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Access the online version here

<https://www.fsa.go.jp/en/newsletter/2023a.html>



Financial Services Agency

General Meeting of the Business Accounting Council

– Minister Suzuki Received a Written Opinion –

On April 7, 2023, the Business Accounting Council held its general meeting*1 and revised the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting (hereinafter referred to as the "Internal Control Standards and Practice Standards") and had discussions on the domestic and foreign trends regarding disclosure and accounting audits and responses to the International Financial Reporting Standards (IFRS).

○ Revision of the Internal Control Standards and Practice Standards

It is over 15 years since the introduction of the Internal Control Report System in 2008. The reliability of financial reporting has surely been improved to a certain degree, but there still are some cases where serious inadequacies that should be disclosed were found outside the scope of assessment of internal control by top management. Accordingly, some people have raised concerns over the effectiveness of the system, pointing out such possibility that top management may not give due consideration to the significance of the influence on the reliability of financial reporting when they deliberate the scope of assessment of internal control.

Therefore, the Internal Control Committee of the Business Accounting Council commenced discussions in October 2022 from the perspective of improving the effectiveness of internal control regarding financial reporting and compiled the draft revision of the Internal Control Standards and Practice Standards.

The draft revision requires top management to ensure an appropriate risk approach when deliberating the scope of assessment of internal control and to fully disclose the idea leading to the final decision. Additionally, it was decided to review the basic framework for internal control in light of the revision of the international framework for internal control.

After Mr. Horie, chairman of the Internal Control Committee, explained the draft revision of the Internal Control Standards and Practice Standards and other matters, the general meeting compiled a written opinion

titled "Revision of the Internal Control Standards and Practice Standards."*2 Mr. Tokuga, chairman of the Business Accounting Council, personally delivered the written opinion to Minister Suzuki, who then delivered remarks.



(Photo: Chairman Tokuga personally delivering the written opinion to Minister Suzuki)

○ Recent major trends concerning accounting audits and accounting standards and responses to the IFRS

The secretariat provided the following explanations, and approval was given to the Audit Standard Committee to discuss responses required for audit reviews associated with reconsideration of the quarterly disclosure requirement and to the Corporate Accounting Committee to also discuss responses to the IFRS.

< Explanations by the secretariat >

- Domestic and foreign trends regarding disclosure and accounting audits
 - (1) Outline of the draft law concerning reconsideration of the quarterly disclosure requirement
 - (2) Amendment of Cabinet Office Orders concerning sustainability disclosure
 - (3) Amendment of Cabinet Orders associated with the amendment of the Certified Public Accountants Act
 - (4) Amendment of the Cabinet Office Order on Audit Certification of Financial Statements
 - (5) Major revised points of the International Standards on Auditing
- Responses to the IFRS

*1 For the agenda and materials for the meeting, see the following:
https://www.fsa.go.jp/singi/singi_kigyousiryoutaikaiki/20230331.html (Available in Japanese).

*2 For the publication of the notice, "On the Revision of the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting (Council Opinions)," on April 7, 2023, see the following:
<https://www.fsa.go.jp/news/r4/sonota/20230407/20230407.html> (Available in Japanese).

FIN/SUM 2023

– Greatest FinTech Conference in Japan –

The FSA and Nikkei Inc. jointly held the "FIN/SUM 2023," the largest FinTech conference in Japan, for four days from March 28 to 31, 2023.

1. Outline of FIN/SUM 2023

This year, with thorough measures against COVID-19, the FSA and Nikkei Inc. invited panelists and visitors to come and join the conference in-person, and **as a result, over 1,300 people in the field of FinTech businesses came to the venue from inside and outside Japan.**



Photo: FSA Commissioner Nakajima delivering opening remarks

2. Outline of the symposium hosted by the FSA

At the symposium hosted by the FSA on March 29, experts from academia, the business sector, financial authorities, and central banks, etc. had discussions from diverse viewpoints under the theme of "Empowering People with Responsible Innovation." At the beginning, FSA Commissioner Nakajima delivered opening remarks and talked about further advancement of financial digitalization, benefits of doing Web 3.0 business in Japan, and innovation in the traditional financial sector. All seven sessions held on March 29 are outlined below.

(Note) Honorifics are omitted. Persons marked with * are moderators.

(i) Building the Future of Web 3.0 through Multi-stakeholder Collaboration

As monetary easing policies are facing a turning point globally and risks of bankruptcies of large crypto-asset exchange service providers are coming up to the surface, **the possibility of industry-government-**

academia collaboration for achieving truly sustainable innovation was discussed.

Panelists:

Alan Lim (Monetary Authority of Singapore); Ito Joichi (Digital Garage); Matsuo Shinichiro (Georgetown University); Michele Korver (Andreessen Horowitz, US); *Ariizumi Shigeru (FSA)

(ii) The Role of Regulation for Innovation – Beyond the Crypto Winter –

Panelists from regulatory authority that request measures against risks of crypto-assets and business side panelists that prioritize the potential of decentralized finance discussed ideal regulations for crypto-assets.

Panelists:

YJ Fischer (US Securities and Exchange Commission); Sandra Tobler (Futurae, Switzerland); Jennifer Schulp (Cato Institute, US); Amaya Tomoko (FSA); *Jemima Kelly (Financial Times, UK)



Photo: Session (ii)

(iii) Frontline of Japan's Web3.0 Strategy

The Japanese government's Web 3.0 Strategy was introduced and panelists discussed the potential of Web 3.0 and digital assets, and challenges and measures to be taken for their further development, while making comparisons with trends in the United States and other foreign countries.

Panelists:

Sheila Warren (Crypto Council for Innovation, US); Watanabe Sota (Astar Network); Taira Masaaki (member of the House of Representatives); Kurita Teruhisa (FSA); *Kusunoki Masanori (Digital Agency)



Photo: Session (i)

(iv) Unleashing the Potential: Exploring Market Opportunities for FinTechs in Japan

Together with panelists from foreign FinTech companies that have entered the Japanese market and an organization that supports foreign companies' entry into the Japanese market, **characteristics and attractions of the Japanese FinTech market were introduced and challenges upon entry and solutions therefor** were discussed.

Panelists:

Okita Takashi (Nudge); Chang Li (Plug and Play Japan); Arimoto Keiichi (The Organization of Global Financial City Tokyo); Peter Kenevan (PayPal, US); *Horimoto Yoshio (FSA)

(v) Frontier of Digital Finance

– Future of Payments –

Technology developments in remittance and payment solutions have **increased convenience but also increased the possibility of transforming risks in payment systems**. Panelists from Japanese and foreign payment service providers and the central bank discussed the future of payment systems.

Panelists:

Nakayama Ichiro (PayPay); Tanizaki Katsunori (Mitsui Sumitomo FG); Diana Avila (Wise, UK); Nakajima Junichi (FSA); *Bessho Masaki (Bank of Japan)

(vi) Tokenization: A Game Changer for Capital Markets

Digital securities are still under development globally but are likely to have unique potential; a) improve the efficiency of payments due to its programmability and b) build relationships with investors different from that of the conventional securities market. Panelists discussed **the potential of digital securities and challenges toward further development from the standpoints of Japanese and foreign companies and security exchange**.

Panelists:

Saito Tatsuya (Mitsubishi UFJ Trust Bank); Kobayashi Eiji (Securitize Japan); Mikazuki Kimio (Osaka Digital Exchange); Sasaki Toshiki (Boostry); *Yanase Mamoru (FSA)

(vii) Beyond Reality

– Building a New Society in Metaverse –

Cutting-edge metaverse-related initiatives by Japanese and foreign companies, including those in the non-financial areas, were introduced and their implication on finance was discussed.

