

High-level Summary: “Report on the State of IT Governance at Financial Institutions”

June 2021



- The “Discussion Paper on IT Governance,” published by the FSA in June 2019, identified the following three topics that the FSA will further analyze:
 - i. Regional institutions’ shared data centers, IT strategy, and governance of regional banks^{*1}
 - ii. Global/Group-wide IT governance at globally operating financial institutions, such as the mega-banks and large life/nonlife insurers
 - iii. FSA’s approach to supervision of IT governance under the circumstances where financial businesses keep changing due to digital transformation
- The FSA conducted a survey and interview with financial institutions on those themes to observe the recent developments and market practices. This follows last year’s survey on themes (i) and (ii) mentioned above.^{*2}

Topics		Background / Fact-finding Survey
(i)	Regional institutions’ shared data centers, IT strategy and governance of regional banks	<ul style="list-style-type: none"> ✓ The FSA conducted a survey and interviews with Shinkin banks as well as regional banks on IT governance. ✓ The FSA also conducted interviews with external experts, such as IT vendors and IT consulting firms, on the topics, including how regional institutions could reduce the switching cost to migrate their core banking systems to new ones.
(ii)	Global IT governance at globally operating financial institutions	<ul style="list-style-type: none"> ✓ Large Japanese banks are accelerating the overseas expansion of businesses, for instance, to Southeast Asia. Several projects were delayed due to factors that are unique to overseas businesses. ✓ The FSA conducted a survey and interviews with large, globally operating Japanese banks on those points in relation to global IT governance.
(iii)	Supervision in a changing environment with a focus on digitalization	<ul style="list-style-type: none"> ✓ Digitalization enables the provision of online financial services in various ways, which facilitates response to changes in the financial industry. ✓ The FSA deliberates how it will supervise new types of businesses, such as intermediary businesses and newly established banks in which customers can complete all transactions with their smartphones.

^{*1} This Business Year, the survey targeted large banks, while the previous Business Year’s survey targeted large life/nonlife insurers.

^{*2} [“Research Report regarding IT Governance of Financial Institutions” \(published on June 30, 2020\)](#)



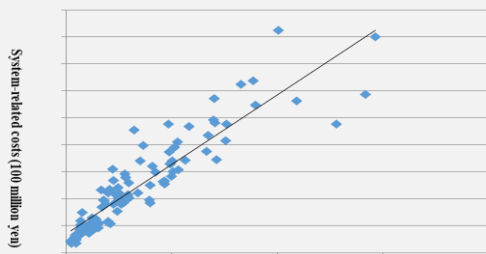
- An indicator of IT-cost effectiveness, defined as the ratio of IT system-related costs to deposits, shows that Shinkin banks are more efficient than regional banks. This result is similar to the result in the previous business year. [See Table A](#)
- Regional banks and Shinkin banks both face challenges in securing and developing IT human resources as the percentage of those responding that they are enforcing IT governance in the field of IT resources was the lowest compared to other fields. [See Chart A](#)
- Responses to questions concerning initiatives relating to new IT and digital technologies show a significant lead of regional banks in their initiatives regarding cloud services, AI technologies, and RPA, compared to Shinkin banks. [See Chart B](#)

[Efficiency of system-related costs] [Table A](#)

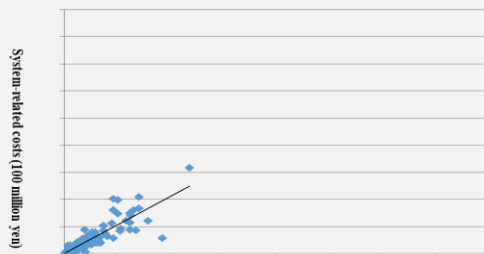
		PY2019		PY2020	
		Regional banks (104 banks)	Shinkin banks (Estimate)	Regional banks (103 banks)	Shinkin banks (254 banks)
BS	Amount of deposits (average)	3.3 trillion yen	554.0 billion yen	3.4 trillion yen	571.9 billion yen
P/L	System expenditure (average)	4.7 billion yen	0.66 billion yen	4.9 billion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

[Correlation between system-related costs and deposited amount by business type]

