



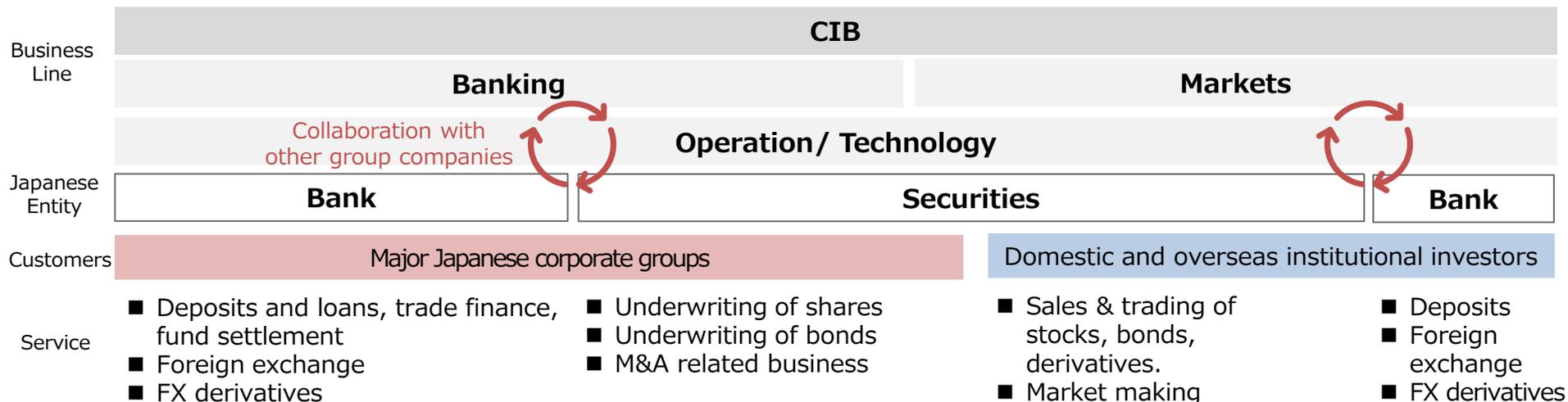
## 1. Introduction

- Foreign bank branches and foreign securities companies play an important role in the Japanese financial market by leveraging the strength of the group's network to support overseas expansion of Japanese corporations and domestic and foreign institutional investors' market access.
- In recent years, the business activities of foreign financial institutions have increased due to changes in interest rates and the economic environment in Japan, progress in corporate governance reforms, and rising geopolitical risks in other parts of Asia.
- With the aim of supporting appropriate and sound business development of each Japanese entity, the FSA has endeavored to deepen its understanding of the business model of Japanese entities, and to monitor whether their governance, compliance, and risk management frameworks are suited to their business models.
- This report summarizes FSA's findings in recent years with a focus on large Japanese entities of US and European banks, as well as the situation of foreign bank branches of Asian banks.

## 2. Business

- US and European banks operate corporate and investment banking business lines such as CIB (Corporate and Investment Banking) through foreign bank branches and foreign securities companies in Japan.
- Business is conducted in cooperation with the head office and other entities of the group. The operations and technologies that support the business are operated and managed across multiple entities of the group.

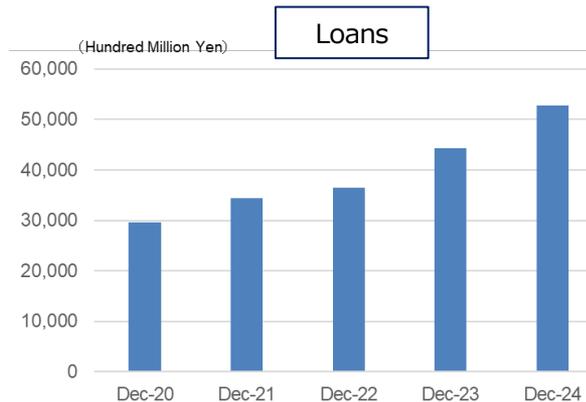
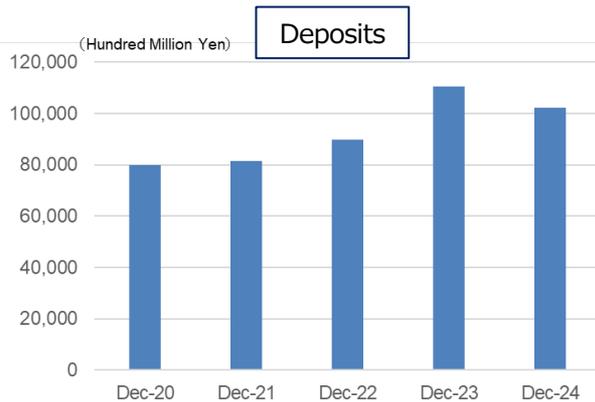
\* Image