Panelists:

Chuman Kazuhiko (KDDI); Yamaguchi Akio (IBM Japan); Kawai Yuko (Japan Digital Design); Yat Siu (Animoca Brands, Hong Kong); *Mashita Toshiharu (FSA)

In the closing remarks, State Minister Fujimaru expressed his expectations for companies endeavoring to further develop FinTech, mentioned the foresight of the FIN/SUM, and declared **the creation of "Japan FinTech Week" in March 2024** with the aim of achieving further internationalization and expansion in scale.



Photo: State Minister Fujimaru delivering closing remarks

3. Consulting services provided by the FinTech

Support Desk

In 2015, the FSA launched the "FinTech Support Desk" as a one-stop contact point for inquiries and exchange of information on FinTech. The Desk receives **consultations on various points related to financial regulation, including matters concerning specific businesses and business plans, from people engaging in FinTech businesses or people considering starting new businesses.**

For three days during the FIN/SUM (from March 28 to 30), the Desk ran a booth at the venue and provided consulting services. In FY2020 and FY2021, consulting services were provided online due to COVID-19, and it was the first trial for face-to-face services. **Opinion exchanges concerning business in general were also conducted in addition to provision of consulting services on matters concerning regulations.** Furthermore, a consulting booth for the Regulatory Sandbox by the Cabinet Secretariat was also established, and collaboration was sought between the FSA and the Cabinet Secretariat.



Photo: Consulting services by dispatched consultants

Should you require assistance of FinTech Support Desk, please email us to this E-mail address:
fintech@fsa.go.jp
Service hours: 9:30 to 18:15 on weekdays

4. Side events, etc.

As pilot initiatives toward the Japan FinTech Week to be held next year, during which various FinTech-related events will be intensively put on, the FSA hosted a reception dinner and organized multiple side events together with the Fintech Association of Japan, Plug and Play Japan, and others. Several hundred people, including people from overseas, participated and networked. Some of those events are introduced below.

Japan Fintech Festival

FinTech companies and authorities gathered from around the world and discussed trends of FinTech in and outside Japan and the significance of global collaboration, etc. Over 120 people participated in the festival and Deputy Director-General Yanase delivered opening remarks.

"For Making Japan a home to Global Financial City" powered by Plug and Play

Related parties gathered from Tokyo, Osaka and Fukuoka and discussed these three cities' current positions as a global financial city and their challenges into the future.

FIN/SUM sub-event Crypto Night 2023

IVS and CoinPost co-hosted this event in which crypto-asset-related companies gathered and networked. Over 100 people participated



Photo: Reception hosted by the FSA

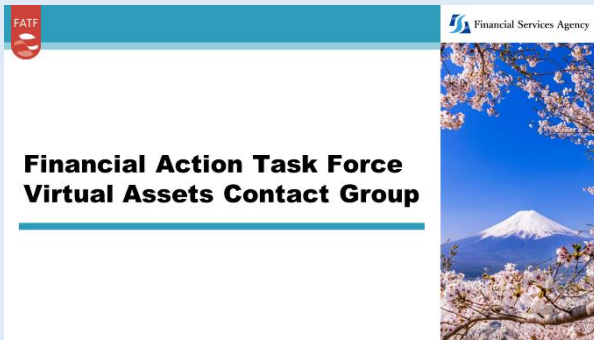
Next FIN/SUM 2024 will be held from Tuesday, March 5 to Friday, March 8, 2024. We look forward to your participation.

Financial Action Task Force (FATF)

Virtual Assets Contact Group Meeting in Tokyo

1. Introduction

On April 12 to 14, 2023, the Virtual Assets Contact Group (VACG) of the Financial Action Task Force (FATF) took place in Tokyo, hosted by the FSA. This article provides an outline of the meeting.



The AML/CFT/CPF measures for virtual assets are one of the priorities of the Finance Track in the G7 meeting held under the Japan's presidency this year. Japan will enshrine the importance of the FATF's initiatives with G7 member countries and lead the discussion, aiming to support and boost these initiatives as G7.

2. Background and outline

The FATF is an intergovernmental body that sets international standards to prevent money laundering, terrorist financing, and proliferation financing. Following the adoption of the FATF Standards on virtual assets, the FATF established the VACG in June 2019. Since then, the FSA has served as Co-Chair of the VACG together with the U.S. Department of the Treasury.

The VACG has been playing a key role in promoting global implementation of the FATF standards and identifying and addressing emerging risks in the cryptosphere. The group continues to engage with industry and monitor market development, as well as publish reports on the current jurisdictions' implementation status and challenges and contribute to the revision of relevant.

Officials from 19 jurisdictions and international organizations attended this meeting. In addition, as for private sector outreach, approximately 80 private-sector participants (virtual assets service providers, blockchain analytics companies, industry bodies, financial institutions, etc.) from all over the world joined the discussion.



Photo: Parliamentary Vice-Minister Suzuki (at the center, back) delivering opening remarks

At the meeting, following the welcome remarks by SUZUKI Eikei, Parliamentary Vice-Minister for Financial Services, the VACG discussed the topics below and agreed that it is important for the FATF and ~~for~~ each jurisdiction to continue promoting effective implementation of the FATF Standards on virtual assets and to monitor and explore responses to emerging risks and growing threats.

- strengthening implementation of the FATF Standards on virtual assets in each jurisdiction and measures to promote the implementation (the Road map)
- progress of implementation of the Travel Rule and challenges for effective implementation
- emerging risks (e.g. Decentralized Finance (DeFi), unhosted wallets including peer-to-peer (P2P) payments, non-fungible tokens (NFT))
- growing risks (e.g. thefts and misuse of virtual assets by North Korea, sanctions evasion, ransomware attacks, misuse of virtual assets by terrorists)

The FATF released [the latest updated report](#) based on the results of this meeting in June 2023.

3. Message from the team in charge

As the restrictions on overseas travel due to COVID-19 were relaxed, we were able to hold a large-scale face-to-face meeting of an international organization in Japan after a long interval. The meeting ended successfully as a result of the thorough coordination with the FATF Secretariats and other parties. We express our gratitude to nearly 60 people who came all the way to Japan to attend the meeting physically, and more than 90 people who participated in the discussion online in spite of the time difference.



Photo: Parliamentary Vice-Minister Suzuki (left),
FSA official serving as a Co-Chair (right)



Photo: At the meeting

We, FSA staff members, are relieved to receive a lot of acknowledgement and compliments from overseas authorities for Japan's organization of the meeting, and feedbacks that the meeting led to strengthening our relationships and fostering trust with other countries.

We will continue to contribute to international discussion and reinforce domestic measures based on international discussion.

* Detailed information on this meeting is posted on the websites of the FSA and the FATF.

• FSA website: <https://www.fsa.go.jp/en/news/2023/20230414/20230414.html>

• Opening remarks by Parliamentary Vice-Minister Suzuki:

https://www.fsa.go.jp/common/conference/danwa/20230412_EN.pdf

• FATF website: <https://www.fatf-gafi.org/en/publications/Virtualassets/Press-Release-FATF-VACG-2023.html>

Signing of an Exchange of Letters for Cooperation between the Bangladesh Securities and Exchange Commission (BSEC) and the FSA

NAGOYA Tomohiro, Deputy Director

International Affairs Office, Planning and Management Division, Strategy Development and Management Bureau / A member of a Emerging Countries Support Laboratory (Frontier Lab)

1. Background

On April 25, 2023, the Bangladesh Securities and Exchange Commission (BSEC) and the FSA signed an Exchange of Letters for Cooperation (EoL).

In recent years, Bangladesh has been achieving remarkable economic growth and has engaged in vigorous activities in the securities field. The FSA signed the EoL in order to confirm further financial cooperation with this country.

