

Provisional Version

# ***ANNUAL REPORT 2014***



**FINANCIAL SERVICES AGENCY  
GOVERNMENT OF JAPAN**

This document is based mainly on the annual report in Japanese (“Kinnyucho no Ichinen”) for the program year 2013 (July 1, 2013 to June 30, 2014) while Chapters I through III are partly updated reflecting the changes until June 24, 2015.

This English annual report is prepared as reference material and is not for official use.

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## I. Message from the Commissioner

The Financial Services Agency (FSA) is responsible for (i) ensuring the stability of the financial system; (ii) protecting the users of financial instruments and services, such as depositors, insurance policy holders, investors and the like; and (iii) facilitating the smooth function of financial services.

This report (Annual Report 2014) covers key issues related to the financial administration in Japan during the calendar year 2014 with the aim to share the development of the regulatory environment of financial and capital markets in Japan. This report is our first English annual report, and is one of our initiatives to promote interactive communication with all those who participate in the global financial market. This document is based mainly on the annual report in Japanese for the program year 2013 (July 1, 2013 to June 30, 2014) while Chapters I through III are partly updated reflecting the changes until June 24, 2015. The FSA will strive to provide more timely and user-friendly English reports in the years to come.

This report covers both short-term and medium- to long-term challenges the FSA is facing. Today, the Japanese government is making strenuous efforts to overcome deflation and achieve sustainable economic growth, the so-called “Growth Strategy” under the “Abenomics” initiative instigated by the strong leadership of Prime Minister Shinzo Abe. The Revised Japan Revitalization Strategy reflects challenges for the current and structural reforms that the Japanese economy is facing.

Regarding short-term issues, at present the Japanese Government is fully engaged in efforts to end the deflation and achieve sustainable growth. To support these efforts from a financial perspective, it is essential for financial institutions to enhance their financial intermediary functions, in order to ensure that there is no funding clog anywhere in Japan, not least in regional economies, and thus adequate funding is available across Japan.

As for medium- to long-term issues affecting the FSA, Japan is faced with structural issues in the form of population decline and hyper-aging. The hyper-aging of the population will continue, accompanied by a steep decline in the working-age population. The exit rate of firms and self-employed businesses is much higher than the entry rate. These factors mean that Japanese financial institutions will face a very difficult business environment in the long term. Economic growth in Asia, on the other hand, is expected to continue at high levels, and Asia will play an increasingly important role in the global economy. One of the core messages of our Growth Strategy is “growing together with Asia.” Japan’s experience after the “bubble economy” in the financial sector and of growing hyper-aging society might give you lots of suggestions, and we are pleased to share the experience and lessons to contribute to the development of the financial infrastructure in Asia.

This year, we would like to highlight our work to formulate Japan's Stewardship Code and Japan's Corporate Governance Code. We believe that the introduction of these Codes represents an epoch-making event for Japan in making its business environment, and financial and capital markets more attractive.

Japan's Stewardship Code is a set of principles for responsible institutional investors in fulfilling their stewardship responsibilities with due regard both to their clients and beneficiaries and to investee companies. It enhances the medium- to long-term investment return for their clients and beneficiaries by improving and fostering the investee companies' corporate value and sustainable growth through constructive engagement, or purposeful dialogue.

Japan's Corporate Governance Code, on the other hand, establishes fundamental principles for effective corporate governance for listed companies. This Code is to present the best practices for listed companies, rather than to force rules on them. Based on the Japan Revitalization Strategy (Revised in 2014) approved by the Cabinet in June 2014, the Council of Experts was formed in August 2014, with the FSA and the Tokyo Stock Exchange (TSE) serving as a joint secretariat. In March 2015, the Council finalized the proposal, taking public comments into account. The TSE formulated a corporate governance code, which has the same content as the proposal finalized in March 2015 by the Council. The TSE's code and the related regulations entered into force on June 1, 2015.

These efforts are to improve our markets and businesses through close and frequent communications among the relevant parties including market participants, investors and companies.

With regard to issues affecting financial administration, in order not to overlook serious potential risks that at first appear to be innocuous, the FSA must have strong surveillance capacities and must position itself to act promptly and appropriately if risk does become apparent. For that purpose, we intend to advance integration between on-site and off-site monitoring.

In the program year 2014, we eliminated the former divisional structure in the Inspection Bureau, and launched a structure comprising monitoring teams for each type of financial institution, and monitoring teams for specialized operation and risk categories: business management, enterprise risk management, legal compliance, market business, and information technology.

Since the program year 2013, we have implemented a horizontal review to make comparisons among multiple peer financial institutions, conducting monitoring on important themes to ascertain actual practice from a unified viewpoint. This identifies best practices at the monitored peer institutions, and extracts relevant issues that exist in individual institutions. Through the Financial Monitoring Report, we provided feedback based on the monitoring results to each financial institution and we expect that this will

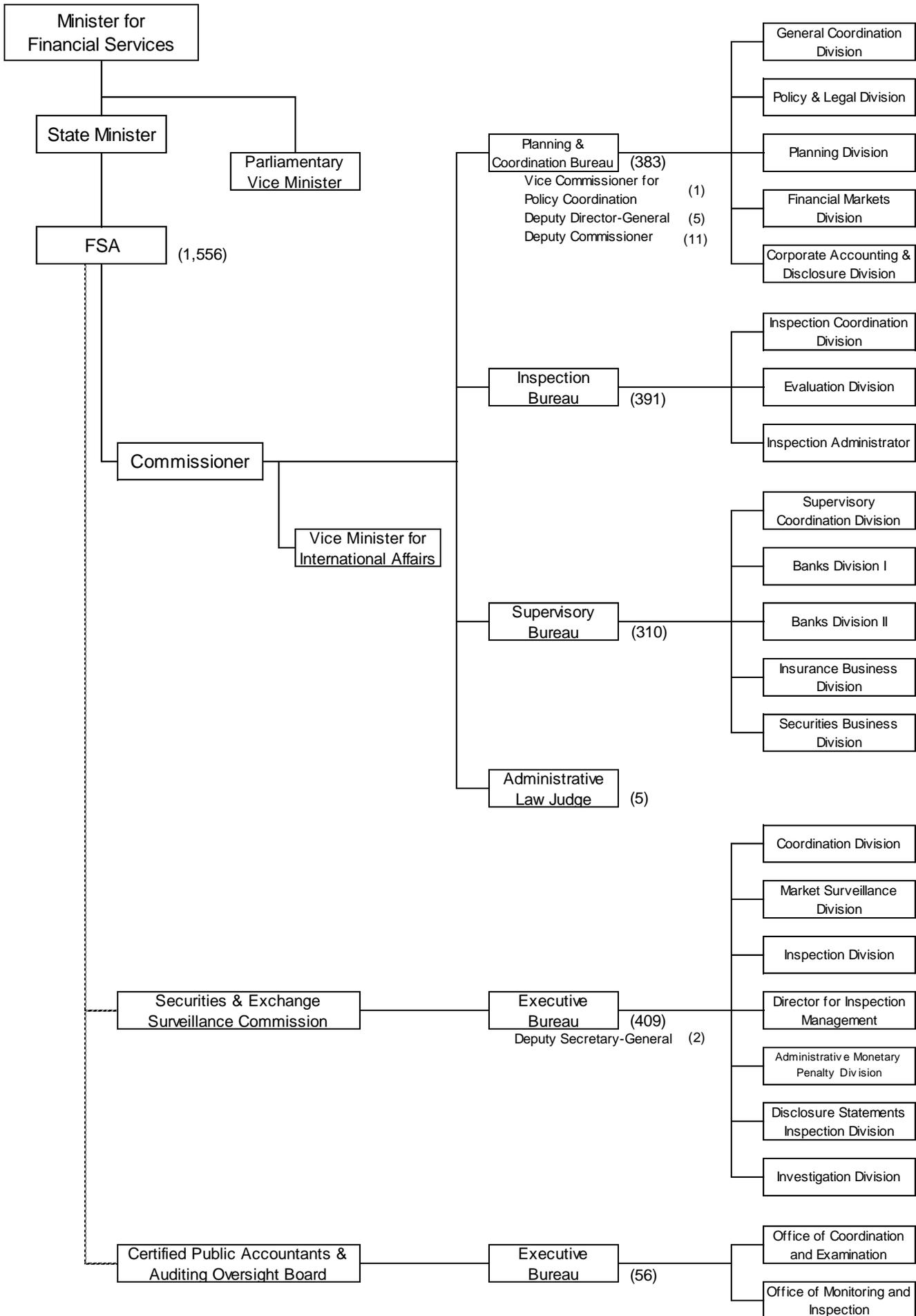
lead to proactive improvements in the management of each financial institution. Everyone involved in the management of financial institutions is encouraged to read this report.

Amid the current economic conditions, our financial administration has been shifting from crisis-alert mode to ordinary vigilance. We wish to have constructive discussions with all those involved with financial services, including financial services consumers, market participants and financial professionals, in order to ensure that our financial sector contributes to sustainable economic growth and stability in people's lives, while providing useful information about our regulatory environment.

細溝 清史

*Kiyoshi Hosomizo*  
*Commissioner, Financial Services Agency*  
*Government of Japan*

## II. Organization of the FSA (Fiscal 2014)



**Notes:**

- Numbers in parenthesis show the number of employees as of the end-March 2015.

- Two out of the five Deputy-Directors General, one out of the two Deputy-Secretaries General, and the Head of the Certified Public Accountant & Auditing Oversight Committee Executive Board are ex officio members.

## Fiscal 2014 Roles & Responsibilities of Bureaus, etc. at the FSA

Name of Bureau	Name of Divisions and Offices	Roles & Responsibilities
Planning & Coordination Bureau	General Coordination Division	Overall coordination of the FSA and planning and policy-making concerning financial system
	Information Systems Management Office	General affairs, personnel affairs, service regulations, training and management of the library
	Office of Management & Budget	Maintenance and management of information system
	Office of International Affairs	Organization, quota of staff, budget, accounting, welfare, etc.
	Economic Partnership and Cooperation Office	Planning and policy making concerning International Affairs
	Policy & Legal Division	International economic partnership and cooperation
	Counseling Office for Financial Service Users	Overall coordination, formulation of fundamental and overall policy of the FSA, coordination about taxation, Diet affairs, review of regulatory provisions, policy evaluation, public relations, information disclosure, liaison and coordination with local finance bureaus, administrative litigation, planning and policy making of the scheme for resolving financial trouble
	Research Planning & Coordination Office	Coping with questions, etc. from financial services users
	Planning Division	Planning and coordinating academic research
	Research Office	Overall planning and policy making of financial system, planning and policy making of fundamental and common issues, planning and policy making concerning banking and nonbanking business, planning and policy making of the scheme for resolving financial trouble
	Financial System Stabilization Planning Office	Research on economic and financial conditions
	Insurance System Planning Office	Planning and policy making concerning deposit insurance system
	Financial Markets Division	Planning and policy making concerning insurance system
	Corporate Accounting & Disclosure Division	Planning and policy making concerning securities markets and other financial markets, monitoring and analysis of these markets and supervision of exchanges
	Inspection Bureau	Inspection Coordination Division
Risk Management System Inspection Office		Inspection of private-sector financial institutions
Information Analysis Office		Overall control of Inspection Bureau, formulation of inspection policy and inspection plans, conduct of financial inspections, establishment of standards for financial inspections
Evaluation Division		Financial inspections concerning integrated risk management systems
Inspection Administrator		Collection and analysis of information for financial inspections
Supervisory Bureau	Supervisory Coordination Division	Review of inspection reports and notification of the results of financial inspections
	Supervisory Research Office	Conduct of important financial inspections
	Financial Conglomerate Office	Supervision of private-sector financial institutions
	Cooperative Financial Institutions Office	Overall coordination affairs, control of affairs concerning the formulation of guidelines on supervisory affairs, supervision of the Postal Saving Bank and the Postal Insurance Company
	Financial System Stabilization Management Office	Research on supervisory affairs
	Nonbank Financial Companies Office	Overall coordination, planning and policy making concerning supervision of financial conglomerates
	Banks Division I	Supervision of credit associations, credit unions, labor credit associations, agricultural and fishery financial institutions
	Banks Division II	Operation of Deposit Insurance Law and management of financial systemic risk
	Insurance Business Division	Supervision of nonbanks
	Non-life Insurance/Small Amount & Short Term Insurance Supervisory Office	Supervision of major banks, new types of banks, branches of foreign banks and trust companies
	Securities Business Division	Supervision of regional and tier II regional banks
	Asset Management Office	Supervision of insurance companies
	Administrative Law Judge	
Securities & Exchange Surveillance Commission Executive Bureau		Supervision of securities companies, securities investment trust management companies, investment advisers and financial futures companies
	Coordination Division	Supervision of investment management companies, advisories and agencies
	Market Surveillance Division	Administrative judgment on civil penalty
	Inspection Division	Market surveillance, inspection of securities companies, investigation of market misconduct, inspection of disclosure statements, investigation of criminal cases, etc.
	Director for Inspection Management	Overall coordination, general affairs and personnel affairs of the Executive Bureau
	Administrative Monetary Penalty Division	Daily market watch and analysis of information
	Disclosure Statements Inspection Division	Formulation of inspection policy and inspection plans for securities companies, and conduct of securities inspections, and review of securities inspection results
	Investigation Division	Conduct of securities inspections
Certified Public Accountants & Auditing Oversight Board Executive Bureau		Investigation of market misconduct
	Office of Coordination & Examination	Investigation of disclosure statements
	Office of Monitoring & Inspection	Investigation of criminal cases including securities frauds

Note: as of the end-March 2015

**Box: Establishment of “Vice Minister for International Affairs”**

Global financial regulatory reforms have been discussed under the G20 leadership since the financial crisis. In such discussions, central bank governors and heads of financial supervisors set the overall direction and framework for policies. Thus, the FSA established the new post of “Vice Minister for International Affairs” in August 2014, upgrading the post of Vice Commissioner for International Affairs (director-general level). This post has the principal responsibility of international negotiation, and its purpose is to ensure effective negotiations with representatives from other overseas authorities at the same level as central bank governors and heads of supervisors.

### III. Highlight of the FSA's Challenges

#### i. Growth Strategy in Financial Field

##### **“Abenomics” and the Financial Services Agency (FSA)**

Since the Abe administration took office in December 2012, the Government of Japan has been carrying out the “Three Arrows” strategy of Abenomics. The three arrows comprise of “Bold Monetary Policy,” “Flexible Fiscal Policy” and “Growth Strategy for Promoting Investment” implemented in an integrated and intensive manner. Our utmost aim is to break out from a prolonged deflationary stagnation and to revitalize the economy. The Growth Strategy was upgraded in June 2014 and June 2015 to advance deregulation and structural reform, and more than 40 laws have already been enacted. It is expected that these revisions will change the mindset of Japanese corporations and encourage companies to mobilize their under-utilized funds for substantial investment and wage increase.