## (1) Banking

- Foreign bank branches provide services such as deposits and loans, trade finance, fund settlement, and foreign exchange mainly to Japanese corporations, and engage in foreign exchange and derivative transactions such as currency swaps with institutional investors such as Japanese banks.
- As for loans, in addition to stand-alone credit related to business needs such as working capital, foreign bank branches respond to customers' funding needs through syndicated loans and project finance for large-scale projects such as corporate restructuring and new energy, as well as asset finance using aircraft and ships as collateral.



(Note) A total of 11 foreign bank branches (10 branches in 2024).  
Source: FSA

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Source: FSA

(Note) A total of 11 foreign bank branches. Figures for 2024 are aggregates for 9 banks that end their fiscal year in December.  
Source: FSA

✓ Some groups are strengthening their cash management service to Japanese corporate groups operating on a cross-border basis.

✓ US and European banks have been making efforts to provide syndicated loans in collaboration with Japanese banks.  
✓ They also play a central role in providing loans to overseas entities of Japanese multinationals.

✓ Revenues have been on an increasing trend, with "interest income" increasing significantly.  
✓ The increase is attributable to an increase in interest margins on loans and swap transactions reflecting changes in the interest rate environment, and an increase in the volume of these transactions.

### [Column] Development of CIB and Strengthening of the Payments Business

Some groups are expanding the customer base of CIB from large, cross-border enterprises to medium-sized enterprises and start-ups, and to strengthen cash management capacities. Behind these developments is the need for these CIB services as medium-sized enterprises and start-ups expand their business globally. For these companies, cash management is a trigger for starting various transactions with the bank. From the bank's perspective cash management is an important means to acquire sticky deposits.



## (2) Securities Business

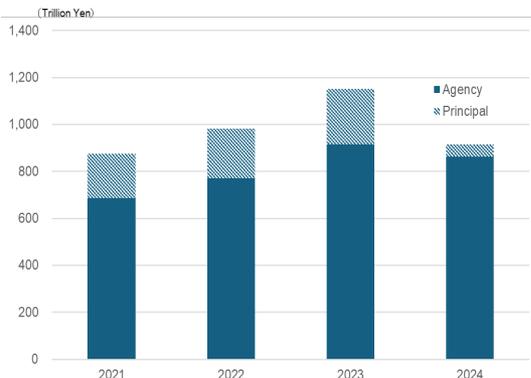
### Markets

- Foreign securities companies conduct brokerage of cash equities and derivatives, bond trading, and various types of over-the-counter derivatives transactions with institutional investors and financial institutions in Japan and overseas, as well as Japanese and foreign companies, depending. Foreign securities companies also actively conducted proprietary trading for the purpose of market-making and earning profits
- Some of them have strengths in accepting orders of high-speed trading and providing liquidity to the market as market makers by conducting high-speed trading themselves.

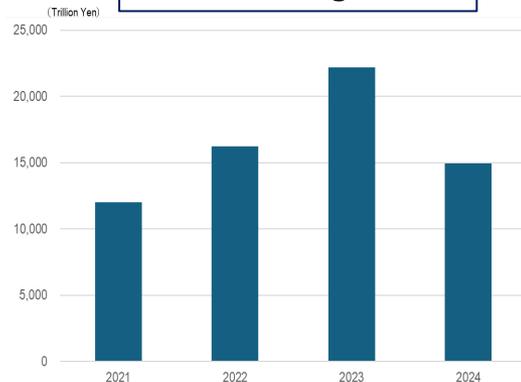
### IB

- Foreign securities companies leverage their global client base to support fundraising through underwriting and secondary offerings of various securities issued by major Japanese companies and financial institutions in Japan as well as to conduct M&A-related business.