Prof. Shibli Rubayat-Ul-Islam, Chairman of the BSEC, has held the post of Vice Chair of the Asia-Pacific Regional Committee (APRC) since October 2022, which is one of the four regional committees under the International Organization of Securities Commissions (IOSCO). Mr. ARIIZUMI Shigeru, Vice Commissioner for International Affairs of the FSA, serves as the Chair of the APRC. Thus, the FSA and the BSEC are responsible for operating meetings of the APRC.

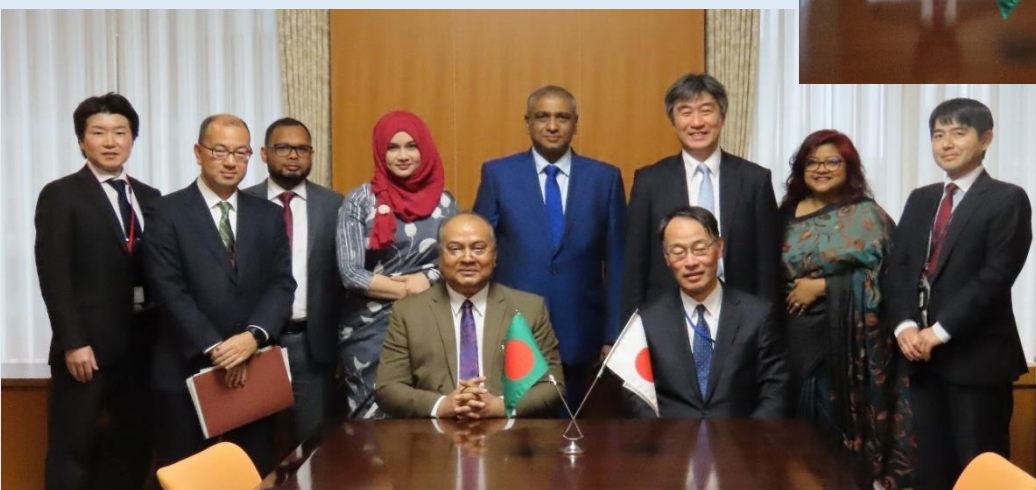
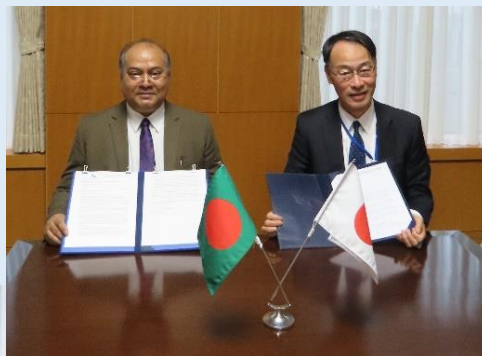
Photo(right):Signing ceremony
Chairman Shibli (left),
Commissioner Nakajima (right)

2. Outline of the EoL

The contents of the EoL signed between the FSA and the BSEC are included in the following points;

- The Authorities intend to share experience and information on legal/regulatory frameworks and developments relevant to financial products and financial markets and those of enforcement.
- The Authorities intend to establish and implement ongoing experience and expertise exchange programs that may include personnel exchange and/or trainee programs in the Global Financial Partnership Center (GLOPAC)* and other international seminars.

At the signing ceremony, both authorities confirmed the importance of strengthening the cooperative relationship between the two countries.



* GLOPAC was founded in 2016 by the FSA in order to discuss various issues concerning financial markets and use the discussion results for the support of financial infrastructure development and to further strengthen cooperative relationships with overseas financial authorities. Its activities include inviting researchers from financial authorities of emerging countries, conducting research and study concerning issues on financial markets, and holding international conferences and seminars.

3. Bangladesh Trade and Investment Summit

On April 27, the Bangladesh Trade and Investment Summit was held by the BSEC and the Bangladesh Investment Development Authority (BIDA) as organizers and the Japan External Trade Organization (JETRO) as one of the co-organizers, and an EoL exchange ceremony was held in the presence of H. E. Sheikh Hasina, Prime Minister of the People's Republic of Bangladesh.

At the summit, Prime Minister Hasina stated that Bangladesh welcomes investors from around the world and provides them with investment opportunities, but substantial investment is still at a low level, so it is recommended to come to Bangladesh and explore the possibilities for business and investment. She also stated that as Bangladesh will graduate from the least developed country (LDC) status by 2026, it is cooperating with

Japan so that an economic partnership agreement can be reached in order to expand trade and investment between the two countries.

BSEC Chairman Shibli pointed out that the return on investment in Bangladesh has been high constantly, and stated that the country's business-friendly fiscal and non-fiscal policies and incentives, stable democracy, deliberate governance and leadership will attract investment from outside the country and bring about good value.

From the FSA, Mr. YAMASHITA Yuji, Deputy Commissioner for International Affairs, and Mr. Tomohiro Nagoya, the author of this article, attended the summit.



Photo: EoL exchange ceremony at the Bangladesh Trade and Investment Summit (photo provided by JETRO)

Of the two persons holding the EoL at the center, the one on the left is Deputy Commissioner Yamashita and the one on the right is Mr. Md. Mahvubul Alam, Executive Director of the BSEC.

The person on the left of Deputy Commissioner Yamashita is the author, the person on the right of Mr. Md. Mahvubul Alam is Ms. Farhana Faruqui, Director of the BSEC, and the person on the right of Ms. Farhana Faruqui is Prime Minister Hasina.

Report of the Commissioned Research on Lending Practices using Security Interest over All Assets

MATSUMOTO Ai, Deputy Director
 SASAKI Yusuke, Section Chief
 Regional Financial Planning Office, Banking Business Division II, Supervision Bureau
 TANI Takahiko, Deputy Director
 Banking Business Division II, Supervision Bureau

1. Introduction

From the perspective of promoting lending practices that focus on cash-flows and business potentials, rather than excessively relying on real estate collateral or personal guarantees, the FSA has been discussing and preparing to establish a new security interest over all assets based on the discussions in the "Study Group on Lending and Business Turnaround Practices to Support Corporate Borrowers' Business Enhancement,"^{*1} established in November 2020, and "Working Group on Legal Institutions for Cash-flow-focused Lending Practices"^{*2} (provisional English title) of the Financial System Council, established in November 2021.

The concept of this security interest is not yet familiar in Japan, but in the United States and the United Kingdom, the practice of conducting cash flow lending focusing on cash flow by using a security interest over all asset (blanket lien or floating charge) has been said to be taken root. In order to study such overseas collateral systems and lending practices and develop a practical image of the use of a security interest over all assets once it is introduced in Japan in the future, the FSA conducted a commissioned research on the characteristics of the systems and practices relating to the security interest over all assets in the United States and the United Kingdom, as well as on the implications for practices in Japan based on such research. The report on the results of this commissioned research was compiled and published on March 31, 2023.^{*3} This article presents the major points of this report.

2. Overview of systems and lending practices regarding security interests over all assets in the United States and the United Kingdom

In the United States and the United Kingdom, although there are differences between security systems of the two countries, lenders may establish security interests over all assets, including assets to be acquired in the future, and may dispose of the borrower's business as a whole in the enforcement procedure. In Japan as well, in the case of leveraged buyout (LBO), for example, there is a practice in which security interests are established for individual assets that constitute the borrower's business, such as real estate, movables, and accounts receivable, thus, in effect, security interests are established for all assets of the borrower. However, in this practice, the security interests only represent the realized value of accumulated individual assets. In addition, especially when the borrower is not cooperative, lenders are unable to dispose of the borrower's business as a whole in the enforcement procedure.

In the United States and the United Kingdom, the practice of cash flow lending using security interests over all assets prevails including loans to SMEs. In such practice, as cash flow is considered as the primary source of repayment, both the lender and the borrower are motivated to build and maintain a good and close relationship between them so that they can be aware at an early stage of the deterioration of the borrower's business condition through monitoring.