The FSA is fully committed to Abenomics approaches related to financial and capital markets. Strategic financing for growth-oriented businesses is the key to successful implementation of initiatives for overcoming deflation and achieving sustainable economic growth under Abenomics. In designing policy measures to establish a “virtuous economic cycle” to enhance the capital shift from “savings” to “investment,” there are three major approaches to elaborate.

##### **Approach toward Households**

This approach means to establish a positive cycle in which household assets are allocated to funding for growing businesses. This approach includes the promotion of NISA to expand the range of investors with the measures to improve financial education. At the same time, the asset management business should improve their activities to increase the transparency in the management of investment funds and offer investment products that faithfully reflect the needs of investors.

##### **Approach toward Financial Institutions**

There are three policy measures in this approach.

###### (1) Promoting lending by financial institutions based on customers' business potential

The FSA is recently promoting lending by financial institutions based on customers' business potential. Our efforts include:

- Revising Financial Monitoring Policy to ensure that financial institutions make efforts to provide financing taking well into consideration the growth potential of debtor's business, and that related stakeholders cooperate with each other to improve the performance, productivity, and sustainability of businesses.
- Encouraging regional financial institutions to make use of the “Guidelines for

Personal Guarantee Provided by Business Owners.”

(2) Growing together with Asia

One of the core messages of our Growth Strategy is “growing together with Asia.” To achieve inclusive growth together with other Asian countries, our Growth Strategy aims at promoting the development of the financial infrastructure in Asia. The FSA has been actively engaged in concluding a Memorandum of Understanding (MOU) and Exchanges of Letters (EOL) for financial technical cooperation with the financial authorities of Cambodia, Indonesia, Mongolia, Myanmar, Philippines, Thailand, and Vietnam, respectively, and has proactively pushed forward such technical cooperation in partnership with relevant organizations.

The FSA established the Asian Financial Partnership Center (hereinafter, “AFPAC”) in April 2014 and has started to invite government officials from Asian financial authorities as visiting fellows. The AFPAC aims to address the issues related to the financial markets in Asia, to review our financial sector technical assistance for infrastructure development, and to further strengthen cooperative relationships with Asian financial authorities.

(3) Enhancing settlement systems

Settlement systems are raising their importance as financial infrastructure. Under these circumstances, the FSA promoted the efforts of banking industry, and the Japanese Bankers Association has begun to create 24/7 operation systems.

### **Approach toward Business Sectors**

There are also three policy measures toward the business sector.

(1) Formulating the Corporate Governance Code

See the following section (III-ii. Corporate Governance Reforms).

(2) Promoting an increase in the number of companies voluntarily adopting the IFRS

The “IFRS Adoption Report” was published in April 2015 as a reference for companies considering adopting the IFRS, based on the research on how companies that have voluntarily adopted the IFRS overcame any challenges they faced during the transition to the IFRS and what advantages their shift to the IFRS has had.

(3) Strengthening the competitiveness of companies

Another measure specified in the Japan Revitalization Strategy is to encourage more widespread use of the JPX-Nikkei Index 400, which consists of companies selected with a focus on profitability and corporate governance and has begun to calculate from January 6, 2014, including support for the prompt listing of futures. Promoting measures to improve the quality of audit and the attractiveness of qualified CPAs are also the agendas for further discussion.

## Box: Panel for Vitalizing Financial and Capital Markets

### - About the Panel for Vitalizing Financial and Capital Markets

The “Panel for Vitalizing Financial and Capital Markets” was set up jointly by the FSA and the Ministry of Finance in November 2013 to carry out cross-sectoral discussions on the measures to make Japanese financial and capital markets more attractive and enhance their international competitiveness, based on the “Japan Revitalization Strategy” (Cabinet decision: June 14, 2013) and the “Action Plan to Implement the Growth Strategy” (decision of the Headquarters for Japan’s Economic Revitalization on October 1, 2013).

The Panel confirms the basic recognition that it is important to provide support from a financial perspective for manufacturing, the foundation of the Japanese economy, in order to achieve a positive cycle of a strong economy driven by the private sector, and that, for this purpose it is necessary for financial institutions and industries to establish a relationship in which the two grow in tandem, just like the two wheels of a cart, and add value to each other, leveraging improved financial functions. Based on this basic recognition, free and vigorous opinions from a broader perspective have been exchanged among experts from various sectors, including financial industry, business sector and academic circles. Reflecting those discussions, “Recommendations for Vitalizing Financial and Capital Markets” (hereinafter, “Recommendations”) was compiled in December 2013, aiming at making Japan as Asia’s number one international financial center by 2020.

In addition, since the beginning of 2014, the Panel has followed up implementation of the measures that were incorporated in the Recommendations and also discussed in depth the points in the Recommendations and new issues. In June 2014, the Panel published a follow-up review and further recommendations for vitalizing financial and capital markets.

As of June 24, 2015, the Panel is evaluating the progress of measures in various areas of the financial and capital markets in Japan and reexamining the policy for 2020, as well as compiling the “Statement for Vitalizing Financial and Capital Markets,” regarding issues that need to be further developed, including new issues considered to be crucial for vitalizing the financial and capital markets in Japan.

### - “Recommendations for Vitalizing Financial and Capital Markets” (published on December 13, 2013)

The Panel for Vitalizing Financial and Capital Markets set the goal of establishing a leading position as an international financial center by 2020, envisaging an ideal state in 2020 and illustrated specific policies to be realized in the short term (measures to be launched within one year) and in the medium term (by 2020) with the focus on four areas as described below.

- (i) Establishing a positive cycle in which abundant financial assets held by households and public pensions are allocated more to funding for growing businesses (Utilizing “inactive” funds)
- (ii) Realizing Asia’s growth potential, improving the market function of the Asian region, paving the way for integral growth of Japan and Asia
- (iii) Strengthening corporate competitiveness and promoting entrepreneurship
- (iv) Developing human resources and establishing a better business environment

The Recommendations incorporate a wide variety of measures to help vitalize the financial and capital markets, including those related to Japan’s business practices and economic systems as well as those directly related to the financial system, in light of changes in the internal and external economic and social structure, such as the rapid development of Asian countries and the falling birth rate and the aging population. The Panel and the Recommendations are positioned as the foundation to help vitalize the financial and capital markets by the year 2020.

- “Further Recommendations for Vitalizing Financial and Capital Markets” (published on June 12, 2014)

Since the beginning of 2014, the Panel has discussed in depth the measures in the Recommendations published in 2013 and new issues, and compiled further recommendations with the focus on the following.

- (i) Strengthening the competitiveness of Japanese companies through formulating a corporate governance code, etc.
- (ii) Further enhancing the positive cycle in which abundant household assets are allocated to growing businesses by reforming the investment trusts and the awareness of trustees
- (iii) Realizing global-based management of cash and securities by enhancing settlement systems in order to bring innovation to commerce and financial transactions in Japan
- (iv) Improving the quality of human resources by promoting financial education and measures for developing global human resources

- “Summary of Statement from the Panel for Vitalizing Financial and Capital Markets” (published on June 24, 2015)

On June 24, 2015, the Panel published the summary of “Statement for Vitalizing Financial and Capital Markets” with the focus on the following.

- (i) Pushing for further improvements in the corporate governance to achieve growth-oriented governance. Encouraging companies to examine the economic rationale of cross shareholdings and take accountability for investors
- (ii) Strengthening asset management businesses by their establishing superior

governance and compensation systems, based on highly independent fiduciary duties

- (iii) Upgrading settlement system and examining how financial groups should work to provide financial services that are really beneficial for their customers

## ii. Corporate Governance Reforms - Formulating Japan's Corporate Governance Code -

### **Background**

Japan's initiatives for the corporate governance system have significantly accelerated in recent years.

The Japan Revitalization Strategy approved by the Cabinet in June 2013 specified as one of its measures the "preparation of principles (a Japanese version of the Stewardship Code) for institutional investors in order to fulfill their stewardship responsibilities, such as promoting the mid- to long-term growth of companies through dialogue." This led to discussions starting in August 2013 by the Council of Experts Concerning the Japanese Version of the Stewardship Code established under the FSA, which drafted and released the "Principles for Responsible Institutional Investors (Japan's Stewardship Code)" (hereinafter, "Japan's Stewardship Code") in February 2014. Japan's Stewardship Code is currently in effect (See the following Box: Japan's Stewardship Code for more details).

Furthermore, the Japan Revitalization Strategy (Revised in 2014) approved by the Cabinet in June 2014 specified as one of its measures the establishment of "a council of experts of which the Tokyo Stock Exchange and the Financial Services Agency will act as joint secretariat, aiming to prepare the key elements of the Corporate Governance Code." This led to the formation of the Council of Experts Concerning the Corporate Governance Code (hereinafter, the "Council of Experts") in August 2014, with the FSA and the Tokyo Stock Exchange (hereinafter, "TSE") serving as joint secretariat. The Council of Experts published its basic thought on a corporate governance code as the "Corporate Governance Code [Final Proposal]" (hereinafter, the "Code") in March 2015, taking into account the comments to the exposure draft which was published in December 2014. Then, in accordance with the Japan Revitalization Strategy (Revised in 2014), the TSE formulated a corporate governance code, which has the same content as the Code. The TSE's code and the related regulations entered into force on June 1, 2015.

### **Objectives of the Code**

The Code has its foundation in the Japan Revitalization Strategy (Revised in 2014), and is formulated as part of Japan's economic growth strategy. The Code seeks "growth-oriented governance" by promoting timely and decisive decision-making based upon transparent and fair decision-making through the fulfillment of companies' accountability in relation to responsibilities to shareholders and stakeholders. Recognizing the board's fiduciary responsibilities to shareholders and other stakeholder responsibilities, the Code includes language that calls for a certain measure of corporate self-discipline. It would not be appropriate, however, to view them as limits on companies' business prerogatives and activities.

Given the concerns regularly perceived about the growth of short-term investment activities in capital markets, it is hoped that the Code will also have the effect of promoting mid- to long-term investing. The Code asks companies to examine whether there are issues in their corporate governance in light of the aim and spirit of the principles of the Code, and take self-motivated actions in response to those issues. Such efforts by companies will make possible further corporate governance improvements, supported by purposeful dialogue with shareholders (institutional investors) based on Japan's Stewardship Code. In this sense, the Code and Japan's Stewardship Code are "the two wheels of a cart," and it is hoped that they will work appropriately and together so as to achieve effective corporate governance in Japan.

### **"Principles-Based Approach" and "Comply-or-Explain Approach"**

The Code specifies General Principles, Principles and Supplementary Principles. The Code does not adopt a rule-based approach, in which the actions to be taken by companies are specified in detail. Rather, it adopts a principles-based approach, and the manner in which the Code's principles are implemented may vary depending on industry, company size, business characteristics, company organization and the environment surrounding the company, so as to achieve effective corporate governance in accordance with each company's particular situation. Shareholders and other stakeholders are also expected to fully understand the significance of this principles-based approach in their dialogue with companies.

Moreover, unlike laws and regulations the Code is not legally binding. The approach it adopts for implementation is "comply or explain" (either comply with a principle or, if not, explain the reasons why not to do so). In other words, the Code assumes that if a company finds specific principles (General Principles, Principles and Supplementary Principles) inappropriate to comply with in view of their individual circumstances, they need not be complied with, provided that the company explains fully the reasons why it does not comply.

### **Implementation of the Code**

The Code is applicable to all companies listed on securities exchanges in Japan (hereinafter, "companies").

Companies in Japan may choose one of the following three forms of corporate organization: Company with *Kansayaku* Board, Company with Three Committees (Nomination, Audit and Remuneration), or Company with Supervisory Committee. The Code does not express a view on any of these forms of company organization. It specifies fundamental principles for corporate governance that should be applicable to whichever form of organization a company may choose. The Code entered into force on June 1, 2015.

## **Future Revisions of the Code**

As noted above, while the Code establishes fundamental principles for effective corporate governance, these principles do not remain unchanged. Under rapidly changing economic and social circumstances, in order to ensure that the Code continues to achieve its objectives, the Council of Experts expects that the Code will be periodically reviewed for possible revisions.

### **General Principles of Japan's Corporate Governance Code**

#### **Securing the Rights and Equal Treatment of Shareholders**

1. Companies should take appropriate measures to fully secure shareholder rights and develop an environment in which shareholders can exercise their rights appropriately and effectively.

In addition, companies should secure effective equal treatment of shareholders.

Given their particular sensitivities, adequate consideration should be given to the issues and concerns of minority shareholders and foreign shareholders for the effective exercise of shareholder rights and effective equal treatment of shareholders.

#### **Appropriate Cooperation with Stakeholders Other Than Shareholders**

2. Companies should fully recognize that their sustainable growth and the creation of mid- to long-term corporate value are brought as a result of the provision of resources and contributions made by a range of stakeholders, including employees, customers, business partners, creditors and local communities. As such, companies should endeavor to appropriately cooperate with these stakeholders.

The board and the management should exercise their leadership in establishing a corporate culture where the rights and positions of stakeholders are respected and sound business ethics are ensured.

#### **Ensuring Appropriate Information Disclosure and Transparency**

3. Companies should appropriately make information disclosure in compliance with the relevant laws and regulations, but should also strive to actively provide information beyond that required by law. This includes both financial information, such as financial standing and operating results, and non-financial information, such as business strategies and business issues, risk, and governance.

The board should recognize that disclosed information will serve as the basis for

constructive dialogue with shareholders, and therefore ensure that such information, particularly non-financial information, is accurate, clear and useful.

### **Responsibilities of the Board**

4. Given its fiduciary responsibility and accountability to shareholders, in order to promote sustainable corporate growth and the increase of corporate value over the mid- to long-term and enhance earnings power and capital efficiency, the board should appropriately fulfill its roles and responsibilities, including:

- (1) Setting the broad direction of corporate strategy;
- (2) Establishing an environment where appropriate risk-taking by the senior management is supported; and
- (3) Carrying out effective oversight of directors and the management (including *shikkoyaku* and so-called *shikkoyakuin*) from an independent and objective standpoint.

Such roles and responsibilities should be equally and appropriately fulfilled regardless of the form of corporate organization – i.e., Company with *Kansayaku* Board (where a part of these roles and responsibilities are performed by *kansayaku* and the *kansayaku* board), Company with Three Committees (Nomination, Audit and Remuneration), or Company with Supervisory Committee.

### **Dialogue with Shareholders**

5. In order to contribute to sustainable growth and the increase of corporate value over the mid- to long-term, companies should engage in constructive dialogue with shareholders even outside the general shareholder meeting.

