September 6, 2013
Financial Services Agency

Annual Supervisory Policy for Major Banks for Program Year 2013[1]

The Financial Services Agency (FSA) publishes its Annual Supervisory Policy for Major Banks for each program year so as to clarify its supervisory priorities. This is prescribed in the "Comprehensive Guidelines for Supervision of Major Banks", which show basic approaches for the supervisory process aimed at Major Banks.

In this program year, in accordance with "Basic Concepts on Supervision of Financial Institutions" as shown below, the FSA will place priority on the areas of 1) performing an active financial intermediary function, including management support for small and medium enterprises (SMEs) , 2) risk management and stability of the financial system and 3) improvement of customer protection and convenience for users, and will supervise Major Banks while striving to have straightforward and in-depth dialogue with them. In addition, FSA will strive to understand conditions and issues facing financial institutions, by enhancing the integration of on-site and off-site monitoring, in accordance with the Financial Monitoring Policy.

It should be noted that this supervisory policy was made considering the circumstances that surrounded financial institutions as of September 2013, and may be subject to review as necessary.

1. Expected Roles of Major Banks and Basic Concepts on Supervision of Financial Institutions

(1) Expected Roles of Major Banks

In view of the economic situations in Japan and overseas, and the market environment changes resulting from the quantitative and qualitative monetary easing by the Bank of Japan (BOJ), etc., it is important for Major Banks to continue to conduct appropriate and forward-looking risk management. At the same time, financial institutions are fundamentally responsible for proactive risk-taking to revitalize real economic activities. To pull Japan out of deflation, financial institutions are expected to enhance their consulting function and their ability to assess business performance accurately under appropriate risk management, and thereby actively provide funds, including new loans, to growing areas. Financial institutions should also gain momentum for their support of improvement of SMEs' business profiles, and reinforcement of business structure. In addition, it is important to provide extensive support for steady wealth buildup in households. In this sense, financial institutions are expected to promote investment products, such as NISAs (the Japanese equivalent of Individual Savings Accounts) to individuals.

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1 In this document, the term "Major Banks" refers to the banks commonly referred to as major banks, as well as Shinsei Bank, Aozora Bank, Citibank, and Japan Post Bank.

Considering the perspective above, it is increasingly important that Major Banks fully recognize their expected roles, and the management personnel should make responsible and prompt business judgments to respond to sudden social and economic changes and to international regulatory reforms. In the meantime, Major Banks should formulate their business strategies for the medium to long-term covering the next 5–10 year period with accurate understandings of the various risks involved.

Further, it is vital for Major Banks, while establishing appropriate governance systems under the leadership of their holding companies, to operate their business in a group-wide effort involving banks, trust banks and securities companies, as this will strengthen the creation of group synergy and help the group understand and resolve potential issues in a centralized manner. As such, it is necessary for Major Banks and their holding companies, while establishing a group-wide governance system led by the holding company, to manage risks appropriately considering the impact that the domestic and overseas economic trends, as well as global regulatory trends, could exert on their group and the financial system. At the same time, they should devise group-wide, medium to long-term business strategies.

(2) Approach Taken by Supervisory Authority

Under these circumstances, the FSA as the supervisory authority, will confirm whether Major Banks, under the appropriate leadership of management personnel, have enhanced their governance and risk management systems, properly verified the sustainability of their business models, and devised short and medium to long-term business strategies, including capital policy. The FSA will push this further through discussions with the management of Major Banks, as necessary.

In this program year, the FSA will continue to make “Better Regulation” (engaging in straightforward and in-depth dialogue with financial institutions, external communications, sharing information and collaboration on the economic and financial situations in Japan and overseas, and improving the transparency and predictability of administrative actions) the basis and strive to have it become further embedded and deepened. To this end, the FSA will continue to take the following approaches as the supervisory authority.

While taking the following approaches, the FSA needs to be aware that financial administration, if implemented through regulations only, may cause distortions in the regulatory regime and result in excessive control, which may negatively impact the real economy. Considering this, the FSA will endeavor to improve the quality of supervisory administration while reducing regulatory costs on a medium to long-term basis by improving the self-discipline of financial institutions and its own capabilities as a supervisory authority.

1) Financial Supervision and Administration with a High Risk Sensitivity

In order to effectively respond to conceivable risks, the FSA will strive to gain a deeper understanding of the macro economy and financial and capital markets, and deepen its understanding and analysis of how these affect the soundness of financial institutions, so as to identify and understand, with a forward-looking perspective, risks which accumulate in each financial institution and in the financial system. The FSA will also enhance the integration of on-site and off-site monitoring to detect risks at an early stage.

Given that problems with IT systems at the core of financial services would greatly affect people's daily lives and the economy, the FSA will urge financial institutions to voluntarily check their risk management frameworks for system glitches and will monitor such IT system risks of financial institutions with a heightened alert even in normal times. In addition, in order to maintain and secure financial functions even in the event of an unexpected contingency, it is important for the FSA to monitor whether financial institutions sufficiently prepare for major risks in their business continuation plans（BCPs）, review these plans as necessary, and conduct relevant training, given the experience of the Great East Japan Earthquake(2011), and past system glitch cases.

2) Financial Supervision and Administration from a Citizen's and User's Point of View

The FSA will strive to further improve customer protection and convenience for users, by supervising from a citizen's and user's point of view.

3) Supervisory Response with Forward-Looking Perspective

The FSA will strive to take actions while being aware of the progress in international discussions and closely monitoring any environmental changes. Its actions should thus include not only short-term responses, but also medium and long-term responses with an eye on the future, while considering common structural issues faced by Japanese financial institutions (strengthening profitability of their main business, etc.).