^{*1}: For detailed information on the Study Group on Lending and Business Turnaround Practices to Support Corporate Borrowers' Business Enhancement, access the following URL: https://www.fsa.go.jp/policy/jigyoku_tanpo/index.html (Available in Japanese)

^{*2}: Published on February 10, 2023, "Summary Report of the Working Group on Legal Institutions for Cash-flow-focused Lending of the Financial System Council": https://www.fsa.go.jp/singi/singi_kinyu/tosin/20230210.html (Available in Japanese)

^{*3}: The Japan Institute of Business Law (commissioned party) set up a study group consisting of lawyers and financial practitioners, which engaged in research and discussion on systems and practices regarding security interests over all assets in the United States and the United, and published a report.
<https://www.fsa.go.jp/common/about/research/20230331/20230331.html> (Available in Japanese)

3. Characteristics of practice using security interests over all assets in the United States and the United Kingdom: in the phase of loan agreement and monitoring

(a) Establishing financial covenants

From the perspective of clarifying the relationship between the lender and the borrower and ensuring effective monitoring on the borrower, with regard to cash flow lending conducted using security interests over all assets in the United States and the United Kingdom, financial covenants clauses (about two to three items in the case of loans to SMEs), which require the borrower to maintain items concerning for example, cash flow and balance sheet at a certain level, and clauses for reporting obligation regarding such items are established in the contract between the lender and the borrower.

In Japan, it is not common to create financial covenants for loans other than syndicate loans, but the lending practices in the United States and the United Kingdom, which set financial covenants according to the characteristics of the borrower, may serve as a useful reference for deepening the communication between the lender and the borrower in lending practices in, including loans to SMEs.

(b) Inter-creditor agreement

In the case of loans using security interests over all assets in the United States and the United Kingdom, if a subordinated security interest is created, the lenders generally enter into an inter-creditor agreement, which regulates respective rights and ranking among lenders in advance such as the maximum amount secured and the appropriation method at the time of enforcement of the security interests. By coordinating the conflict of interests between the lenders in advance by entering into this agreement, when the borrower's business condition deteriorates, it may become easier to carry out restructuring without taking time for such coordination. Such practice may serve as a useful reference for developing lending practices in Japan, which enable the lenders to smoothly control

costs and uncertainties in business loans as well as enabling the borrower to raise funds in various ways.

4. Characteristics of practice using security interests over all assets in the United States and the United Kingdom: in the phase of enforcement and business turnaround

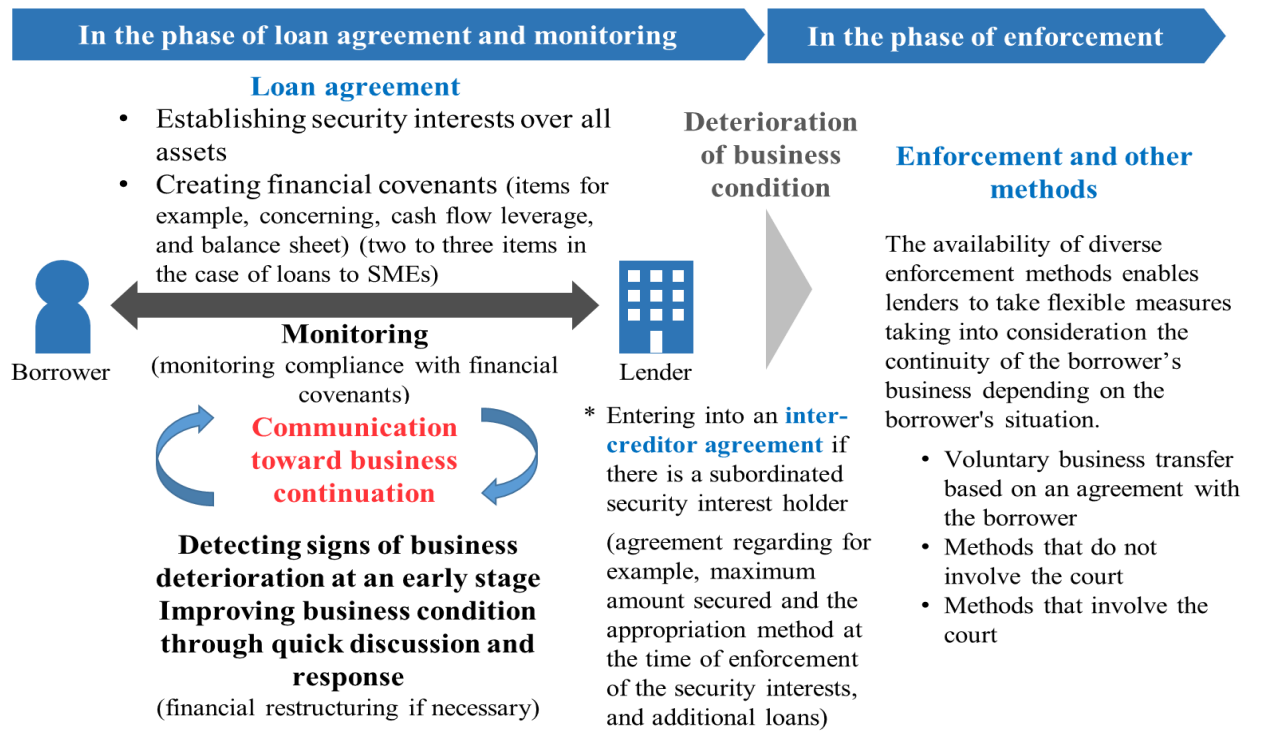
(a) Measures taken at the time of deterioration of the borrower's business condition

The use of security interests over all assets gives incentives to the lender to prevent a decline in the value of the borrower's business, which is the value of the security interests, and maximize the value to be collected, while it also gives strong incentives to the borrower to comply with the financial covenants and eventually maintain and improve the value of its business in order to avoid business transfer through the enforcement of the security interest. As the lender and the borrower share an objective toward business continuation, they may detect signs of business deterioration at an early stage through monitoring and start discussions regarding the business as well as responding quickly and actively for business improvement. Such practice may be an important factor when considering the lending practices that contribute to the support for businesses.

(b) Diverse methods of enforcement

In the United States and the United Kingdom, lenders have diverse means of enforcement of security interests over all assets, such as voluntary business transfer based on an agreement with the borrower, and compulsory methods that involve or do not involve the court. Having such diverse options, even in the phase of enforcement procedures, lenders are able to take flexible measures taking into consideration the continuity of the borrower's business depending on the borrower's situation. Such systems and practices may serve as a useful reference for promoting the practice with a focus on maintaining and improving the value of the business in Japan.

An image of lending practice using security interests over all assets in the US and the UK



5. Conclusion

The use of a security interest over all assets will facilitate the establishment of close relationships and communication between financial institutions and business companies, enabling financial institutions to provide a wider range of support to business companies. It is important both for financial institutions and business companies that financial institutions provide various support for business companies according to their needs.

Taking account of the content of this report, the FSA will continue to deepen study for designing a

system that financial institutions and business companies can smoothly use and to carry out discussion for developing an environment where financial institutions will be able to engage in lending business with a focus on business companies' business feasibility and future potential, including the use of security interests over all assets.

The FSA hopes that this report will be of some help for financial institutions and other relevant parties that are considering the use of security interest over all assets once such system is introduced in Japan.

Initiative to Back up Regional Financial Institutions' Efforts for Enhancing Abilities to Provide Support to Companies (Second Part)

– Improving Efficiency of Business Improvement Support Utilizing AI Technologies–

USUI Kotaro, Deputy Director
OKAMURA Ryuji, Deputy Director
MATSUMOTO Shinya, Section Chief
YOKOYAMA Yuki, Section Chief

Regional Financial Planning Office, Banking Business Division II, Supervision Bureau
YOSHIHARA Tsubasa, (former) Deputy Director, Regional Financial Planning Office, Banking Business Division II, Supervision Bureau

1. Enhancing regional financial institutions' abilities to provide support to companies

Regional financial institutions are expected to contribute to the growth of local economies, as the key players thereof, through supporting local companies. Recently, in particular, diverse business types of companies in broad areas have been affected by COVID-19 pandemic and price hikes, etc., and the regional financial institutions that they have relationships with have been increasingly required to provide support effectively and efficiently.

