Financing" Current Status and Challenges (as of March 2022) " (Figure 1).

(Figure 1) Composition of the AML/CFT/CPF report

Composition of the report

Chapter 1 Risks Surrounding Financial Institutions in Japan

Risks surrounding financial institutions in Japan

- AML/CFT/CPF risks are changing due to the spread of COVID-19 infections and technological development.
- Need for measures based on risk changes (Risk-Based Approach)

Overview of money laundering crime in Japan and the perpetrators (Explanations based on the National Risk Assessment (December 2021))

- Frequent occurrences of money laundering cases involving Boryokudan (organized crime groups), specialized fraud crime groups and foreign nationals in Japan ⇒ A fall in the number of specialized fraud cases
- Increase of cybercrime expansion (including ransomware attacks)

Crime types and risks that should be noted in AML/CFT/CPF

・Money laundering, terrorist financing and proliferation financing using crypto-assets

Risks involved in settlement of funds

- Risks in non-face-to-face transactions
- Risks associated with verification methods such as e-KYC (electronic Know Your Customer)
- Cybercrime (Phishing, ransomware)
- Fraud cases such as specialized fraud
- Terrorist financing risk
- Geopolitical risks (proliferation financing, economic sanctions, etc.)

Chapter 2 Current Status and Challenges of ML/TF/PF Risk Management at Financial Institutions by Business Sector

Deposit-taking financial institutions

-Regional financial institutions

-3 mega-banks

Crypto-asset exchange service providers

Fund transfer service providers

Insurance companies

Financial instruments business operators

Trust banks and trust companies

Money lending business operators

Chapter 3 FATF Mutual Evaluation of Japan

FATF and Mutual Evaluation framework

- FATF overview
- Mutual Evaluation framework
- Japan's responses until 4th Mutual Evaluation

Results of the FATF 4th Mutual Evaluation of Japan

- IO4: Effectiveness of preventive measures by financial institutions, etc.
- IO3: Effectiveness of supervision on financial institutions, etc.

Chapter 4 JFSA initiatives on AML/CFT/CPF

JFSA initiatives on AML/CFT/CPF

- Revision of guidelines, preparation and publication of FAQs
- Risk assessment at financial institutions, etc.
- Specifying deadlines for developing the control framework required by guidelines
- Inspections focusing on AML/CFT/CPF measures for financial institutions
- Considering shared AML/CFT/CPF systems
- Requesting financial institutions to provide courteous customer service related to AML/CFT/CPF preventive measures
- Service for foreign nationals
- Strengthening inter-agency cooperation (including measures taken after the publication of the FATF 4th Mutual Evaluation Report of Japan)
- Public-private cooperation
- Public relations activities for customers of financial institutions
- Contributions to the FATF

(Source) JFSA

[10] See the main text in 1.2. (1) (iii)(a) Enhancing measures for anti-money laundering, counter financing of terrorism, and counter-proliferation financing (AML/CFT/CPF).

Chapter 1 of the report explains risks involving AML/CFT/CPF. Particularly, it points out that (i) AML/CFT/CPF risks have changed as an increase in non-face-to-face transactions under the COVID-19 pandemic has led to new crimes, including fraudulent acts related to COVID-19 countermeasures, (ii) there are cases that so-called collection or payment agent service providers seem to undertake de facto foreign exchange remittance services in Japan, and (iii) the importance of customer risk assessment based on an understanding on customers' commercial flows and actual situations, the risk-based ongoing customer due diligence according to risks and the monitoring of transactions have become even more important in regard to responses to economic sanctions on Russia for its invasion into Ukraine.

Chapter 2 describes progress in and challenges regarding AML/CFT/CPF measures of each sector and financial institution, based on information collected through monitoring. Financial institutions have generally made progress towards the end of March 2024, deadline for the development of AML/CFT/CPF framework, but some have lagged behind others (Figure 2).

(Figure 2) Overview of Chapter 2 of the AML/CFT/CPF report

Chapter 2 Current Status and Challenges of ML/TF/PF Risk Management at Financial Institutions

Current status and challenges by business sectors

Based on information collected through supervision and inspections as well as on the national risk assessment (NRA), **the chapter describes the following current status and challenges as well as the outline of risks by business sector in the same way as the previous AML/CFT/CPF report.**

(i) Overall trends common to all sectors
Financial institutions are developing their respective AML/CFT/CPF framework with the target of the end of March 2024 and their overall level is considered to be upgraded. However, some of them are lagging behind others in implementing the framework as much time is required to identify and assess risks comprehensively and specifically and to prepare action plans.

(ii) Regional financial institutions
Regional financial institutions are proceeding with the development of an AML/CFT/CPF framework. However, some of them are lagging behind others in identifying and assessing risks, conducting ongoing customer due diligence, and transaction monitoring/filtering.

(iii) 3 mega-banks
The mega-banks have generally implemented the framework required in the guidelines or made progress in developing AML/CFT/CPF framework under specific plans. As for ongoing customer due diligence, they have made progress in updating customer information regularly and are considering improving efficiency. They are expected to continue sophisticating responses to economic sanctions.

(iv) Crypto-asset exchange service providers
Risks arising from the difficulty in tracking crypto-asset transactions and from dominant non-face-to-face transactions as well as discussions on relevant international regulations may lead to dramatic environmental changes. Crypto-asset exchange service providers are expected to sophisticate the identification and assessment of risks, the use of IT systems, the management of data and business management frameworks.

(v) Fund transfer service providers
Risks regarding non-face-to-face transactions and the vulnerability of procedures have emerged, such as occurrence of cases of fraudulent withdrawals using fund transfer service providers' settlement services. Challenges include delays in the securement of accurate customer information, such as "customer identification information," customer due diligence and monitoring and filtering of transactions.

(vi) Other business operators (insurance companies, financial instruments business operators, trust banks and trust companies and money lending business operators)
Large companies in each business sector have made progress in developing an AML/CFT/CPF framework, while small and medium-sized firms are lagging behind. Their challenge is the development of such framework by the deadline.

(Source) JFSA

Chapter 3 outlines the FATF Mutual Evaluations framework and explains the effectiveness of supervision on financial institutions and of their AML/CFT/CPF measures as part of the Report on the FATF 4th round of Mutual Evaluation of Japan. The Report concludes that while AML/CFT/CPF measures in Japan have made some achievements, Japan should prioritize addressing the issues of supervision and inspection of financial institutions, prevention of misuse of corporations, investigation and prosecution. Overall, the Report evaluates Japan as an enhanced follow-up country.

Chapter 4 explains the JFSA's AML/CFT/CPF initiatives. In response to the Report on the FATF 4th Mutual Evaluation of Japan, the government established the AML/CFT/CPF Policy Council, and published an action plan including policy goals and deadlines for AML/CFT/CPF measures over the next three years. In conjunction with its past initiatives and the action plan, the JFSA has cooperated with other relevant government agencies and taken the initiative in enhancing AML/CFT/CPF measures.

The chapter also points out that the JFSA has cooperated with industry associations within the framework for public-private cooperation to conduct public relations activities for promoting financial institution users' understanding on AML/CFT/CPF measures through internet advertisements and government public relations. It is also described that the JFSA has proactively hosted study meetings for industry associations[11] in efforts to support financial institutions' enhancement of AML/CFT/CPF measures.

[11] In BY2021, 133 lecture/study meetings were implemented.

Column 7: Analysis report on system failures at financial institutions[12]

The JFSA receives reports about system failures from financial institutions in accordance with supervisory guidelines[13] and other regulations. Based on these reports, the FSA has annually published the Analysis Report on IT System Failures in Financial Institutions since 2019.

The latest version of this report was published in June 2022. The report categorizes incidents, including those covered in the older versions of the report, into the following four groups in accordance with triggers of the incidents. The report then makes analysis of individual cased and draw lessons learnt to provide insight for financial institutions to address issues in controls and management in IT system risk (Figure 1).

(1) Incidents triggered by IT system integration, renewal of IT system or addition of functions to IT system

Factors behind failures tend to include the lack of understanding about specifications of old systems, defective design drawings and programming mistakes.

Challenges are: senior management should have an accurate understanding of circumstances on the site of the IT system development; financial institutions should develop IT assets, such as system specifications and written manuals for operation procedures; and financial institutions should develop and retain IT human resources.

(2) Incidents triggered by program renewal or any other non-routine/special operations

Some incidents tend to originate from changes to settings in IT systems and operational mistakes under extraordinary circumstances, such as changes to settings of IT systems in the non-testing/operating environment and any other non-routine/special operations.

Challenges are improving operational quality, such as the development of checking arrangements to accurately reflect goals and conditions in work procedures, the implementation of tests to meet production environments and the creation of a mechanism to prevent personnel changes from triggering operational mistakes.

(3) Incidents occurring during routine operations and maintenance checks

These incidents tend to originate from the malfunctioning of redundancy mechanisms that did not work as intended and the defective recovery procedures.

Challenges are: the securement of effective redundancy configuration and the identification of failure signs to prevent failures; the revision of procedures and arrangements for recovery from failures based on system failure patterns; relevant training, the development of failure response plans and procedures from customers' point of view; and the securement of substitute systems in preparation for failures at outsourcing contractors and cooperation with outsourcing contractors.

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12 See the main text in 1.2. (1) (iii)(c) Enhancing IT risk management.

13 Based on supervisory guidelines and other regulations, the JFSA receives reports on IT system failures from financial institutions, inquires with them on recovery from failures and gets reports on causes of failures and relevant improvement measures.

(4) Incidents caused by intentional factors, including cyberattacks and unauthorized accesses

Factors behind these system failures tend to include defects of basic security measures, such as access control, responses to suspicious emails and security patch application.

As the expansion of outsourcing has widened and complicated the scope of IT asset management, a challenge is to enhance organization-wide cyber hygiene[14] arrangements to steadily implement basic measures.[15] As cyberattacks have been sophisticated, financial institutions are required to forestall cyberattacks and enhance the resilience of operations and services through training for all staff including senior management team to minimize the impacts of incidents on operations and customers within the tolerance levels.

(Figure 1) Overview of trends and challenges in IT system failures at financial institutions

Triggers of incidents/failures	Factors behind system failures	Problems and solutions
(1) Triggered by IT system integration, renewal of IT system or addition of functions to IT system	The lack of understanding about specifications of old systems	✓ **Responses to human resources shortages caused by the aging of experts of legacy systems** ➢ Accurate understanding of senior management about circumstances on the site of the IT system development ➢ Development of necessary IT assets, and development and retainment of IT human resources
(2) Triggered by program renewal or any other non-routine special operations	Changes to settings in IT systems and operational mistakes	✓ **Improvement of operational quality** ➢ Development of checking arrangements and implementation of tests to meet production environments ➢ Creation of a mechanism to prevent personnel changes from triggering operational mistakes.
(3) Occurring during routine operations and maintenance checks	(i)The malfunctioning of redundancy mechanisms that caused the configuration's failure to work as intended *The redundancy configuration/mechanism that have in place multiple devices that system failures is designed to secure continuous operations even in the event of partial failures.	✓ **Improvement in effectiveness of contingency plans** ➢ Securement of effectiveness redundancy configuration ➢ Identification of failure signs to prevent failures ➢ Development of procedures and arrangements for recovery from failures and conduce training ➢ Development of failure response plans and procedures from customers' point of view
	(ii) Defective recovery procedures	
	(iii) Services provided by third parties	✓ **Securement of alternative measures on the premise of system failures and continuous information exchange with third parties**
(4) Caused by intentional factors, including cyberattacks and unauthorized accesses	(ii) Infection with malware (including Emotet) (i) Defects in basic cyberattack countermeasures / incidents triggered by the fact that basic countermeasures against cyberattacks were in place only in an insufficient way	✓ **Enhancement of organization-wide cyber hygiene arrangements to steadily implement basic measures** ➢ Development of procedures to respond to vulnerability and unauthorized access ➢ Development of arrangements to nullify macro execution, take anti-malware measures, such as control over unauthorized communications with outside servers, and responses to suspicious emails ➢ Regular training to check and maintain effectiveness of incident responses in operations and services

(Source) JFSA

[14] "Policy Approaches to Strengthen Cybersecurity in the Financial Sector (Version 3.0)" cites this as "addressing new risks". (February 18, 2022) (https://www.fsa.go.jp/news/r3/cyber/torikumi2022.html (Available in Japanese))

[15] Given that cyberattack risks have increased recently, the FSA issued the following warnings to financial institutions on enhancements to cybersecurity measures:
"Warning with respect to the recent developments that call for enhancements to cybersecurity measures" (February 23, 2022) (https://www.fsa.go.jp/news/r3/cyber/0224oshirase.html (Available in Japanese))
"Warning with respect to the recent developments that call for enhancements to cybersecurity measures" (March 1, 2022) (https://www.fsa.go.jp/news/r3/cyber/0301oshirase.html (Available in Japanese))
"Warning with respect to the recent developments that call for enhancements to cybersecurity measures" (March 24, 2022) (https://www.fsa.go.jp/news/r3/cyber/0324oshirase.html (Available in Japanese))
"Warning with respect to the recent developments that call for implementation of cybersecurity measures at financial institutions, particularly for the period in and around the national holiday-studded golden week in 2022"
(April 25, 2022) (https://www.fsa.go.jp/news/r3/cyber/0425oshirase.html (Available in Japanese))

Column 8: Business conditions of regional banks[16]

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 to fully achieve their financial intermediary functions. The JFSA will closely watch economic and financial market trends, analyze and identify potential financial system risks quickly and take appropriate measures to secure financial system stability.