4) Supervisory Response which Contributes to Financial Institutions' Improvement of their Management and Making Better Business Judgments

The FSA will help financial institutions to improve their own management and make better business judgments via straightforward and in-depth dialogue, and external communication with them. Above all, the FSA will promote exchanges of opinions and other methods to introduce to other financial institutions the innovative initiatives of each financial institution concerning the performance of financial intermediary functions, risk management, improvement in customer protection, convenience for users, etc. The FSA will thereby work to enhance the level of the entire financial industry.

When performing supervision, in addition to these approaches, the FSA will also emphasize the following points.

- In order to promptly and accurately understand and enable quick response to risks faced by financial institutions and the financial system, the FSA, as the supervision authority, will cooperate with the Inspection Bureau to improve and reinforce the integration of on-site and off-site monitoring by incorporating the macro-prudential point of view. In addition to encouraging closer cooperation internally among the Inspection Bureau and the Supervisory Bureau, and externally with the Securities and Exchange Surveillance Commission (SESC), and the Bank of Japan (BOJ), the FSA will also cooperate with foreign authorities via supervisory colleges, actively contribute to international standard-setting bodies, and exchange information with the Japanese Institute of Certified Public Accountants, etc.

- Based on the ongoing international discussions on enhancing the methodology to supervise systemically important financial institutions (SIFIs), the FSA will constantly work on enhancing its supervisory methods, and as necessary, further clarify the key supervisory requirements for those financial groups conducting large and complex business operations.
- The necessity to collect reports and submitted documents will be periodically reviewed once a year, as part of consideration for reducing burdens on financial institutions.
- Through thorough fostering, securing, and training of professional human resources in addition to personnel exchange with overseas supervisory authorities, the FSA will redouble efforts for human resource development.

2. Performing an Active Financial Intermediary Function, including Management Support for SMEs

To pull Japan out of deflation and achieve powerful growth, financial institutions are expected not only to support business improvement and recovery of customer enterprise, but also to play their primary role more effectively and give strong support for the development and growth of their customer enterprises, by actively providing funds including new loans, while controlling risk appropriately.

As such, it is important to encourage financial institutions to become actively involved in the provision of new loans that will likely result in business improvement and recovery, development and growth of customer enterprises, taking into consideration the "Japan Revitalization Strategy" adopted by the Cabinet in June 2013.

Considering the above, in this program year, the FSA will supervise the performance of financial intermediary functions by Major Banks from the following viewpoints.

(1) Response to the Great East Japan Earthquake from Financial Aspects

The FSA will check whether each financial institution appropriately responds to consultations and requests for altering lending terms in ways to suit the situation of disaster-affected people. In an effort to handle the overlapping debt problem, the FSA will pay attention to whether each institution promptly and effectively responds to borrowers' consultations and requests based on the Individual Debtor Guidelines for Out-of-Court Workouts as released in July 2011 (particularly, whether each financial institution takes proactive actions, including a positive recommendation for borrowers' utilization of the Guidelines based on a more detailed analysis of disaster-affected people's situations and a sufficient study on optimum solutions meeting borrowers' respective situations).

As reconstruction demand gets into full swing, the FSA will also check whether each financial institution appropriately meets money demand toward restoration and reconstruction, and disaster-affected people's rehabilitation of livelihood and business operations.

(2) Promote Initiatives of Financial Institutions which Emphasize Growth Potential

The FSA will encourage the active involvement of the Major Banks in the provision of new loans, by verifying their efforts to promote new loans that will likely result in business improvement, business recovery, development and growth of their customer enterprises. The FSA will intensively check the following points.

1) Management policies for active provision of new loans (especially lending to SMEs and other small business owners); and how such management policies are disseminated to front line sales staff
2) Whether Major Banks set their lending policy based on an analysis of the outlook regarding the additional money demand in the economic recovery phase in the future.
3) Whether Major Banks regularly conduct analyses regarding business categories and regions with potential growth of money demand, and set their strategy, policy, and specific goals based on the results of such analyses
4) Specific efforts or devices to identify funding needs
5) Whether Major Banks respond to requests for new loans by borrowers even having changed loan terms or other measures, based on a full understanding of the borrower's financial conditions; in case of denial, whether Major Banks clarify specific reasons to the borrower, and whether they do not refuse consultation and requests for new loans solely on the basis of past changes in loan terms.
6) Specific efforts or devices by Major Banks to execute new financing through performing effective consulting functions aligned with the business life stage of the customer enterprise (support for developing sales channels, expanding into foreign markets)
7) Types of new loans that require mortgage collateral and guarantee provided by Credit Guarantee Association or personal guarantee
8) Specific efforts or devices for promoting ABL (including the use of electronically recorded monetary claims) and other measures of loans not dependent on mortgage collateral and guarantee, and for utilizing equity-capital-like-debt borrowings
9) Details of the credit screening standard for new loans, especially efforts or devices related to credit screening of SMEs and small business owners
10) Specific devices (such as qualitative assessment) and efforts for preventing excessive reliance on quantitative credit screening using scoring (screening on P/L and B/S)
11) Details of the system for processing complaints and consultation related to new loans
12) Whether Major Banks consider efforts for promoting new loans when providing performance or personnel evaluations
13) Approach to analyze and disclose information in relation to the promotion of new loans and the status of Major Banks' portfolios, including the loan-to-deposit ratio

Major Banks are expected to recognize their own roles and provide advanced financial products and services that are needed but unavailable from other providers in the industry. Such advanced financial products and services include assistance for overseas expansion, support for starting up operations and new businesses through the provision of equity, and encouragement for infrastructure development through project finance.