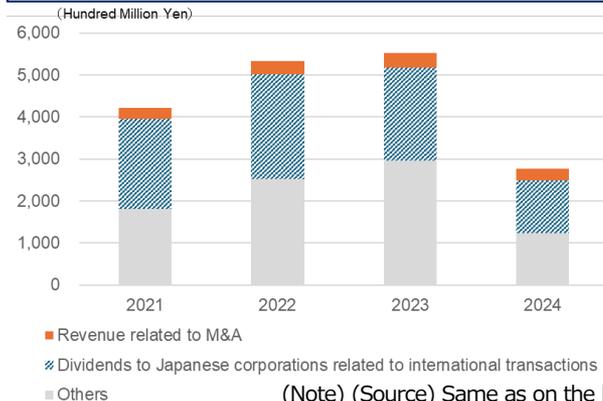
Equity trading value



Bond trading value



Revenue (Other fees received)



(Note) Total of Jan.-Dec. (companies whose fiscal year-end is Dec. 31) or Apr.-Mar. (companies whose fiscal year-end is Mar. 31) for 13 foreign securities companies. 2024 figures are aggregates of 10 companies whose fiscal year-end is Dec. 31

Source: Financial Services Agency

(Note) (Source) Same as on the left

Financing support

- U.S. groups play a central role in the overseas underwriting of shares of Japanese companies
- U.S. and European groups have a high track record in overseas bond issuance

M&A related business

- U.S. groups are key players in cross-border M&A

- ✓ Fees and commissions revenue remained solid. The majority is "other fees received."
- ✓ Revenues earned from supporting M&A activities are accounted for as "revenues related to M&A." Revenues from contribution to earnings from overseas underwriting business are accounted for as "dividends to Japanese corporations related to international transactions."
- ✓ "Others" includes revenues from characteristic businesses such as system usage fees related to the acceptance of orders of high-speed trading.

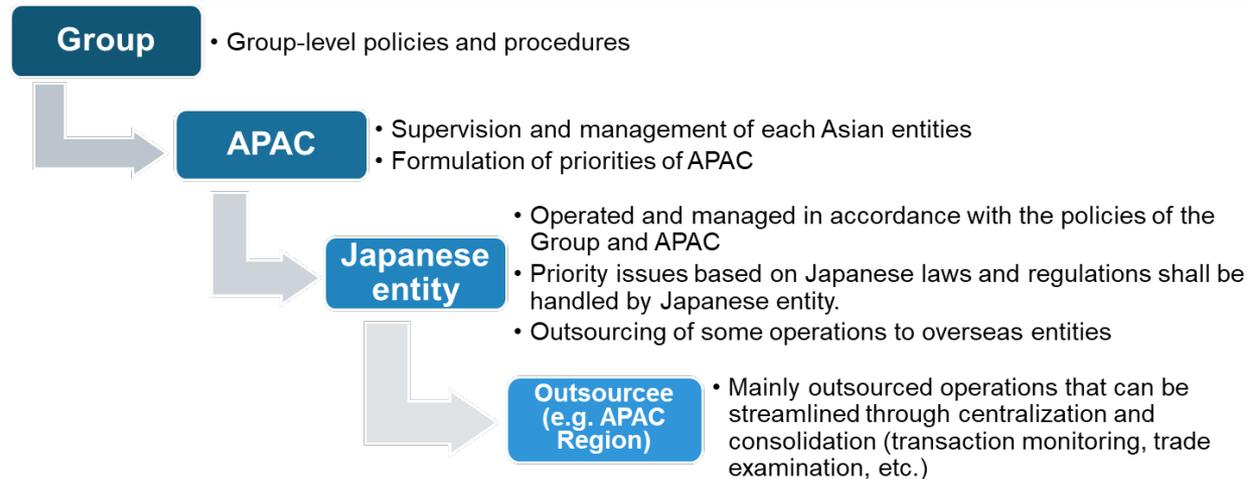


## 3. Compliance

### (1) Compliance Framework

#### I) Org

- The compliance department operates under the group's policies and procedures. Issues related to compliance with local laws and regulations are reflected in risk assessment and compliance planning.
- Some activities are outsourced to other entities in the group while ensuring their appropriateness as the outsourcer. These activities include transaction monitoring relating to AML/CFT and trade surveillance.



Source: FSA

#### II) Process

- (a) Risk Assessment
- Residual risk is assessed based on the assessment of inherent risk and effectiveness of controls for departments or business processes
  - In some entities, the compliance department carries out its own risk assessment. Some entities utilize RCSA, whereby the self-assessment by the first line is challenged by the second line.
- (b) Formulation and Implementation of a Compliance Plan
- The Compliance Department formulates a compliance plan (monitoring, testing, training, and other relevant activities) based on the group's priority and risk assessment results and carries out various activities accordingly.
- (c) Reporting on Compliance Activities
- When issues such as suspected violations of laws and regulations are identified, they are reported within the Japanese entity and to the group. In addition, after the causes are identified and remediation plans are determined, the progress of remediation is followed up on until completion.
  - The status of activities by the compliance department is regularly reported to the Management Committee.