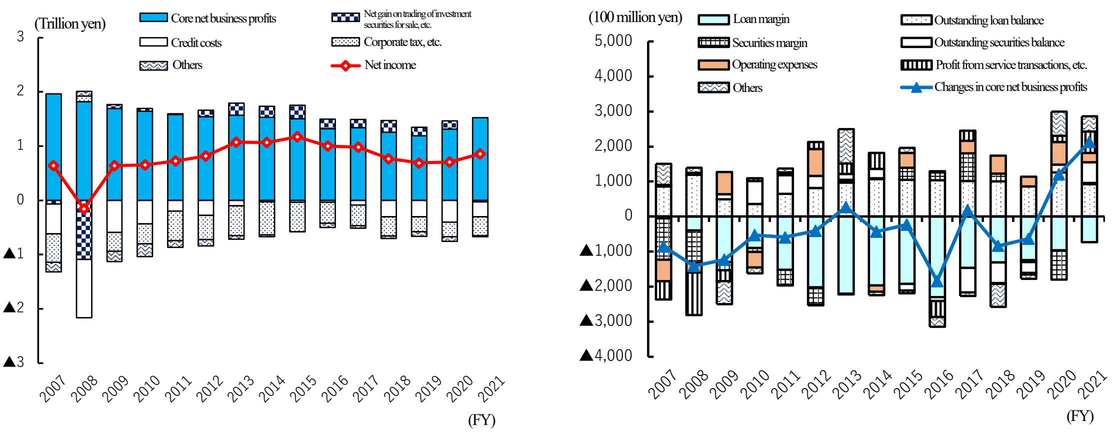
Regional banks' financial results show that their core net business profits, which indicate their basic profitability, have increased since FY2020 but basically followed a downtrend. Decreasing loan margins have been made up for by the positive effects of an increase in outstanding loans and credit cuts (Figure 1).

Interest rate trends include extremely low deposit rates and falling rates on new loans, indicating that the spread between deposit and lending rates has been shrinking. Yields on Japanese government bonds, banks' dominant securities investment target, followed a downtrend, remaining negative since FY2016 (Figure 2).

Their capital adequacy ratios, which indicate capacity to absorb losses, have remained well above the minimum regulatory level (Figure 3).

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 deposits at the end of FY2021 increased due to the BOJ's special funds-supplying operations to facilitate finance in response to the COVID-19 crisis. Their outstanding loans at the end of FY2021 increased about 7 trillion yen or 2.4% year on year to 298 trillion yen as they proactively supported business operators in view of the COVID-19 impact (Figure 4).

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



(Note 1) Data cover regional banks, second-tier regional banks and Saitama Resona Bank. Data for regional financial institutions that failed to survive mergers during each fiscal year are excluded

(Note 2) Core net business profits = Gross profit – Costs – Net gain on bonds

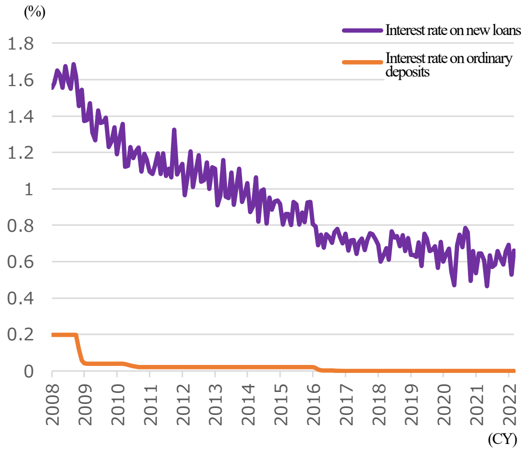
(Note 3) Net gain on trading of investment securities for sale, etc. = Net gain on equity securities + Net gain on bonds

(Note 4) 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)

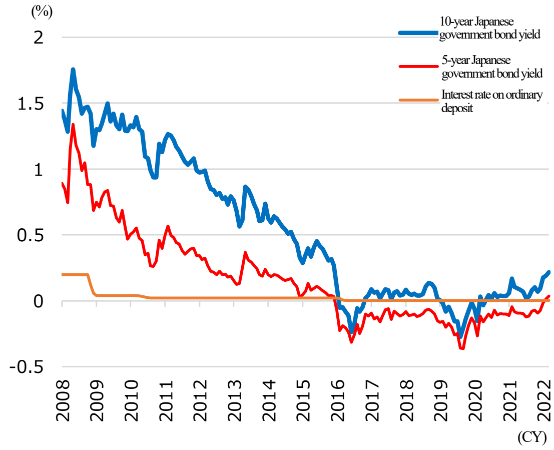
(Source) JFSA

[16] See the main text in 1.2. (2) (ii)Regional financial institutions.

(Figure 2) Interest rate trend

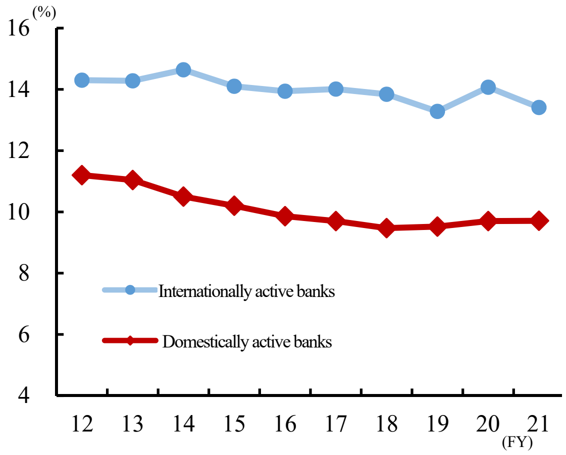


(Source) Prepared by the JFSA from BOJ data.



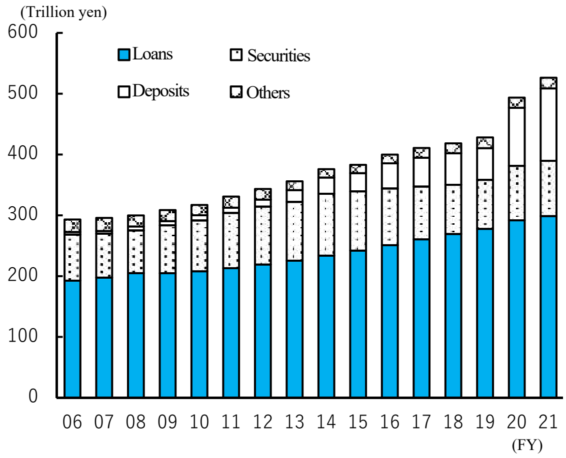
(Source) Prepared by the JFSA from Ministry of Finance and BOJ data.

(Figure 3) Capital adequacy ratio trend



(Source) JFSA

(Figure 4) Details of assets



(Source) JFSA

Column 9: Sustainability of regional banks' retail businesses, including financial instruments sales[17]

Regarding the sales of financial instruments, the JFSA has held dialogues with regional banks since BY2021 on the meaning of such sales in their business strategies and on their suitable business management, as well as on their customer-oriented business conduct.

Through the dialogues, the JFSA found regional banks that fell short of segmenting earnings appropriately, had issues concerning the balance between allocated resources and earnings, or had controversial sales structures in terms of customers' needs.

(1) Earnings segmentation

The JFSA examined the condition of segment-wise earnings from the viewpoint of ensuring the sustainability of retail businesses, including financial instruments sales in regional banks.

As a result, the JFSA found that 39 out of the 100 regional banks were able to segment revenues and expenses from the financial instruments sales according to this survey.[18] The banks could not segment earnings mainly because they could not compute the cost of personnel, equipment, IT system and other costs for financial instruments sales.

Of the 39 banks that were able to segment earnings, 15 posted losses in the financial instruments sales segment for the year to March 2022. If the costs of indirect segments were taken into account,[19] the number of the banks operating at a loss in this segment rose by 13 to reach 28. The considerable number of regional banks thus failed to cover personnel and other costs for financial instruments sales with relevant revenues (Figures 1 and 2).

On the other hand, some regional banks secured profits for the segment by allocating resources appropriately in line with their elaborate business strategies.

It is important for regional banks to formulate their business strategies based on their business philosophies and regional roles, establish and implement policies for allocating capital and resources to each business segment, taking into account risks to take and earnings to make, follow the plan-do-check-act cycle effectively, and achieve their respective business and sales goals. To this end, they need to segment earnings according to their respective business strategies.

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[17] See the main text in 1.2. (2) (ii)Regional financial institutions.

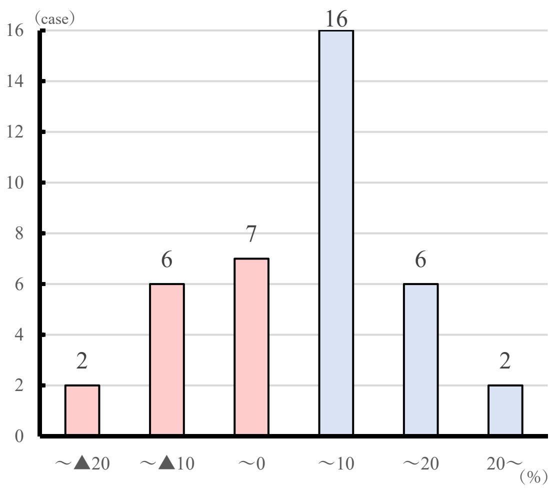
[18] Based on the aggregated data written on voluntary survey responses.

[19] They are estimated by allocating costs in general planning, audit, and other non-revenue divisions, which were difficult to allocate to each segment, in proportion to segments' shares of total costs.

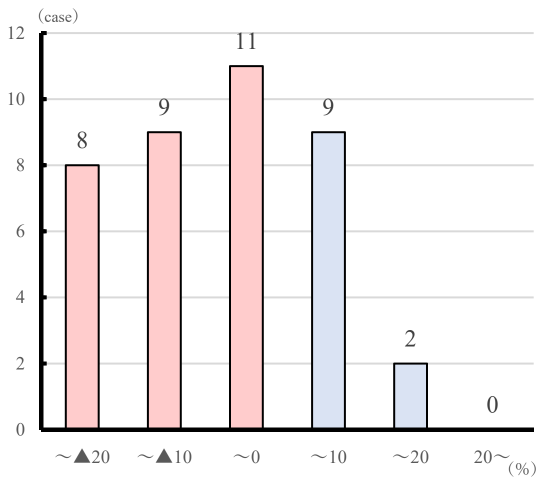
From this viewpoint, management teams of the regional banks that post losses in the financial instruments sales segment need to fully discuss how to position retail businesses including financial instruments sales in line with their business philosophies, and consider optimum capital and resource allocations covering those for corporate sales.

Earnings in financial instruments sales segment (FY2021)

(Figure 1) Before indirect division cost deduction



(Figure 2) After indirect division cost deduction



(Note) Comparison of earnings in financial instruments sales segment divided by core net business profits (excluding gain/loss on cancellation of investment trusts) before and after the deduction of indirect division costs.

(Source) JFSA

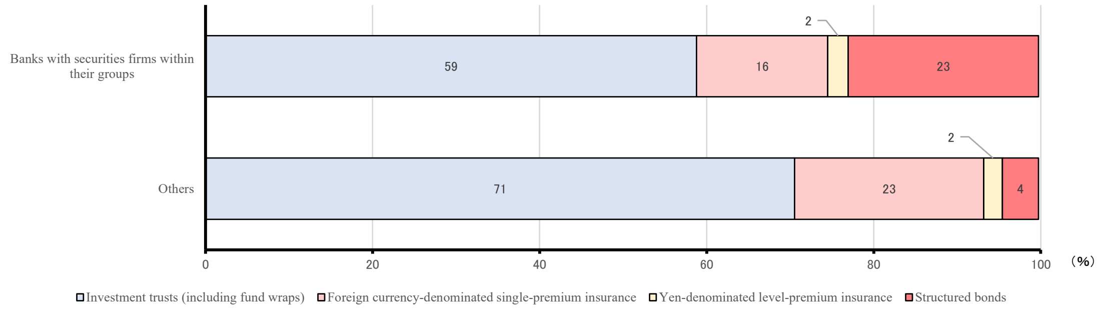
(2) Building assets for customers

From the analysis of regional banks' financial instruments sales, the JFSA found that some of them focused on sales of risk-involving financial products giving higher sales commissions including foreign currency-denominated single-premium insurance products and structured bonds. In addition, given the analysis of complaints from their customers, it is doubtful whether they conduct sales based on customers' true needs.

For instance, the comparison between banks with and without securities companies within their respective groups indicates that the sales (and the introduction) of structured bonds have a larger share in those banks with securities companies. Distributors' sales attitudes might have an influence on financial instruments purchased by customers (Figure 3).