Considering the above points, the FSA will confirm whether Major Banks adopt business strategies for the medium to long-term improvement of their profitability, and take actions, including the following efforts, proactively. At the same time, the FSA will also confirm whether there is an adequate group-wide synergy effect.

1) Using investment subsidiaries, equity funds, etc. to support corporate growth (including entrepreneurships, start-ups and new project launchings), business realignment and other efforts,
2) Proactive utilization of diverse financing methods (debt-debt swap (including equity-capital-like-debt borrowings), debt-equity swap, and asset-based lending)
3) Establishment of an environment to provide sufficient services to support Japanese companies' expansion into Asian and other foreign markets in cooperation with regional financial institutions, and strengthening of coordination with regional financial institutions and other organizations in relation to large-scale lending overseas
4) Enhancing financial services for Japanese and non-Japanese customers in Asia and other foreign markets
5) Enhancing project financing and other finance for infrastructure development, etc. including Public Private Partnership (PPP) and Public Finance Initiative (PFI)
6) Appropriate provision of services using electronically recorded monetary claims
7) Provision of retail financial products that meet recent customer's needs, including NISA, deposit and trust for educational funds.

(3) Support for Business Improvement, etc. to SMEs

This program year is considered crucial for financial institutions to start their full scale support for improvement of SMEs' business profiles, and reinforcement of business structure.

Comprehensive measures taken as the exit strategy of the SME Financing Facilitation Act ("SME Act") are being implemented under strong public-private cooperation. Considering this, each financial institution should work towards real improvement of SMEs' business profiles, by providing greater support for business improvement and recovery, such as support for devising highly effective business rehabilitation plans through performing an active consulting function while coordinating and cooperating with outside experts and other financial institutions.

In doing so, financial institutions are expected to make active and appropriate efforts to invigorate regional economies and facilitate finance in the regions, taking into account the purpose of the Act on Regional Economy Vitalization Corporation of Japan ("REVIC Act").

Needless to say, even after the expiry of the SME Act, financial institutions are continuously expected to provide fine-tuned support for SMEs, and endeavor to provide a smooth supply of funds, in response to changes in their loan terms, or other measures.

Based on the above, the FSA will confirm the following points.

1) In order to establish a cycle where financial institutions can boost their profitability and financial soundness by improving borrowing enterprises' debt servicing capacity through the future expansion of sound money demand,

   i) whether financial institutions are actively performing consulting functions for enterprises to make them aware of their business issues and make efforts for business improvement and recovery, while cooperating as necessary with outside experts and organizations (including REVIC and SME Business Rehabilitation Support Cooperatives), such as SME groups and other financial institutions, Credit Guarantee Associations, etc.; and actively coordinating and cooperating through bank meetings, etc. with other financial institutions leading the support for business recovery.

   ii) whether financial institutions give appropriate advice on not only financial aspects but also issues concerning the management of the borrower enterprises, such as increasing sales and business succession.

2) In particular, for SMEs that allowed changes to their loan terms or other measures, the FSA will intensively verify whether financial institutions provide support for devising highly effective business rehabilitation plans, and regularly follow up on the progress of such plans.

3) In view of the purpose of the REVIC Act, whether financial institutions, in support for business turnaround and business activities for invigorating regional economy, are working in coordination with REVIC and other related organizations to contribute to the invigoration of regional economies and finance facilitation through the improvement of the region's overall economic strength; and whether they have expanded the scope of their support to include small and micro enterprises that need support.

4) The FSA will verify whether Major Banks are implementing appropriate initiatives to establish loan practices which in principle do not require third party joint and several guarantee, except managers of the borrower company, and to consider the guarantor's abilities to pay when executing guarantee obligations. The FSA will particularly verify whether there are objective and rational reasons for signing such a contract (ie., third party joint and several guarantee), and whether a contracting party agreed with these contract terms based on his/her voluntary will and thus it is confirmed in writing that it is due neither to pressure nor to demands from the financial institution, in cases where such contracts are signed in exceptional circumstances by a third-party that does not substantially participate in the management of the company.

(4)Initiative for Loans to Individuals

1) Mortgage Loans

As for mortgage loans, the FSA will specially consider the points listed below.

- The FSA will strive to ensure that banks give customers appropriate and detailed explanations about the characteristics of mortgage loans, including the potential fluctuation of interest rates, in order to obtain customers' understanding and consent, and will confirm whether the financial institutions are making efforts to establish the framework of such explanations.
- The FSA will encourage financial institutions to maintain smooth financing with appropriate loan judgments that take account of customers' situations, including their economic circumstances, in view of repayment plans that would remain feasible for customers.
- The FSA will intensively verify whether, in response to requests from borrowers for changing loan terms, etc. the financial institutions deal properly with borrowers while fully considering the economic situation the borrowers are faced with.
- In the case of mortgage loans insured by group guarantee companies (including cases where a guarantee company, etc. acquires mortgage loan claims through payment in subrogation), the FSA will intensively check whether financial institutions are giving guidance to, having dialogue with, and making requests to such guarantee companies so as to ensure that they properly deal with the facilitation of financing.

2) Efforts for Formation of a Sound Consumer Finance Market

From the viewpoint of forming a sound consumer finance market in the medium and long term, there is a need for banks to actively handle loans to consumers. Therefore, the FSA will continue its work from the previous program year on supervision for loans to consumers with the following points in mind.

- Understanding the situation as to whether banks are dealing actively with consumer loans, considering their own needs.
- Encouraging banks to build up appropriate screening systems which consider the situations of customers, in order to prevent customers from being entangled with excess borrowing. The FSA also encourages banks to properly grasp customers' situations on their own for loan examination, instead of relying solely on information from credit information institutions or guarantee examinations of credit guarantee companies even when using them.