(i) 103 regional banks



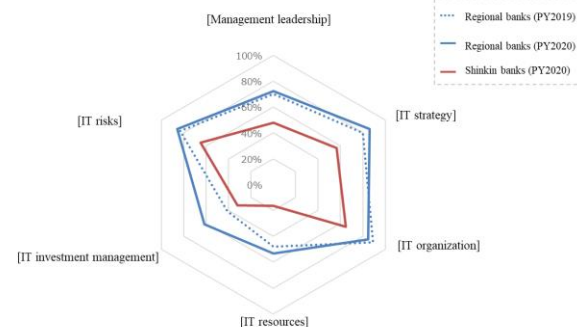
(ii) 254 Shinkin banks



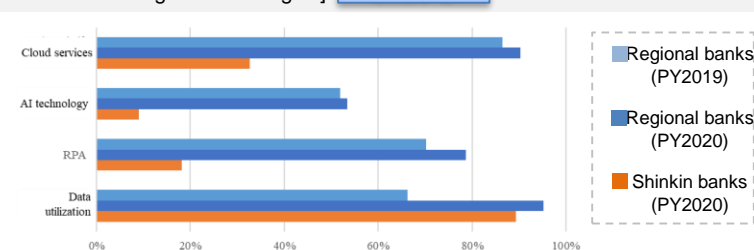
Deposited amount (10 billion yen)

Deposited amount (10 billion yen)

[Percentages of those responding "Yes" to questions regarding six approaches and viewpoints relating to IT governance] [Chart A](#)



[Use of new IT/digital technologies] [Chart B](#)



- ☞ Lower IT cost effectiveness **may indicate that complicated and bloated IT systems** that regional banks have as a result of adding different functions to core banking systems over time could be contributing factors. Regional banks might not have distinguished and clarified nonstrategic areas (basic functions of their banking system for deposits and settlements) and strategic areas (other functions for business support). Regional banks would need to address these issues in their next-generation IT systems, for instance, by use of API connections and loosely coupled system architectures.
- ☞ Financial institutions have a strong need for human resources who can utilize ever-changing IT and digital technologies to create new businesses and improve existing operations. **Financial institutions will need to be more strategic in securing and developing IT human resources.**



- The FSA interviewed experts at IT vendors and consulting firms about options to reduce cost for migrating legacy core banking systems to new ones.^{*3}
- The following are the summary of potential options for reducing migration cost for regional banks:

^{*3} Cases in which a large amount of penalty is incurred when withdrawing from the shared system center during the contract period, cases in which a large amount of expense is requested from the system vendor in order to obtain information necessary for the migration in addition to the penalty, etc.

Overall process of system migration that represents a breakdown of the migration cost	Potential options to reduce migration cost (X indicates that it may be an applicable option)		
	Data migration with tools	Lesser extent of customization, streamlining operations	System architectures that enable system migration
(i) Development of the overall migration plan			
(ii) Migration of general ledger data	X	X	
(iii) Migration of batch processing and ledger sheets		X	
(iv) Migration of systems that control branches and ATMs		X	X
(v) Migration of sub-systems		X	X
(vi) Migration of networks and systems that are connected with the outside		X	X

Description of the potential options for cost reduction	
Data migration using tools	➤ The cost for migrating data of the general ledger account accounts for a large portion of the total cost of migrating the entire core banking system. Data migration tools are often used in many cases to enhance efficiency.
Lesser extent of customization, streamlining operations	➤ The migration of products and services that are directly linked to core banking systems has priority in the migration project over other products and services that are less linked. One option is to compare the current version of a core banking system and a new one that a bank plans to migrate, minimize customization to have additional functions and streamline operations to the extent possible, thereby reducing migration costs.
System architectures that enable system migration	➤ Examples of IT architectures that enable system migration are for example the following: developing a compact IT system by minimizing additional functions due to the fact that a core banking system is not a strategic area for banks, and migrating to an open system rather than a general purpose system to reduce costs.



- Overseas operations of large Japanese banks often made progress on **the standardization of business operations and IT systems by using common packaged IT products**, but **overseas IT projects sometimes tend to be delayed due to factors described below**.
- This year's research found that **it is necessary for globally operating financial institutions to further strengthen IT governance on a global basis to appropriately operate IT systems on a global basis amid the expansion of overseas businesses**.