With respect to whether the sales of risk-involving financial instruments contribute to customers' medium to long-term asset formation and whether the sales of these financial instruments reflect customers' true needs, management teams of regional banks need to fully discuss business management strategies once again for the establishment of sustainable retail businesses, from the viewpoint of maintaining or expanding their customer bases.

(Figure 3) Regional banks' major financial instruments sales by category (FY2021)



(Source) JFSA

II. Build the Financial System in which Economic Growth is Achieved by Resolving Social Issues and is Shared with Individuals

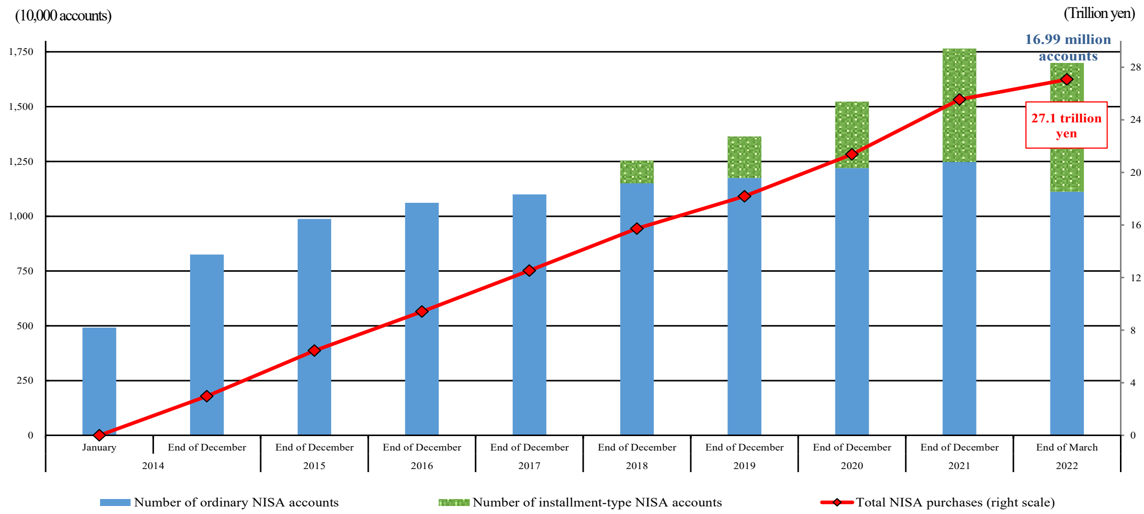
Column 10: Shift from savings to investment (Promotion of financial and economic education, spread of NISA)[20]

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, the JFSA has tried to diffuse and promote the Nippon Individual Savings Account (NISA) tax incentive system, particularly the installment-type NISA.

According to a questionnaire survey[21] (conducted in December 2021 by the Investment Trust Association, Japan), the recognition rate for the installment-type NISA system rose by 6.6 percentage points year on year to 71.2%. The recognition rate for details of the system came to 27.7%, up by 4.5 points from the previous year.

At the end of March 2022, the number of general and installment-type NISA accounts came to about 16.99 million, with purchases totaling about 27.1 trillion yen, indicating a steady diffusion (Figure 1).

(Figure 1) Trends in the number of general and installment-type NISA accounts and purchases



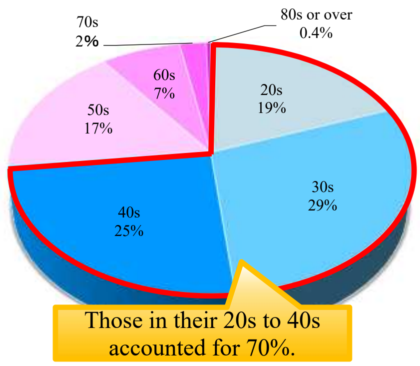
(Note) The purchases from the end of March 2018 are the total of ordinary and installment-type NISA purchases due to the launch of the installment-type NISA in January 2018.
(Source) JFSA

[20] See the main text in II. 1. (1) (i) From savings to investment.
[21] Report on the 2021 Questionnaire on Investment Trusts (Survey on NISA, iDeCo and Other Programs) https://www.toushin.or.jp/files/statistics/70/ToushinReport2021seido.pdf (Available in Japanese)

As of the end of March 2022, about 5.87 million installment-type NISA accounts were opened with purchases totaling about 1,804.3 billion yen. In particular, for a period of one year and three months from the end of December 2020 to the end of March 2022, the number of installment-type NISA accounts newly opened amounted to about 2.84 million (an increase of 93.7%), showing a significant increase.

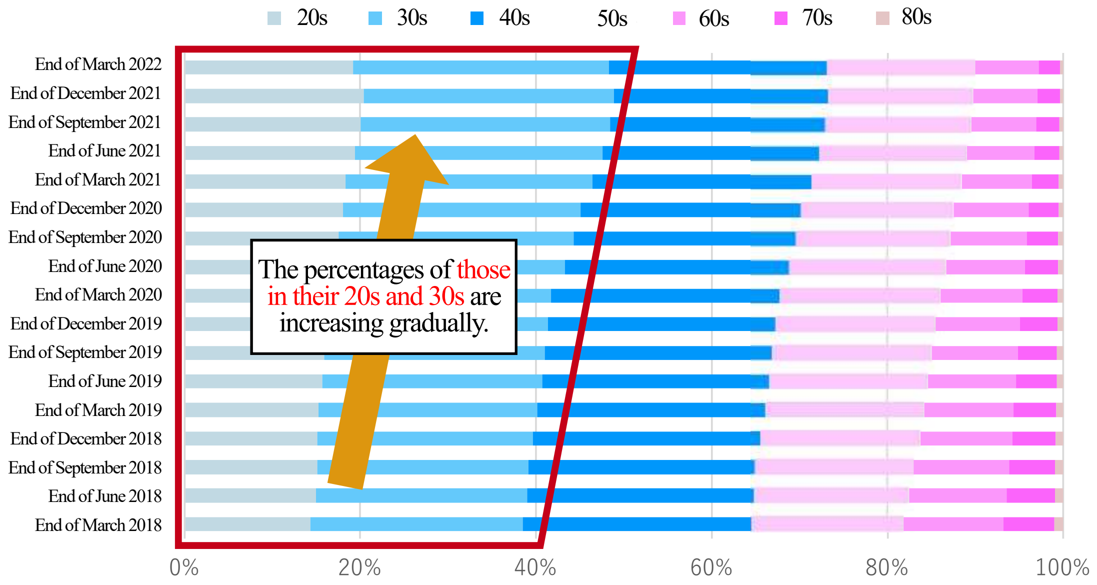
A breakdown of NISA account holders by age bracket indicates that those in their 20s to 40s accounted for about 30% of general NISA accounts and for about 70% of installment-type NISA accounts at the end of March 2022 (Figure 2). Nearly half of the people who newly opened installment-type NISA accounts were in their 20s or 30s, suggesting that a new layer of investors including young people has been expanding through the installment-type NISA system (Figure 3).

(Figure 2) Installment-type NISA account holders (by age bracket)



(Note) Survey of all financial institutions (as of the end of March 2022)
(Source) JFSA

(Figure 3) Trends in the percentage of purchasers of installment-type NISA by age bracket



(Source) JFSA

Financial literacy is indispensable to enable individuals to appropriately select financial services suited to their own life plans and needs, and it is important to secure opportunities for them to receive financial and economic education at various stages in life.

The JFSA has provided classes at schools and created teaching materials. Three contents created in BY2021 are introduced below.

(i) Teaching materials for senior high schools

As the Course of Study for senior high schools was revised in April 2022 and the content of financial and economic education was expanded, the JFSA created teaching materials corresponding to the revision while collecting opinions from teachers, etc. Published materials are in Power Point files so that parts thereof can be extracted freely, and key points in using the materials in class are indicated as notes in the files. Additionally, videos based on these teaching materials were also created and published.

(ii) Video for introducing the installment-type NISA

Some say that they know and are interested in purchasing installment-type NISA but have failed during the process as they found it difficult to understand how to open an account and how to select products. Accordingly, the JFSA created and published a video for beginners to explain key points in opening an account and selecting products.

(iii) "*Unko* (Teacher Poopy) Money Drill"[22] for elementary school children

"*Unko* Money Drill: Day-to-Day Life Edition" published in March 2021 picks up stories about money that elementary school children are likely to experience in their day-to-day lives. As a sequel, "*Unko* Money Drill: Economy Edition" was published in October 2021. The Economy Edition, in which the main character opens a cookie shop, helps children learn about the fun and troubles of business and the economic mechanism such as how money circulates in society.

The JFSA prepared leaflets explaining the Day-to-Day Life Edition and the Economy Edition and started to distribute them in April 2022.

[22] "*Unko* Drill" is a workbook series published by Bunkyosha in which all questions are created using cute characters in the motif of *unko* or poop. The series have increased lineups, such as for workbooks for Japanese, arithmetic and English for elementary school children and workbooks for preschoolers. "*Unko* Money Drill" is web content created with the cooperation of Bunkyosha.

Column 11: Progress Report on Enhancing Asset Management Business 2022[23]

In order to facilitate initiatives for enhancing the asset management business, the JFSA published the "Progress Report on Enhancing Asset Management Business 2022" in May 2022. The report points out problems regarding asset management firms' product governance, and also presents problems in designing and information disclosure regarding fund wraps and structured bonds dealt with by distributors. The JSFS surveyed the current status of publicly offered ESG-related investment funds (ESG funds) and compiled the "Supervisory expectations for asset management firms providing ESG funds." Four major points are explained below.

(1) Product origination, delivery and monitoring (product governance)

Verification of domestic equity active funds managed by individual firms revealed that many of the funds that are suspected to have failed in providing added value to customers in the medium to long term were those managed by large asset management firms. The JFSA checked this point through talks with individual companies and found multiple cases where (i) performance verification from the perspective of customer interests has not been sufficient, (ii) a reference period for performance evaluation is too short, and (iii) trust fee levels are not reviewed from the perspective of whether added value is provided rightly to customers. It was thus made clear that the leadership of top management is not being fully exercised for securing the effectiveness of customer-oriented business conduct, which many large asset management firms advocate as their policy. Top management needs to responsibly establish effective product governance through developing a system for performance verification and reviewing trust fee levels in consideration of long-term customer interests so as not to let their initiatives for customer-oriented business conduct end up being merely a formality.

(2) Situation concerning ESG funds

Regarding ESG funds, there are concerns over so-called "Green Washing" or "ESG Washing," causing doubts about the possibility that "such funds, which advocate environmental friendliness, may actually be managed in a completely different manner, leading to a misunderstanding of investors." Accordingly, the JFSA conducted a survey targeting 225 ESG funds dealt with by 37 asset management firms in Japan, and compiled the supervisory expectations for them. When providing ESG funds, firms should create a required organizational structure, while securing experts, make continued efforts to strengthen their management process and approach, and enhance information provision and disclosure in a consistent manner according to the actuality of the management process so that customers can make investment decisions appropriately.

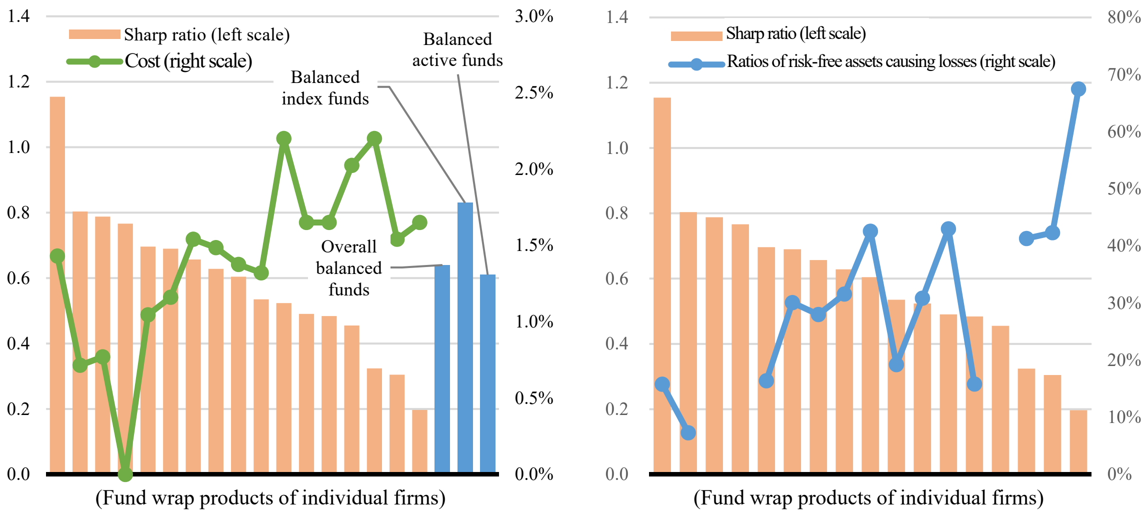
23 See the main text in II. 1. (2) Enhancing asset management business.

(3) Fund wraps

Costly fund wraps are often inferior in terms of performance compared to balanced funds. Some in the industry argue that a simple comparison with balanced funds is impossible as fund wraps incorporate services such as advice to customers. However, as far as the JFSA has ascertained, there is no firm that can clearly and quantitatively explain whether high fees for fund wraps are sufficiently commensurate with the added value such as advisory services.