3. Risk Management and Financial System Stability

The FSA will, with continued close monitoring of the economic and market trends in Japan and overseas, conduct in-depth supervision on the risks facing Major Banks, in terms of the macro-prudential point of view as given below. In addition, the FSA, through discussions with the management, as necessary, will encourage Major Banks to further review their initiatives for strengthening profitability and medium to long-term business strategies—including overseas strategies.

(1) Supervision Based on the Macro-prudential Point of View

It is vital for Major Banks to ensure robust and comprehensive risk management thoroughly under appropriate management control (governance). This is necessary not only for the financial soundness of each financial institution and overall stability of the financial system, but also for Major Banks to fully perform financial intermediary functions by providing a stable supply of funds to support the growth of private companies as well as the real economy in a changing environment.

It is important for the FSA, while enhancing its own risk sensitivity as a supervisor, to encourage voluntary efforts by individual financial institutions toward appropriate risk taking backed by robust risk management, thereby achieving an active provision of funds to borrower companies and the financial soundness of financial institutions at the same time.

To this end, it is critical for the FSA, as its basic stance for supervision, to continue to analyze and supervise from the macro-prudential perspective; striving to monitor whether the entire financial system would develop in a sustainable and stable manner. In doing so, the FSA will recognize strong feedback loops between the situation of macro economy and financial markets as well as of financial intermediary functions and the soundness of banking and will pay particular attention to the situation of risk concentration and the channel of propagation.

In supervising Major Banks based on the macro-prudential viewpoints, the FSA will carefully consider the possibility that rational behavior of individual financial institutions, may, in aggregate, cause a negative impact on the overall economy ("fallacy of composition").

1) Risk Areas which Should be Focused On

・ The FSA will properly grasp the possible impacts of the trends in the European sovereign debt problem, China and other emerging markets, U.S. economic and financial developments, on the financial institutions.

・ In the share of the overall assets held by financial institutions remains a large proportions of debts, particularly government bonds. Under the situation, the FSA will monitor risk management systems in financial institutions, for example in terms of whether they formulate portfolio management policy, including plans for bond holding, taking into account the medium to long-term perspective and the market outlook given the BOJ's quantitative and qualitative money easing, of whether they appropriately control the risks involved in the scenario analysis assuming the potential impact of increases in long-term interest rates and market volatility, and of whether they have enhanced their capital sufficiently as the absorbency of potential losses.

・ As for mortgage loans, in view of their product characteristics, the intensifying competition among financial institutions, and market trends, the FSA will check whether Major Banks have established a risk management system that takes into account not only the management of payment in arrears, but also losses on loans incurred due to the falling interest rate, prepayment trends, and peculiarities of housing loans (i.e, default tends to occur after a certain period of time from loan underwriting).

・ The risk of equity holdings could weigh more on Major Banks than other risks to which they are exposed. In this vein, the FSA will continue to check, with regards to shares, etc. held by banks, whether possible impacts of market fluctuations on their incomes and capital are accurately identified and whether financial robustness would be appropriately maintained even if such risk materializes. The FSA will also monitor progress in reduction by Major Banks of their holdings in strategically-held stocks.
・ For real estate financing, the FSA will check whether Major Banks are making lending decisions and determining lending conditions appropriately by considering the lending period and loan to value (LTV) ratio (ratio of debt—e.g. loan—to the value of the property being financed), while closely monitoring market trends, especially in the three major metropolitan areas where the land price is shifting away from a declining trend and is stabilizing or increasing.
・ In view of the accelerating overseas expansion by Japanese banks and the fact that the financial crisis is often caused by tightened liquidity first, the FSA will check whether Major Banks (particularly including Japanese banks' overseas bases and foreign banks' Japanese bases) have built up an appropriate foreign currency liquidity risk management, etc. Among others, the FSA in cooperation with the Bank of Japan will confirm the appropriateness of group-wide liquidity management (including cross-border liquidity management between a head office and overseas branches), of foreign currency liquidity management, and of a level of necessary liquid asset holdings.

2) Improved Risk Management Techniques

As with risk management techniques, the FSA will encourage Major Banks to appropriately implement not only quantitative risk control techniques (e.g., standard economic capital models and VaR control) but also stress tests to capture tail risks appropriately.

Furthermore, the FSA will continue in-depth two-way dialogue with Major Banks on their risk characteristics and business management challenges.

3) Enhancement of Financial Foundations

Since capital provides the basis for active risk taking and forms the foundation of market confidence, the FSA will encourage financial institutions to strengthen their capital base, including through securing a reliable stream of profits, in order to improve their resilience and robustness against future stresses, taking into account the capital standard for internationally active banks, which was in force from end-March 2013, and the new capital standard for domestically active banks, which will come in force from end-March 2014.

(2) Enhanced Risk Management Systems to Support Initiatives for Stronger Profitability

In light of both the current financial environment and uncertainties over prospects of Japan's real economy, strengthening profitability by banks will likely gain more importance among management challenges for the banking business, in order for them to continue operations on stable footing.

Major Banks are currently striving to strengthen their profitability by expanding their operations in Asia and other regions overseas and by developing business lines outside traditional commercial banking operations such as deposits, loans, and cash settlement. It has also been witnessed that some mergers and acquisitions over foreign financial institutions were undertaken by banks with the aim of effectively expanding their profit opportunities on a group-wide basis.