The April issue of Access FSA introduced the document titled “Business Support Viewpoints Appropriate for Respective Industries,” the compilation of the outcomes of the survey conducted for the purpose of compiling points to note by respective industries in initial responses when employees of financial institutions provide companies with business improvement support, as part of the FSA’s initiative to encourage regional financial institutions’ individual efforts to enhance their business support capabilities to companies. This issue introduces the FSA’s program for Improving efficiency of business improvement support utilizing AI technologies as the second part of the relevant topic.

2. Survey and Research for improving efficiency of business improvement support utilizing AI technologies

Regional financial institutions select companies that need to improve their businesses earlier from among a large number of their customer companies to enable front-line sales personnel to surely provide support to such companies. The

FSA entrusted KPMG AZSA LLC with a survey and research regarding the possibility of creating a mechanism utilizing AI technologies to enable more effective and efficient prioritization of customer companies for early commencement of support for business improvement.

In the survey and research, a machine learning-based method was used to first analyze the relationship between big data on individual companies’ financial data (data on balance sheets and profit-and-loss statements) and attribute data (data showing companies’ nature and characteristics, such as business types and histories) and external environmental data, such as GDP growth rates and oil prices.

Regarding companies’ big data, joint research participants that would be able to provide data were publicly sought in April 2022 and it was decided to get cooperation from four companies, including Teikoku Databank Ltd., which has credit investigation data, and an industry organization that provides cross-sectoral credit risk information services for the financial industry. Using the relationship between the big data provided by these four companies concerning their individual financial affairs and attributes and external environmental data, a machine learning model (the “AI model”) was developed with the following two concepts:

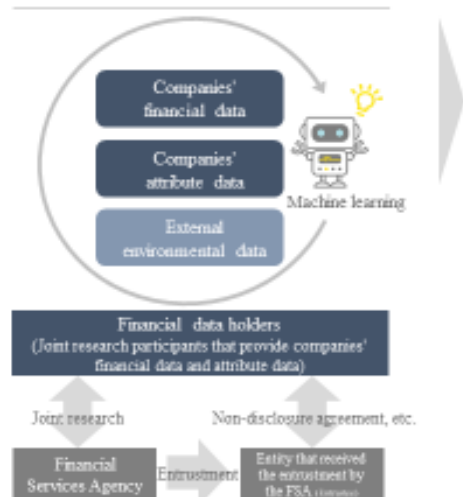
- (a) to discover, at an early stage, companies that are considered to be in urgent need of business improvement support; and
- (b) to discover companies whose business performance is poor at present but which have a high degree of potential for business improvement through financial institutions’ support.

Conceptual drawing showing how to develop a model for this survey and research

- A model for this survey and research was developed as follows.
- This fiscal year, a model is to be developed with the concepts: "to discover, at an early stage, companies that are considered to be in urgent need of business improvement support" and "to discover companies whose business performance is poor at present but which have a high degree of potential for business improvement through financial institutions' support." with the aim of helping financial institutions to prioritize support recipients.

* For applying for the delivery of the versatile model developed as a result of this survey and research, see the following website.
URL: <https://www.fsa.go.jp/policy/chunkai/index.html#x> (Available in Japanese)

(i) Development of the AI model (prototype)



(ii) Data input



(iii) Output of the results (Prioritization of companies to which business improvement support is to be provided)

NO	Company name	Area	Business type	Points
1	●●● Kogyo Co., Ltd.	○○ City, ○○ Prefecture	Manufacturing	12
2	△△△ Shokuhin Co., Ltd.	○○ City, △△ Prefecture	Manufacturing	25
3	Limited Liability Company ■■■ Kogei	△△ City, ○○ Prefecture	Manufacturing	33
4	○○○ Shoten Co., Ltd.	△△ City, □□ Prefecture	Retailing	64

(e.g.) A financial institution had considered a certain company as having no problem in the current business conditions, but had a talk with the top of the company at an early stage regarding its business conditions as the company had many points.

3. Outline of the AI model

In this survey and research, the entrustee established a panel consisting of intellectuals,^{*1} such as researchers of AI technologies and financial practitioners, and held panel meetings four times in total to discuss (i) procedures for developing the AI model, AI algorithms to be adopted, and handling of data in developing the AI model, (ii) increasing the prediction accuracy of the developed AI model, and (iii) the possibility of utilizing the AI model in practices of financial institutions.

The panel evaluated various AI algorithms from the perspectives of the accuracy of AI algorithms, the ease of interpreting prediction results, and the status of actual utilization in the financial industry, and decided to adopt logistics regression,^{*2} random forest,^{*3} and gradient boosting.^{*4}

For definitions of the population and supervisor's labels (variables to define the occurrence of incidents to be detected by the AI model as the ground truth) for the AI model, companies' debtor categories and credit scores were adopted as indicators for evaluating business performance while taking into account the characteristics of and differences in the data provided by the joint research participants.

More specifically, under the development concept (a), the population of the AI model was set

to be a group of companies that were originally categorized as being safe in terms of debtor category, and a supervisor's label was defined by considering companies whose debtor category was lowered in a certain period of time as those in need of business improvement support at an early stage.

Through these deliberations and discussions by the panel, approximately 380 types of models were developed based on the data provided by the joint research participants, and the AI model for which a certain level of accuracy was recognized was developed out of those models.

4. Demonstration and workshop

In order to verify the possibility of utilizing the developed AI model at regional financial institutions, a demonstration and workshop were conducted with cooperation of some regional financial institutions.

In the demonstration, the following two points were verified using actual data of regional financial institutions:

- whether the AI model can effectively function in actual data of financial institutions; and
- whether it is possible to increase the accuracy of the AI model by having the model additionally learn actual data of financial institutions.

As a result, it was found that a certain level of accuracy was also secured for the AI model when using customer companies' data held by individual regional financial institutions, and that the accuracy increased by having the AI model additionally learn data of those financial institutions.

Furthermore, a workshop was conducted to verify whether it is possible to improve operational efficiency by using the AI model in individual regional financial institutions' existing operation flow for providing business improvement support.

Through dialogues with responsible personnel of those regional financial institutions based on the outputs from the AI model, the following were found regarding problems in the current operations and the possibility of improving operational efficiency by the use of the AI model, and it was suggested that it is possible to enable regional financial institutions to determine their priorities in commencing business improvement support among their customer companies more effectively and efficiently.

(Problems in the current operations)

- Selection of targets for business improvement support is based on responsible personnel's subjective views.
- Targets are finally selected from the viewpoint of

human beings, which requires a proportionate period of time and may sometimes lack completeness.

(Possibility of utilizing the AI model)

- Variation by person in selection of targets for business improvement support may be reduced.
- The use of the AI model may make it possible to select targets from among all customer companies more easily.

The AI model is distributed to regional financial institutions and others who filed an application on the FSA's official website. It is expected that regional financial institutions' studies and utilization of the AI model as a prototype will facilitate the development of data they hold and the utilization of data for efficiency improvement and sophistication of their operations and will lead to business improvement of their customer companies in individual regions.

For filing an application for the use of the AI model, please access the following:

<https://www.fsa.go.jp/policy/chuukai/index.html#ai>
(Available in Japanese)

*1 Members of the panel (13 members) are as follows. *Honorifics are omitted.