Additionally, regarding risk-free assets contained in fund wraps, management performance is lower than costs for many of them. Asset management firms need to reconsider the nature of their products from the perspective of customer interests, as to whether high ratios of risk-free assets are suited for fund wraps with higher costs or whether fee systems contain any factors that cause a conflict of interest.

(Figure 1) Performance of fund wraps

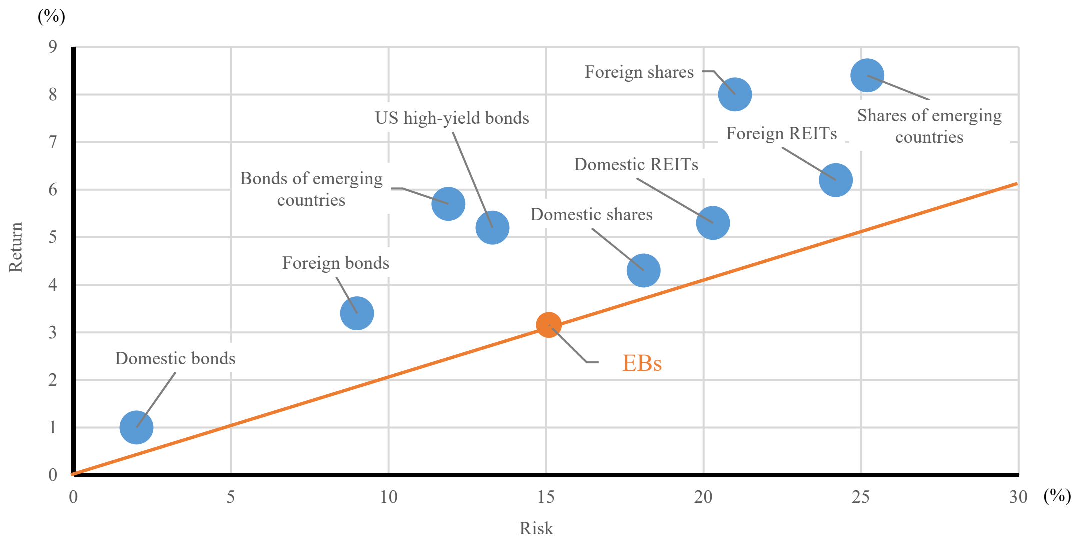


(Source) JFSA

(4) Structured bonds

The JFSA conducted performance analysis for EBs (equity exchangeable bonds) out of structured bonds by obtaining data from multiple distributors. As a result, it became clear that EBs are inferior to other assets in risk-return ratios. It was also revealed that EBs, which can generate revenue in a short period, are characteristically likely to trigger distributors' acts similar to churning. Given the above, financial institutions dealing with structured bonds and industry bodies should preferably compile data and regularly publish them voluntarily, and should disclose substantial costs (difference between the principal and the fair value) for structuring and selling EBs in a material information sheet or otherwise enhance information provision to customers.

(Figure 2) Comparison of risk-return ratios of EBs and other assets



(Source) JFSA

Column 12: Interim Report of Working Group on Capital Market Regulations of the Financial System Council[24]

On June 22, 2022, the "Interim Report of Working Group on Capital Market Regulations of the Financial System Council" (the interim report) was published (Figure 1).

(1) Developments

In order to achieve a "virtuous circle of growth and distribution" in which sustainable economic growth is to be achieved through the provision of funds for growth and business rehabilitation, and the outcome of growth by households' appropriate selection of financial products would be returned to increase the asset income of households, Working Group on Capital Market Regulations of the Financial System Council has conducted deliberations. The working group compiled the content of the deliberations into the interim report.

(2) Interim Report of Working Group on Capital Market Regulations of the Financial System Council

(i) Smooth provision of funds for growth and business rehabilitation

In order to create new businesses and industries that support Japan's sustainable economic growth in the future and smoothly promote further growth of existing businesses and business rehabilitation and succession, it is necessary to develop capital markets that can smoothly provide support and required funds to companies, irrespective of whether they are listed or not. With such awareness of the issue, the following recommendations were made.

i. Smooth provision of funds for growth and business rehabilitation to startups and unlisted companies

- Expansion of VC investment, etc. by asset owners
- Development of a framework for incorporating unlisted stocks into investment trusts
- Facilitation of secondary transactions of unlisted stocks by institutional investors, etc.
- Expansion of the coverage of transactions of unlisted stocks available for solicitation for facilitating local companies' business rehabilitation and succession
- Expansion of debt finance (deliberations about the "Enterprise Charge for Business Enhancement (provisional title)")

(Note) Regarding firewall regulations separating banks and securities companies, deliberations are to be continued.

ii. Ideal listing, etc. that will contribute to companies' growth

- Realization of a listing examination by exchanges based on companies' characteristics
- Development of an environment for facilitating the use of direct listing at exchanges, etc.

24 See the main text in II. 1. (3) Strengthening the functions of capital markets to encourage the growth of startups, etc.

(ii) Promotion of the return of the outcome of economic growth to households

In order to promote the return of the outcome of economic growth to households, it is indispensable to carry out measures comprehensively to encourage all financial services providers involved in each stage of product origination, delivery and monitoring to ensure customer-oriented business conduct seeking customers' best interests, and also to enhance households' financial literacy. With such awareness of the issue, the following recommendations were made.

i. Ensuring of customer-oriented business conduct

(Appropriate solicitation and advice, and enhancement of information provision to customers)

- Development of an environment for distributors to concurrently engage in the investment advisory business, and creation of an institutional framework to ensure appropriate solicitation and advisory services
- Improvement of information provision to customers by the use of digital tools, etc.

(Product governance)

- Structuring of financial products, setting of fees, and information provision concerning the nature of the products in conformity to customers' best interests
- Evaluation and verification by independent outside directors, etc.
- Securing of appropriateness in the solicitation and management of funds operated by those engaged in the type II financial instruments business

ii. Enhancement of financial literacy

- Strengthening of collaboration with related organizations and bodies, and support for financial and economic education at schools and workplaces, etc.

(iii) Enhancement of functions of the market infrastructure

As places for transactions of financial products, there are the Proprietary Trading System (PTS) operated by securities companies, and over-the-counter transactions by securities companies, in addition to exchanges, such as the Tokyo Stock Exchange.

In order to respond to user needs and enhance functions of Japanese markets as an international financial center, efforts need to be made so that individual places for transactions will surely provide stable, efficient and fair transaction means depending on products' characteristics and fulfill price discovery functions. With such awareness of the issue, the following recommendations were made.

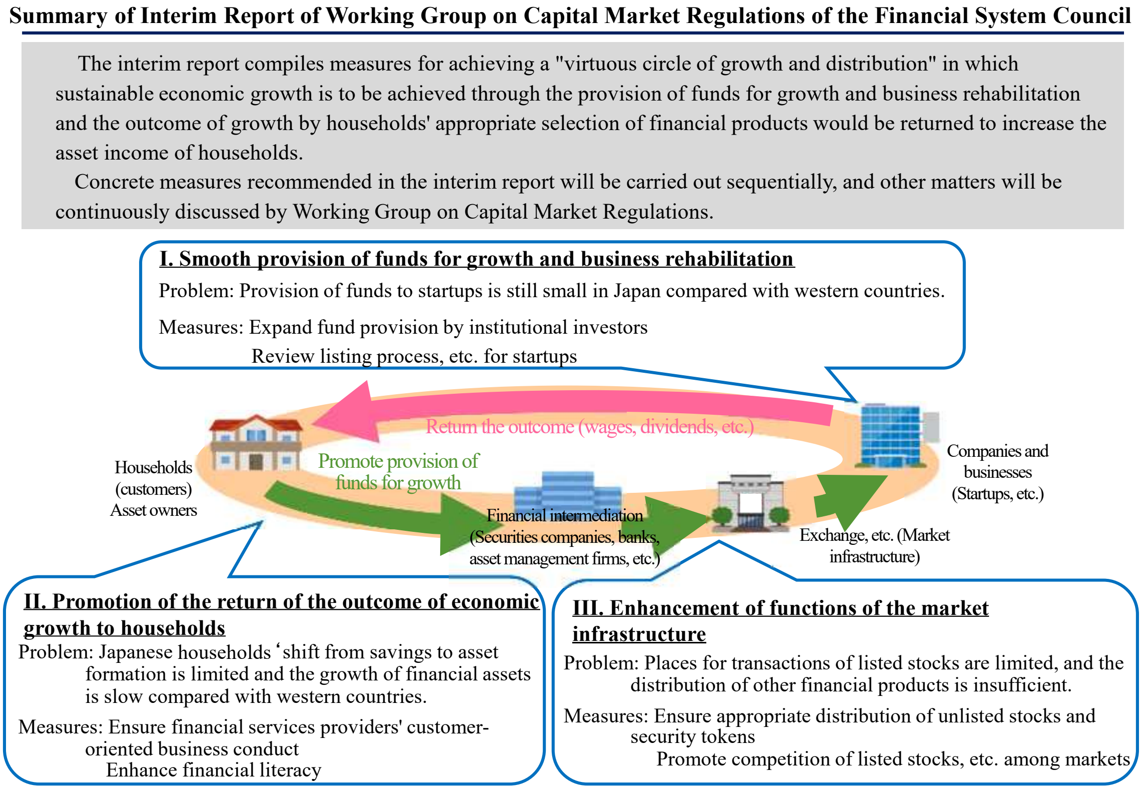
i. Transaction platform for listed stocks, etc.

- Strengthening of countermeasures against unfair transactions, and deliberations about the easing of the upper limit for transactions of listed stocks, etc. under the PTS, etc.

ii. Transaction platform for unlisted securities, etc.

- Review of examinations for authorization for facilitating active utilization of PTS in the distribution of unlisted stocks and security tokens.
- Development of a framework for checking the appropriateness of products for protecting investors, etc.

(Figure 1) Summary of Interim Report of Working Group on Capital Market Regulations of the Financial System Council



(Source) JFSA

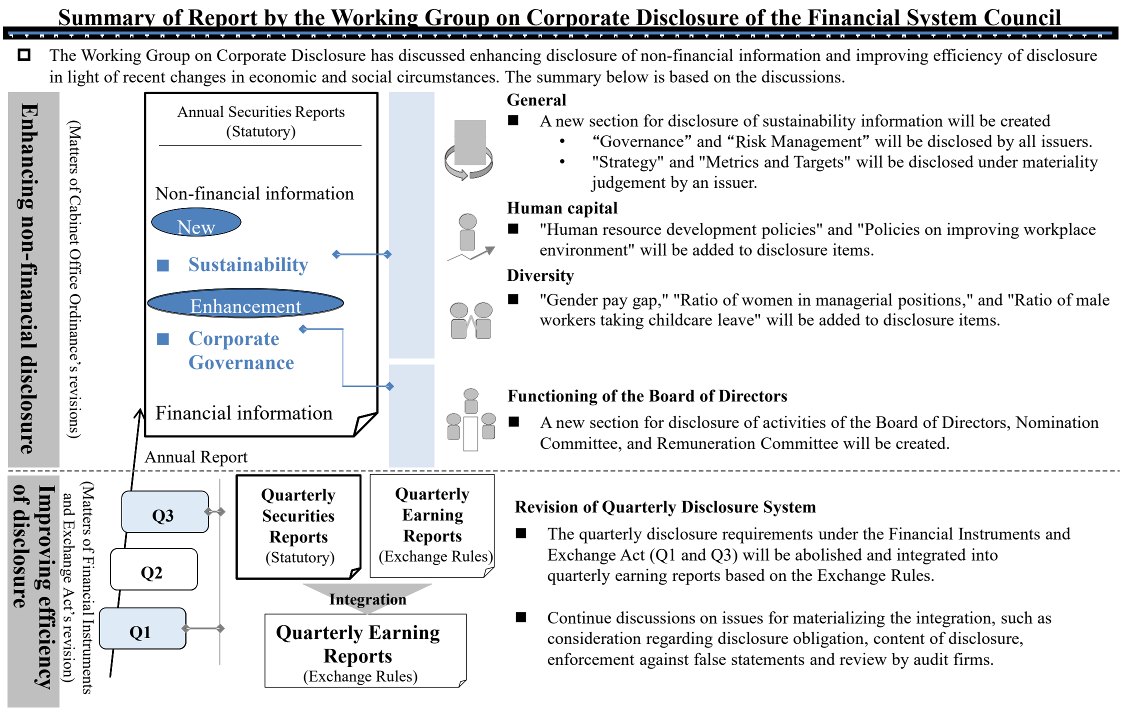
(3) Future plan

Concrete measures recommended in the interim report will be carried out sequentially, and other matters will be continuously discussed by Working Group on Capital Market Regulations based on the content of the interim report.

Column 13: Deliberations concerning disclosure of corporate information[25]

Recent economic conditions concerning disclosure of corporate information show significant changes, such as growing awareness of the significance of sustainability in corporate management and investors' investment decisions, and progress in discussions on corporate governance. With such awareness of the issue, the Financial System Council's Working Group on Corporate Disclosure started deliberations in September 2021, and published a report titled "Report of Working Group on Corporate Disclosure – For Developing Capital Markets to Achieve a Mid- and Long-term Improvement in Corporate Value" (Figure 1) in June 2022.

