

*Highlights of the Japan FSA's  
New Financial Monitoring Policy*

**September 2013**



# I The mission of financial oversight

- Monitor timely and address appropriately economic and market changes
- Contribute to the current economic policy to get out of deflation, leading to the following positive cycle.

**Uncertainties in the world economy**  
(China, emerging markets, Europe, etc)

**Budget deficits and decreasing and aging population in Japan**

**Rapid and huge amount of money flows across borders under the global monetary easing**

**Positive cycle**

**Effective financial intermediation with appropriate risk management by financial institutions**

**Sustainable safety and soundness of each financial institution and the entire financial system**

**Complete end of deflation and contributing to sustainable economic growth and business expansion**

## II The approach of the new financial monitoring policy

### **1. Real-time monitoring of developments within the financial sector and financial systems, and identification of potential risks**

- In addition to the ex-post snap-shot of individual financial institution by on-site inspection, more focus on forward-looking identification of potential vulnerabilities and risks to the financial sector and system as a whole.
- For that, timely and continuous monitoring of developments within the financial institutions and markets will be enhanced.
- Also, analysis of macro economic developments with possible impact to safety and soundness of the financial system will be incorporated into the financial monitoring.

## II The approach of the new financial monitoring policy

### **2. Identification of common issues and risks across each industry and proactive policy response**

- In addition to reviews of individual financial institutions' issues, identification of issues and risks that are common across the financial industry or the financial system as a whole is required for proactive policy response to address potential risk and vulnerabilities to the financial system.
- Under the newly introduced horizontal reviews, thematic approaches will be adopted and common issues and areas will be reviewed across the industry, e.g., oversight of overseas operations under the expanding international business and contribution of the revitalization of rural economies.

## II The approach of the new financial monitoring policy

### 3. Encouraging towards the best practices

- In addition to reviews of compliance with and risk management at minimum standard level required by laws, regulations and inspection manuals, higher level or best practices of risk management are necessary subject to business and risk profiles of financial institutions, including large financial institutions competing with global top players.
- Dialogues which would encourage financial institutions upgrading towards the best practices level will be conducted as part of the new financial monitoring.
- Also, root causes of the issues and weaknesses will be addressed more effectively in the monitoring, rather than ad-hoc and superficial compliance with minimum standard requirements.

### III New financial monitoring policy for each financial sector

#### **1. Monitoring of financial systems with macro prudential perspectives**

- Continuous monitoring of business strategies and risk profiles of individual financial institutions; regular review of various reports and documents from the institutions (figures, policies and procedures, minutes and records of meetings, audit reports and etc.) as well as discussions with their management and staff.
- Review or identification of potential risks and vulnerabilities to the financial systems.
- Analysis of macro economic developments at domestic and global level is incorporated into the above exercise to identify potential risks and vulnerabilities of the financial system.
- Policy response is taken as necessary to address the risks.

### III New financial monitoring policy for each financial sector

#### **2. Monitoring of the SIFIs (Systemically Important Financial Institutions)**

- Japanese SIFIs, as global players, need to achieve the global best practices for their risk managements, rather than minimum standards.
- Horizontal reviews of the SIFIs, which will address common important issues including group-wide risk management and IT infrastructure, will identify gaps vis-à-vis the global best practices.
- The results of the horizontal reviews will be feed-backed to the SIFIs to encourage them to upgrade towards the global best practices.

## III New financial monitoring policy for each financial sector

### **3. Monitoring of regional banks**

- Focus on sustainability of business strategy under local economic environment for individual regional bank.
- Horizontal review of significant issues among regional banks, including revitalization of local economies.
- Need for FSA's monitoring to get deeper understanding of and acquaintance with local economic conditions, in cooperation with Local Bureaus.

### Ⅲ New financial monitoring policy for each financial sector

#### 4. Monitoring of foreign banks

- Enhancing and updating basic information necessary for monitoring of all foreign banks in Japan; surveys with questionnaires and their responses to be conducted.
- Based on the survey, on-site monitoring of all foreign banks in Japan to be conducted as target inspections for a short period.
- Enhanced communication with senior management of headquarters or parent companies as well as their home country supervisors.

### Ⅲ New financial monitoring policy for each financial sector

#### **5. Monitoring of insurance companies**

- Enhancing off-site risk assessment of business and risk profiles of insurance companies.
- Horizontal reviews of large insurance companies with focus on significant issues including business strategy under the aging Japanese populations as well as expanding overseas business.

## IV Issues or focuses of financial monitoring

### **1. Analysis of sustainability of business models by financial institutions**

- Review of future sustainability of business strategy and models for profits origination.
- Identification of potential risks due to gaps between business models and changing economic environment.

### **2. Review of banks' abilities to appraise borrowers**

- Identification of root causes behind banks' cautious approaches for taking credit risks.
- More attention to growth potentials of borrowers as part of credit risk appraisals.

## IV Issues or focuses of financial monitoring

### **3. More risk-based review of asset classification by banks**

- More focus on higher risk categories of assets which are materials to safety and soundness of banks, including large exposures and highly concentrated sectors.
- Less attention to low risk small exposures, and acceptance of banks' asset classification subject to effective credit risk management.

### **4. More focus on substantive compliance functions**

- Review of fundamental effectiveness of compliance functions, rather than ad-hoc and superficial compliance with insignificant and trivial rules and procedures.

## IV Issues or focuses of financial monitoring

### **5. More focus on internal audit functions**

- Enhancing review of effectiveness of internal audit functions at financial institutions.
- Review of cooperation among internal audit, audit committee and external audit functions.

### **6. Enhanced cooperation with foreign supervisors and other regulatory bodies**

- Enhancing cooperation with foreign supervisors for oversight of foreign institutions, in particular, G-SIFIs, including bilateral and multilateral communications on particular firms.
- Enhancing cooperation with other regulatory bodies, including SESC, Bank of Japan as well as relevant agencies and self-regulatory bodies.

## IV Issues or focuses of financial monitoring

### **7. Enhancing information and intelligence collection mechanism**

- In addition to the existing information/intelligence collection mechanism such as for customer complaints, more FSA-wide mechanism needs to be established, to cover wider range of information and intelligence that are useful for financial monitoring.

### **8. More understanding and knowledge of local economies**

- Need for FSA's monitoring to get deeper understanding of and acquaintance with local economic conditions, in cooperation with Local Bureaus.

## IV Issues or focuses of financial monitoring

### **9. Upgrading expertise of inspectors**

- More recruiting experts from private sectors for individual risk and business categories for monitoring.
- Training of inspectors with knowledge and expertise on global best practices.

### **10. Closer communication with financial institutions and more attention to their regulatory costs**

- More attention to regulatory costs for financial institutions; focus on material issues for on-site inspections with more effective off-site risk assessment prior to on-site visits.
- Closer and constructive communications with the institutions regarding financial monitoring.