A summary of this business year's survey results

Global IT strategy/ organization	<ul style="list-style-type: none"> ● Under supervision by a global CIO who is responsible for IT on a global/group-wide basis, regional CIOs are appointed. ● A challenge for these firms is to strengthen and maintain collaboration among those officials and have them properly fulfill their roles and functions.
IT investment management/ resources management	<ul style="list-style-type: none"> ● Large banks that the FSA surveyed have a mechanism to ensure that there is a certain level of involvement by the headquarters in Japan in the development of IT systems in their overseas operations. The progress on the IT development project is reported to the Board at the headquarters. Senior management at the headquarters examined investment efficiency on IT system developments. ● There are some good practices where banks improved the cost effectiveness of IT investment: a bank achieved cost reduction by facilitating the standardization of the core banking systems, and a bank gained a stronger bargaining power than before by integrating the procurement of large quantities of expensive products in different regions into procurement in Japan.
Difficulties in overseas businesses	<ul style="list-style-type: none"> ● The following challenges were observed due to different business environments in each region: <ul style="list-style-type: none"> ✓ Each of the overseas businesses in different locations developed different IT systems on a silo basis to comply with different regulatory requirements that are specific to each region. ✓ Overseas operations tend to have a high turnover rate, including that of CIOs and personnel with strong IT skills, compared with that in Japan. Banks struggle to secure human resources in a stable manner.
Problems concerning system development (examples)	<ul style="list-style-type: none"> ● Each of the overseas businesses has an IT system and controls in place in its own way. This tends to not have been appropriately reported to the headquarters in Japan or regional headquarters, which makes it difficult for the headquarters in Japan or each region to ascertain the progress in the development projects and control the quality of IT systems. ● A small, insufficient number of staff managed and operate IT systems overseas. Policies and procedures for IT management and controls are not properly documented. A project team for upgrading IT systems could not have a proper understanding of the specifications of the current IT systems, which left requirements for the new IT systems not well defined and caused a delay in the project.



- The progress of digitalization and other factors has brought about changes in the financial industry. The FSA will devise monitoring methods as necessary, paying attention to the characteristics of business operations influenced by digitalization and changes in IT risks caused by such developments in the financial industry.

Changes in the Financial Industry

- Based on the law enacted on June 5, 2020,^{*4} a category of financial service intermediary businesses was newly established. In the new law, unlike conventional intermediary businesses, an affiliation scheme^{*5} is not adopted. A financial service intermediary only needs one single registration to provide all financial services, including those in the banking, securities, and insurance sectors.
 - The FSA will pay attention to developments in the market and hold dialogues with the industry as necessary on the stability and safety of the market as a whole and any issues related to data sharing between intermediaries and financial institutions.
- New types of banks recently emerged. These banks provide all services through smartphones targeting customers of the digital native generation, who will play central roles in economic activities.
 - When an application for a license is filed by applicants aiming at creating such banks, the FSA will examine the application based on its supervisory guidelines that cover, among others, supervisory viewpoints on IT risk management. The FSA has started to strengthen collaboration with the Bank of Japan in this regard.

^{*4} The Act Partially Amending the Act on Sales, etc. of Financial Instruments for the Convenience and Protection of Financial Service Users, etc. (Act No. 50 of 2020), which was enacted on June 5, 2020.

^{*5} Bank agents, financial instruments intermediary service providers, and insurance agents are institutionally required to be affiliated with specific financial institutions.

FSA's plan

- Promoting use of case studies
 - ✓ The FSA will update use cases that are relevant to the supervisory viewpoints described in the “Discussion Paper on IT Governance” by reflecting the latest information obtained in dialogues with financial institutions and experts. The FSA will encourage a wider range of stakeholders to refer to those case studies.
- “Enterprise System and Frontrunner Support-Hub”
 - ✓ The FSA will continue encouraging financial institutions to access the Support-Hub for IT projects on mission-critical systems even at the time when a project is still at an early stage. By doing this, the FSA intends to discuss interactively with financial institutions and promote innovative projects.
- Review of approaches to examinations and monitoring in response to changes in the financial sector
 - ✓ The FSA will ascertain risks based on the characteristics of individual business operations and IT systems and flexibly consider means for appropriate examinations and monitoring of IT risk management, including in reviewing an application for registration or a license for financial service intermediary businesses or new banking incenses as well as supervision after granting a license.