(Figure 1) Summary of the report by the Working Group on Corporate Disclosure of the Financial System Council



(Note)In addition to the above, clarification of disclosure requirements for material contracts entered into by companies with other parties, and promotion of disclosure in English have been also summarized.
(Source) JFSA

(1) Disclosure of information on companies' sustainability-related initiatives

(i) Disclosure of information related to sustainability in general

Initiatives concerning sustainability have become central challenges in corporate management and have been attracting increasing interest from investors globally. At the same time, establishment of standards for disclosure of sustainable information and active utilization thereof are rapidly progressing.

Under such circumstances, also in Japan, it is necessary to position sustainability information as major items for corporate disclosure and to make constant efforts to enhance the content of the disclosure.

[25] See the main text in II. 1. (4) Enhancing corporate governance reform and disclosure of non-financial information, such as that on human capital.

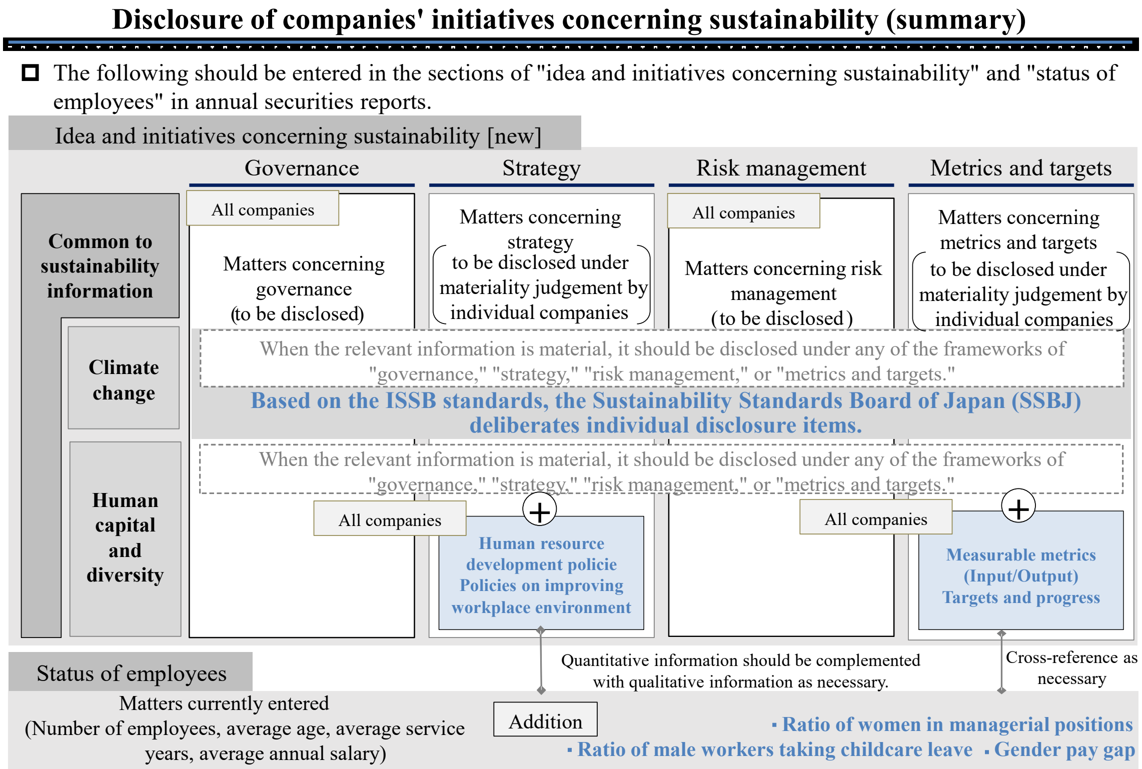
In order to respond to these requests, the Working Group recommended the creation of a new section to enter sustainability information in annual securities reports, wherein information on "governance" and "risk management" is to be disclosed by all companies and information on "strategy" and "metrics and targets" is to be disclosed under materiality judgement by individual companies (Figure 2).

(ii) Disclosure of information related to human capital and diversity

Human capital and diversity are recently attracting the attention of institutional investors as information relating to corporate value on a long-term basis, and are included in disclosure items under multiple international frameworks for disclosure of sustainable information. Accordingly, information on human capital, including initiatives concerning diversity, has come to be disclosed recently.

In light of these trends, from the perspective of providing information necessary for investors' investment decisions, the Working Group recommended adding "human resource development policies" and "policies on improving workplace environment" as disclosure items to be entered in the strategy section for sustainability information, and also adding the "ratio of women in managerial positions," "ratio of male workers taking childcare leave," and "gender pay gap" as disclosure items, and putting these newly added items in line with other legal definitions and frameworks in consideration of burdens on companies, etc. (Figure 2).

(Figure 2) Disclosure of companies' initiatives concerning sustainability (summary)



(Source) JFSA

(2) Disclosure of information on corporate governance

As of April 2022, companies with a nominating committee and a remuneration committee accounted for approximately 80% of all companies listed on the Prime Market of the Tokyo Stock Exchange. In line with the revision of the Corporate Governance Code in June 2021, investors' interest in how the board is in its functions has grown significantly.

Information on activities of boards of directors, etc. has come to be disclosed in corporate governance reports in Japan and has been disclosed in detail in legal documents in the United States, United Kingdom, Germany, France, etc. Accordingly, the Working Group recommended the creation of a section to enter activities of the board of directors in annual securities reports, wherein frequency of holding meetings, major agendas and attendance of individual members are to be disclosed (Figure 1).

(3) Frequency and timing of disclosure, including quarterly information disclosure

The issues concerning the new capitalism and the relation between corporate management and quarterly information disclosure are being discussed actively from a mid- and long-term perspective.

Regarding current practices, it is pointed out that quarterly securities reports based on the Financial Instruments and Exchange Act and quarterly earnings reports based on the Exchange Rules contain overlapped content and the timings of their disclosures are close to each other. The Working Group suggested that it may be possible to reduce cost and improve efficiency through the integration of these documents by devising enforcement strategies.

Integration may be achieved either by consolidating them into quarterly securities reports or into quarterly earnings reports, but the Working Group concluded that consolidation into quarterly earnings reports would be appropriate in consideration of the following:

- Consolidation into quarterly securities reports, which are published later than quarterly earnings reports, may decrease the usefulness and timeliness of disclosed information
- Quarterly earnings reports, by which information is actively disclosed to investors, are broadly utilized by investors
- It is also important to encourage companies to take a positive stance toward information disclosure; and some point out that it may also possible to ensure disclosure not in the form of quarterly securities reports but by any other alternative methods from the perspective of securing accuracy.

Specifically, the Working Group recommended abolishing the legal obligation of quarterly information disclosure (the first and the third quarters) currently imposed on listed companies and integrate them into quarterly earnings reports based on the Exchange Rules (Figure 1).

(4) Other individual problems concerning disclosure

Additionally, the Working Group recommended that types of material contracts and concrete content thereof to be disclosed in annual securities reports should be clarified and that information disclosure in English should be conducted with regard to items that are highly used in particular.

(5) Future responses

Based on these recommendations, the FSA will work on developing systems for disclosure of information concerning sustainability and corporate governance, with the expectation that the development of the environment for facilitating corporate disclosure and constructive dialogues between companies and investors will lead to the creation of capital markets that will increase corporate value over the mid- to long-term.

The Working Group will continue deliberations on the clarification of the roles of the Sustainability Standards Board of Japan (SSBJ), and challenges in the integration of quarterly securities reports into quarterly earnings reports (how to make the disclosure mandatory, matters to be disclosed, enforcement against false statements, review by auditing corporations, etc.).

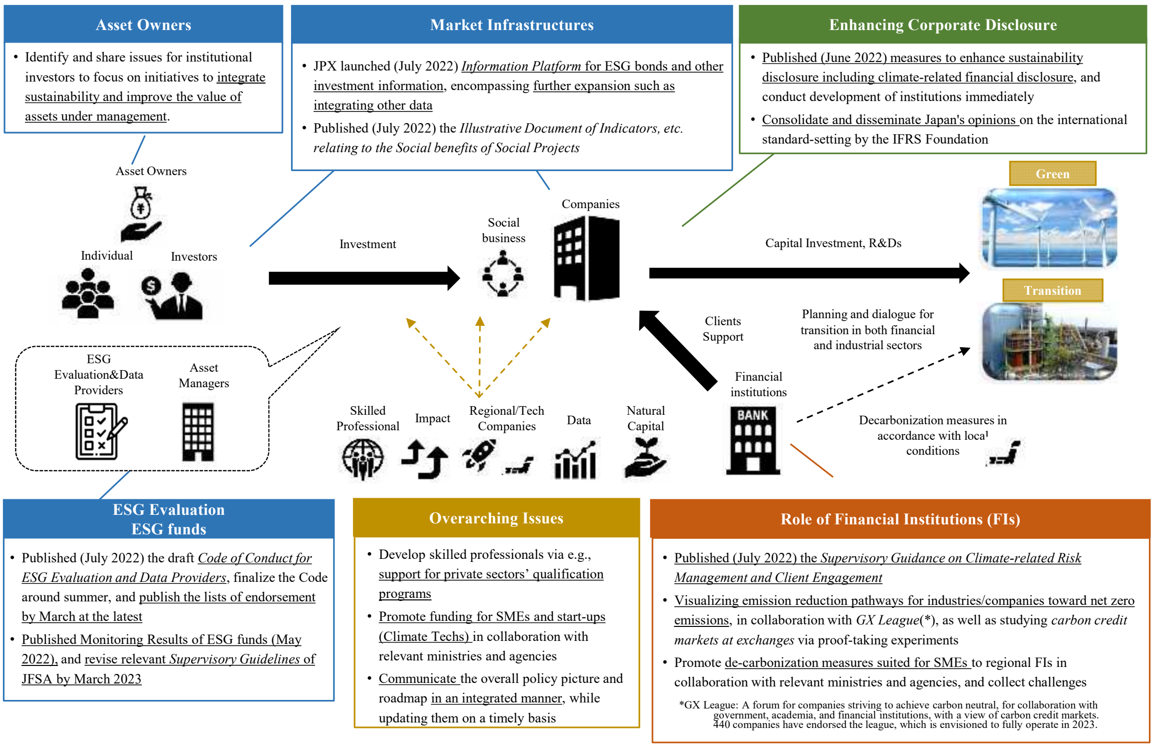
Column 14: JFSA's initiatives for sustainable finance[26]

The JFSA established the Expert Panel on Sustainable Finance in December 2020 and the panel compiled its first report in June 2021. The report illustrates 1) enhance corporate disclosure, 2) demonstrate capital market functions, and 3) financial institutions' support for borrowers and investees, and risk management as three major pillars and presents concrete recommendations on measures to promote sustainable finance.

In BY2021, the JFSA took measures in line with these three pillars, and published the "Second Report of the Expert Panel on Sustainable Finance – Financial System to Develop a Sustainable New Society" in July 2022. This second report compiles the progress of measures and new issue, and makes recommendations (Figure 1).

Major outcomes regarding the second and third pillars above and new issues pointed out in the second report are summarized below (for major outcomes regarding the first pillar, see Column 13).

(Figure 1) Whole picture of the JFSA's initiatives for sustainable finance



(Source) JFSA

[26] See the main text in II. 2. Promoting sustainable finance.

(1) Technical Committee for ESG Evaluation and Data Providers, etc.

As sustainable finance, expands globally, the role of "ESG evaluation and data providers", that conduct surveys and analyses of companies' ESG-related initiatives and collect and provide ESG data, are becoming more significant. However, problems such as transparency and fairness of evaluations have been pointed out domestically and internationally. Therefore, the International Organization of Securities Commissions (IOSCO)[27] published a report titled "Environmental, Social and Governance (ESG) Ratings and Data Products Providers," which compiles actions expected for ESG evaluation and data providers and investors who use them, as well as companies subject to ESG evaluation and data provision.

The JFSA established the Technical Committee for ESG Evaluation and Data Providers, etc. in February 2022. The committee had discussions on the current situation concerning ESG evaluation and data provision and challenges to be addressed, while looking ahead to the future market development, and compiled concrete actions expected for ESG evaluation and data providers, investors, and companies as recommendations. Additionally, the JFSA published the draft Code of Conduct in July 2022 for ESG evaluation and data providers, for which there are no specific regulations at present and which are not under the supervision of the authority.

Based on the IOSCO's report mentioned above, the draft Code was formulated as a practical and useful norm by adding and reorganizing matters of special importance as discussed by the committee, and deepening the content (Figure 2). The JFSA is calling for the endorsement of the Code of Conduct on the basis of the "comply or explain" approach, and will publicize the status of support and endorsement in a consistent manner.

(Figure 2) Code of Conduct for ESG Evaluation and Data Providers (draft)

Recommendations for ESG evaluation and data providers (draft Code of Conduct)

- **Ensure transparency**
  Evaluation providers should publicize the purpose, approach, and basic methodology regarding their ESG evaluation.
- **Foster human resources**
  Evaluation providers should secure necessary professional human resources, and should develop their own professional skills.
- **Avoid conflicts of interest**
  Evaluation providers should identify their own activities and situations that could undermine the independence, objectivity, and neutrality of their business, and avoid potential conflicts of interest or appropriately manage and reduce the risk of conflict of interest.
- **Communicate with companies**
  Evaluation providers should clarify the point of contact with companies subject to evaluation and should keep data serving as the grounds for evaluation in a manner to enable confirmation and correction thereof, and publish these procedures in advance.