It is vital that, along with these initiatives, financial institutions build up systems to manage risks appropriately. In this context, it is important to look into how to integrate risk management with profit management as a way to substantially underpin and back up initiatives to strengthen their profitability, instead of looking at risk management as a measure for preventive and defensive purposes.

The FSA will check the status of Major Banks' activities to enhance their ability to generate earnings and their risk management approach in relation to such activities. For instance, the FSA will verify management systems for expanding business operations by overseas bases (including subsidiaries) in terms of risk management, while closely monitoring management efforts for profitability enhancement (whether credit risks, including those for non-Japanese customers, are appropriately managed and whether comprehensive risk management systems covering overseas branches and subsidiaries have been developed and upgraded accordingly).

The FSA will also confirm whether Major Banks appropriately manage foreign currency liquidity in line with their efforts for boosting overseas expansion. In doing so, the FSA will cooperate with foreign authorities as necessary.

(3) In-depth Supervision of Financial Groups with Large and Complex Operation

The FSA will conduct in-depth supervision, particularly of financial groups operating large, complex businesses both in Japan and overseas, in view of international discussions at the FSB (Financial Stability Board) and other forums given that the deterioration of these financial groups will likely cause a significant impact on the entire financial system. The FSA will supervise these financial groups from the macro-prudential perspectives while encouraging closer cooperation with the BOJ and foreign authorities, etc.

It should be noted that given the growing interconnectedness and interdependencies among companies within a financial group, materialization of risk in a group company (covering administrative, operational, reputational, and other wide-ranging risks) can also materialize as risks for the group as a whole. In view of this, the FSA will supervise financial groups in terms of issues such as whether the development and enhancement of business management and risk management system, etc. for the group as well as individual group companies, are appropriately led by the group holding company and whether the roles of the holding company within the group have been clarified. In this regard, the FSA will focus on the points listed below in this section.

In addition, the FSA will apply such focus points not only to the bank groups designated as Global Systematically Important Banks (G-SIBs) but also to other financial groups with large and complex operations, as necessary, considering international discussions in the meantime. The FSA will pay special attention to the importance of supervision that will suit the characteristics of individual groups, such as details of business and size.

Further, the FSA will monitor, as necessary, the progress of actions taken by overseas subsidiaries to deal with new laws and regulations introduced in overseas and the potential impact on financial institutions in Japan.

1) Enhancement of Group Governance System

For financial groups with large and complex operations, especially including financial institutions with various risk characteristics, it is important that the holding company takes the lead and properly understands and controls risks facing the group.

Therefore, the FSA will check whether the management personnel clarify the financial group's management policy, establish the system to enhance group-wide profit and risk management, and take appropriate actions to implement a risk appetite framework (a group-wide framework to discuss, understand, and evaluate the risk level which the group is willing to take based on the group management strategy).

Further, the FSA will encourage financial groups to develop organization structures where each division, the business, risk management, finance, and internal audit division, function properly, which ultimately contribute to the improvement of the group's internal control and support the group governance as a whole.

2) Actions to Comply with the Basel III Standard

The FSA will request financial groups to enhance their organization by setting a medium to long-term capital policy in view of the Basel III gradual implementation and the introduction of an additional capital buffer requirement to G-SIBs.

3) Recovery and Resolution Plans (RRPs)

For financial institutions specified as G-SIBs, etc., the FSA will request them to develop or revise their recovery plans. At the same time, the FSA will continue working to elaborate resolution plans of these firms, incorporating the contents of the revised Deposit Insurance Law approved by the Diet in June 2013. Along with this, the FSA will promote the enhancement of group risk management for times of crisis and normal situations.

Additionally, in its resolution planning, the FSA will continue its efforts to accurately understand the inter-connectedness of financial institutions within and outside their associated group.

4) Stress Testing

In order to capture risks that cannot be fully identified through the risk management methodologies normally employed, it is important to actively utilize the stress testing covering the entire group that assume a deterioration of the macroeconomic environment. In implementing stress testing, from the viewpoint of the PDCA (plan-do-check-act) cycle, the FSA will request financial groups to establish a framework to improve modeling and statistical approaches continuously.

The FSA will also require stress tests based on a common stress scenario incorporating the focused risk areas detailed in Section 3 (1) 1) and confirmation of the results as necessary.

5) Management Information Systems

In order to control risk appropriately including the above 1) through 4), it is essential to enhance management information systems (MIS) in a group-wide effort to strengthen data totalizing capability, etc. It should be noted that from the macro-prudential point of view, financial groups identified as G-SIBs are required to provide data to the FSB Data Gaps Project, etc. Considering this, the FSA will urge G-SIBs and other related institutions to devise and implement system development plans to achieve quick aggregation and reporting on a group-wide basis, which are needed for making business judgment and reporting to the FSA. At the same time, the FSA will verify the progress of "principles for effective risk data aggregation and risk reporting," issued by Basel Committee.

6) Legal Compliance Systems, etc.

Financial groups with large and complex operations provide various types of business, such as cross-border deposits, settlements, and trade finance, through cooperation among multiple financial institutions in the group (i.e. banks and securities firms). In terms of these businesses, the FSA will confirm whether the financial group appropriately establishes and makes a functioning legal compliance system encompassing the prevention of the abuse of dominant bargaining power, control of customer information, and management of conflicts of interest.

7) Human Resource Management

In view of the fact that risks facing financial groups with large and complex operations are becoming more and more complex, the FSA will encourage these financial groups to take actions from a medium to long-term perspective to ensure that personnel, including at the management level, in charge of risk management and internal control, are fostered and retained.

(4) New Entry Banks, Foreign Bank Branches, etc.