## III) Initiatives on Important Compliance Topics

Topics	Initiatives by the Compliance Division
<b>AML/CFT</b>	<ul style="list-style-type: none"> <li>● Efforts are being made to strengthen KYC and transaction monitoring for clients such as funds transfer service providers and payment receiving agents (“Shuno-Daiko”).</li> <li>● Regarding transaction monitoring, many branches have introduced a system to detect and automatically stop remittances to related to economic sanctions.</li> </ul>
<b>Fraudulent Trading</b>	<ul style="list-style-type: none"> <li>● Trade surveillance is conducted with both group standards and Japanese standards.</li> <li>● Communication monitoring is conducted based on group- and Japan-specific scenarios.</li> </ul>
<b>Measures to Prevent Conflict of Interest</b>	<ul style="list-style-type: none"> <li>● The control framework is reviewed by considering recent cases of administrative disciplinary actions.</li> </ul>
<b>Customer-Oriented Business Conduct and Product Governance</b>	<ul style="list-style-type: none"> <li>● To ensure customer-oriented business conduct and product governance pertaining to the 3<sup>rd</sup>-party distribution of structured bonds, entities make efforts such as review by the compliance department and screening and discussion by the new product committee.</li> </ul>

## (2) Initiatives Related to Strengthening the Compliance Framework

### I) Compliance With the Laws & Regulations of Each Country

- Several groups have developed a framework for systematically recording laws and regulations of each country using a dedicated system and updating them through monitoring of regulatory trends (regulatory change management).

### II) Rebalancing the Three Lines of Defense Model

- Several groups have been rebalancing their three lines of defense model, such as transferring the operations of the 2nd line to the 1st line, to increase the 1st line's risk ownership and allow the 2nd to focus on challenging the 1st line.

### III) Strengthening Non-Financial Risk Management

- Several groups have changed their approach to managing compliance risk and operational risk by integrating the management of those risks as non-financial risk. Others have launched projects to strengthen operational risk management, including increasing staff numbers and strengthening coordination among relevant departments.
- Multiple groups are taking steps to improve data quality, such as digitizing and quantifying non-financial risks and unifying the formats for collecting and aggregating data.



## **[Column] Cooperation with Home Regulators**

The FSA has participated in supervisory college meetings for foreign financial groups with large entities in Japan, and deepened its understanding of the group's governance, business, and issues regarding risk management. In addition, the FSA has made efforts to share supervisory priorities and issues with the home regulators on multiple occasions including bilateral meetings.

In 2024, the FSA held for the first time a global college of supervisors meeting for a foreign financial group, co-hosted by the home regulator and the Bank of Japan. Going forward, the JFSA will continue to deepen cooperation with overseas regulators through active participation in college meetings, to ensure effective monitoring of Japanese entities.

## **[Column] Recovery and Resolution Planning (RRP) and Crisis Management Group (CMG)**

For the G-SIB groups, in addition to the requirement of recovery and resolution planning (RRP), a crisis management group (CMG) has been established for the purpose of preparing for a cross-border financial crisis. The FSA has participated in the meetings for foreign financial groups with large entities in Japan and has deepened its understanding of each resolution plan and the progress each group has made toward the smooth implementation of the plan. The interest of the CMG meetings recently has shifted to assessing financial institutions' efforts to improve the feasibility of resolution plans. Specifically, there has been active discussion on the status of development of frameworks for measuring capital and liquidity required for each group in resolution, measures to smoothly provide capital and liquidity to significant subsidiaries, and communication strategy with external stakeholders, as well as the status of efforts to verify the feasibility of these frameworks. The FSA will continue to strengthen its preparedness for a crisis through active participation in the CMG meetings.

## **[Column] RCSA**

Within each group, RCSA is used primarily as a framework for managing operational risk, where the owners of the activities identify the processes involved, identify the risks inherent in those processes, assess the riskiness of those processes, assess the effectiveness of the controls in place to manage risk, and combine their assessment of the riskiness with that of the control environment to determine whether risks are adequately mitigated.