ARITAKE Hiroshi, Director of Business Supervising Sector, Business Supervising Office, Credit Guarantee Corporation of Tokyo

IZUMI Kiyoshi, Professor, Department of Systems Innovation, School of Engineering, The University of Tokyo

UCHIYAMA Koji, Chief, Digital Operation Section, Digital Promotion Department, Hamamatsu Iwata Shinkin Bank

KAWAI Yuko, Representative Director CEO, Japan Digital Design, Inc.

SANKAWA Tsuyoshi, Director, Eltes Co., Ltd.

SUZUKI Akemi, Executive Board Member and Director of General Planning Department, Daitokyo Shinyokumiai

TSUTSUKI Hikaru, Member of Editorial Subcommittee for Business Analysis & Statistics by TKC, System Development Committee, TKC National Federation

NAKAMURA Yasuhiro, Director, Loan Department, Bank of Yokohama

NATORI Yoshinori, Assistant Manager, Shinkin Innovation Hub, General Planning Department, Shinkin Central Bank

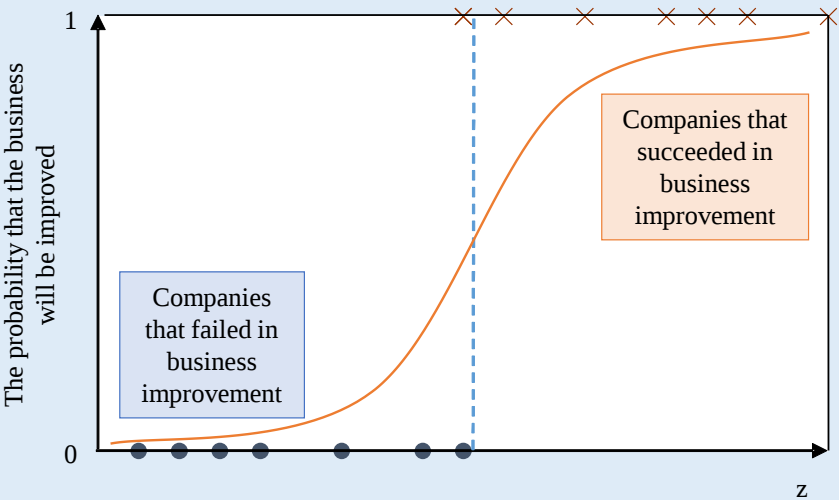
HARA Koji, Senior Researcher, Business Support Department, Tochigi Bank

MATSUZAKI Kentaro, Vice-Chairman, SME Support Committee, TKC National Federation

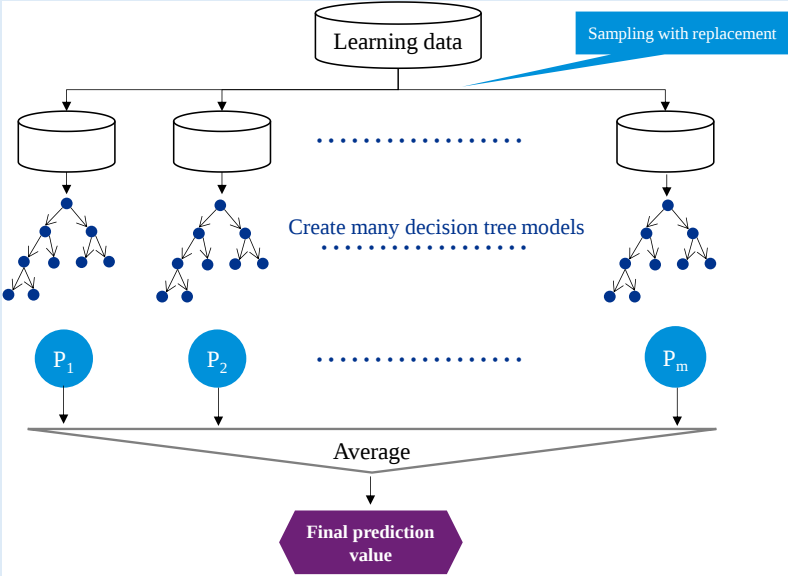
MIYAGAWA Daisuke, Professor, Hitotsubashi University Faculty of Commerce and Management and Graduate School of Business Administration

YAUCHI Hiroyuki, Chief, Planning Office, Planning and General Affairs Department, Teikoku Databank Ltd.

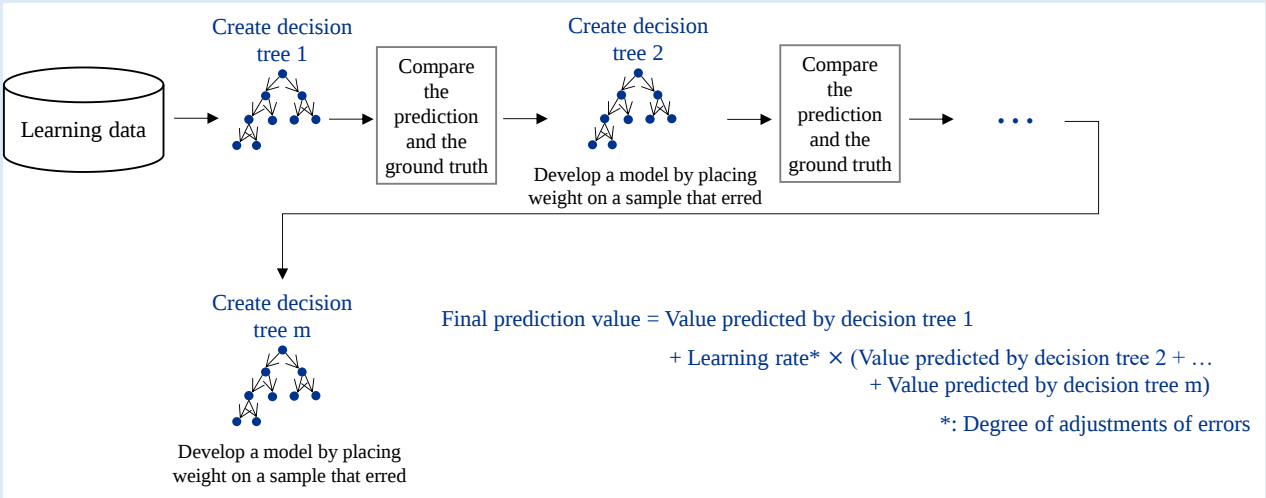
*2 A method of predicting objective variables by means of regression analysis using a logistic curve as shown in the figure below. This is said to be the method that is most utilized in financial institutions' practices when evaluating companies' creditworthiness.



*3 A method of creating many decision tree models and using the average of the values predicted by those many decision trees as the final prediction value.



*4 A method of first creating a decision tree, then adjusting the weight so as to fit into a sample in which the decision tree erred and creating the next decision tree, repeating this process several times, and finally obtaining the final prediction value.



Partial Amendment of the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc. Regarding ESG Investment Trusts

NAKAGAWA Motohiro, Coordinator for Asset Management, Asset Management Monitoring Office, Securities Business Division, Supervision Bureau

In recent years, funds using the term "ESG" in their names or investment strategies are increasing in and outside Japan, and the possibility of a mismatch with the actual status of investment management (the issue of greenwashing) has been pointed out globally. In order to secure market reliability, promote ESG investments, and develop a sustainable society, the FSA decided to amend the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc. (VI-2-3-5; hereinafter referred to as the "Comprehensive Guidelines for Supervision") and specify in detail matters to be verified regarding the scope of ESG investment trusts in Japan, ESG information disclosure for publicly offered investment trusts, and the development of relevant structures of investment trust management companies.