1) Beside Major Banks, it is important for new entry banks and trust companies, etc. to work on establishing their new business models, which was expected at the time of new entry into the business, in parallel with having legal compliance systems more embedded. On the other

hand, the FSA will encourage them to put in place a risk management system, which is compatible with their business size and current business model, where they experience a rapid expansion of the business or encounter a deviation from the business model initially planned at the time of entry.

2) It is expected that subsidiaries and branches of foreign banks ("Foreign Banks Branches, etc") in Japan add diversity to Japanese markets by providing new services not on offer by Japanese banks, or by supporting foreign companies' activities in Japan. But there is a concern that they may be directly or indirectly controlled by their own foreign head offices beyond the reach of Japanese law, and that regulation and governance within their Japanese branches may not function sufficiently as a result of the management and control styles adopted by their head offices. In this vein, it is important that subsidiaries and branches of foreign banks in Japan are given sufficient authority and responsibility to establish governance and internal control systems on their own inside the jurisdiction of Japan, while instructed and supported by the head office.

It is also necessary for them to thoroughly implement customer protection measures, and risk management including by conveying accurate information to customers concerning that deposits in Foreign Bank Branches, etc. are not eligible for deposit insurance. With these supervisory key points in mind, the FSA will conduct in-depth supervision over them in terms of their governance (management control) and risk management (including liquidity management), while paying attention to international discussions. In doing so, the FSA will exchange views with senior management at head offices and through the supervisory college and other frameworks with home supervisory authorities, while taking into account the global environment surrounding internationally active financial institutions.

4. Improvement of Customer Protection and Convenience for Users

Improving customer protection and increasing convenience for users in financial institutions not only contribute to developing a sound national economy, but also help to stabilize the Japanese financial system by enhancing citizens' trust in financial institutions.

It is important for financial institutions to ensure the protection of customers' interest and a sense of security and trust. In doing so, managers of a financial institution should fully provide leadership in establishing a solid business system, while implementing measures such as strict control of customer information, prevention of the abuse of dominant bargaining power, and management of conflicts of interest. For customer protection, particularly, nominal compliance with laws is insufficient; financial institutions should fully understand the effects and purposes of specific laws, identify compliance levels required by customers and society, and meet their expectations, as highly public financial institutions that are expected to be reliable. To this end, a financial institution must discuss and make appropriate judgments as to whether individual financial products and services are suitable for sale and solicitation in light of the attributes of their customers (e.g. knowledge, experience, wealth level, and objective), before developing these instruments and services. In selling and soliciting financial products and services, it is important to provide appropriate explanations that suit the customers' attributes mentioned above. At the same time, financial institutions should perform consulting functions properly from the customer's viewpoint, truly understanding the customer's needs for asset management, such as life and financial planning.

In addition, financial institutions must recognize that complaints and requests for consultations from customers after sale may provide them with opportunities to discover potential customer needs. Therefore, they must respond to them appropriately and actively.

Considering the above, the FSA will intensively confirm the following efforts of financial institutions that aim to improve customer protection and convenience for users. In doing so, the FSA will respect the self-improvement efforts of each bank, and proceed with supervision, in a manner that places emphasis on the incentives to make them take such efforts.

(1) Ensuring Business Continuity

1) IT System Inspections, etc.

Computer systems of financial institutions are at the core of the systems that are used to settle accounts. These computer systems have a strong public aspect as social infrastructure. If a failure occurs, it could impair user convenience and have a large impact on society, and could inevitably lead to the financial institution's losing credibility.

Therefore, the FSA will confirm whether each financial institution, under active leadership by the management, is making efforts as detailed below.

i) Whether top managers of financial institutions fully recognize the prevention of computer system glitches and the prompt recovery from such glitches as great business management challenges and have built sufficient relevant systems (for example, whether financial institutions outsourcing computer system management have taken measures such as the appropriate internal distribution of system experts without leaving everything to outsourcees to undertake system management)

ii) Whether financial institutions have identified their data-processing capacities and have considered systemic and administrative responses to cases where demand exceeds capacity limits

iii) Whether financial institutions continuously sort out present underlying system risks and implement methodical investment in system maintenance and improvement

iv) Whether financial institutions make and implement specific plans for the succession of their present systems and technologies, and for the development of relevant experts

v) Whether financial institutions have fully understood the details of outsourced systems, specified how to share roles, responsibilities, etc. with outsourcees in advance and made monitoring arrangements to the system including outsources.

vi) Whether top managers identify risks accompanying the replacement and integration of systems, and whether they conduct project management appropriately.

Further, if system glitches occur, the FSA will also confirm the causes and measures to prevent recurrence of such glitches by conducting interviews even with outsourcees as needed.

2) Validation of Business Continuity System

・ The FSA will check whether financial institutions are adequately prepared and able to continue the minimum required operation in a crisis event, including the following.

i) Whether financial institutions set up solid business continuity systems sufficiently assuming major risks, such as earthquakes and other natural disasters, pandemic influenza, and large electricity blackouts

ii) Whether financial institutions review their BCPs in light of experiences in major natural disasters and system glitches in the past, discussion results at Central Disaster Prevention Council, etc.

・ The FSA will confirm whether business continuity could remain unaffected at system centers and other key business bases. More specifically, the FSA will confirm whether financial institutions and their outsourcees check the preparation of BCPs, the establishment of private power generators and back-up centers, and training for securing the effectiveness of BCPs as necessary.

・ Additionally, the FSA will confirm whether financial institutions that offer Internet banking services have an adequate business continuity system in case of emergency. Particularly, for banks providing Internet banking services as their primary business, in view of the shortage in manned branch offices, the FSA will check whether those Internet banks establish necessary procedures to offer alternative services, under the transition to back up systems, such as receipts and payments over-the-counter and foreign currency transfer at other financial institutions.