During such dialogue, senior management and directors, including outside directors, should listen to the views of shareholders and pay due attention to their interests and concerns, clearly explain business policies to shareholders in an understandable manner so as to gain their support, and work for developing a balanced understanding of the positions of shareholders and other stakeholders and acting accordingly.

For more information on Japan's Corporate Governance Code, please refer to the following website:

<http://www.fsa.go.jp/en/refer/councils/corporategovernance/index.html>

#### Box: Japan's Stewardship Code

The Council of Experts Concerning the Japanese Version of the Stewardship Code requested the FSA to publish and periodically update the list of institutional investors who announced their acceptance of Japan's Stewardship Code.

On June 11, 2015, the FSA published the updated version of the list of institutional investors who had notified the FSA of their intention to accept the Code as of the end of May 2015. There are 191 institutional investors from Japan and abroad on the list.

- Trust banks (Shintaku Ginko) : 7
- Investment managers (Toshishintaku/Toshikomom Gaisha) : 133
- Pension funds : 23
- Insurance companies : 21
- Others (service providers, etc.) : 7

(Total) : 191

The FSA is planning to update the list quarterly. More specifically, the information as of the end of February, May, August and November respectively is due to be published early in the following month.

The principles of Japan's Stewardship Code are as follows:

1. Institutional investors should have a clear policy on how they fulfill their stewardship responsibilities, and publicly disclose it.
2. Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.
3. Institutional investors should monitor investee companies so that they can appropriately fulfill their stewardship responsibilities with an orientation towards the sustainable growth of the companies.
4. Institutional investors should seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with investee companies.
5. Institutional investors should have a clear policy on voting and disclosure of voting activity. The policy on voting should not be comprised only of a mechanical checklist; it should be designed to contribute to the sustainable growth of investee companies.
6. Institutional investors in principle should report periodically on how they fulfill

their stewardship responsibilities, including their voting responsibilities, to their clients and beneficiaries.

7. To contribute positively to the sustainable growth of investee companies, institutional investors should have in-depth knowledge of the investee companies and their business environment and skills and resources needed to appropriately engage with the companies and make proper judgments in fulfilling their stewardship activities.

For more information on Japan's Stewardship Code, please refer to the following website:

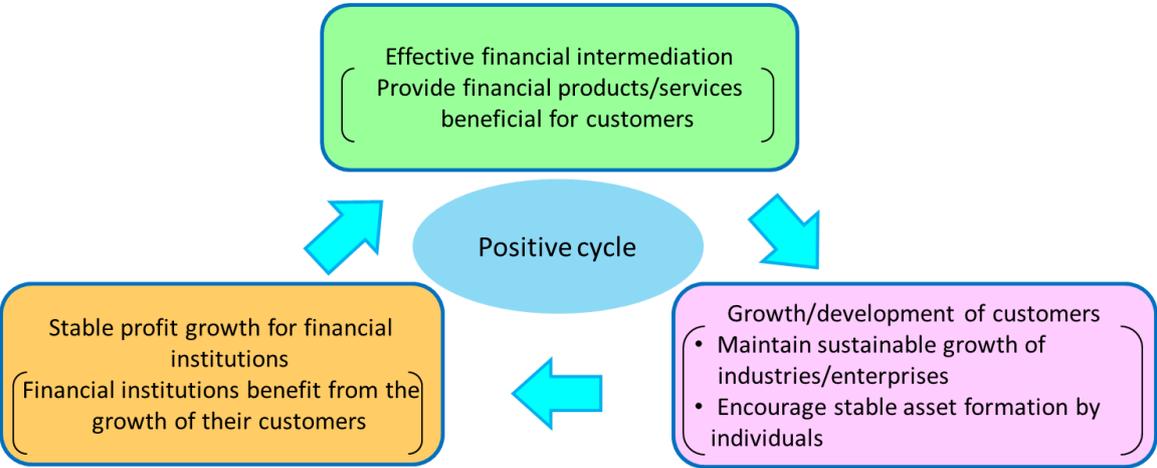
<http://www.fsa.go.jp/en/refer/councils/stewardship/index.html>

iii. Monitoring of Financial Institutions

**Financial Monitoring Policy**

The FSA has been working to improve the quality of Japan’s financial regulations especially since the program year 2007. In the program year 2013, aiming for an in-depth understanding of the condition of financial institutions and the financial system, the FSA published “Financial Monitoring Policy” which includes focus of financial monitoring and measures regarding on-site and off-site monitoring process. The policy is implemented using a principles-based approach as opposed to a rule-based approach.

It is vitally important to give support from the financial sector to the real economy to overcome deflation and to maintain sustainable growth. Building a positive cycle among (i) financial institutions, (ii) their customers, and (iii) economy as a whole is significant. First, the financial institutions engage in financial intermediation in a way that provides financial products and services that are really beneficial for their customers. Second, proper financial products and services supplied to enterprise customers will lead these customers to enjoy sustainable economic growth, and those supplied to individual customers, investors or depositors will encourage stable asset formation. Third, growth or development of customers will bring financial institutions stable profit growth (See the figure below).



A vital prerequisite for effective financial intermediation is that the financial system and individual institutions maintain their soundness. Financial Monitoring Policy describes nine aspects on which the FSA places particular importance in conducting supervision and inspection.

(1) Effective response to the needs of their customers

The FSA will review whether financial institutions provide financial products/services that are really beneficial for their customers, regardless of the level of commission and fees and the customer’s corporate group association. The FSA will

also review the adequacy of financial institutions' governance, including the prevention of abuse of a dominant position of institutions and conflicts of interest between institutions and customers. Financial institutions are encouraged to review current business practice from this perspective and, if necessary, alter the mind-set of their officers and employees or their corporate culture.

(2) Lending based on customers' business potential

With the tough memories of disposing of the non-performing loans in the 1990's and early 2000's, Japanese banks have been unwilling to lend without collateral or personal guarantees of company managers. For the purpose of providing smooth finance to the economy, fighting against deflationary pressure, the FSA will review whether financial institutions provide credits and other services based on appropriate appraisal of their customers' business potential, without depending excessively on collateral, guarantees or superficial financial data on their customers.

(3) Upgrading asset management capacity

To give support from the financial side to the steps being taken to overcome deflation and regenerate the economy, it is important to ensure that the financial assets held by the household sector are managed appropriately, in accordance with the needs of the asset owners. Financial institutions engaging in activities such as product development, sales and asset management are required to fulfill their roles and responsibilities. The FSA will review financial institutions' management approaches, the products and services they provide, and how they assess business performance.

(4) Macro prudence

It is necessary to pay attention to the change in financial markets. The FSA will make an analysis of the impact of the global economy and market trends on the safety and soundness of the Japanese financial system and institutions. With regard to the impact, the FSA will utilize stress testing to identify potential risks in a forward-looking manner, and address them as necessary. Based on these analyses, the FSA will review the risk management framework of individual financial institutions.

(5) Enterprise risk management (ERM) [Micro prudence]

Financial inspection had focused on asset assessment. However, in order to continuously ensure the soundness of overall business management in financial institutions, it is important to identify critical risks and vulnerabilities for financial institutions. The FSA will review the effectiveness of the ERM of each financial institution, including assessment of interest risk in banking account, credit concentration risk and the use of the stress testing.

(6) Sustainability of business model and corporate governance

The FSA will have discussions with financial institutions about the sustainability of their business model in cases where their business environment changes as a result of factors such as decreasing population in Japan. With regard to governance, the FSA will discuss not the nominal matters such as whether they have nominated outside and

independent directors to their boards, but substantial matters such as how their governance system functions.

(7) Ensuring customers' trust/security

Since the financial system is an important element of the economic infrastructure, the FSA will review the effectiveness of internal controls at each financial institution to address the issues of information security, abuse of Internet banking, cyber-attacks, business continuity plans, Anti-Money Laundering and Countering Financing of Terrorism as well as other issues for the security of customers.

(8) Acceleration of recovery from the Great East Japan Earthquake

As the recovery from the Great East Japan Earthquake has advanced, it is important for financial institutions to support the development of industries/enterprises with significant roles in the regions as well as community development in the new financial environment. The FSA will urge financial institutions to support the recovery and continue to address the double loan problem of the disaster-affected people.

(9) Public finance and private finance

The FSA will develop better understanding of the competing and complementary relations between public and private finance through discussions with financial institutions and their customers, to be followed by discussions with relevant stakeholders on how better relations between the public and private financial systems could be established.

The measures for monitoring for the 2014-2015 period are characterized by the following four pillars.

(1) Integration of on-site and off-site monitoring process

Under the common policy, both Supervisory Bureau and Inspection Bureau will work together in close cooperation and mitigate the burden for financial institutions.

(2) Enhancement of constructive dialogues between the FSA and financial sector

The FSA will continue constructive and interactive dialogues with financial institutions. The FSA will give importance to exchanges of views that stimulate improvements in business management, rather than just compliance with regulations.

(3) Enhanced international cooperation

The FSA will participate more actively in the discussion on the international financial regulatory reforms, and make its supervision more effective and efficient through enhanced cooperation with foreign authorities.

(4) Enhancement of dialogues with stakeholders of financial institutions

The FSA will exchange views widely with stakeholders of financial institutions aiming to understand and analyze financial institutions from a variety of angles.

For more information on Financial Monitoring Policy for 2014-2015, please refer to the following: <http://www.fsa.go.jp/en/news/2014/20141225-1.html>

## **Financial Monitoring Report**

In order to encourage every financial institution to adopt the best practice and to foster the sound development of the financial system and financial markets, the FSA compiled and published “Financial Monitoring Report” starting from the program year 2013. This report contains results and issues identified through financial monitoring (See paragraph 56 in Chapter IV of this document for more information).

#### iv. Growing together with Asia

##### **Support for developing the financial infrastructure in Asia**

In recent years, Japanese companies and financial institutions have accelerated their business expansion in Asia. As a result, it has been increasingly necessary for them to receive governmental support for their entry into the Asian markets through the financial infrastructure development. The “Japan Revitalization Strategy - JAPAN is BACK” (Cabinet decision: June 14, 2013) includes promoting the development of the financial infrastructure in Asia. “Japan Revitalization Strategy (Revised in 2014) - Japan’s challenge for the future” (Cabinet decision: June 24, 2014) also mentions measures “to promote the organizational fortification to support the activities of Japanese financial institutions in Asia in order to improve the business environment for Japanese companies and financial institutions operating in Asian countries.”

Through financial consultations with the financial supervisory authorities in Asian countries, the FSA has been actively engaged in concluding a Memorandum of Understanding (MOU) and Exchanges of Letters (EOL) for financial technical cooperation, etc. to build a long-term framework for cooperation.

##### **Box: Signing of MOU / EOL with Asian Countries (As of June 2015)**

October 2013	Financial Services Authority of Indonesia (EOL)
January 2014	Financial Regulatory Commission of Mongolia (EOL)
January 2014	Ministry of Finance of Myanmar (MOU)
February 2014	Securities and Exchange Commission Thailand (EOL)
March 2014	State Securities Commission of Vietnam (EOL)
May 2014	Bank of Thailand (EOL)
June 2014	Insurance Supervisory Authority of the Ministry of Finance of Vietnam (EOL)
June 2014	State Bank of Vietnam (EOL)
June 2014	Financial Services Authority of Indonesia (EOL)
June 2014	Bank of Mongolia (EOL)
July 2014	Ministry of Finance Thailand (EOL)
August 2014	Office of Insurance Commission of Thailand (EOL)
December 2014	Bangko Sentral ng Pilipinas (EOL)
June 2015	National Bank of Cambodia (EOL)
June 2015	Securities and Exchange Commission of Cambodia (EOL)

Based on the MOU / EOL, the FSA has run seminars in Japan or the partner countries and received the delegations in Japan, etc., thereby formulating and implementing concrete cooperative projects such as assisting the development of the

legal and regulatory systems and sharing expertise and experiences pertaining to the financial administration with Asian countries, while fully taking their needs into consideration. The FSA has proactively pushed forward such technical cooperation for financial infrastructure development in partnership with relevant organizations. In doing so, the FSA has further strengthened the relationships with the financial authorities in each country and significantly contributed to the financial sector development of Asian countries.

A number of consultations have been held to reinforce the ties with the financial authorities in Asia in FY 2014. The FSA had top-level bilateral meetings with the counterparts of Indonesia (June 2014/January 2015), Thailand (August/October/December 2014 and March 2015), Vietnam (June 2014), Myanmar (April/June/August/November/December 2014 and January/February 2015), and Mongolia (May/July 2014 and March 2015) to exchange views on the enhanced partnership in the arena of financial sector supervision.

Multilateral talks went along with the above-mentioned bilateral efforts. Japan hosted meetings of the Financial Stability Board Regional Consultative Group for Asia (co-chaired by the FSA), as well as the Asia-Pacific Regional Committee of the International Organization of Securities Commissions. The FSA played a leading role in promoting information sharing and enhancing cooperation on various issues related to the financial system in the Asian region and on countermeasures for them.

Moreover, since it has become increasingly important to achieve the sound development of the financial system in emerging Asian countries that have close relations with Japan in order to enhance the stability of the international financial system, including Japan, the FSA held seminars for government officials responsible for financial administration in emerging Asian countries, which would lead to the improvement of supervisory capabilities in the banking, securities, and insurance sectors there.

## **The Asian Financial Partnership Center**

### **(1) Main objectives and activities of the Asian Financial Partnership Center**

The FSA established the Asian Financial PARTnership Center (“AFPAC”) on April 30, 2014, to address the issues related to the financial markets in Asia, to review our financial sector technical assistance for infrastructure development, and to further strengthen cooperative relationships with Asian financial authorities.

The AFPAC invites government officials from Asian financial authorities as visiting fellows and offers training programs tailored to the areas of interest of each visiting fellow. The outcomes of the programs are expected to be disseminated at seminars/symposiums and to be utilized for financial infrastructure development in Asia and contribution towards global financial regulatory reforms.

Through offering the programs, the AFPAC aims to build stronger networks with Asian financial authorities.

## (2) Details of the activities

Since July 2014, 22 officials from Cambodia, Mongolia, Myanmar, Thailand and Vietnam have participated in the program as visiting fellows and student interns.

The visiting fellows attended basic lectures on the FSA's organizational structure, financial regulatory framework and supervisory practices and visited other relevant organizations. Some of the visiting fellows also visited regional areas and exchanged views with regional financial institutions on their business strategies in Asia and on the outlook of the regional economy.

In addition, the visiting fellows undertook customized sessions at relevant divisions of the FSA, focusing on respective areas of interest, such as supervisory and inspection practices, market surveillance and fraud investigation practices.

