

The main issues raised by the FSA at opinion exchange meetings with trade associations

[held on February 14, 2023, with the Japan Securities Dealers Association]

1. Establishment of AML/CFT/CPF framework

- The FSA is requesting all financial institutions to complete the establishment of their AML/CFT/CPF framework in light of the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism by the end of March 2024. The FSA has been sequentially conducting on-site AML/CFT/CPF inspections since 2021, and the deadline to establish the framework is approaching around one year ahead.
- As a reference for establishing framework by the end of March 2024, the FSA introduces some of the identified cases as follows.
- Regarding the point "whether the identified risks are sufficiently broken down into concrete, specific, and smaller categories in line with actual practices", some financial institutions have failed to satisfy this due to their low level of granularity in risk identification (for example, in addition to sort out whether a customer is an individual or a corporation, in the case where the customer is a corporation, its business type, whether it's listed or not, or whether it's a public organization or not, etc. should be identified in line with actual practices).
- Also, though the requirements under the Guidelines include those related to the establishment of policies and procedures, many financial institutions have yet established ones.
- In such cases, the management framework of the financial institution might also have issues, so the FSA requests that the top managements re-confirm their own deficiency items and provide an instruction to address them as soon as possible.
- The FSA again requests top managements to understand the current level of their own achievements and to promote efforts to steadily complete the framework establishment by the deadline with these cases taken into account.

2. Provision of the outcome of the cybersecurity exercise

- The FSA provided feedback based on the result of the financial-industry-wide cybersecurity exercise (Delta Wall VII), which was conducted in October 2022, for the financial institutions that participated in the exercise.
- Financial institutions are expected to utilize the outcome of the exercise and further enhance their ability to deal with incidents. The assessment result from the Delta Wall VII is however not an evaluation of the state of cybersecurity posture of individual institutions, but an evaluation under single scenario. Even if the outcome of the latest exercise was good, individual financial institutions should strengthen their incident response capabilities taking into account the most recent trends in cyber threats, such as attacks that target at weak points in the supply chain of financial institutions, ransomware attacks, and phishing attacks, which are broader than threats that were considered in Delta Wall VII. Financial institutions should periodically conduct an exercise and provide training to examine the effectiveness of their own incident response capabilities.
- Via the Japan Securities Dealers Association, the FSA will share the information relating to challenges that are commonly observed among all business types of financial institutions in each sector based on the result of the Delta Wall VII and best practices observed in the Delta Wall VII with all financial institutions in each sector, including entities that did not participate in the Delta Wall VII. The FSA expects that financial institutions that did not participate in the Delta Wall VII refer to the information provided by the FSA and strengthen their incident response capabilities, for example, but not limited to, by improving such capabilities through exercises and training.

3. Significance of distributors' product governance

- As we have repeatedly pointed out, for people's stable asset building, it is indispensable to secure financial institutions' customer-oriented business conduct at

each stage of development, sale and management, etc. of financial products . Here, we would like to talk about the significance of the involvement of top management in distributors' product governance, that is, a process of selecting individual financial instruments, making recommendations of financial instruments to customers, and performing after-sales follow-up.

- When recommending a certain financial products to a customer, it is necessary to consider [i] risks of the financial instrument, [ii] whether the return that the customer expects is commensurate with the risks, and [iii] whether the return to the customer does not become too small after the distributor's passing on of the cost. Then, it is also important for the second-line and the third-line personnel to verify data on the customer's gains and losses, etc. ex post facto, and look back on whether the customer's best interest has been achieved with the involvement of top management.
- Top management is not necessarily required to be involved in the selection of financial instruments one by one but should develop a product governance system to ensure that verifications and reporting of the results thereof are properly conducted.

4. Basic Guidelines for Securing Stable Provision of Critical Infrastructure Services (draft) based on the Economic Security Promotion Act

- On February 8, the fifth meeting of the Expert Panel on Economic Security Legislation was held at the Cabinet Secretariat, and the following were publicized regarding the preliminary review system for critical infrastructure under the Economic Security Promotion Act:
 - Basic Guidelines for Securing Stable Provision of Critical Infrastructure Services (draft);
 - Schedule for the implementation of the preliminary review system; and
 - Designation criteria for targeted business providers (draft).
- This preliminary review system is to require businesses providers providing critical infrastructure services, including financial services, to receive preliminary review by the authority when introducing any material facility.
- The FSA will have dialogues with financial institutions meticulously for smoothly

implementing the preliminary review system. The FSA appreciate their continued cooperation in the dialogues.