・ Further, the FSA will check whether financial institutions take security measures for cyber-attacks, prepare systems in case of emergency, including those to minimize damage upon attack, and establish a monitoring and reporting system, etc.

(2) Thorough Management of Information Security

Customer information forms the basis of financial transactions, and it is important to strictly manage it from the viewpoint of protecting personal information. Furthermore, it is important to strictly manage corporate information in order to increase trust in market transparency and fairness. From these viewpoints, the FSA will strongly encourage the appropriate maintenance of internal management systems for information security, and the enhancement of rules on professional conduct to prevent inappropriate actions of managers (such as information leaks or insider trading). Particularly, the FSA will confirm whether financial institutions have built sufficient internal management systems, including the frequency and details of ex post facto checks and reporting to top managers, to prevent illegal acts on a group-wide basis covering subsidiaries, sister companies, trust banking divisions, etc.

After reviewing firewall regulations, the FSA built a principle-based framework of encouraging financial institutions to develop their voluntary conflict-of-interest management systems. In this respect, the FSA will confirm whether financial institutions attempt to take accurate measures to harmonize improved customer convenience with the conflict-of-interest prevention.

(3) Maintenance and Improvement of Reliability and Transparency of the Benchmark Interest Rate

Recently, the reported manipulation of the London interbank offered rate (LIBOR) has gained global attention. The reliability of important financial market benchmarks must not be affected. Financial institutions that offer benchmark interest rates must acknowledge the public nature of banking operations and be sure to secure their fairness and transparency. In this respect, the FSA will continue to check internal management systems of financial institutions involved in offering benchmark rates. In view of the progress of international discussions, the FSA will also confirm whether meaningful discussions are ongoing at the Japanese Bankers Association, the administrators for Tokyo Interbank Offered Rate (TIBOR), in order to maintain and improve the transparency and reliability of the benchmark interest rate.

(4) Establishment of Systems for People with Disabilities, etc.

The FSA will strongly encourage financial institutions to develop facilities and systems to allow people with disabilities and elderly people to easily and securely utilize financial services through counters and ATMs at financial institutions. Also, the FSA will encourage financial institutions to make positive efforts to encourage their staff to participate in internal and external training and seminars, so they will be able to provide fine-tuned services aligned with the needs of people with disabilities.

(5) Enhancement of the System for Selling Risky Products

Regarding the sale of risky products, such as investment trusts, structured bonds and derivatives (including foreign exchange derivatives), and insurance solicitation, the FSA will consider the following points in supervising financial institutions. Given that deposit-handling banks have customers who prioritize the safety of principal, particularly, the FSA will note that the following points cover the development, promotion, and sales of not only the abovementioned products but also other risky products that could lead to a loss of principal. It is important for financial institutions to make fine-tuned efforts to secure elderly customers' understanding of the products and risk characteristics, while accurately capturing changes in the level of their ability to make decisions for each investment through following-up carefully aftersales.

In the sale of foreign exchange derivatives, the FSA will check whether the financial institutions are selling them appropriately, especially regarding troubles in the past. In addition, the FSA will also check not only whether financial institutions give explanations on losses for worst scenarios when selling these derivatives but also whether they respond carefully and appropriately to customers' claims and consultation requests.

Consequently, in this program year, the FSA will also pay attention to (1) under what kinds of management policies, financial institutions are providing what kinds of financial products and services to customers with what kinds of attributes, (2) whether there are not warped incentives that may arise due to pursuing short-term profits or the existence of conflicts of interest, (3) whether an internal checking system for employees including executives has been developed to verify that management policies are thoroughly implemented by the sales staff. Meanwhile, the FSA will cooperate with the police authorities and the Consumer Affairs Agency as necessary.

1) Systems for Sale of Investment Trusts, Structured Bonds, Derivatives, Insurance Products, etc.

The FSA will intensively verify whether financial institutions establish and make functioning frameworks for solicitation and explanation to each customer that are compliant with regulations on unsolicited offers, taking into account the supervisory guidelines related to solicitation and explanation. In particular, the FSA will especially focus on the following points:

i) Do financial institutions make appropriate sales preparations, including the targeting of suitable customers according to the characteristics, complexity and risks of the products they develop, promote and sell? Do they swiftly and appropriately implement sales strategy revisions, including changes of the targeting of customers, in consideration of customer claims, risk fluctuations, etc. even after sales?

ii) Do financial institutions give appropriate and flexible explanations about risks and inherencies of products to customers, providing documents with easily understood descriptions prepared in light of their knowledge, experience, wealth level, and the purpose of investment, so as to help them make the right decision for each investment? Particularly, do financial institutions give appropriate explanations on the product characteristics, price risk, sales and cancellation fees, trust fund fees and other costs, the possibility of including part or all of dividends in principal withdrawn and other matters that influence customers' investment decisions? Further, do financial institutions provide careful explanations on these points to customers planning to switch from some investment trusts to others, while preventing any unnecessary switching for customers?

iii) Especially for elderly customers, even if they have enough investment experience, do the financial institutions make fine-tuned efforts to secure their understandings of the products and risk characteristics, and to prevent or detect potential problems at an early stage, at each phase of the transaction (solicitation, order receipt, execution of transaction, and monitoring after execution) for each sales channel (face-to-face, telephone and over-the-counter)? In doing so, do they give advice in detail from the customers' point of view?

iv) Do financial institutions make check-sheets as needed and collect them from customers to confirm their understanding about the contents of explanations?

v) Do financial institutions provide customers with warning documents?

vi) Are the salary and bonus systems of the sales staff and managers not biased and do the systems not have excessive links to gaining short-term profits?

vii) Do the sales system and product composition not place too much emphasis on gaining fee earnings?

viii) Are measures taken to prevent practices or events, such as the abuse of the dominant bargaining position and false recognition by customers with deposits and risky products?

ix) Are the necessary actions, such as system adjustments, taken to prepare for upcoming revisions to the self-regulatory regulations by the Japan Securities Dealers Association and other organizations in relation to the notification system for the total return of investment trusts and other financial products?