During their stays, they made interim presentations on their home organizational structures, financial regulatory frameworks, and details of their areas of interest. At the end of the program, they delivered final presentations on their outcomes of the program; what they learned, how they would utilize the learnings, and the challenges that may lie ahead.

Some of the visiting fellows spoke at international symposiums held in Japan and made presentations on issues related to the financial sectors of their countries. On October 30, 2014, a visiting fellow from the State Bank of Vietnam participated in a symposium entitled "Financial Activity of Households and SME Financing in the Regional Economy." He made a presentation on SME activities and financing in Vietnam, and described the current status of Vietnamese SMEs and challenges in supporting their development. On January 23, 2015, a visiting fellow from the Securities and Exchange Commission of Thailand also spoke at a symposium entitled "ADB-Japan-OECD High-level Global Symposium: Promoting Better Lifetime Planning through Financial Education." She delivered her presentation on the Thai SEC's measures to promote access to the capital market.

Through the program, the visiting fellows are expected to acquire knowledge, enhance understanding, and develop expertise in areas of their interests, eventually contributing to the development of the financial systems in their home countries.

## IV. Policy Developments

### i. Overview

The FSA adopted several important policy measures during the program year 2013 (July 1, 2013 to June 30, 2014). The policy measures contain updating rules and regulations to establish fair, transparent, and vibrant markets, improving of inspection and supervision, and contributing to international discussions between financial regulators.

<b>Policy Measures for the Establishment of Fair, Transparent, and Vibrant Markets</b>
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- |   |
|---|
| <ul style="list-style-type: none"><li>- Revising the Act for Partial Revision of the Financial Instruments and Exchange Act, etc. and relevant Cabinet Orders and Cabinet Office Ordinances</li><li>- Improving disclosure system, financial tax system, and other systems related to financial markets</li><li>- Developing regulatory and institutional reforms</li></ul> |
|---|

<b>Inspection and Supervision</b>
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Promoting the financial institutions

- |   |
|---|
| <ul style="list-style-type: none"><li>- to play appropriate roles as financial intermediaries so that funds are supplied smoothly</li><li>- to make efforts to manage risks and maintain the stability of the financial system</li><li>- to protect customers and improve their convenience</li></ul> |
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<b>Trends in the Development of International Relations</b>
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- |   |
|---|
| <ul style="list-style-type: none"><li>- Actively contributing to global financial regulatory reform</li><li>- Making efforts to provide financial sector technical assistance to other Asian countries for their development of financial infrastructures</li></ul> |
|---|

## ii. Establishment of Fair, Transparent, and Vibrant Markets

### a. The Act for Partial Revision of the Financial Instruments and Exchange Act, etc. (enacted on May 23, 2014)

#### 1. Aim of the amendment

The “Act for Partial Revision of the Financial Instruments and Exchange Act, etc.” was enacted on May 23, 2014 and promulgated on May 30, 2014. The FSA developed comprehensive measures to improve the attractiveness of financial and capital markets in Japan, including measures to allocate households assets into growing businesses, and accelerate and strengthen the growth strategy from a financial aspect, for the revitalization of the Japanese economy. Specifically, the amendment aimed at (i) promoting the provision of risk money to emerging and growing companies; (ii) promoting new listings and facilitating financing by listed companies; and (iii) improving market reliability.

#### 2. Review of regulations relating to the financing of listed companies

(1) With regard to the submission of an annual securities report containing false statements, persons who disposed of the relevant securities are added as parties who may claim damages in relation to such false statements. Furthermore, in relation to submitter’s liability for such damage, in the case where the submitter certifies that he/she had no intention or negligence, he/she is not liable for the damage.

(2) In the case where the legal submission deadline for a reference document is stated in the shelf registration statement and the reference document is submitted by the deadline, it is not necessary to submit an amended shelf registration statement.

(3) The number of treasury shares is exempted from the total number of shares that serves as a basis to judge necessity for submission of large shareholding reports.

(4) Matters relating to recipients of small numbers of shares are excluded from the matters that must be included in short-term large volume transfer reports.

(5) In the case where a new cause for submission occurs by the day before the filing date of the large shareholding report or change report, the additional change report relating to the new cause for submission needs to be submitted within five business days from the date on which the new cause for submission occurred, instead of simultaneously submitting with the large shareholding report or change report (simultaneous submission of a

change report in this case was a statutory requirement before this amendment).

- (6) In the case where a large shareholding report or change report is submitted through the EDINET, the filer of such report is not required to send a copy of the report to the issuer of shares relating to such report.
3. Regulatory revisions relating to financial instruments business operators dealing with financing through the Internet
    - (1) When dealing in the offering of unlisted securities etc. via electronic means (i.e. via the Internet), financial instruments business operators are required to make the information that has material impact on investors' decisions, out of the information to be included in the documents to be delivered prior to the conclusion of a contract, accessible to investors via the Internet.
    - (2) In the case where, out of Type I or Type II financial instruments business, a financial instruments business that deals in the offering of unlisted securities etc. via electronic means, meets the requirements such as the limitation on the issuance price, the requirements for the registration as Type I or Type II financial instruments business operators are partially eased.
  4. Review of regulations on financial instruments business operators
    - (1) In the case where a financial instruments business operator provides a notification of abolishment of business during a period from the date when the financial instruments business operator was notified a rescission of its business until the date when its disposition is determined, the FSA will reject any application for registration unless five years have passed since the notification date.
    - (2) Financial instruments business operators are required to develop a business management system in order to optimally carry out the financial instruments business.
    - (3) The application for registration of Type I financial instruments business, Type II financial instruments business or investment management business by a person who does not have any office in Japan, will be rejected.
    - (4) In the case where a person intends to engage in Type I financial instruments business, Type II financial instruments business, investment management business or registered financial institution business, the registration for such businesses by the person who does not participate in a financial instruments firms association nor prepare any internal rules pursuant to the association rules, will be rejected.

- (5) Financial instruments business operators engaging in Type II financial instruments business are prohibited from soliciting an investment fund, when knowing that the money contributed to the investment fund is used for other than the intended purposes.
5. Review of business year regulations

The business year for financial instruments business operator engaging in Type I financial instruments business, shall be during one year from the date on which the financial instruments business operator selects from the first day of any month.
6. Review of the scope of Tradable Securities

Unlisted securities, of which their liquidity is deemed to be limited under the rules of Authorized Association, are excluded from the scope of Tradable Securities.
7. Addition of services that may be performed by financial instruments exchanges

Specification of identifier for parties engaging in financial instruments transactions (excluding those conducted in the financial instruments exchange markets) is included in the business scope of financial instruments exchanges under the approval by the Prime Minister.
8. Development of regulatory framework related to financial benchmarks
  - (1) Introduction of the designating system for administrators of specified financial benchmarks
    - A. The Prime Minister will designate “specified financial benchmark” as a financial benchmark, which may have a significant impact on Japanese capital markets when its credibility declines.
    - B. When the Prime Minister recognizes that it is necessary to ensure appropriate performance of the person who engages in specified financial benchmark administration for the public interest and protection of investors, the Prime Minister may designate the person as a “specified financial benchmark administrator.” The FSA will improve regulations regarding the duty to file notifications and documents for the designated specified financial benchmark administrator.
    - C. Specified financial benchmark administrators are required to establish operational rules relating to specified financial benchmark administrators computation operations and obtain the approval of the Prime Minister. Upon receipt of the approval, specified financial

benchmark administrators are required to perform their duties in accordance with the provisions of the operational regulations.

- D. When a specified financial benchmark administrator intends to suspend or abolish specified financial benchmark administrators computation operations, they are required to notify the Prime Minister in advance, to that effect.
- E. The FSA will formulate the required provisions on the specified financial benchmark administrators computation operation relating to requests for reports, on-site inspection, order for improvement, order for business suspension and supervision of recommendations of business relocation.

- (2) Prohibition of providing incorrect basic information for computation by financial instruments business operators

Financial instruments business operators and/or its officers/employees shall not provide any basic information for computation with no good ground to the person computing specified financial indicators, for the purpose of achieving their own or a third party's interests.

- 9. Review of the regulations associated with new listing

The exemption from an obligation to audit internal control reports includes the case where a company submits its internal control report during the period of three years from the date on which the company became an issuer of listed securities.

- 10. Development of forfeiture procedures for intangible property

With regard to the forfeiture procedures for property acquired by a criminal using unfair trading (insider trading or market manipulation) or as compensation for loss, the FSA will formulate the provision in the case that the property subject to forfeiture is intangible.

- 11. Enforcement date

This Act comes into effect from the date specified by a Cabinet Order within a period not exceeding one year from the date of promulgation. However, the cases listed below are excluded.

- (1) The provisions relating to additional operations of financial instruments exchanges come into effect as from the date of promulgation.
- (2) The provisions relating to the review of business year regulations and the development of forfeiture procedures for intangible property come into force as from the date specified by a Cabinet Order within a period not exceeding six months from the date of promulgation.

- b. Formulation of the relevant Cabinet Orders and Cabinet Office Ordinances pursuant to the partial enforcement of the Act for Partial Revision of the Financial Instruments and Exchange Act, etc. (Law No. 45, 2013)

12. Aim of the amendment

The legislative bill for the Act for Partial Revision of the Financial Instruments and Exchange Act, etc. was established on June 12, 2013 and promulgated on June 19, 2013. This Act aims to formulate provisions to address market-oriented financial crisis, recover the reliability of financial business and enhance financial and capital markets, leveraging the lessons of the recent financial crisis.

The details of the amendment include measures related to (i) the handling of suspicious transactions on the basis of cases of insider trading related to the public offering of shares; (ii) the review of asset management regulations based on the AIJ case<sup>1</sup>, (iii) the establishment of measures for orderly resolution of assets and liabilities of financial institutions, etc. for ensuring financial system stability; (iv) the enhancement of quasi-capital fund supplies by banks; and (v) the diversification of financing and capital policy means by investment corporations.

In response to this amendment, the FSA formulated the related Cabinet Orders and Cabinet Office Ordinances with respect to the parts that come into force within 20 days, nine months, one year or one and a half years after promulgation.

13. Formulation of the relevant Cabinet Order that comes into effect within 20 days after promulgation

As a review of asset management regulations based on the AIJ case in response to the amendment of the Act, the FSA strengthened the penalty for false statements in investment reports made by discretionary investment management business operators. Accordingly, the FSA formulated the required provisions of the Cabinet Order (promulgated on July 3, 2013, enforced on July 9, 2013).

14. Formulation of the relevant Cabinet Order that comes into effect within nine months after promulgation

By the amendment of the Act, the FSA established measures for orderly resolution of assets and liabilities of financial institutions, etc. for ensuring

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<sup>1</sup> AIJ Investment Advisors Co., Ltd. (AIJ) engaged in investment advisory business, with its main office headquartered in Tokyo. AIJ used fraudulent means for the purpose of concluding discretionary pension fund management agreements, etc., causing serious damage to its clients and overall investor confidence in the market intermediary function of financial instruments business operators. On March 23, 2012, the FSA cancelled the registration of AIJ.

financial system stability. Accordingly, the FSA formulated the required provisions of the relevant Cabinet Order and the Cabinet Office Ordinance (promulgated on March 5, 2014 and enforced on March 6, 2014).

15. Formulation of the relevant Cabinet Order that comes into effect within one year after promulgation

(1) Handling of suspicious transactions on the basis of the cases of insider trading related to the public offering of shares

As a response in light of public offering insider trading cases, the FSA introduced restrictions on information transmission and trading recommendations by corporate insiders, and added such behavior to the Administrative Monetary Penalties. Accordingly, the FSA specified the computation method of the amount of penalty charges in the relevant Cabinet Order and the Cabinet Office Ordinance (Decree: promulgated on January 24, 2014 and enforced on April 1, 2014; Cabinet Office Ordinance: promulgated on February 14, 2014 and enforced on April 1, 2014).

(2) Introduction of insider trading regulations to investment corporations

The FSA enlarged the scope of the insider trading regulations by including transactions of investment securities issued by a listed investment corporation, and also added asset management companies to the scope of “company insiders” (i.e. insider). Accordingly, the FSA specified the important matters related to the operations of listed investment corporations in the Order for Enforcement of the Financial Instruments and Exchange Act. In addition, the FSA also specified the matters with a material influence on investors’ investment decisions in the Cabinet Office Ordinance on Restrictions securities Transactions etc. (Order: promulgated on January 24, 2014 and enforced on April 1, 2014; Cabinet Office Ordinance: promulgated on February 14, 2014 and enforced on April 1, 2014).

(3) New establishment of obligation on foreign bank branches to hold assets in Japan

The FSA imposed on foreign bank branches the obligation to hold assets corresponding to a capital contribution in Japan. The FSA designated in the Order for Enforcement of the Banking Act the type of assets to be held in Japan and the minimum value of assets (JPY 2 billion) to be held in Japan corresponding to a capital contribution (promulgated on January 24, 2014 and enforced on April 1, 2014).

(4) Review of regulations on the scope of subsidiaries’ operations in respect of overseas acquisition

Only in the case of acquisition of an overseas business entity by a

bank, the FSA allowed the acquiring bank to hold the overseas business entity's subsidiary (subsidiaries) other than those eligible for the acquiring bank's subsidiary (subsidiaries) for five years, and also allowed extending the holding period by one year in cases where it is difficult to exclude the relevant non-eligible subsidiary (subsidiaries) from the scope of subsidiaries within five years from the acquisition. Accordingly, the FSA specified the necessary procedures in the Ordinance for Enforcement of the Banking Act (promulgated on March 31, 2014 and enforced on April 1, 2014).

(5) Enhancement of quasi-capital fund supplies by banks

A. The FSA allowed a bank to hold through its investment subsidiary voting rights in excess of 5% of a business entity which is acknowledged to contribute to the activation of the region. Specific provisions regarding "business entities that are acknowledged to contribute to the activation of the region" were made in the Order for Enforcement of the Banking Act (promulgated on March 31, 2014 and enforced on April 1, 2014).

B. The FSA allowed a bank itself to directly hold the voting rights of a corporate revitalization operator. In addition, the FSA also specified the detailed requirements on corporate revitalization operators whose voting rights may be held by banks in the Ordinance for Enforcement of the Banking Act. Furthermore, the FSA expanded the scope of venture business companies whose voting rights may be held by banks through its investment subsidiary (promulgated on March 31, 2014 and enforced on April 1, 2014).

(6) Prior notification of appointment and retirement of bank directors

The FSA regulated in the Ordinance for Enforcement of the Banking Act that the appointment and resignation or retirement of directors, executive officers, corporate auditors and accounting auditors needs to be notified in advance to the FSA (promulgated on March 31, 2014 and enforced on April 1, 2014).