For this amendment of the Comprehensive Guidelines for Supervision, 323 opinions in total were collected through public comment procedures, suggesting a high level of interest among people. Key points of the amendment are briefly introduced below.*

1. Scope of ESG investment trusts

The Comprehensive Guidelines for Supervision specify matters to be noted by investment trust management companies when taking into account ESG factors for Japanese publicly offered investment trusts. Out of those publicly offered investment trusts, ESG investment trusts are defined as investment trusts for which ESGs are the major factors when selecting investment targets and that

fact is stated in the section of objective and characteristics of the fund in a prospectus to be delivered to customers (in the case of outsourced investment management, such as a fund of funds scheme, a judgment is made based on an investment strategy and portfolio structure). In order to avoid being suspected of greenwashing, investment trust management companies are to be required to disclose information for ESG investment trusts, such as how they consider ESG factors in their investment strategies.

Regarding the term "major factors" as used in the definition, in a case where ESGs are decisively important factors (for example, if any companies that do not satisfy the established ESG standards are excluded from investment targets or if investment ratios are determined in accordance with the established standards), ESGs fall under the "major factors," but in a case where ESGs are taken into account merely as part of the factors together with financial indices and other factors when selecting investment targets, ESGs do not fall under the "major factors."

2. Disclosure of ESG information for publicly offered investment trusts

The Comprehensive Guidelines for Supervision provide that publicly offered investment trusts that do not fall under ESG investment trusts must not include any term related to ESG in their names or nicknames and that statements concerning ESG factors in their prospectus to be delivered to customers, sales materials and advertisements, etc.

* For the outline of the amendment of the Comprehensive Guidelines for Supervision and opinions thereon, see "Response to the FSA's Consultation on the Proposed Amendment of the Comprehensive Supervisory Guidelines for Financial Instruments Business Operators, etc. regarding ESG Investment Trusts" published on March 31, 2023. <https://www.fsa.go.jp/en/news/2023/20230331/20230331.html>

must not mislead investors to believe that ESGs are the major factors when selecting investment targets for the relevant publicly offered investment trusts.

Information to be disclosed for ESG investment trusts includes goals and rough standards for investment strategies and portfolio structures, such as specific details of ESG factors that constitute the major factors when selecting investment targets and how to take into account those details in the investment management process, as well as how to take into account ESG factors in the reference index when aiming to link the investment trusts to the ESG indices. The progress and status of related actions also need to be disclosed regularly. If disclosure is difficult for any matter, the reason for being unable to disclose that information must be stated.

A certain period of time must be required for information disclosure due to such reasons as the need to reflect the content to be disclosed in a prospectus. Accordingly, specific deadlines are not set, but related parties are expected to make prompt responses within a period that is considered reasonable.

3. Development of investment trust management companies' structures

Investment trust management companies that deal with ESG investment trusts are required to

secure resources for appropriately implementing investment management in line with their investment strategies and for monitoring the implementation status on an ongoing basis. When they use ESG rating and data providers, they are also required to properly conduct due diligence on those providers' organizational structures and rating targets.

This also applies to investment trust management companies that create and manage publicly offered investment trusts in consideration of ESG factors that are not categorized into ESG investment trusts.

4. Conclusion

At present, the Comprehensive Guidelines for Supervision limits the coverage to Japanese publicly offered investment trusts and investment trust management companies that create and manage such investment trusts. However, in light of future responses by investment trust management companies and the entire industry related to the management and sale of funds, etc. with due consideration to ESG factors and relevant international trends, the Comprehensive Guidelines for Supervision may be reviewed as necessary.

Related parties in the industry are expected to positively disclose information and develop structures based on the purport of the Comprehensive Guidelines for Supervision.

Securities and Exchange Surveillance Commission, "Strategy & Policy of the SESC 2023-2025"

—For Trusted, Fair and Transparent Markets in Response to the Changing Times—

FUKUDOME Tsukasa, Coordinator for Market Oversight
 KASAI Kozo, Section Chief
 KANETAKA Ayako, Officer

Planning and Management Division, Executive Bureau, Securities and Exchange Surveillance Commission

Introduction

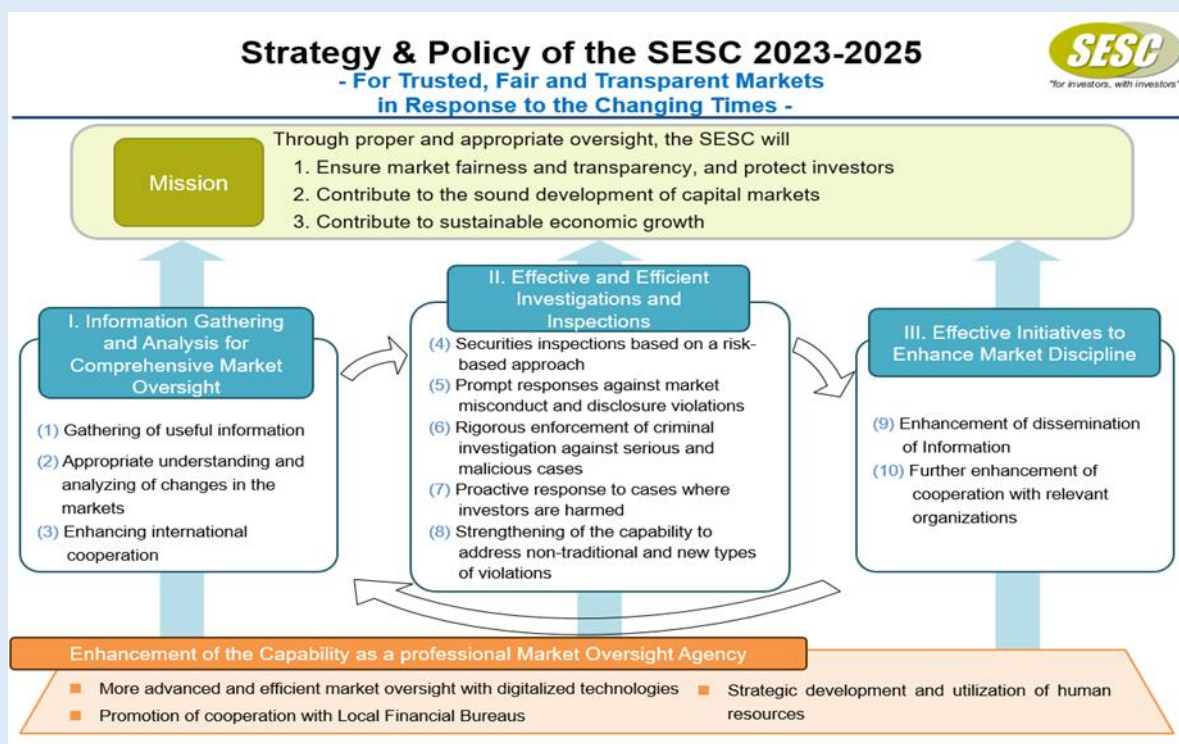
The Securities and Exchange Surveillance Commission (hereinafter referred as the "SESC") inaugurated its 11th term in December 2022 with newly appointed Chairman NAKAHARA Ryoichi and Commissioner HASHIMOTO Takashi and reappointed Commissioner KATO Sayuri. In January 2023, it formulated and published* its medium-term activity policy titled "Strategy & Policy of the SESC 2023-2025," which indicates the SESC's policy on initiatives, etc. for the three-year term under the new administration, and started holding explanatory meetings on this policy for related organizations. This article provides an outline of the policy.

Outline of the medium-term activity policy

The medium-term activity policy has the subtitle "For Trusted, Fair and Transparent Markets in Response to the Changing Times." The environment surrounding markets is undergoing significant changes, with progress in digitalization and

globalization, etc. and the spread of COVID-19 and heightening geopolitical risks. Under such circumstances, the SESC aims to achieve a virtuous cycle of market oversight: a cycle in which the SESC performs "I. Information Gathering and Analysis for Comprehensive Market Oversight," then conducts "II. Effective and Efficient Investigations and Inspections" by using the information gathered and analyzed, and carries out "III. Effective Initiatives to Enhance Market Discipline" based on the results of the investigations and inspections, thereby contributing to preventing violations and inappropriate conduct. In addition, as the basis for achieving that cycle, the SESC will engage in "enhancement of the capability as a professional market oversight agency," such as digitalization and human resource development.