5. 63rd Meeting of the Financial Service ADR (Alternative Dispute Resolution) Liaison Group

- The FSA has held the Meeting of the Financial Service ADR Liaison Group, which consists of academic experts and persons from consumer organizations and financial and other industrial bodies, as a platform for exchanging opinions on the operational status and future challenges of the financial ADR system.
- On January 6, the 63rd meeting was held and individual financial institutions, not limited to ADR organizations, provided explanations for the first time. Specifically, they explained how they develop information shared among financial institutions via ADR organizations and users' complains, etc. directly received by financial institutions, and utilize such information for improving their business operations.
- Group members presented their expectations for financial institutions' further efforts, and pointed out the significance of the following:
 - Not only promptly responding to complaints separately, but identifying problems at an early stage and feeding them back to top management; and
 - Instead of only focusing on the numbers of complaints, paying attention to possible frustrations of customers that have yet to be expressed as complaints.
- Materials for the meeting are made available on the FSA's website, and the details of the meeting will also be publicized later. Please refer to them.
(https://www.fsa.go.jp/singi/singi_trouble/siryou/20230106.html)
- The FSA considers it important for financial institutions to properly analyze and share information from ADR organizations and customer service offices, etc. and make improvements with respect to any problems for the purpose of ensuring customer-oriented business conduct. We would like to have dialogues with individual financial institutions as needed when conducting monitoring or on other occasions.

6. Invitation to the FIN/SUM 2023

- The FSA and Nikkei Inc. have jointly held the "FIN/SUM," an international symposium on FinTech, since 2016.
- The FIN/SUM 2023 will be held from March 28 to 31 at the Marunouchi Building Hall.
- Under the themes of Web3.0, digital securities, metaverse, financial institutions' DX, and ESG, etc., major domestic and foreign financial institutions and companies providing solutions to financial institutions are invited to have multifaceted discussions with the aim of achieving sustainable development of FinTech.
- For the last two years, the meeting mainly consisted of online events due to the impact of COVID-19, but this year, many FinTech companies will participate in-person from inside and outside Japan, including those participating in the exhibition by setting up booths. Please come and join us at the FIN/SUM.

(Reference) Outline of the event

Time and Dates: 9:00-18:00 from Tuesday, March 28, to Friday, March 31, 2023

* The symposium hosted by the FSA is on the Wednesday, March 29.

Venue: Marunouchi Building Hall (to be simultaneously delivered online)

Organizers: Financial Services Agency and Nikkei Inc.

Website: https://www.finsum.jp/en_index.html

Ticket registration: From the website above.

7. Deliberations on self-regulatory rules for structured bonds

- The FSA understands that you have been reviewing self-regulatory rules concerning the sale of complicated structured bonds toward making rules to be observed by distributors stricter in light of the sales status of structured bonds up until now.
- In consideration of the complexities of structured bonds as financial instruments and complaints from customers, etc., the FSA has repeatedly pointed out the significance of sufficiently verifying the characteristics of each instrument and the coverage of targeted customers in accordance with the verification results and of providing customers with material information for making investment decisions, such as costs

(substantial burden on customers, including cost at the stage of development) and the results of verification of risks and returns (quantitative results of verification using sufficient data), in an easy-to-understand manner upon selling structured bonds to customers.

We expect that your future responses will work effectively in solving various problems upon selling structured bonds, including the points mentioned above.

8. Revision of the guidelines concerning the storage of statutory books on foreign servers

- Based on requests from the industry, which were received in the course of legal inspections for achieving government-wide digitalization, the FSA publicized a draft revision of the Comprehensive Guidelines for Supervision on January 27. The revision aims to confirm that statutory books electromagnetically prepared by financial instruments business operators, etc. may be stored electromagnetically on a foreign server when statutory requirements are satisfied and to newly provide for matters to note when storing statutory books on a foreign server. The FSA seeks public comments until the end of February.
- Financial institutions that are storing or are considering storing statutory books on a foreign server are requested to check the content of the draft and present opinions if any.
- Additionally, the FSA asks for the Japan Securities Dealers Association's continued cooperation so that your members will properly prepare and store their statutory books.

9. Promotion of dissemination and utilization of individual number cards

- We appreciate your cooperation in promoting dissemination and utilization of Individual Number Cards.

The government is strongly promoting initiatives for the dissemination and utilization with the aim of achieving the goal of having almost all people acquire Individual

Number Cards by the end of this fiscal year.

- The acquisition rate is steadily increasing, but we consider it important to continue efforts for dissemination to achieve the government's goal. You are expected to make further efforts, such as by positively assisting customers with their acquisition of Individual Number Cards.

10. Enhancement of regional financial institutions' function of mediating human resources to companies

- In the project to match workers with management skills with local companies, which the FSA has been promoting to further enhance regional financial institutions' function of mediating human resources to companies, large companies, including those in the securities industry, have cooperatively registered their employees with the REVICareer.

Registration of those employees has facilitated further utilization of REVICareer, and employment contracts have been concluded in some cases, including those covered by public benefits. We appreciate your cooperation.

- The FSA has also been carrying out PR activities to disseminate regional financial institutions' function of mediating human resources to companies.

On February 11, the FSA held events mainly targeting workers of large companies in urban areas to deepen their understanding concerning the meaning of working for regional companies and the worth thereof.

The events are archived and being delivered. Please view them.

(Reference) Archives of the events are delivered as follows.

[i] The Yomiuri Shimbun: From Monday, February 13

URL: <https://yab.yomiuri.co.jp/adv/secondcareer/>

[ii] Alphadrive Co., Ltd.: From 17:00 on Saturday, February 11

URL: <https://newspicks.com/live-movie/2488/>