Expectations for institutional investors and companies

- Investors are expected to clarify how they utilize ESG evaluations in their investments.
- Companies are expected to disclose their information concerning sustainability in an easy-to-understand manner and clarify the point of contact with evaluation providers.

(Source) JFSA

[27] International Organization of Securities Commissions

(2) Supervisory Guidance on Climate-related Risk Management and Client Engagement (Figure 3)

In Japan, where the ratio of indirect financing is high, it is significant for banks and other financial institutions to incorporate viewpoints of sustainability opportunities and risks into their business strategies and risk management. However, a management approach for climate-related risks has yet to be established and financial institutions have not accumulated the required know-how. In light of such circumstances, the JFSA published the Supervisory Guidance on Climate-related Risk Management and Client Engagement in July 2022 to present an overview of discussions and the background on climate change, and viewpoints of dialogue with financial institutions on their responses to climate change.

Based on the concepts that it is important for financial institutions to build a resilient business foundation and sustainable business models through engaging with their clients and supporting clients' responses to climate change, the Guidance documents viewpoints of supervisory dialogues regarding financial institutions' climate-related risk management and financial institutions' engagement with their clients. Additionally, the Guidance introduces case examples of pioneering initiatives in Japan and overseas as reference for Japanese financial institutions.

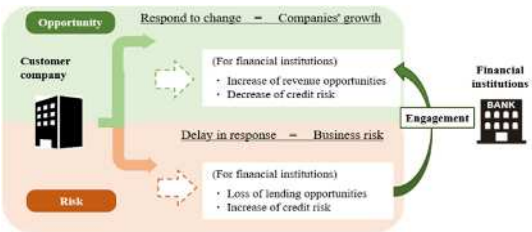
The JFSA will encourage the use of the Guidance through dialogues with domestic financial institutions, including regional financial institutions, offer support to financial institutions' responses to climate change through providing information on the government's support programs and on concrete examples, and flexibly review the content of the Guidance in accordance with trends in Japan and overseas.

(Figure 3) Supervisory Guidance on Climate-related Risk Management and Client Engagement

Basic idea regarding responses to climate change and viewpoints of dialogue

Basic idea

As companies face various environmental changes in relation to climate change, it is important for financial institutions to **support** customer companies' **responses to climate change**, thereby making their management base resilient to change and eventually **achieving sustainable business operation**.



Development of financial institutions' systems

- **Formulation of strategies** regarding responses to climate change and **establishment of governance**
- **Forward-looking awareness and evaluation of opportunities and risks** for business of customer companies and financial institutions themselves that climate change may create
- **Support for customer companies' responses to climate change**, including their efforts for transition
- **Responses to risks** relating to climate change
- **Information provision to stakeholders** through disclosure, etc.

Examples of how to offer support to customer companies

Financial institutions are expected to enhance their knowledge on climate change, ascertain influences on customer companies exerted by changes in technology, industry, natural environment due to climate change, understand the status and needs of customer companies, and offer support from the following perspective, for example.

Provision of consulting services and solutions

(Example)
- Support customer companies' efforts to make their greenhouse gas emissions visible
- Introduction of customer companies with energy efficiency technology (matching among customers)

Provision of growth capital

(Example)
- Provision of funds to encourage efforts for decarbonization, etc. in accordance with customer companies' needs (transition loans, green loans, etc.)
- Provision of growth capital through funds, etc. for efforts to develop new technologies and industries to counter climate change

Provision of support broadly to companies and strengthening of collaboration among related parties

(Example)
- Provision of support broadly, such as for deliberating strategies for a regional supplier group as a whole in consideration of responses taken by core manufacturers
- Provision of support for decarbonization and resource utilization in a region as a whole through collaboration with a local government and research institutions

(Source) JFSA

(3) Challenges to be newly addressed

The first report published by the Expert Panel on Sustainable Finance in June 2021 broadly covered issues concerning sustainable finance, centered on climate-related ones. However, in this rapidly changing field, issues to be newly addressed came up to the surface over the past year.

Against such a background, the second report addresses and declares to tackle new issues including those faced by asset owners as institutional investors in promoting sustainable finance, efforts toward a initiatives for steady transition consistent with the goal of achieving carbon neutrality by 2050, creation of an ecosystem to realize a virtuous circle of impact investment, development of human resources with expertise in sustainable finance, and climate tech companies with new technologies indispensable for solving climate change issues, and matters other than climate change such as biodiversity and natural capital.

Within the government, as each ministry and agency has been implementing various sustainable finance-related measures, it is also important for related ministries and agencies to collaborate with each other to present, update, and disseminate a roadmap of government-wide initiatives regarding sustainable finance.

In particular, given that Japan will host and chair the G7 meeting in 2023, it is expected that these efforts will be communicated internationally and contribute to the international discussion.

Column 15: Initiatives for transition finance in Japan[28]

In order to smoothly achieve the transition of economy and society and meet the goal of Net Zero in 2050,[29] a tremendous investment is required over an extended period of time. Therefore, environmental development and promotion of transition finance[30] is an urgent issue. At present, international discussions are going on regarding the framework for judging eligibility from the perspective of climate change, ahead of the G20 Finance Ministers and Central Bank Governor Meeting and the Summit Meeting in October 2022. Major common elements for transition finance, such as being dynamic, are being discussed as summarized below.

Countries in EU and ASEAN[31] specify economic activities corresponding to Net Zero as "taxonomy"[32] and there is a move intending to expand this mechanism to include appropriate activities in the process of the transition to a green economy as part of taxonomy.

In Japan, focus is mainly placed on fields and companies.

Specifically, as shown in Table 1, the following are considered as elements for transition finance (Figure 1):

(1) Each company seeking funds for responses to climate change is to formulate a reliable transition plan in line with concrete steps for each of the related fields.

(2) Investors and financial institutions are to appropriately evaluate companies' transition plans and secure the reliability thereof.

When these two elements are satisfied, required funds are provided for the transition of companies currently emitting a large amount of greenhouse gas and this will eventually lead to the achievement of Japan's goal of Net Zero. For this purpose, jointly with relevant ministries and agencies, including the Ministry of Economy, Trade and Industry and the Ministry of the Environment, the JFSA formulated and published the Basic Guidelines on Climate Transition Finance as reference for companies, investors and external evaluators, and the Roadmap for Individual Fields as reference for companies when formulating their own transition strategies. As independent initiatives, the JFSA has been implementing measures for ESG evaluation and data providers, which are external evaluators, as explained in Column 14.

28 See the main text in II. 2. Promoting sustainable finance.

29 To reduce the total obtained by subtracting the absorbed amount and the eliminated amount from the greenhouse gas emissions of the whole world or of a country as a whole to zero

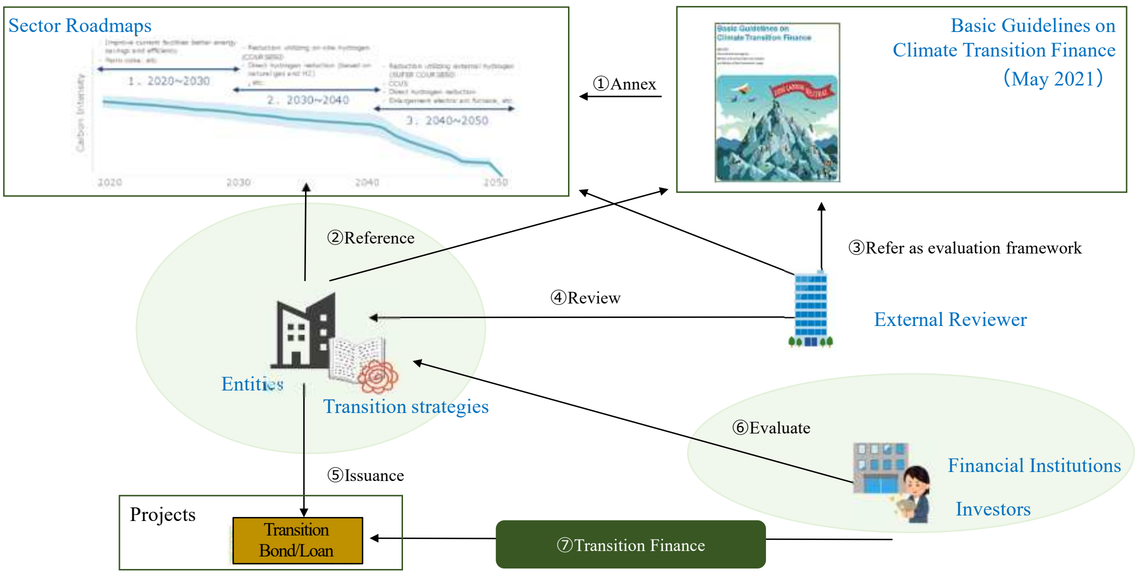
30 Finance aiming to offer support to companies that are considering taking measures against climate change and are actually trying to reduce greenhouse gas emissions in line with their individual long-term strategies for achieving a decarbonized society

31 Association of South-East Asian Nations

32 In order to prevent so-called "Green Washing" (pretending to be environmentally friendly without any substantial effects of environmental improvement), there are moves, centered on EU countries, to create clear standards on the concept of being "green" or "sustainable."

As a result, the JFSA considers from its experience that the major value of Japan's approach is being "Dynamic," "Flexible," and "Interactive" (Figure 2). As there are not many concrete examples of transition finance at present, efforts by all stakeholders, that is, processes of formulation of transition plans by companies and evaluation thereof by investors and financial institutions, need to be refined through dialogue from a variety of perspectives. The JFSA will continue to encourage efforts by both companies and investors/evaluators in order to further develop transition finance.

(Figure 1) Transition finance initiatives in Japan (overview)



(Source) JFSA

(Figure 2) Key points in Japan's approach

Dynamic

- Sector roadmaps are practical tools which capture and depict “movement” toward transitions, unlike “static” categorization of economic activities.
- This enables companies to develop dynamic transition strategies.
- Transition strategies should be revised and updated in a timely manner.

Flexible

- The Basic Guidelines and roadmaps give enough clarity of effective practices and future outlook that companies can refer to, but they are not uniform “rigid” standards.
- Companies can flexibly develop their own transition strategies by referring to various international/ national tools, depending on their sector and transition situation.
- Transparency is needed in strategy rationale and evaluation.

Interactive

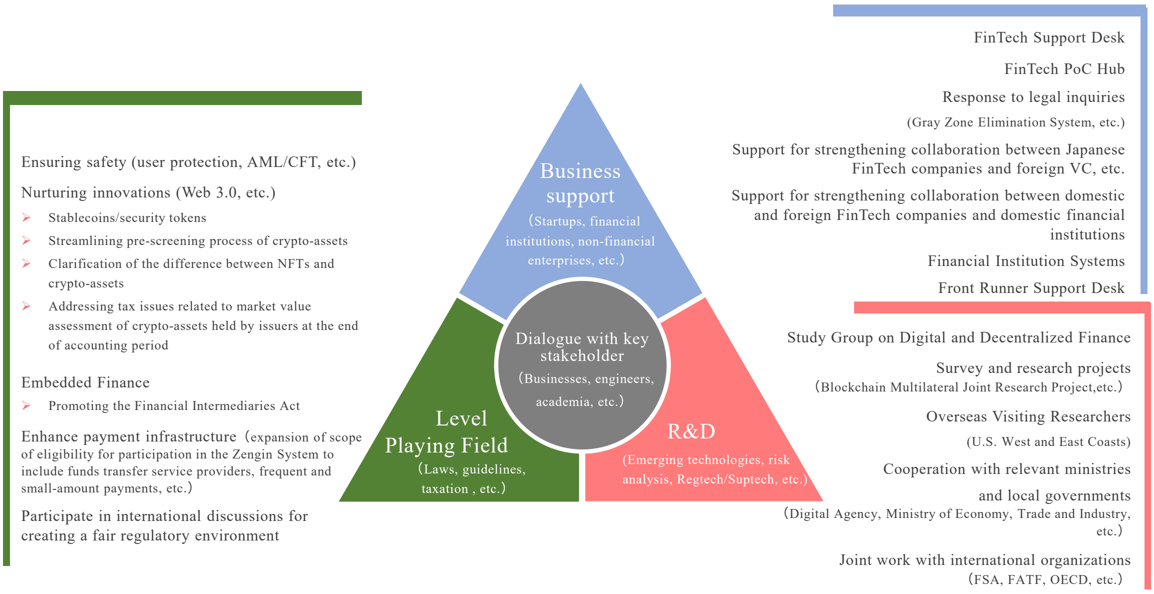
- Efforts by all stakeholders (e.g., the development and evaluation of transition strategies) should be refined through dialogue from a variety of perspectives.
- This interactive process contributes to the credibility and capacity of these efforts.