16. Development of the relevant Cabinet Order that comes into effect within one and a half years after promulgation

The FSA formulated the provisions as listed below with regard to the Cabinet Order relating to the review of the regulations on investment trusts and investment corporations (promulgated on July 2, 2014 and enforced on December 1, 2014).

(1) Investment Trusts

A. Review of the scope that requires written resolution due to a change in

basic terms and conditions of or consolidation of investment trusts

In the event of the consolidation of investment trusts, if the impact on the interests of the beneficiaries is insignificant, a written resolution is not required. Accordingly, the FSA specified the minimal standard criteria in the Ordinance for Enforcement of the Act on Investment Trusts and Investment Corporations (hereinafter, the “Ordinance for Enforcement of Investment Trusts Act”).

B. Review of investment reports

The FSA imposed on investment trust management companies the obligation to prepare and deliver written documents containing important matters to be described in investment reports, which may be delivered via electronic means. Accordingly, the FSA formulated the necessary provisions of the Ordinance for Enforcement of the Investment Trusts Act and the Ordinance on Accountings of Investment Trust Property (description items of the documents and the method of delivery of investment reports via electronic means).

C. Acceptance of compensation for losses in MRF

The FSA allowed investment trust management companies to compensate for losses that are incurred on the principal of an investment trust subject to use of securities settlement. Accordingly, the FSA specified the investment trusts (MRF) subject to compensation for loss in the Cabinet Office Ordinance on Financial Instruments Business, etc.

D. Introduction of regulations on credit risk

The FSA prohibited investment trust management companies from going against the rational methods for properly managing the credit risk of their investment assets, the methods which are predetermined individually by themselves.

E. Development related to deemed annual securities report system

The FSA introduced a system that deems documents describing subscription requirements as a securities registration statement in the case where these documents are submitted in conjunction with the annual securities report. Accordingly, the FSA formulated the necessary provisions, for example, the designation of “Beneficiary Certificate of an Investment Trust” as securities that are subject to the system.

F. Formulation of transfer procedures in respect of consolidation of investment trusts

In response to the expected increase of the investment trusts consolidation following the relaxation of the requirements regarding

the consolidation of investment trusts due to the amendment of the Act, the FSA formulated the necessary provisions related to the recording procedures of the consolidation of investment trusts in the Order for Enforcement of the Act on Book-Entry Transfer of Company Bonds, Shares, etc.

(2) Investment Corporation

A. Diversification of financing sources

The FSA established a system related to investment equity subscription rights and relaxed the prohibition on an investment corporation's acquisition of its own investment equity. Accordingly, the FSA formulated the rules on accounting treatment and other necessary provisions.

B. Review of the restriction on holding the majority of voting rights to facilitate the acquisition of overseas real estate

With regard to the majority acquisition of shares of other investment corporations that had been prohibited to investment corporations, the FSA allowed investment corporations to acquire a majority of shares of a corporation holding overseas real estate. Accordingly, the FSA formulated the provisions regarding the cases where an investment corporation is allowed to hold a majority of shares of other investment corporation(s) (the cases where they are not allowed to engage in real estate transactions pursuant to the provisions of foreign laws and regulations, overseas practices or other unavoidable reasons) in the Order for Enforcement of the Act on Investment Trust and Investment Corporations etc. and other rules.

C. Imposition of obligation of obtaining a prior approval for a transaction with an interested person from the Board of Officers

With regard to a real estate transaction executed between an investment corporation and the interested person(s) of the asset management company, the FSA imposed on investment corporations the obligation to obtain a prior approval for such transaction from the Board of Officers, except for those with a minor influence on the assets of the investment corporation. Accordingly, the FSA specified the insignificance criteria (the value of real estate property that will be acquired or transferred is less than 10% of the book values of fixed assets as of the final date of the previous business period of the Investment Corporation) in the Ordinance for Enforcement of Investment Trusts Act.

D. Establishment of investment equity subscription rights

Investment equity subscription rights were established as a result of the

amendment of the Act. Accordingly, the FSA formulated the necessary provisions related to the transfer procedures of the relevant rights in the Order for Enforcement of the Act on Book-Entry Transfer of Company Bonds, Shares, etc.

- c. Formulation of the relevant Cabinet Orders and Cabinet Office Ordinances pursuant to the partial enforcement of the Act for Partial Revision of the Financial Instruments and Exchange Act, etc. (Law No. 86, 2012)

17. Aim of the amendment

The “Act for Partial Revision of the Financial Instruments and Exchange Act, etc.” was established on September 6, 2012 and promulgated on September 12, 2012. Based on the changes in circumstances surrounding the capital market, this amendment aims at enhancing the international competitiveness of Japan’s markets and achieving fair and transparent transactions of financial instruments. In response to this amendment, the FSA formulated the necessary provisions of the Cabinet Orders and Cabinet Office Ordinances regarding the relevant parts that are supposed to be enforced within one year after promulgation of the amended Act.

In addition, the FSA formulated the necessary provisions of the Cabinet Orders and Cabinet Office Ordinances regarding the relevant parts (related to comprehensive exchange) that are supposed to be enforced within one and a half years after promulgation of the amended Act.

18. Development of the relevant Cabinet Order and the Cabinet Office Ordinance that comes into effect within one year after the promulgation (promulgated on September 4, 2013 and enforced on September 6, 2013)

(1) Pursuant to the amended Act, the FSA developed the systems as described below.

A. Review of the administrative monetary penalty system: the FSA enlarged the scope of penalty imposed by including: (i) an external party’s assistance for the submission of disclosure documents with false statements by the disclosing company; and (ii) unfair transactions by a person other than financial instruments business operators on account of another person. In addition, a provision was added to allow the authority to order offenders to appear for the investigation related to an administrative monetary penalty.

B. Review of the regulation on insider trading: the FSA included inheritance of regulated securities of listed companies by merger or demerger in the scope subject to the regulation on insider trading. In addition, the FSA introduced the exclusion provisions regarding inheritance of regulated securities in the case of an extremely low portion of inherited assets in the regulated securities due to merger.

(2) In response to these approaches, the FSA took the following measures on the related Cabinet Order and Cabinet Office Ordinance.

A. The FSA specified the detailed calculation method of the amount of

administrative monetary penalty charges in relation to the items which became subject to the administrative monetary penalty under the amended Act. In addition, the FSA specified the procedure of delivery or dispatch of a written order to appear against offenders.

- B. The FSA designated the percentage as less than 20% as to the low portion of inherited assets in the regulated securities due to merger.
- C. The FSA also reviewed announcement measures relating to a tender offer performed by a person other than an issuer as well as the insignificance criteria of important facts relating to a pure holding company.

19. Amendment of the relevant Cabinet Order and the Cabinet Office Ordinance (related to comprehensive exchange; excluding the matters related to the behavior regulations<sup>2</sup>) that comes into effect within one and a half years after promulgation (promulgated on February 26, 2014 and enforced on March 11, 2014)

(1) Pursuant to the amended Act, the FSA developed the systems as described below.

- A. Commodity derivatives transactions may be traded on financial instruments exchanges. In addition, commodity derivatives transactions on a “comprehensive exchange” are thoroughly supervised by the FSA, under the Financial Instruments and Exchange Act.
- B. In light of preventing adverse effects on the “production and distribution of goods,” the FSA achieved consultation and cooperation with the Ministry of Economy, Trade and Industry and the Ministry of Agriculture, Forestry and Fisheries.
- C. The FSA developed the system in which intermediaries and clearing organizations are able to trade and to process securities, financial derivatives and commodity derivatives comprehensively.

(2) In response to these approaches, the FSA took the following measures on the related Cabinet Order and Cabinet Office Ordinance.

- A. The FSA specified that “commodities” serving as “financial instruments” is designated through discussions between the Commissioner of the FSA and each minister having jurisdiction over the commodity markets.
- B. The FSA specified the amount of minimum capital at JPY 500 million for a financial instruments clearing organization engaging in financial

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<sup>2</sup> The FSA continued to examine the provisions relating to the behavior regulations on financial instruments business operators, including the invitation procedure of public comment from May 30, 2014 to June 30, 2014.

instruments debt assumption service solely on commodity-related market derivative transactions.

- C. The FSA made required revisions with regard to the provisions relating to administrative monetary penalties due to the addition of commodity related market derivatives transactions.
- D. Provisions regarding matters consulted with each minister having jurisdiction over the commodity markets
- E. Designation of the scope of customer assets related to commodity-related market derivatives transactions
- F. Provisions regarding classification management of securities and money related to commodity-related market derivatives transactions
- G. Provisions regarding books and documents related to commodity-related market derivatives transactions
- H. The FSA included holdings of government bonds in the separate management method of clearing margin by financial instruments exchanges and clearing organizations

d. Improvement and management of disclosure systems

20. Development of disclosure systems

Based on the practices of securities trading and demands of investors and issuers, the FSA has developed the disclosure systems in light of making them investor friendly and requiring issuers to disclose investment information that is truly necessary for investors. In addition the FSA considers it important to reflect the practices of securities trading and demands of investors and issuers.

Specifically, the FSA developed the systems as described below.

21. Exemption granted to foreign companies from the obligation to submit annual securities reports

Reflecting deregulation requests, the FSA amended the “Order for Enforcement of the Financial Instruments and Exchange Act” and “Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc.” The main amendments are as follows (promulgated and enforced on August 26, 2013).

- (1) As is the case with domestic companies, when the number of shareholders of a foreign company in Japan has been less than 300 for five successive years, the foreign company may apply to be exempted from the obligation to submit annual securities reports.
- (2) The FSA corrected the discrepancy between the scope of issuer and related parties subject to the secondary distribution of securities and the scope of issuer and related parties who are required to submit securities notification statements and prepare a prospectus.
- (3) With regard to quarterly reports to be prepared by foreign companies, in the case where a foreign company requests approval to extend a deadline for submission of quarterly reports on the ground of foreign laws, regulations and practices, the FSA rationalized its approval for the extension of the deadline for the submission of all quarterly reports so that it will be applicable to the subsequent submissions by such foreign company until the laws, regulations and practices in issue are extinguished or changed.

22. Review of reasons for the submission of extraordinary report on regulated securities

In response to the Act for Partial Revision of the Financial Instruments and Exchange Act, etc. (law No. 45, 2013), the FSA introduced regulations on insider trading regarding the transactions of investment securities issued by an investment corporation. This amended Act brought about revisions to the “Cabinet Office Ordinance on Disclosure of Information, etc. of Regulated Securities.” Specifically, the FSA added the following grounds for the

submission of an extraordinary report on regulated securities (including investment securities) for the extraordinary report (promulgated on February 14, 2014 and enforced on April 1, 2014).

- (1) Determination of change in major subsidiary or affiliate
- (2) Material change in management structure of an investment fund regarding the investment trust securities
- (3) Material disaster
- (4) Filing or resolution of lawsuit
- (5) Approval of the Board of Officers regarding merger of investment corporations
- (6) Notification of consolidation of domestic or foreign investment trusts
- (7) Petition for bankruptcy proceedings
- (8) Likelihood of uncollectible or delayed accounts receivable due to dishonored checks
- (9) Occurrence of events with a significant effect on financial condition
- (10) Dispositions including rescission of registration or suspension of business
- (11) Dissolution or decision of proposal to dissolve

23. Development of disclosure regulations in relation to the revisions of the regulations on investment trusts and investment corporations

Based on the final report issued by the “Working Group on Review of Investment Trust and Investment Corporation System” (the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council) published on December 12, 2012, the FSA amended the “Order for Enforcement of the Financial Instruments and Exchange Act” and the “Cabinet Office Ordinance on Disclosure of Information, etc. of Regulated Securities.” The main amendments are as follows (promulgated on July 2, 2014 and enforced on December 1, 2014).

- (1) In response to the amendment of the Financial Instruments and Exchange Act, the FSA introduced a system that deems a document describing only “securities information” (documents describing matters regarding subscription) as a securities registration statement in the case where such a document is submitted together with the annual securities report. Accordingly, the FSA designated “investment trust beneficiary securities” as securities subject to this new system.
- (2) In relation to a substitution report system, the rules of the Financial Instruments Firms Association were designated as the rules similar to the “rules of financial instruments exchanges.”
- (3) Requirement to include information regarding the services to be provided in consideration for sales commissions and trust fees as well as investment

risk involved using a chart for the comparison of the net asset value with other representative investment assets in securities registration statement and prospectus was introduced.

- (4) In the case where a trustee issuing beneficiary certificates is an annual securities report submitting company, the trustee is no longer required to describe the financial statements in the column of “trustee information” of a securities registration statement, but instead, it is satisfactory to include in such column that the trustee submitted the ongoing disclosure documents.

24. Review of joint operating money trusts with compensation agreement on losses in principal

The issue date as securities of beneficiary interest regarding a joint operating money trust with compensation agreement on losses in principal (so-called “self-benefit trust”) was changed from “effective date of joint operating money trust” to “transfer date of beneficiary interest” as in the case of an ordinary self-benefit trust. In addition, the Trust Business Act is applicable to the agency and/or brokerage services related to the conclusion of the trust agreement (promulgated on March 24, 2014 and enforced on April 1, 2014).

25. Management of disclosure systems

With regard to disclosure documents submitted by companies, it is important to ensure that information necessary for investment judgment by investors is disclosed properly in an easy-to-understand and investor-friendly manner without giving a misleading description. For this reason, the FSA, together with each local finance bureau, has conducted a review of disclosure documents submitted and taken appropriate measures on violations.

26. Review of disclosure documents

(1) Review of annual securities reports

In order to ensure the adequacy of the information contained in the annual securities reports, the FSA conducted the following reviews and published the results.

- i) Review of the compliance by each company with the newly applied disclosure regulations and accounting standards.
- ii) Focused review of selected companies in accordance with the priority issues.
- iii) Focused review based on timely disclosure or information provided to the FSA.

In addition, based on the on-going focused review of annual securities

reports, the FSA announced the matters that need to be addressed in annual securities reports (FY 2014). Furthermore, the FSA published the plan to review annual securities reports for FY 2014.

(2) Review of other disclosure documents

Each local finance bureau has checked disclosure documents other than annual securities reports at the time of receipt to ensure proper disclosure. For example, each local finance bureau checked the appropriateness of the description on securities registration statements submitted by listed companies in the case of large-scale third party allotment of shares and on tender offer notifications submitted by tender offerors, and required the submitting companies to correct the description, if necessary.

27. Decision on commencement of trial procedures regarding administrative monetary penalty payment orders

The FSA made a decision to commence trial procedures regarding administrative monetary penalty payment orders imposed on issuers that submitted disclosure documents containing a false statement on important matters with the aim of preventing violations adequately and ensuring the effectiveness of the regulations.