2) Systems for Sale of NISA (Nippon Individual Savings Account)

The NISA system, scheduled to be introduced in January 2014, is expected to offer opportunities for a wide range of households to build-up assets by long-term and diversified investments. Especially, it is a noteworthy system that will support the Japanese people’s self-supporting efforts (wealth buildup) to provide for old age and education. However, bank customers are largely retail depositors, who have little experience and knowledge of investment. As such, the FSA will check whether the financial institutions establish frameworks for explanations to customers and whether they provide and manage financial products that reflect the purpose of the NISA system, in accordance with the supervisory guidelines revised in August 2013.

3) Sales System to Corporate Customers (Pension Funds, etc.)

There are differences in knowledge and understanding of financial products between financial institutions and their corporate customers as well as individual customers, in regard to the development, sales, and promotion of the abovementioned financial products and services. Therefore the FSA will check whether financial institutions implement the adequate development and revision of sales strategies, explanations to customers upon sales and solicitation, ex-post follow-up actions based on market environment changes, etc.

Regarding pension fund trusts funded by Employees' Pension Fund, particularly, the FSA will check intensively whether trust banks are taking action according to the review of the regulations on asset management, triggered by the AIJ scandal.

(6) Enhancing Systems for Processing Consultations and Complaints from Customers

It is extremely important for banks to have proactive, timely and appropriate consultations and complaint handling, in order to ensure customer’s trust in financial products and services, and to positively utilize the customers’ needs for better management of business. From this viewpoint, the FSA will check whether banks develop an internal management system, under the involvement of the top management, for maintaining a consultation counter, analyzing the causes of consultations and complaints, sharing information within the institution, taking measures and notifications to prevent the recurrence of complaints, and following up the implementation of these measures, in an appropriate manner.

Also, in connection with the financial Alternative Dispute Resolution (ADR) system, which was introduced in October 2010, the FSA will carefully confirm whether financial institutions are:

i) making sincere efforts for quick dispute resolution, such as active disclosure of required information;

ii) preparing arrangements for facilitating easy use of the system nationwide;

iii) introducing the ADR system to customers as needed when they make consultations; and

iv) providing explanations anew on the ADR system when customers' consent is difficult to obtain between parties or when financial damages are difficult to determine.

(7) Preventing Abuse of Financial Functions

In order to ensure security for users, the FSA will verify, based on the following perspectives, whether Major Banks develop management systems to prevent financial functions from being abused in addition to taking adequate care of crime victims. In doing so, the FSA will also check IT systems and other arrangements at financial institutions to properly confirm customers' identities, and to detect transactions that are strongly suspected of being illegal and take appropriate actions, including the freezing of deposit accounts.

1) Do banks make efforts to eliminate crime, including the "Furikome" Fraud, that harms other people's assets? From the viewpoint of prompt recovery of victims' financial damages, in accordance with the Furikome Fraud Relief Act, do banks continuously deal with victims properly by halting transactions involving deposit accounts used in crime, providing information to suspected victims regarding funds remaining in such accounts, and distribute funds thereafter, etc.?

2) Do banks make efforts to prevent unauthorized withdrawals from counterfeit/stolen cash cards, stolen passbooks, and Internet banking? Do banks pay compensation to victims properly according to the Depositor Protection Act and agreements within the industry? Do banks make efforts to enhance cooperation with the police through such measures as the conclusion of a crime prevention agreement with the police in order to respond to various cyber-attacks, etc. based on the fact that the Act on the Prohibition of Unauthorized Computer Access was revised in May 2012 to toughen penalties for unauthorized access? Do banks take adequate security measures for customer protection such as adopting appropriate personal identification methods for Internet banking, including variable passwords and electronic certificates that do not depend only on fixed IDs or passwords, to deal with the rapid increase in illegal money transfer this year?

3) Do banks develop systems to appropriately execute tasks, such as verification at the time of a transaction, preparation and preservation of such verification and transaction record, and reporting of suspicious transactions based on the revised Act on Prevention of Transfer of Criminal Proceeds ("PTCP Act") enforced in April 2013 for preventing money laundering and terrorism financing of transaction? For account opening requests from corporate customers, financial institutions should remain reasonable and take into account customer convenience by allowing verification by requiring either one of specified documents under Article 4-1 and related ordinance of competent ministries, unless Article 4-2 of the PTCP Act is applicable to the transaction and additional verification is required.

Do banks develop systems for cross-sectional cooperation and information-sharing between relevant divisions for organized efforts to prevent money laundering and terrorism financing transactions?

4) Do banks make appropriate efforts, such as developing procedures and arrangements to cut relationships with antisocial groups, aiming to prevent antisocial groups from damaging the financial institution, managers, and various stakeholders such as customers, with the strong will of top management and entire bank organizations to eliminate antisocial groups from financial transactions? Do banks develop group-wide internal management systems that allow subsidiaries, sister companies, a real estate division for a bank with trust banking services, and other affiliates or divisions engaged in operations other than commercial banking to make the same efforts that the bank makes?