(Source) JFSA

Column 16: Development and dissemination of new financial services[33]

Financial services using new technologies, such as smartphones, APIs, AI, and blockchains, they are expected to function safety while sustainably developing through contribution to economic growth. The JFSA has been offering support to companies, developing an environment, and conducting surveys and research activities, based on dialogues with diverse stakeholders (Figure 1). The JFSA's relevant initiatives to support business and dialogues with stakeholders are introduced as below.

(Figure 1) Whole picture of fostering new financial services



(Source) JFSA

(1) FinTech Support Desk

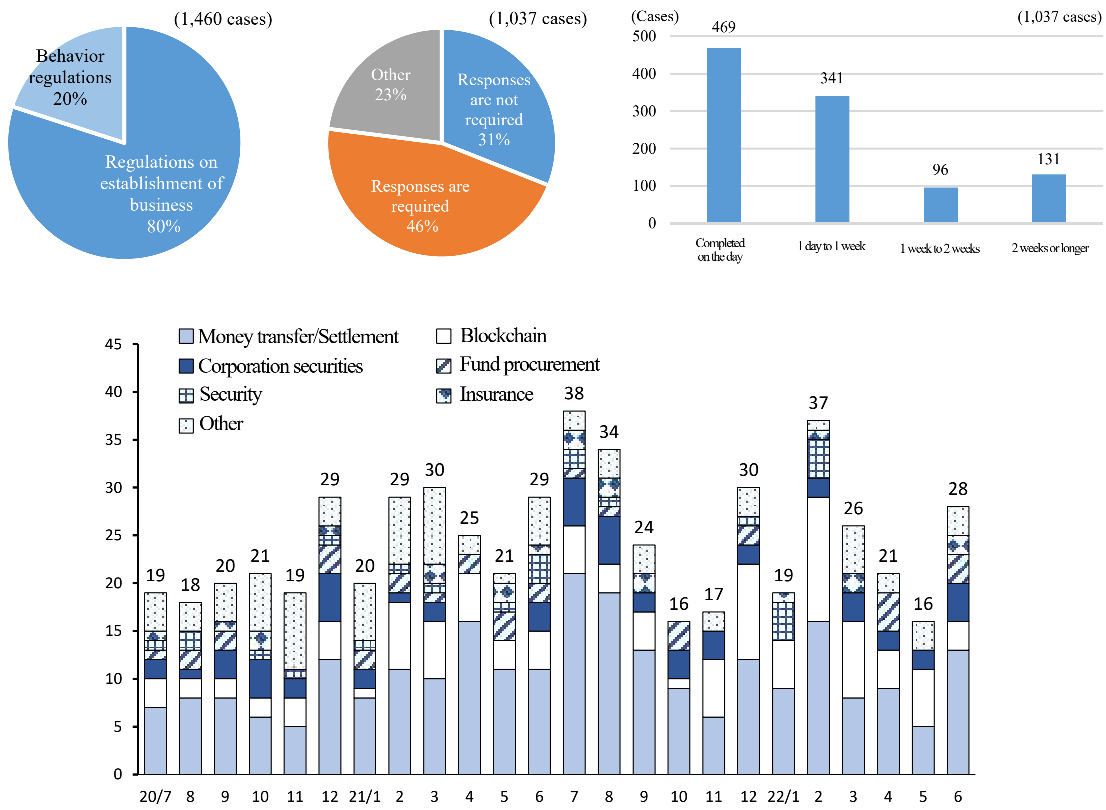
As a one-stop service office to respond to consultations on legal interpretations, etc. from FinTech companies that are considering starting a new business, the JFSA opened the FinTech Support Desk on December 14, 2015, and has responded to consultations for over 1,700 cases.

The desk makes responses on legal interpretations, such as whether the relevant business conforms with existing laws and regulations, or provides guidance for each case within five business days on average. Matters frequently asked are compiled as FAQ to broadly disseminate information.

Most frequent consultations remain to be related to money transfer or settlement, but consultations on new businesses utilizing blockchain technologies are increasing recently (Figure 2).

[33] See the main text in II. 3. Realizing a digital society.

(Figure 2) Services at FinTech Support Desk

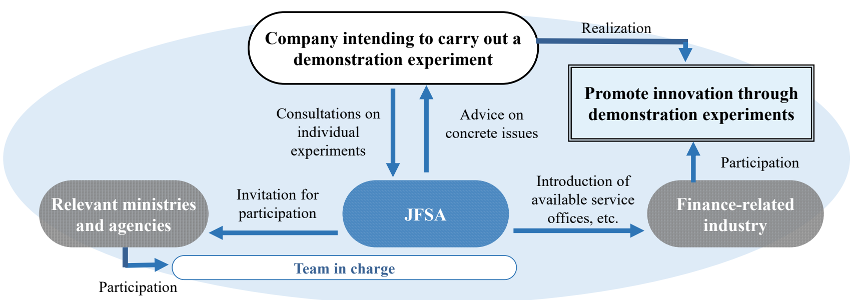


(Source) JFSA

(2) FinTech PoC Hub

FinTech companies and financial institutions that are considering a new business to provide unprecedented services may have concerns over legal interpretations when commencing demonstration experiments. In order to eliminate such concerns, the FinTech PoC(Proof-of-Concept) Hub was opened on September 21, 2017. A team in charge is made in the JFSA for each experiment and continuously provides support by giving answers and advice on the issues, such as compliance risk and supervisory risk, that each company intends to understand through the experiment (Figures 3 and 4).

(Figure 3) Mechanism of FinTech PoC (Proof-of-Concept) Hub



(Source) JFSA

(Figure 4) Outline of recent cases for which support by FinTech PoC (Proof-of-Concept) Hub was decided

	Applicant	Outline of demonstration experiment	Decision announced	Results published
6	Mizuho Bank Google Cloud Japan Nomura Research Institute Dai Nippon Printing	Experiment on the sophistication of personal authentication and customer management using biological information and location information of smartphones, etc.	Apr.10 2020	Mar.25 2022
7	Shinsei Bank Sumitomo Mitsui DS asset Management Goldman Sachs Asset Management PayPay Asset Management SOMPO Asset Management	Experiment for the sophistication of electronic delivery for prospectuses of investment trusts	May 29 2020	Jun.28 2022
8	Mitsubishi UFJ Trust and Bank BHI	Experiment for starting an information bank service by utilizing buying history data	Aug.27 2020	Jul.29 2022

(Source) JFSA

(3) Dialogues with FinTech stakeholders

Amid rapid development of technological innovation and application of innovated technologies in the finance sector, it is indispensable to strengthen communication with domestic and foreign stakeholders in order to offer support for sustainable growth of ever-changing FinTech-related business.

Accordingly, the JFSA has maintained dialogues with domestic FinTech companies by using FINOLAB or other places outside the JFSA offices (Figure 5). In June 2022, the JFSA hosted a meet-up to exchange opinions with companies jointly with the Fintech Association of Japan in a face-to-face style for the first time in two-and-a-half years (Figure 6).

Additionally, in collaboration with the Japan External Trade Organization (JETRO) and embassies in Japan, the JFSA hosts online meet-ups on an ongoing basis to create opportunities for foreign FinTech companies and Japanese financial institutions (in BY2021: In UK, US, Singapore, Canada, Israel, and Germany).

Furthermore, in March 2022, the JFSA held an international conference on FinTech, "FIN/SUM 2022" (the JFSA has continuously held "FIN/SUM" since 2016). At the conference, business people, engineers, academic experts, the authorities and other diverse stakeholders discussed major topics, such as decentralized finance, embedded finance, and climate tech (Figure 7).

(Figure 5) Appearance of FINOLAB

(Figure 6) Meet-up

(Figure 7) FIN/SUM

(Source) JFSA

Column 17: Measures relating to the international financial center[34]

In order to make Japan an international financial center open to the whole world, the JFSA has been endeavoring to develop an environment to attract foreign companies and highly skilled professionals. Two characteristic measures are introduced below.

(1) Active online information provision

In March 2021, the JFSA opened a dedicated website for the international financial center and has been providing comprehensive information in Japanese and in English, targeting foreign asset management firms that are considering newly entering Japanese markets. Provided information includes procedures for registration for asset management business, the Japanese government's policies on taxation and status of residence, and helpful information for starting business and life in Japan.

In particular, the introduction of concrete examples, known as “case studies” attracts attention as an easy-to-understand explanation of the flow of procedures for entering Japanese markets. The introduction shows interviews with foreign companies that have completed the registration in English via the Financial Market Entry Office (FMEO). Services of the office are favorably evaluated (Figure 1).

(Figure 1) Examples of companies introduced on the dedicated website

"By using the Financial Market Entry Office, we were able to communicate effectively in a timely manner, and by preparing registration applications in English, we were able to complete registration earlier than expected."

"I found the "Guidebook for Registration of Investment Management Business and Other Financial Instruments Businesses", published by JFSA in January 2021 very helpful."
"As soon as we were accepted into this project [the Financial Start-up Support Program], we were able to consult with Tricor Japan, the subcontractor of JFSA, whom we found very reliable."

"We think that the establishment of Financial Market Entry Office, one-stop all-in-English office for foreign asset managers' considering new business in Japan, is really a big step."

"As usual with this kind of application, there has been several rounds of emails back and forth, but the responses [from the FMEO] were very prompt and straightforward."

(Source) JFSA

34 See the main text in II. 4. Building foundation to further develop as international financial center.

In addition, in January 2022, the JFSA opened its official website on LinkedIn, the world largest professional SNS, and has provided information in English around once a week, targeting overseas financial professionals (Figure 2).

(2) Development of a highly-accurate AI translation system for the finance sector

In order to strengthen information collection and provision in English, the JFSA commissioned the development of a highly-accurate AI translation system to the National Institute of Information and Communications Technology (NICT). The system is to be dedicated to translating documents in the finance sector, and for its development, not only the JFSA but also financial institutions and industry bodies provided bilingual finance-related data to the NICT.

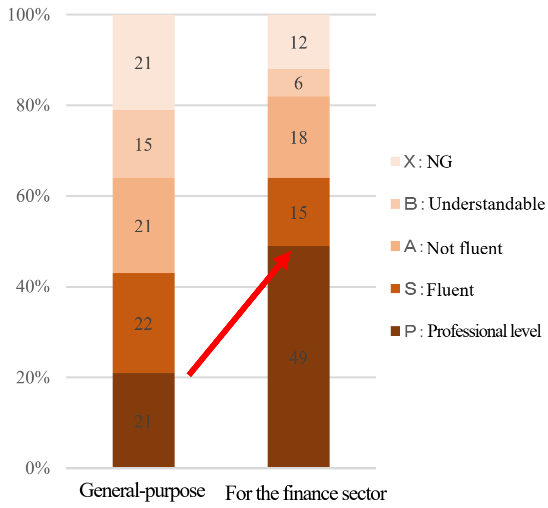
Thanks to this highly-accurate new translation system, the percentage of translated documents at a level of translators specialized in finance increased from around 20% to 50% (Figure 3), and it is expected that the JFSA's information collection and provision in English will be greatly enhanced. This system was implemented in the JFSA's system in April 2022 so that all staff members can use it.

The NICT started technology transfer to private companies in March 2022. Therefore, the research outcome can be broadly shared at present, not limited within the JFSA.

(Figure 2) JFSA's official website on LinkedIn

(Source) JFSA

(Figure 3) Comparison between a conventional general-purpose translation system and the highly accurate AI translation system for the finance sector



(Source) JFSA

Column 18: Data analysis project[35]

To enhance JFSA staff members' analytical capacity, the JFSA since BY2020 has integrated and supported its data analysis projects in order to encourage self-motivated data analysis for policy planning and monitoring.

In BY2021, 27 projects were registered, up from 15 in BY2020. Among them, 16 analysis results were presented in front of academic experts to seek comments. Some of the results were also published as part of JFSA policy measures (see below).

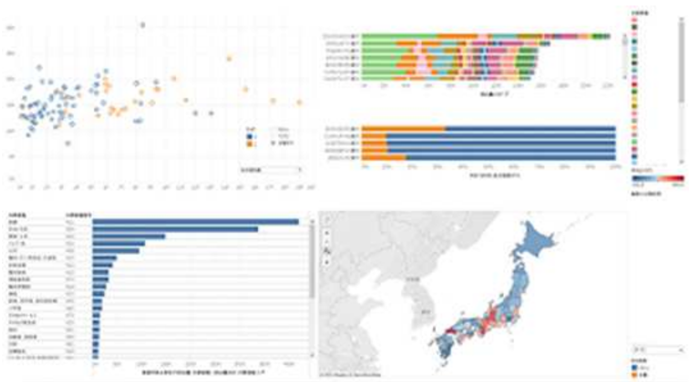
Theme	Publication medium
Impacts of COVID-19 on corporate finance	"Progress Report on the Efficiency of Financial Intermediation" https://www.fsa.go.jp/news/r3/ginkou/20220630-4/20220630.html (Available in Japanese)
Visualization of performance of instruments provided by Japanese asset management companies and distributors	"Progress Report on Enhancing Asset Management Business 2022" https://www.fsa.go.jp/en/news/2022/20220527.html

Project examples in BY2021

(i) Dashboard and visualization of climate change data

- Existing climate information and data related to financial institutions were aggregated and visualized, including the extent of sector-level greenhouse gas emissions and financial institutions' loans (Figure 1).