28. Issuance of warnings to those engaging in soliciting the securities without giving notification

In recent years, mostly elderly people have been targeted for solicitation, in particular, for “unlisted stocks,” “private placement bonds” and “investment funds.” There were some cases where, despite the necessity to file securities registration statements to meet the requirement of offering for subscription of the securities, the violators engaged in soliciting the securities without complying with the procedures.

For this reason, the FSA issued warnings based on Guideline for the Disclosure of Corporate Affairs to those who were found to engage in such solicitation without notification. The FSA encouraged the issuers to correct their behaviors and also urged the investors to take precautions.

In the program year 2013, the FSA issued one warning.

e. Development of systems related to financial market

29. Necessary measures relating to the establishment of an infrastructure fund market (not yet promulgated)

Japan Exchange Group, Inc. planned to establish a market for listing infrastructure funds in the legal form of an investment corporation and investment trust. Accordingly, the FSA announced a legal revision regarding the addition of infrastructure assets (renewable energy power generation facilities and right to operate public facility etc.) to the specified assets (assets that may be mainly invested in by investment corporations and investment trusts) on June 6, 2014 (scheduled to be promulgated and enforced on September 3, 2014).

30. Review of a price disclosure system regarding transactions outside financial instruments exchange markets using proprietary trading systems (PTS) (not yet promulgated)

With regard to reporting related to trading outside financial instruments exchange markets, the FSA formulated an amendment of the Cabinet Office Ordinance in order not to require real-time reporting of individual stock prices by PTS operators (within five minutes), which was published on May 27, 2014<sup>3</sup> (scheduled to be promulgated on July 14, 2014, and enforced on September 5, 2016).

This amendment is to be performed in order to reduce the workload of PTS operators and the Japan Securities Dealers Association (JSDA) that will receive and announce the prices.

31. Disclosure of Proposed Cabinet Order and Cabinet Office Ordinance Regarding the Review of Specially Permitted Businesses for Qualified Institutional Investor, etc.

The FSA formulated proposed revisions of Order for Enforcement of the Financial Instruments and Exchange Act and Cabinet Office Ordinance on Financial Instruments Business, etc., to the effect that the scope of investors to which those engaging in specially permitted businesses for qualified institutional investor, etc. may sell investment funds will be changed from the current “One or more qualified institutional investors + 49 or less non-qualified institutional investors” to “One or more qualified institutional investors + 49 or less persons acknowledged to have certain investment decision capabilities.”

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<sup>3</sup> The JSDA also reviewed the self-regulatory rules for trading outside financial instruments exchange markets. The new rules require PTS operators to disclose individual stock prices in real time (within five minutes) using the system of the JSDA. In addition, information regarding PTS will also be available in real time through the website of the JSDA in the same manner as before.

The proposal was published on May 14, 2014<sup>4</sup>.

32. Expansion of central clearing obligation

The “Act for Partial Revision of the Financial Instruments and Exchange Act, etc.” that was established in May 2010 (hereinafter, “Amended FIEA 2010”) introduced the central clearing obligation (enforced in November 2012). The “Summary of Discussions in ‘Study Group on OTC Derivative Market Regulation’” (published in December 2011) indicates that the FSA intends to expand the scope of persons and financial instruments subject to the central clearing obligation in two years after the enforcement.

In line with the approach, the FSA revised the Cabinet Office Ordinance to expand the scope of persons and financial instruments with respect to yen interest rate swap transactions and improve the regulations of over-the-counter derivative transactions (promulgated on June 20, 2014).

- (1) The FSA specified that financial instruments business operators subject to the central clearing obligation are those whose average notional principal amount of the over-the-counter derivative transactions (each month-end in previous years) was JPY 300 billion or more (JPY 1 trillion or more for the period from December 1, 2014 to November 30, 2015) (to be enforced on December 1, 2014).
- (2) The FSA added Euroyen TIBOR 3 months (within five years maturity) and Euroyen TIBOR 6 months (within 10 years maturity) to the scope of financial instruments subject to the central clearing obligation (scheduled to be enforced on July 1, 2015).

33. Review of restriction on underwriting business for parent/subsidiary corporation

The FSA reviewed the restriction on lead-management by a financial instruments business operator whose parent or subsidiary corporation issues securities. Specifically, the FSA revised the Cabinet Office Ordinance on Financial Instruments Business, etc. to include investment securities and investment corporation bond certificates in the scope of securities exempt from the application of the regulation, in addition to the share certificates and corporate bonds that were previously exempt (promulgated on May 28, 2014 and enforced on June 1, 2014).

34. Review of firewall regulations

In response to requests for relaxation of the firewall regulations, the FSA

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<sup>4</sup> With reference to public comments, Financial Instrument and Exchange Act was reviewed. The Act for Partial Revision of the Financial Instrument and Exchange Act was put forward in March 2015. The proposal for revision was adopted in May 2015 and promulgated in June 2015.

revised the Cabinet Office Ordinance on Financial Instruments Business, etc. as follows (promulgated on March 28, 2014 and enforced on April 1, 2014).

- (1) With regard to the regulations in the case where a bank and its securities affiliate communicate non-disclosure information of an issuer or customer, which is subject to one of the firewall regulations, the FSA took the following measures:
  - A. Relaxation of written consent requirements allowing for exclusion from the application.
  - B. Review of the scope of “business related to internal management” allowing for exclusion from the application.
  - C. Flexible provision of opt-out opportunities for issuers and customers.
- (2) At the same time, with regard to the restriction on communication of non-disclosure information, the FSA published a Q&A that shows applicable examples in mergers and acquisitions cases.

### 35. Comprehensive review of short selling regulations

In respect of short-selling regulations, with reference to the regulatory trends in foreign countries, the FSA revised the Order for Enforcement of the Financial Instruments and Exchange Act (promulgated on August 26, 2013 and enforced on November 5, 2013).

#### (1) Price regulation

The FSA revised the framework from continuous application of the regulations to the effective period applicable until the close of the relevant day and the following trading day for stocks whose values dropped by 10% or more as a general rule.

#### (2) System for reporting and publication of short positions

The FSA abolished the time framework of the system for reporting and publication of short positions that was introduced as a temporary measure, and made the obligation of reporting and publication permanent. The FSA also revised the current reporting and publication levels (ratio of short positions to the total number of shares issued: 0.25% or more for both reporting and publication) to different levels of 0.2% or more for reporting and 0.5% or more for publication, respectively.

#### (3) Ban on short sales in which stocks are not owned or borrowed at the time of selling

The FSA abolished the time framework of the ban on selling stocks short without owning or borrowing the stocks at the time of selling that was introduced as a temporary measure, and made the measure permanent.

### 36. Reorganization and market integration of the Japan Exchange Group

(developments regarding financial instruments exchanges)

The Tokyo Stock Exchange (hereinafter, “TSE”) and the Osaka Securities Exchange (hereinafter, “OSE”) merged their management operations on January 1, 2013. The new organization includes stock exchanges (TSE and OSE), a clearing organization (Japan Securities Clearing Corporation) and a self-regulation corporation (TSE Regulation) under the holding company “Japan Exchange Group” (hereinafter, “JPX”).

JPX implemented an integration of cash markets through the merger of OSE’s cash market into TSE’s one on July 16, 2013<sup>5</sup>, and then also implemented an integration of derivative markets through the merger of TSE’s derivative market into OSE’s one on March 24, 2014<sup>6</sup>. As a result, JPX completed a series of reorganizations associated with management integration.

37. JPX-Nikkei Index 400 (developments regarding financial instruments exchanges)

JPX and TSE, in collaboration with the *Nihon Keizai Shimbun*, developed “JPX-Nikkei Index 400,” a new stock index consisting of “component companies attractive to investors” meeting global investment requirements, e.g. profitability and corporate governance, and commenced computation from January 6, 2014.

Accordingly, there are several financial instruments linked to JPX-Nikkei Index 400, such as ETFs listed on TSE and a large number of public investment trusts. In addition, Osaka Exchange is scheduled to start futures trading of the index from November 25, 2014.

38. Trends in development of securities and derivatives settlement system

In response to the recent global financial crisis, the FSA summarized the issues to be addressed immediately in Japan’s financial and capital markets, titled “Development of Institutional Frameworks Pertaining to Financial and Capital Markets,”<sup>7</sup> which was published in January 2010.

Accordingly, the FSA stipulates that Amended FIEA 2010 contains the

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<sup>5</sup> Coupled with the integration of cash markets, on the same date, JPX also unified OSE’s clearing business into Japan Securities Clearing Corporation, and integrated self-regulation operations into TSE Regulation.

<sup>6</sup> Coupled with the integration of derivative markets, on the same date, OSE changed its trade name to “Osaka Exchange.”

<sup>7</sup> “Development of Institutional Frameworks Pertaining to Financial and Capital Markets” includes initiatives related to a securities and derivatives settlement system, consisting of (i) introduction of a central clearing obligation over certain over-the-counter derivative transactions as well as the obligations to archive and report the trade data, and (ii) strengthening of securities settlement and clearing functions (improvement of the operational strength of the Japan Government Bond Clearing Corporation, and clarified rules of DVP Settlement of stock lending transactions).

mandatory use of certain over-the-counter derivative transactions by clearing organizations and the archiving and reporting system of the trade data. The FSA promulgated the relevant Cabinet Order in May 2012 and Cabinet Office Ordinance in July 2012.

39. Actions regarding securities and derivatives settlement system

(1) Improvement of stability and transparency of the settlement of over-the-counter derivative transactions

As described in Paragraph 32, the FSA promulgated the relevant Cabinet Office Ordinance with the aim of expanding the scope of persons and financial instruments subject to a central clearing obligation.

In addition, in response to the establishment of the Act for Partial Revision of the Financial Instruments and Exchange Act, etc. (in September 2012) that stipulates the mandatory obligation to use an electronic trading platform for certain over-the-counter derivative transactions, the FSA exchanged opinions with market participants for the development and publication of the relevant Cabinet Order and the Cabinet Office Ordinance with the aim of facilitating smooth enforcement of the Act.

(2) Strengthening the securities settlement and clearing functions for government bond trading and stock lending transactions

Market participants published the “Roadmap regarding the settlement risk reduction of government bond trading” in June 2010 on the basis of the “Development of Institutional Frameworks Pertaining to Financial and Capital Markets” and compiled a preliminary version of the grand design of trading methodologies for further shortening the settlement period of government bond trading by market participants (T + 1). In addition, the Japan Securities Clearing Corporation and Japan Government Bond Clearing Corporation merged their management operations in October 2013 to improve the strength of government bonds clearing organizations. Trust banks have started to participate in the Japan Securities Clearing Corporation since June 2014.

In addition, based on the “Roadmap on settlement risk reduction related to stock lending transactions” that was published in December 2010, the relevant institutions implemented a revision of the rules and system support. As a result, DVP Settlement of stock lending transaction was introduced in January 2014.

The FSA has actively participated in these initiatives, and also provided support for market participants, including publication and dissemination of the roadmap that has been updated on a semi-annual basis

via the FSA's website (December 2013 and June 2014).

40. Japan's response to IFRS and international trends

(1) Japan's response to the International Financial Reporting Standards (IFRS)

A. Circumstances

In June 2013, the Business Accounting Council compiled "The Present Policy on the Application of International Financial Reporting Standards (IFRS)" (hereinafter, "Present Policy") on how to address IFRS in Japan. The Present Policy suggests that it is important to achieve the accumulation of optional application of IFRS, and recommends addressing IFRS in respect of (i) relaxation of statutory requirements for voluntary application of IFRS; (ii) formulation of partly modified IFRS in light of "IFRS as they should be" (modified international standards); and (iii) simplification of the disclosure of non-consolidated (single-entity) financial statements (hereinafter, "these Measures").

On the other hand, the Present Policy indicated then that it was too early to make a decision as to whether the IFRS should be mandatorily applied. In this regard, the Present Policy suggests that the relevant players should continue discussions through verification and confirmation of the attainment or progress of these Measures, including the trends of the number of companies that have applied IFRS, while also assessing the international situation, such as the trends of the United States and IFRS standards development.

In addition, there are 42 companies that have already adopted IFRS and plan to adopt IFRS through timely disclosure as of June 30, 2014<sup>8</sup>.

B. Responses to the measures indicated in the "Present Policy"

(A) With regard to the relaxation of statutory requirements for voluntary application of IFRS, the FSA revised the rules on consolidated financial statements in October 2013. In this revision, out of optional application requirements, the FSA abolished two requirements, namely "listed companies" and "Conducting financial or business activities internationally" (however, no change for the requirements on efforts to ensure adequacy of consolidated financial statements).

(B) As for the "formulation of modified international standards," the Accounting Standards Board of Japan (ASBJ) commenced studies from August 2013 (under examination as of June 30, 2014).

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<sup>8</sup> There are 91 companies that have already adopted IFRS and plan to adopt IFRS through timely disclosure as of June 30, 2015.

- (C) As for the “simplification of the disclosure of non-consolidated (single-entity) financial statements,” the FSA revised the regulations for financial statements on March 26, 2014, which allows for partial exemption from the descriptive obligation of notes to the non-consolidated financial statements under the Financial Instruments and Exchange Act.
  - (D) The “Working Group for the Endorsement of IFRS” was established in September 2013 with the aim to strengthen Japan’s overall capacity to address IFRS and to achieve a consensus in Japan of opinions regarding IFRS. The working group exchanges views on the achievement status of measures as instructed in the Immediate Policy, as well as the trends in the United States and the international situation of the development status of IFRS standards.
- (2) Involvement in the global accounting standard-setting process

As part of strengthening the governance of the IFRS Foundation, the IFRS Foundation Monitoring Board consisting of capital market authorities (hereinafter, “MB”) was established in April 2009. The FSA has long served as the Chair of the MB since October 2010, including the period of Interim Chair from October 2010 to February 2013. Currently, the MB has dedicated efforts to expand its membership in line with the recommendations of the “Final Report on the Review of the IFRS Foundation’s Governance” that was published in February 2012. In May 2013, the MB launched a call for nominations for new members. In January 2014, the MB announced that the Comissão de Valores Mobiliários (CVM) of Brazil and the Financial Services Commission (FSC) of Korea were selected as new members.

The FSA has strengthened cooperation with foreign authorities by taking the opportunities of international conferences such as International Organization of Securities Commissions (IOSCO) that discusses accounting issues arising from securities markets. The FSA has actively conveyed our thoughts to foreign authorities in coordination with domestic stakeholders. In June 2014, the FSA had an experience of hosting a Committee 1 of IOSCO (Committee 1 treats accounting, audit and disclosure issues) in Tokyo.