For the first pillar, "I. Information Gathering and Analysis for Comprehensive Market Oversight," the policy sets forth that the SESC will work on the gathering of useful information and appropriate understanding and analyzing of changes in the



* Securities and Exchange Surveillance Commission, Strategy & Policy of the SESC 2023-2025—For Trusted, Fair and Transparent Markets in Response to the Changing Times—, published on January 27, 2023:

https://www.fsa.go.jp/sesc/news/c_2023/2023/20230127-1/01_english.pdf

markets, etc. to conduct seamless market oversight. In particular, the SESC has been making efforts to gather useful information since the time of its establishment, but in light of the importance of such information, the SESC clearly indicated in the policy that it will gather a wide range of useful information through various information sources, such as the SESC's contact point for providing information and self-regulatory organizations.

The second pillar, "II. Effective and Efficient Investigations and Inspections," incorporates measures to implement the prompt exercise of administrative functions relating to administrative monetary penalties, etc. and strict enforcement against serious and malicious cases, properly on a timely basis. The SESC will make proactive responses to cases where investors are harmed from the perspective of protecting diverse investors, including the elderly and youth. While oversight targets have become increasingly complicated and sophisticated, the SESC will also take actions against non-traditional and new types of violations, etc. (such as legally-evasive large volume holding and purchase and new-type of usage of fraudulent means) with broad perspectives.

With regard to the third pillar, "III. Effective Initiatives to Enhance Market Discipline," the SESC will aim to prevent illegal and inappropriate conduct and reinforce the effectiveness of market oversight through enhancement of dissemination of information via various channels, such as press briefings, press releases, and the casebooks, and cooperation with relevant organizations, including self-regulatory organizations, etc.

As for "enhancement of the capability as a professional market oversight agency" as the basis for achieving a "virtuous cycle of market oversight" consisting of the three actions above, the SESC will aim to enhance its capability as an organization through, for example, enhancement of the data processing capacity against the background of an increase in high-speed trading, and development and utilization of human resources by training and OJT, etc. Moreover, while the SESC regards that cooperation with Local Financial Bureaus, which play roles in market oversight in respective areas nationwide, is indispensable for fulfilling its mission, it clearly indicated this fact in the medium-term activity policy this time. The SESC will continue to ensure information sharing, etc. with Local Financial Bureaus to achieve integrated business operation.

Holding of explanatory meetings on the medium-term activity policy (for enhancement of cooperation with relevant organizations)

Based on the recognition that cooperation with market players, such as self-regulatory organizations, financial instruments business operators, and audit corporations etc., is indispensable for ensuring market fairness and transparency and protecting investors, the SESC has held explanatory meetings for these market players on various measures incorporated in the medium-term activity policy. The SESC intends to take various occasions, including these explanatory meetings, to share information and problem awareness concerning market oversight in a timely manner.



(Chairman Nakahara)



(Commissioner Kato)



(Commissioner Hashimoto)

※ Explanatory meetings are held at various locations as a hybrid of online and local in-person meetings.

"Global Money Week 2023 FSA Special Event —Let's Think about Future Financial Education Together!—"

On March 29, 2023, the FSA held "Global Money Week 2023 FSA Special Event—Let's think about future financial education together!"*

Global Money Week or "GMW" is an international awareness campaign which started in 2012 to promote financial education and financial inclusion for children and young people. Currently, the OECD International Network on Financial Education plays the role of the GMW secretariat. This year, in Japan, Global Money Week was held for about three weeks from March 11 through 31. The special event was hosted by the FSA, an OECD/INFE-participating authority, and it mainly targeted school teachers/staff and other people involved in education, who will be core actors of financial and economic education.

At the event, Ms. KUWABARA Tomomi, teacher at Tokyo Gakugei University Senior High School, Ms. HARA Naoko, teacher at Tokyo Metropolitan Oshukan Secondary School, and Ms. YAGI Yoko, representative of E-Company Co., Ltd. were invited to hold an approximately one-hour panel discussion, which was distributed online.



About one year has passed since the contents of financial and economic education were expanded

with the introduction of a new Course of Study for high-school home economics in April 2022. During that one year, the FSA received many comments from teachers regarding their confusion over how the class should be taught. Accordingly, at this event, Ms. Kuwahara and Ms. Hara talked about the current state of teaching at schools, practical examples of financial education, ingenious approaches that could be used, and future challenges, among other matters. In addition, Ms. Yagi, a financial planner who also plans and manages events relating to financial education, provided comments and asked questions, while mentioning her own experience. The panelists engaged in a lively discussion.



Toward the end of the discussion, a question and answer session was held, and panelists answered questions from viewers while referring to their experience. Many viewers provided positive comments about the event, stating for example that the discussion was very helpful for thinking about future financial education, and that they intend to introduce ingenious approaches themselves in engaging in financial and economic education by using the teaching examples provided by the panelists as a reference.



* For details of "Global Money Week 2023 FSA Special Event—Let's think about future financial education together!" see: <https://www.fsa.go.jp/news/r4/sonota/20230303/20230303.html> (Available in Japanese)

JFSA's Major Activities in April (April 1 to April 30, 2023)



- [Appointment for New Chair of the International Forum of Independent Audit Regulators \(IFIAR\) \(April 28, 2023\)](#)
- [Contribution of "The crypto-asset world is sobering up" to the Eurofi Magazine \(April 27, 2023\)](#)
- [A speech on "Four Lessons Learned from Recent Events: Do not miss the real issues" at the Eurofi High Level Seminar 2023 \(April 27, 2023\)](#)
- [Publication of the "Action Program for Accelerating Corporate Governance Reform: From Form to Substance \(April 26, 2023\)](#)
- [Exchange of Letters for cooperation with the Bangladesh Securities and Exchange Commission \(BSEC\) \(April 26, 2023\)](#)
- [Summary of results of the International Conference on Sustainability Disclosure \(April 19, 2023\)](#)
- [Eighteenth Meeting of the "Council for Cooperation on Financial Stability"\(April 17, 2023\)](#)
- [JFSA hosted Financial Action Task Force \(FATF\) Virtual Assets Contact Group Meeting in Tokyo \(April 14, 2023\)](#)
- [The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code: Twenty-Eighth Meeting \(April 12, 2023\)](#)
- [Stewardship Code : 323 institutional investors have signed up to the Principles for Responsible Institutional Investors as of March 31, 2023 \(April 11, 2023\)](#)
- [EU-Asia Pacific Forum on Financial Regulation \(April 7, 2023\)](#)
- [G7 High-Level Corporate Governance Roundtable \(April 5, 2023\)](#)
- [Japan and Vietnam Sign Letters on Cooperation Framework regarding Innovation in the Financial Sector \(April 5, 2023\)](#)

- JFSA's official English Twitter account
https://twitter.com/JFSA_en



**We are promoting
information dissemination
using Twitter!**

- Please send your opinions using the following email address to the Public Relations Office's personnel in charge of Access FSA.

E-mail : fsa_kouhou@fsa.go.jp

Editorial Postscript

During Golden Week, I often heard on the news that things were back to, or even surpassing, the level before the COVID-19 pandemic, making me realize that our everyday lives are returning to normal.

I hope that the economy will continue to move toward full-fledged recovery and achieve vibrancy beyond the pre-pandemic level.

On that note, I happened to look at a calendar and noticed that we do not have another national holiday for ten weeks after Golden Week. I will hold on until the next holiday, Marine Day, while taking a break at times to enjoy the lively energy returning to the streets.

MORIYA Takayuki, Director,
Public Relations Office, FSA