In recent years, several groups have been working to enhance the effectiveness of their RCSAs by developing a group-wide taxonomy for the definition of processes, risks, and controls and applying it to their RCSAs. In other groups, compliance risk assessment and RCSA are integrated; the results of RCSA by the 1<sup>st</sup> line is challenged by the 2<sup>nd</sup> line. The internal audit department of some groups uses the same assessment unit as RCSA.

The JFSA will continue to pay attention to RCSA and groups' efforts to strengthen operational risk management, as well as the implementation at each Japanese entity.



## 4. Internal Audit

### (1) Internal Audit Framework

#### I) Org

- The internal audit department operates under group-level policies and procedures, and compliance with local laws and regulations is reflected in risk assessment and audit planning.
- Auditable entities within the Japanese entity may be covered by audits conducted by the local audit team. Also, they may be covered as part of a regional audit or a group audit.

#### II) Process

##### (a) Risk Assessment

- As the nature and structure of business may change, the audit team uses organizational charts and mappings of risk events to ensure the sufficiency of the audit universe.
- The audit department assesses residual risk based on the inherent risk of each auditable entity and the effectiveness of the control environment.
- To ensure the appropriateness of risk assessment, several audit teams compare and adjust risk assessment results across similar auditable entities within the group.

##### (b) Audit Planning and Execution

- The audit plan is designed to meet the audit frequency determined based on the residual risk of each auditable unit.
- Validation audits for audit findings and regulator findings, audits for events that have a significant impact on the control environment, such as large-scale system updates, and continuous monitoring of business activities are also included in the audit plan and executed accordingly.

##### (c) Reporting of Audit Results & Status of Audits

- The audit report includes audit scores as well as the audited items, scope, procedures, findings, root-cause analysis results, and the remediation plan that is owned by the management of the audited department.
- Audit results and findings of ongoing audits are reported to the Management Committee to ensure necessary information is shared with management.

##### (d) Follow-Up Process

- In many cases, audit results and findings are registered in a dedicated system of the internal audit department, and the progress of remediation measures is also managed within the system.

##### (e) Quality Assurance (QA)

- The QA team conducts internal assessments to determine whether each audit complies with group-level internal audit policies and procedures and whether it is conducted efficiently and effectively.
- Furthermore, external reviews are regularly conducted at the group level.



## III) Initiatives on important audit topics

Topics	Initiatives by the Internal Audit Department
<b>Compliance with Japanese Laws and Regulations</b>	<ul style="list-style-type: none"> <li>● The audit department conducts audits on compliance with local laws and regulations reflecting the business of each entity.</li> <li>● The audit department conducted thematic audits on trade surveillance for JGB futures, the management framework of firewalls between the banking entity and the securities entity, and reviews and approvals of the 3<sup>rd</sup>-party distribution of structured bonds, referring to cases of administrative sanctions imposed on other firms.</li> </ul>
<b>AML/CFT</b>	<ul style="list-style-type: none"> <li>● Each Japanese entity conducts audits on the timeliness and appropriateness of KYC and transaction monitoring, including other entities that provide outsourced services.</li> <li>● Some groups have auditors with AML/CFT expertise at group and regional audit teams that support audits of the Japanese entity.</li> </ul>
<b>IT Systems (Systems Specific to the Japanese Entity) &amp; 3<sup>rd</sup>-Party risk</b>	<ul style="list-style-type: none"> <li>● As reliance on external systems and vendors is increasing, some audit departments are conducting audits on the ability to appropriately respond to system failures.</li> <li>● Through continuous monitoring, some audit departments recognized and pointed out issues in the governance of projects related to the updating and migration of systems unique to the Japanese entity.</li> </ul>
<b>Outsourcing</b>	<ul style="list-style-type: none"> <li>● Some groups have a dedicated team within the group that conducts an audit on the outsourcer's oversight of 3<sup>rd</sup>-parties. Some groups conduct an audit on the central outsourcing management team. Some groups set up an internal audit team within the operation centers.</li> <li>● Some audit departments identified issues with respect to the oversight of outsourcing related to regulatory reporting.</li> </ul>
<b>Operational Resilience</b>	<ul style="list-style-type: none"> <li>● Cybersecurity is being addressed by strengthening system audits at each Japanese entity.</li> </ul>
<b>Data Governance</b>	<ul style="list-style-type: none"> <li>● With the increase in volume of data, there are challenges in data governance, such as traceability of data and systems for transactions, settlement, and accounting.</li> <li>● To address these challenges, audits on data integrity and controls over the use of EUCs are conducted as an example.</li> </ul>
<b>AI Governance</b>	<ul style="list-style-type: none"> <li>● Some audit departments conduct audits from the perspective of whether AI has been introduced with a sufficient assessment of the appropriateness of data and models.</li> <li>● Some audit departments conduct an audit on whether AI is appropriately implemented and operating as intended, and whether it contributes to improving productivity.</li> </ul>