In March 2013, the Accounting Standards Advisory Forum (ASAF) was established as a communication framework between the International Accounting Standards Board (IASB) and national or regional accounting standard-setters. The ASAF is composed of 12 national or regional standard-setters, including the Accounting Standards Board of Japan (ASBJ), which has actively contributed to the development of IFRS.

#### 41. Response to ISA and international trends

##### (1) Response to the International Standards on Auditing (ISA)

In July 2013, the International Auditing and Assurance Standards Board (IAASB), developing the International Standards on Auditing (ISA), published an exposure draft on the revisions of the ISA which requires an auditor of a listed company to describe in the audit report the “Key Audit Matters (KAM)” identified as the most significant matters in the audit of financial statements during the business year in the auditor’s professional judgment. At the 36th Audit Committee Meeting of the Business Accounting Council held in November 2013, the members of the committee exchanged views on the exposure draft with the member of the IAASB.

##### (2) Notification system of foreign audit firms

In April 2008, a notification and supervision system for foreign audit firms was introduced to Japan through the revision of the Certified Public Accountants Act. In September 2009, both the FSA and the Certified Public Accountants and Auditing Oversight Board (CPAAOB) published the policies on information gathering and inspections regarding foreign audit firms as a “Framework for Inspection/Supervision of Foreign Audit Firms, etc.”

Both the FSA and the CPAAOB stated in the framework that they will, in principle, rely on information gathering and inspections regarding foreign audit firms by the competent authorities of the firms’ home jurisdictions, instead of seeking to obtain information from or conducting inspections on firms themselves, provided that (i) audit and public oversight systems in the firms’ home jurisdictions are equivalent to those of Japan; (ii) necessary information can be provided from the foreign competent authorities through appropriate arrangements of information exchange; and (iii) reciprocity is ensured (mutual reliance). Accordingly, the FSA and the CPAAOB exchanged letters relating to the rules of information exchange with the foreign audit oversight authorities overseas<sup>9</sup>.

In addition, the FSA and the CPAAOB summarized the framework regarding the equivalent assessment of a foreign audit oversight system in

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<sup>9</sup> The FSA and the CPAAOB exchanged letters relating to the rules of information exchange with the US Public Company Accounting Oversight Board (PCAOB) on October 6, 2011, Canadian Public Accountability Board (CPAB) on March 23, 2012, the Malaysian Audit Oversight Board (AOB) on October 3, 2012, the Netherlands AFM on March 26, 2013, the Luxembourg financial regulator, the Commission de Surveillance du Secteur Financier (CSSF) on August 2, 2013, and the UK’s Financial Reporting Council (FRC) on May 23, 2014.

the form of “guidance,” which was released on July 10, 2012.<sup>10</sup>

Until 2013, the FSA and the CPAAOB established a collaborative relationship (meeting the requirements (i) and (ii) above) with the Netherlands Authority for the Financial Markets (AFM). On June 11, 2014, the FSA and the CPAAOB exchanged letters with AFM to further strengthen cooperation between the authorities by securing the requirement (iii) above (securing reciprocity) and expressing their intentions to mutually rely on the oversight of foreign audit firms in their home countries (information gathering and inspections). Netherlands AFM was the first foreign authority to secure mutual reliance in the area of audit oversight.

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<sup>10</sup> On July 11, 2013, in light of the guidance, the FSA and the CPAAOB expressed that they assessed the audit system and audit oversight system of Netherlands and Luxembourg and that their systems were equivalent to the corresponding systems in Japan.

f. Financial Tax System

42. Tax reform in fiscal 2014

In FY 2014, the FSA requested the tax authority (Ministry of Finance) to reform the financial tax system. The request was designed to achieve various policy goals, including:

- (1) Supporting asset formation for households and promoting supply of the growth capital (Enhancement of convenience of NISA)
- (2) Promoting business revitalization and contributing to full-scale local regeneration (Establishment of special measures for a revitalization taxation scheme for self-employed individuals engaging in business)

As a result of screening the requests after discussion between the FSA and the tax authority, the Outline for the FY 2014 Tax Reform (decided by the Cabinet on December 24, 2013) accepted several measures, mainly those of providing support of asset formation for households and promoting supply of the growth capital. The major measures are as follows.

43. Enhancement of convenience of NISA (tax-exempt individual investment accounts)

With respect to NISA, the following measures were approved in light of making the system popularized and well established.

- (1) The account holders of NISA can change their financial institutions (prior to the revision, during the restriction periods ((i) from January 1, 2014 to December 31, 2017; (ii) from January 1, 2018 to December 31, 2021; and (iii) January 1, 2022 to December 31, 2025), the account holders of NISA could not change their financial institutions once a NISA account was opened).
- (2) The account holders of NISA can reopen their account during the restriction periods, even if once they close their accounts.
- (3) The following description is included in the Outline for the FY 2014 Tax Reform compiled by the Ruling Parties:

“The treatment of NISA will be continuously discussed based on the verification results and effectiveness of the measures taken in light of expanding the range of investors and promoting supply of the growth capital.”

44. Integration of financial income taxation

The scope for offsetting profits and losses between financial instruments will be extended from dividend and capital gains/losses derived from stocks (currently applicable) to interest and capital gains/losses derived from bonds from January 2016.

While derivative transactions are not currently included in the scope for offsetting profits and losses, the Outline for the FY 2014 Tax Reform compiled by the Ruling Parties gives the following description in light of creating an investor-friendly environment for a variety of financial instruments.

“A further integration of financial income taxation, including derivative transactions will be continuously discussed and examined in light of contributing to the realization of comprehensive exchange with the capability of handling securities, financial instruments and commodities in a collective manner, while giving sufficient consideration to preventing intentional tax avoidance.”

45. Taxation measures for the further promotion of business revitalization and contribution to full-scale local regeneration

The following measures were approved in light of supporting the regeneration of small and medium-sized enterprises and private individual businesses.

- Establishment of a revitalization taxation scheme for self-employed individuals engaging in business

With regard to the case where an individual engaging in business is exempt from obligations under a reasonable revitalization plan, special measures were established for individual businesses allowing him/her to include in the necessary expenses the amount equivalent to the write-downs of depreciable assets.

- Expansion of business rehabilitation tax system

The business rehabilitation tax system is applicable to the case where the Regional Economy Vitalization Corporation of Japan (REVIC) makes coordination of the interest of creditors to carry out debt forgiveness for the target corporation when the rehabilitation is based on a reasonable rehabilitation plan.

- Expansion of tax-free deemed capital gain

With regard to turnaround support from the Corporation for Revitalizing Earthquake affected Business, the tax will not be applicable to deemed capital gains from private assets provided by an executive who is a guarantor of the reviving enterprise on the basis of a reasonable rehabilitation plan.

46. Review of international taxation principles (change from aggregation principle to attribution principle)

The following measures were approved as taxation principles applicable to foreign companies in light of removing impediments to investment in Japan by

bringing Japanese taxation system up to global standards.

- The taxation principles in regard to foreign companies were revised from the conventional “aggregation principle”-based domestic legislation to “attribution principle” in line with the OECD Model Tax Convention as amended in 2010.

47. Extension of the tax exemption related to the Japanese version of Sukuk (Islamic bonds)

The following measures were approved in light of attracting Islamic investors and issuers to the Japanese market through issuance of Sukuk (a financial instrument for Islamic investors or issuers who cannot deal with interest-bearing bonds) in the Japanese capital market.

- (1) With regard to the Japanese version of Sukuk, the exemption from registration and license tax on repurchase of assets of the trust is extended for two years.

48. Initiatives for making NISA (tax-exempt individual investment accounts) popularized and well established

NISA was introduced in January 2014 with the aim of expanding the range of investors as well as providing support of asset formation for households and promoting supply of the growth capital. NISA is a tax-exempt scheme for a small investment, applicable to a new investment in listed shares and publicly-offered investment funds with an amount of up to JPY 1 million per year, making dividend income and capital gains exempt from tax for five years maximum.

As of March 31, 2014, the number of NISA accounts is more than 6.5 million with a total investment value of more than JPY 1 trillion. The FSA promotes a variety of initiatives to expand the range of investors, in light of making the scheme more popularized especially to inexperienced investors and young generations.

In the program year 2013, the FSA implemented the following initiatives:

- (1) Revision of Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.

The FSA made a revision of “Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.” in August 2013. Specifically, this revision was to make financial institutions provide financial instruments in line with the design and purpose of the NISA scheme with sufficient description to customers including a commitment to improving the financial literacy of customers, with the aim of ensuring that each financial institution will provide services in light of NISA’s scheme

and purpose.

(2) Implementation of dissemination and publication activities

The FSA decided to engage in aggressive publicity activities with the aim of facilitating the correct understanding of the scheme and improving the financial literacy of investors as well as making the scheme more popularized and steadily well established. For example, the FSA published the outline and purpose of the scheme through the website of the Public Relations Office and the FSA's website. The FSA also prepared leaflets, and sent information via Twitter (on a weekly basis for six months from July 2013 to the commencement of the scheme, and as needed after the introduction). In addition, the FSA held a "NISA Day" Symposium (in Tokyo on February 13, 2014, in Nagoya on February 18, 2014, and in Osaka on February 19, 2014).

The FSA also conducted the following measures as publicity opportunities.

- Cooperation on "Asset formation support project" (sponsored by *Nihon Keizai Shimbun*)
- Acceptance of media interviews and requests for lecturers in seminars as necessary.

g. Approach toward Regulatory and Institutional Reforms

49. The “Regulatory Reform Council” and its “Implementation Plan for Regulatory Reform”

The “Regulatory Reform Council” (a council consisting of members from the private sector) was newly set up in January 2013 and launched five working groups thereunder. As a result, the government’s policy was compiled as the “Implementation Plan for Regulatory Reform” (Cabinet decision: June 24, 2014)<sup>11</sup>.

Approach toward Regulatory and Institutional Reforms in the program year 2013

Year/Month	Development of Action
2013 July	▽ WG on Health and Medical established (First Meeting held on July 31)
August	▽ WG on Employment established (First Meeting held on August 29)
September	▽ WG on Trade and Investment (First Meeting held on September 4) ▽ WG on Business Creation and IT (First Meeting held on September 6) ▽ WG on Agriculture (First Meeting held on September 10) ▽ Discussion forums open to public (September 28)
November	▽ Discussion forums open to public (November 25)
2014 March	▽ Publication of the follow-up survey on regulatory and institutional reforms (March 1)
April	▽ Publication of the follow-up report on the Implementation Plan for Regulatory Reforms (Cabinet decision: June 14, 2013) (April 13)
June	▽ Submission of “Second Report of Recommendations on Regulatory Reform” to the Prime Minister by the Regulatory Reform Council (June 13) <ul style="list-style-type: none"> <li>• The Council compiled the results of the consideration focusing on regulatory reforms leading to growth strategy and diverse options to the public.</li> </ul>
	▽ “Implementation Plan for Regulatory Reform” approved by the Cabinet (June 24) <ul style="list-style-type: none"> <li>• In accordance with the “Second Report of Recommendations on Regulatory Reform,” this plan including timeframes was formulated so that the government will undertake and realize the reforms.</li> </ul>

50. The FSA’s main policy correspondences on the basis of the “Implementation Plan for Regulatory Reform” (Cabinet decision: June 14, 2013)

(1) Review of the regulations included in the “Implementation Plan for

<sup>11</sup> The “Hotline on Regulatory Reform” was opened for the purpose of receiving a variety of proposals from the public and companies in March 2013, and has considered the proposals as appropriate.

Regulatory Reform”

The FSA formulated the relevant Cabinet Orders and Cabinet Office Ordinances related to comprehensive exchange included in the Act for Partial Revision of the Financial Instruments and Exchange Act, etc. (established on September 6, 2012 and promulgated on September 12, 2012). The FSA also reviewed the regulations pertaining to the supply of risk money to new and growing companies as specified in the Implementation Plan.

- (2) Review of the regulations related to the proposals received through the “Hotline on Regulatory Reform”

Based on the proposals received through the Hotline, the FSA submitted to the Diet a bill for amendment of the Insurance Business Act to introduce a special treatment regarding the restriction of the scope of business operated by insurer’s subsidiaries through M&A of foreign financial institutions. This bill was established on May 23, 2014 and promulgated on May 30, 2014.

In addition, the FSA also revised the Order for Enforcement of the Money Lending Business Act and the Ordinance for Enforcement of the Money Lending Business Act with respect to lending executed between group companies consisting of subsidiaries based on a parent company and its subsidiary under the effective control criteria (parent company, subsidiary company or fellow subsidiary), allowing for exemption from Moneylending Control Regulations under certain requirements (enforced on April 1, 2014).

51. The FSA’s policy measures on the basis of the “Implementation Plan for Regulatory Reform (Cabinet decision: June 24, 2014)”

The “Regulatory Reform Council” placed the focus on regulatory reforms leading to a growth strategy and broader public options. The Council submitted the “Second Report of Recommendations on Regulatory Reform” to the Prime Minister on June 13, 2014. In accordance with the report, the Cabinet decided the “Implementation Plan for Regulatory Reform” composed of five fields: “Health and Medical,” “Employment,” “Business Creation and IT,” “Agriculture” and “Trade and Investment.”

The Cabinet Office conducts follow up on the status of implementation on the measures incorporated in the Implementation Plan at the end of each program year, and reports the results to the Regulatory Reform Council. The results are also published.

The following were incorporated as the main measures related to the FSA.

Box: Business Creation and IT Field

- Clarification of the supervisory viewpoints on outsourcing contractors
- Review of the scope of specified business activities on products regarding a special subsidiary company under the Banking Act
- Expansion of business matching services as business incidental to insurer's inherent business
- Simplification of portfolio transfer procedure of insurance contracts
- Alternative use of electronic means for public notice obligations to a daily newspaper at the time of discontinuance of application (with prepaid payment instruments)
- Lifting of the prohibition of banks from owning a subsidiary engaging in asset management advisory services including real estate investment advisory services
- Replacement authorization with notification regarding the concurrent holding of positions by director engaging in the day-to-day business of an insurer (inter-group only)
- Expansion of intended company regarding the income dependency requirement for incidental business carried out by insurer
- Review of the scope of "special provision of same content" at the time of automatic renewal of foreign currency time deposits (one year)
- Relaxation of display of resumption of business after the temporary close
- Relaxation of deadline for submission of consolidated operating results
- Review of calculation method for ownership ratio of shares in Tender Offer Regulation
- Omission of affixing a seal by offeror on the "Notification of Tender Offer"
- Relaxation of publication method in the special case for the omission of delivery of amended prospectus at the time of pricing

Box: Trade and Investment Field

- Enabling banks to be involved in credit transactions falling under Islamic finance having no heterogeneous risk
- Expansion of special treatment regarding the restriction of the scope of business operated by insurer's subsidiaries through M&A of foreign non-insurers by an insurer

52. Overview of systems for requests and inquiries regarding regulations based on the Industrial Competitiveness Enhancement Act

In order to securely implement the measures that are included in "Japan Revitalization Strategy" (Cabinet decision: June 14, 2013) for the purpose of enhancing the industrial competitiveness of Japanese business sector, "the Industrial Competitiveness Enhancement Act" was established on December 4, 2013 and promulgated on December 11, 2013 (enforced on January 21, 2014).