(Figure 1) Dashboard of climate change data (image)



(Source) JFSA

[35] See the main text in III. 1. (1) Enhancing staff members' capacity and quality.

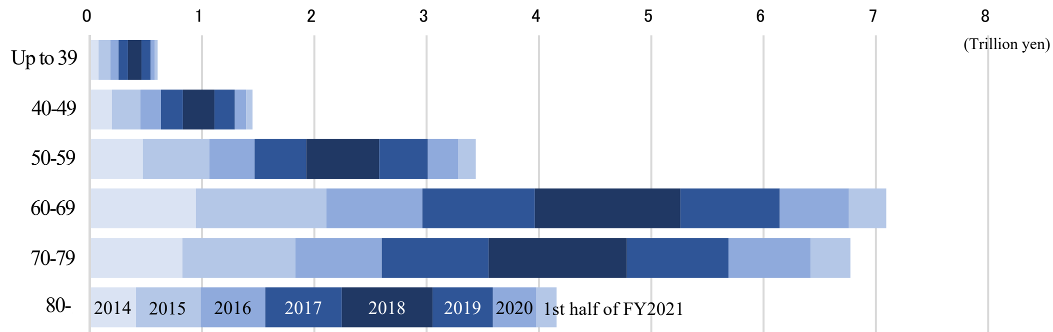
(ii) Identifying trends of foreign currency insurance contracts

- The analysis found that foreign currency insurance sales to people aged 60 or more have accounted for some 80% of total such sales since 2014 and clarified relationship between insurance companies developing foreign currency insurance products, financial institutions distributing these products and customers buying them by age group (Figure 2).

(iii) Analysis of household financial asset portfolios

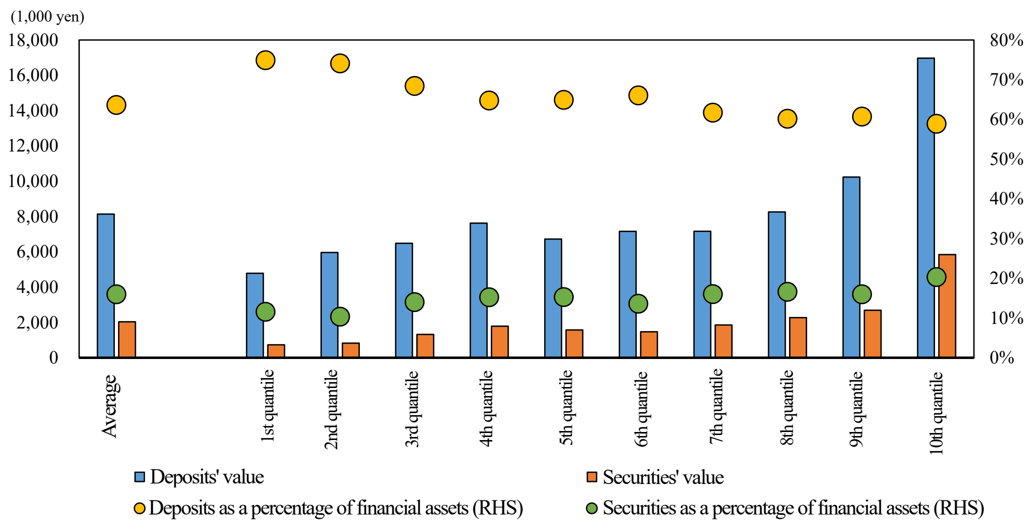
- The analysis found that deposits among households with income less than a certain level do not necessarily increase in proportion to their income, and that securities' share of financial assets do not differ so much by income level or household structure (Figure 3).

(Figure 2) Financial institutions' foreign currency insurance sales by customer age group between FY2014 and the first half of FY2021



(Note) It must be noted that sales data cover financial institutions' sales of insurance products from insurance companies ranked high, accounting for more than 95% of their total insurance sales.
(Source) Prepared by the JFSA from sales data from insurance companies.

(Figure 3) Deposits and securities holdings by income group and their percentage shares of total financial assets



(Note) Deposits/Securities as a percentage of financial assets in "average" are the average of total deposits/securities as a percentage of total gross financial assets.
(Source) Prepared by the JFSA from 2019 National Survey of Family Income, Consumption and Wealth.

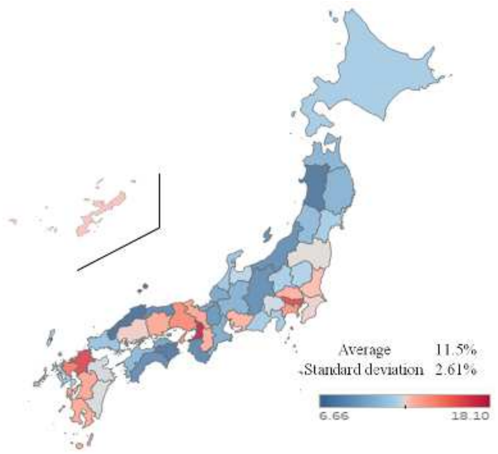
(iv) Analysis of changes in business relations between financial institutions and companies

- The analysis used individual company data to check changes in relations between financial institutions and companies (main bank relations) and found that the frequency of switching main bank varies by region and that the frequency is higher for younger companies with higher sales growth (Figure 4).

(v) Analysis of stock trading trends just before closing

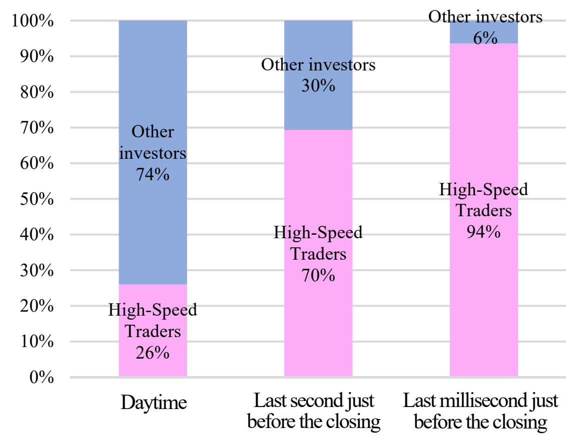
- The analysis checked stock trading data at the Tokyo Stock Exchange and found that High-Speed Traders (investors registered as those conducting High-Speed Trading under the Financial Instruments and Exchange Act) take advantage of their high trading speed to make on close orders (orders to be executed only during the closing auction) until just before the closing, while such on close orders' share of total daytime on close orders is limited (Figure 5).[36]

(Figure 4) Frequency of switching main bank by companies located in each prefecture



(Note) The main bank switching frequency is the percentage share for companies that switched main banks among those located in each prefecture. This figure covers about 700,000 joint stock and limited liability companies for which data in 2009 and 2019 exist.
(Source) Prepared by the JFSA from data from Teikoku Data Bank.

(Figure 5) The ratio of on close orders conducted by High-Speed Traders by time zone



(Note) Numbers in parentheses represent percentage shares for con close orders made in specific time zones among total daytime orders.
(Source) Prepared by the JFSA from trading data at the Tokyo Stock Exchange.

[36] The analysis was published as a column (Financial Research Center) written by a JFSA staff member. https://www.fsa.go.jp/frtc/report/index.html

Column 19：Major "Open Policy Lab" activities[37]

In the BY2021 Open Policy Lab[38], 17 teams covering a total of more than 120 JFSA officials participated. The following introduces major projects:

(1) Sophistication of JFSA English website

The JFSA has tried to enhance English information dissemination to promote Japan as an international financial center. In this respect, the team considered how to further improve the quality and quantity of information posted on the JFSA English website. Specifically, the team identified the current status of English information dissemination and relevant problems through interviews with stakeholders within and outside the JFSA and found through a poll of all JFSA staff members that there are more potential English language experts than earlier assumed in the JFSA. Based on these findings, the team summarized problems regarding the current English website and proposed their solutions. The team also consolidated useful information (including vocabulary and how to effectively use AI translation tools) to an English help site available within the JFSA (Figure 1).

In the future, the team will try to sophisticate the English website to improve the quality and quantity of posted information, contributing to the JFSA's timely, useful English information dissemination through this project.

(Figure 1) Overview of JFSA "English help site"

Content name	Details
(1) Poll results	Results of a poll on English covering all JFSA staff members
(2) Proposals on the JFSA's English website	Proposals drafted by the team for contents that should be posted on the English website
(3) Description of law translation	(3)-1 Law translation flow (3)-2 Inhouse cooperation in English translation accompanying law amendments
(4) Tips for using translation service providers	(4)-1 Tips for using translation service providers (4)-2 Note for checking translations
(5) Notes for doing translation by yourself	(5)-1 Notes for doing translation (5)-2 **(Recommended)** Hints for law translation (5)-3 Guidelines for law translation (5)-4 Japanese-English translation dictionary for legal terminology (5)-5 **(Recommended)** "Integrated translation list" by the JFSA Policy and Markets Bureau (5)-6 Use JFSA resources: "Introduction of useful sites"
(6) Use JFSA resources: "Tips for using AI translation tools"	(6)-1 **(Recommended)** (for beginners) Use JFSA resources: "How to use AI translation tools" (6)-2 (Hints for improving accuracy) Effects of pre-editing of Japanese documents before AI translation
(7) Use JFSA resources: "Native Check"	(7)-1 Information email on native check services by native English speakers

(Source) JFSA Open Policy Lab

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[37] See the main text in III. 1. (2) Placing priority on self-motivated initiatives.

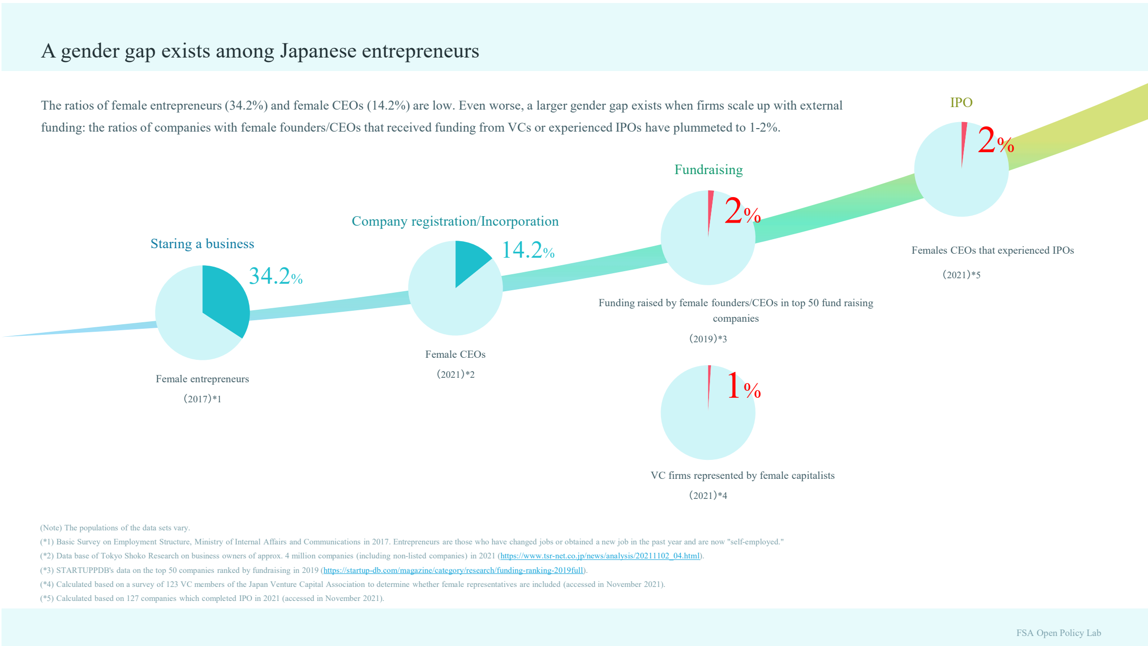
[38] The JFSA has established the Open Policy Lab in BY2018, a framework for voluntary submission of policy proposals by employees that is intended to train and better use employees, centered on young employees, and invigorate the organization and also to promote the formulation of novel and original policies by actively accepting employees' new inspirations and ideas.

(2) Diversity, Equity & Inclusion in the Financial Sector

In order to solve gender diversity challenges in Japan's startup ecosystem by entrepreneurs and investors, the team has conducted data research and literature research, has had interviews personally with female entrepreneurs and venture capitals and sponsored a dialogue-based workshop in which a total of 53 participants including entrepreneurs, venture capitalists and their supporters accumulated discussions to propose more practical solutions (Figure 2).

In July 2022, the team published a report[39] titled "Proposals to Solve Gender Diversity Challenges in Japan's Startup Ecosystem." The report summarizes what stakeholders should do to resolve issues, reflecting various ideas gained through the abovementioned workshop. Based on the report, the team in the future will promote initiatives to encourage stakeholders to change their behavior

(Figure 2) Circumstances surrounding female entrepreneurs



(Source) JFSA Open Policy Lab

[39] "Proposals to Solve Gender Diversity Challenges in Japan's Startup Ecosystem" (published in July 2022) https://www.fsa.go.jp/en/about/openpolicylab/dei_startup01.pdf