## (2) Utilization of Data and AI

- In response to the increase in data volume accompanying the expansion of business, some groups established data and analytics teams to support auditors in the extraction, processing, and analysis of data in order to improve the completeness of the audit universe and accuracy of audits and to increase the accountability to audited departments.
- Some groups used AI to automate routine tasks including preparing draft audit reports and checking consistency between audit scores and findings.
- Some firms in Japan were experiencing vacancies in the audit division due to difficulties in recruitment, but they are trying to optimize resources through these initiatives.

### [Column] Evaluation of Management's Risk Ownership in Internal Audits.

Management in audited departments is required to take ownership of their own risks, i.e., to be aware and take measures to make the control environment function appropriately so that risks in their own department are sufficiently mitigated. A sound organizational culture is fostered through such ownership.

In some firms, risk ownership of the management and organizational culture is assessed in audits. For example, some firms' auditors evaluate the appropriateness of management self-identified issues in risk assessments and individual audits. Some firms' auditors evaluate whether management is promoting activities necessary for the appropriate functioning of the control environment, separately from the evaluation of the effectiveness of the control environment.

## 5. Foreign Bank Branches of Asian and Other Regions' Banks

- Most bank branches are focused on providing specific financial services. For example, some are seeking to strengthen ties with domestic banks in areas such as syndicated loans and project finance. Some are focusing on trade finance between Japan and their home country or neighboring regions, providing loans for wealthy home-country residents to acquire real estate in Japan, and providing remittances to the hometowns of home-country residents.
- Some are expanding their offices in Japan to meet various funding needs in response to the entry of their home-country corporations into Japan. Some banks are setting up representative offices with the aim of entering the banking industry.
- As for the business model of Asian foreign bank branches, the FSA found that some increased the ratio of securities investment in commercial banking activities. Other branches increased the amount of syndicated loans arranged by domestic banks in lending activities. Considering these changes in business and the occurrence of losses, foreign bank branches strengthened their risk management by enhancing interest rate risk measurement methods, strengthening concentration risk management by lowering credit limits, and introducing timely reviews of credit ratings.
- These bank branches that operate solely in Japan generally have small staff numbers and rely on their head offices for part of their operations such as internal audits. Therefore, it is necessary to conduct monitoring of these branches through dialogues with head offices and close cooperation with the home regulators, as in the past.



## 6. Conclusion

### US and European Banks and Securities Companies

- US and European banks provide banking services such as deposits, various credit transactions, foreign exchange and fund settlement, and investment banking services such as fundraising and M&A support in Japan and overseas to Japanese multinational corporations. They also provide market business, such as sales and trading of securities and derivatives, to Japanese and overseas institutional investors.
- These businesses are conducted in cooperation with the head office and other entities of the group. The Japanese entities play a role in building relationships with clients in Japan and working as a liaison between the head office and the group.
- The compliance department at each entity in Japan was conducting monitoring and other activities based on risk assessments that reflect the risks specific to the Japanese entities. Overall, the FSA recognized that the compliance framework has been developed and is being operated in accordance with the compliance risks of the business model of Japanese entities.
- The internal audit department of each Japanese entity also conducted internal audits based on risk assessments reflecting the risks specific to each entity. The FSA recognized that the risks of the business model of the Japanese entities were generally covered.

Some Japanese entities have been taking remediation actions, regarding issues in compliance, outsourcing management, and operational risk management that were identified through inspections by the FSA and the SESC.

From the perspective of promoting appropriate and sound business, the FSA expects each Japanese entity to continue to make efforts to ensure the effectiveness of the three lines of defense model, including securing necessary resources, reflecting business expansion and the complexity of business operations.

### Foreign Bank Branches of Asian and Other Regions' Banks

- Banks have developed unique businesses such as trade finance and hometown remittances, in addition to participation in syndicate loans and project finance.
- Some banks have strengthened their risk management frameworks in alignment with their business.

**The FSA will continue its efforts to gain a deeper understanding of the strengths and characteristics of the business as well as the operations and technologies that support the business, with the understanding and cooperation of the Japanese entities, and will verify whether the three lines of defense model appropriate for their business models is developed and implemented in each entity.**