The Act stipulates the establishment of an implementation protocol for the "Japan Revitalization Strategy," and the creation of the menu for promoting regulatory reforms, and promoting approaches to renovation of industries.

Among them, “System of Special Arrangements for Corporate Field Tests” and “System to Remove the Gray Zone Areas” were newly created as a breakthrough to realize accelerated regulatory reforms. The System of Special Arrangements for Corporate Field Tests provides preferential regulatory flexibility to individual enterprises satisfying certain requirements. The System to Remove the Gray Zone Areas is a system in which enterprises planning to develop new businesses can confirm whether their businesses satisfy related regulations in advance based on their concrete business plan.

In both systems, an enterprise planning to develop new businesses may request or inquire to the ministry and/or agency having jurisdiction over the businesses, and any ministry and/or agency receiving requests /inquiries is required to coordinate with the related ministry and/or agency to give an answer within a month as a general rule.

53. Results of these systems

In the program year 2013, there was one inquiry using the System to Remove the Gray Zone Areas from an enterprise to another ministry/agency and the FSA replied to the ministry/agency which received the inquiry. There was no request using the System of Special Arrangement for Corporate Field Tests, or inquiry to the FSA using the System to Remove the Gray Zone Areas.

54. Overview of efforts on local regeneration

Pursuant to Article 4, paragraph 1 of the Local Revitalization Act (Law No. 24, 2005), the government set the Basic Policy for Local Regeneration (Cabinet decision: April 22, 2005; Final revision: April 25, 2014) to promote the implementation of the measures by the government. The Basic Policy aims at realizing local revitalization in a comprehensive and effective manner by creating an environment in which unique, autonomous and independent efforts are promoted by local governments to vitalize regional economy as well as by creating employment opportunities in localities.

The Basic Policy describes measures to be implemented by each ministry/agency in conjunction with the local revitalization plan. The Regional Revitalization Bureau of the Cabinet Secretariat aggregates and posts on its website measures related to the local revitalization implemented either collectively or independently by each ministry/agency.

55. Certification of regional revitalization plan

In the program year 2013, out of the applications for certification of regional revitalization plans received by the Office for Promotion of Regional Revitalization of the Cabinet Office from local governments (26th <September

13 2013- September 27, 2013>; 27th < January 10, 2014 - January 24, 2014>;  
and 28th <April 23, 2014 - May 9, 2014>), there were no plans under the  
jurisdiction of the FSA.

### iii. Inspection and Supervision

#### a. Financial Monitoring Report

##### 56. Summary

Based on the Financial Monitoring Policy announced in 2013, the FSA published the results and challenges of financial monitoring as “Financial Monitoring Report” for the first time<sup>12</sup>.

This report not only contains the results and challenges of financial sectors (megabank, regional bank, etc.) through financial monitoring, but also covers the cross-sectorial monitoring results of horizontal review carried out across multiple financial institutions.

The FSA expects that this report will enhance further discussions among financial institutions, market participants as well as financial services users and support better financial services.

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<sup>12</sup> The FSA published the report (in Japanese) and the summary (both in Japanese and English) in July 2014.  
<http://www.fsa.go.jp/en/news/2014/20140731-1/01.pdf>

b. Developments regarding Supervision of Deposit-Taking Financial Institutions

- Major Banks

57. Measures taken based on the Annual Supervisory Policy for Major Banks for Program Year 2013

In the program year 2013, in accordance with “Basic concepts on supervision of financial institutions” as shown below, the FSA placed priority on the areas of (i) performing an active financial intermediary function, including management support for small and medium enterprises (SMEs); (ii) risk management and stability of the financial system; and (iii) improvement of customer protection and convenience for users, and supervised major banks while striving to have straightforward and in-depth dialogue with them. In addition, the FSA strived 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.

58. Basic concepts on supervision of financial institutions

To have “Better Regulation” become further embedded and deepened, the FSA took the following approaches: (i) financial supervision and administration with a high risk sensitivity; (ii) financial supervision and administration from a citizen’s and user’s point of view; (iii) supervisory response with a forward-looking perspective; and (iv) supervisory response which contributes to financial institutions’ improvement of their management and making better business judgments. Especially, 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. Under these recognitions, the FSA (i) required major banks, under the appropriate leadership of management personnel, to enhance their governance and risk management systems; and (ii) urged them to properly verify the sustainability of their business models, and to devise short and medium to long-term business strategies, including capital policy. The FSA pushed this further through discussions with the management of major banks, as necessary. Furthermore, 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. Therefore, 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.

59. 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.

With regard to response to the Great East Japan Earthquake from financial aspects, successively from the program year 2012, the FSA (i) checked whether each financial institution appropriately responded to consultations and requests for altering lending terms in ways to suit the situation of borrowers; and (ii) in an effort to handle the overlapping debt problem, confirmed whether each institution promptly and effectively responded to borrowers' consultations and requests. In addition, the FSA also checked whether each financial institution appropriately met money demand toward restoration and reconstruction, and disaster-affected people's rehabilitation of livelihood and business operations.

The FSA considered the program year 2013 crucial for financial institutions to start their full scale support for improvement of SMEs' business profiles, and reinforcement of business structure. Accordingly, even after the expiry of the SME Financing Facilitation Act (hereinafter, "SME Act"), the FSA continuously urged financial institutions to provide fine-tuned support for SMEs, to endeavor to provide a smooth supply of funds, in response to changes in their loan terms, or other measures, and to actively perform consulting functions for enterprises, while cooperating as necessary with outside experts and organizations and other financial institutions. The FSA also checked whether financial institutions give appropriate advice on not only financial aspects but also issues concerning the management of the borrower enterprises, whether they provide support for devising highly effective business rehabilitation plans, and whether they 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").

Furthermore, as for initiative for loans to individuals, such as mortgage loans and loans to consumers, the FSA engaged in understanding the situation as to whether banks were dealing properly with loans to individuals considering their own needs.

The FSA continued to verify major banks' efforts to promote new loans that would contribute to business improvement, business recovery, development and growth of their customer enterprises. In addition, the FSA confirmed

whether major banks provided advanced financial products and services that were needed but unavailable from other providers in the industry. Such advanced financial products and services included assistance for overseas expansion, support for starting up operations and new businesses through the provision of equity, encouragement for infrastructure development through project finance, and retail financial products that met recent customer's needs, including NISA, deposit and trust for educational funds. At the same time, the FSA also confirmed whether there was an adequate group-wide synergy effect.

60. Risk management and financial system stability

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. Based on these points, the FSA continued to monitor the situation of macro economy and financial markets, while enhancing its own risk sensitivity as a supervisor, and encouraged voluntary efforts by individual financial institutions, considering the following points: (i) risk areas which should be focused on; (ii) improved risk management techniques; and (iii) enhancement of financial foundations. The FSA conducted in-depth supervision, particularly of financial groups operating large, complex businesses both in Japan and overseas given that the deterioration of these financial groups will likely cause a significant impact on the entire financial system. The FSA supervised these financial groups from the macro-prudential perspectives while encouraging closer cooperation with the Bank of Japan and foreign authorities. In particular, the FSA focused on the following points: (i) enhancement of group governance system; (ii) actions to comply with the Basel III standard; (iii) recovery and resolution plans (RRPs); (iv) stress testing; (v) management information systems; (vi) legal compliance systems; and (vii) human resource management.

61. 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.

Considering the above, as a supervisor, the FSA verified major banks with a focus on the following items: (i) ensuring business continuity; (ii) thorough management of information security; (iii) maintenance and improvement of reliability and transparency of the benchmark interest rate; (iv) establishment of systems for people with disabilities; (v) enhancement of the system for selling risky products; (vi) enhancing systems for processing consultations and complaints from customers; and (vii) preventing abuse of financial functions.

62. Revision of Comprehensive Guidelines for Supervision of Major Banks, etc.

These supervisory guidelines were formulated on October 28, 2005, and then have been revised as needed, in order to respond appropriately to environmental changes and new issues. In the program year 2013, they were amended as follows (63~73<sup>13</sup>).

63. Revision based on the recommendations of “Summary of discussions in the ‘experts’ meeting on the follow-up to the financial ADR system” (August 2, 2013)

The FSA made a revision to reflect the recommendations of “Summary of discussions in the ‘experts’ meeting on the follow-up to the financial ADR system” published on March 8, 2013 (establishment of framework for the contribution to the improvement of convenience for users in each financial institution) (applicable from August 2, 2013).

64. Revision pursuant to the amendment to administrative notice on the capital adequacy rules under domestic standards (November 22, 2013)

In response to the introduction of the new capital adequacy requirements (new domestic standards) that have been gradually applied from the end-March 2014 (promulgated March 8, 2014), the FSA made a revision to the supervisory guidelines and policies in consideration of appropriateness and accuracy of equity capital (applicable from March 31, 2014).

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<sup>13</sup> Out of those revisions, the Financial Inspection Manual was also revised in respect of 63 through 65, 67 and 72.

65. Revision that reflects the application of the “Guidelines for Personal Guarantee Provided by Business Owners” (January 31, 2014)

In light of promoting active use of the guidelines by financial institutions and to familiarize and popularize them as lending practices, the FSA made a revision specifying the points for the establishment of a framework pursuant to the guidelines (applicable from February 1, 2014).

66. Revision pursuant to the amendment to administrative notice on the capital adequacy rules under domestic standards (third pillar) (February 18, 2014)

In response to the introduction of the new capital adequacy requirements (new domestic standards) that have been gradually applied from the end-March 2013 (promulgated March 8, 2013), the FSA made a revision on disclosure related to the capital adequacy ratio (applicable from March 31, 2014).

67. Revision that reflects the review of restriction on holding of voting rights by a bank (so-called 5% rule) (March 31, 2014)

The Banking Act was revised to accommodate the Act for Partial Revision of the Financial Instruments and Exchange Act, etc. that was established in June 2013 (hereinafter, “Amended FIEA 2013”). As a result, a revision was made so as to allow banks to flexibly provide capital. Accordingly, the FSA made a revision specifying the points for risk management to the supervisory guidelines and policies (applicable from April 1, 2014).

68. Revision that reflects the introduction of fit and proper requirements for auditors of banks (March 31, 2014)

The Banking Act was revised to accommodate the Amended FIEA 2013, with the introduction of fit and proper requirements for auditors and the audit committee member of banks. Accordingly, the FSA made a revision to the supervisory guidelines (applicable from April 1, 2014).

69. Revision that reflects the review of regulation on scope of a bank’s subsidiary company concerning overseas M&As (March 31, 2014)

The Banking Act was revised to accommodate the Amended FIEA 2013. As a result, in the case of overseas M&As by banks, banks are allowed to hold the acquired foreign financial institution’s subsidiary companies that do not fall on an eligible subsidiary company for a certain period. Accordingly, the FSA made a revision to the supervisory guidelines (applicable from April 1, 2014).

70. Revision that reflects the “Principles for effective risk data aggregation and risk reporting” issued by the Basel Committee (June 2, 2014)

Referring to the “Principles for effective risk data aggregation and risk reporting” that were announced by the Basel Committee in January 2013,

global systemically important banks (G-SIBs) are required to follow the principles by the beginning of 2016. In response to this situation, the FSA made a revision to the effect that it will perform supervision with attention to the contents of the “Principles for effective risk data aggregation and risk reporting” in respect of the implementation of initiatives aimed at the development and improvement of the infrastructure, process, and framework necessary to aggregate the risk data (applicable from June 2, 2014).

71. Revision related to the disclosure of the indicators for assessing G-SIBs (June 2, 2014)

The FSA made a revision to the effect that, in the case where the denominator of the leverage ratio of a holding company exceeds EUR 200 billion, the FSA may request the financial institutions to disclose the indicators appropriately for assessing G-SIBs pursuant to the instructions published by the Basel Committee (applicable from June 2, 2014).

72. Revision related to the response against anti-social groups (June 4, 2014)

Based on the “Encouraging the Efforts to Sever Relationships with Antisocial Groups” published by the FSA in December 2013, the FSA made a revision aimed at promoting efforts to sever relationships with antisocial groups (applicable from June 4, 2014).

73. Revision regarding the introduction of outside directors in listed banks (June 4 2014)

The FSA made a revision on two points in the case of listed banks: (i) at least one independent outside director is required; and (ii) a bank holding company specified as a global systemically important financial institution (G-SIFI) is urged to place a committee or to ensure the selection of independent outside director(s) for a major bank owned by the above holding companies, even if it is a non-listed company (applicable from June 4, 2014).

- Regional Financial Institutions

74. Measures taken based on the Annual Supervisory Policy for Regional Financial Institutions for Program Year 2013

In the program year 2013, in accordance with “Basic Concepts on Supervision of Financial Institutions” as shown below, the FSA placed priority on the areas of: (i) performing an active financial intermediary function including management support for SMEs; (ii) risk management and stability of the regional financial system; and (iii) improvement of customer protection and convenience for users, and supervised regional financial institutions while

striving to have straightforward and in-depth dialogue with them. In addition, the FSA strived 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.

75. Basic concepts on supervision of financial institutions

To have “Better Regulation” become further embedded and deepened, the FSA took the following approaches: (i) financial supervision and administration with a high risk sensitivity; (ii) financial supervision and administration from a citizen’s and user’s point of view; (iii) supervisory response with a forward-looking perspective; and (iv) supervisory response which contributes to financial institutions autonomously improving management and making better business judgments. Especially, in the program year 2013, the FSA discussed with the management teams, if necessary, and implemented the following measures: under the appropriate leadership of management personnel, regional financial institutions have enhanced their governance and risk management systems including capital policy. Furthermore, the FSA announced 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 endeavored 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.

76. 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 regional financial institutions to become actively involved in the provision of new loans that will contribute to business improvement and recovery, development and growth of customer enterprises, taking into consideration the “Japan Revitalization Strategy.”

Considering the above, in the program year 2013, the FSA supervised the performance of financial intermediary functions by regional financial institutions from the following viewpoints.

(1) Response to reconstruction following the Great East Japan Earthquake

from financial aspects

- A. The FSA confirmed whether regional financial institutions in the disaster-affected areas provide support—such as recommending and implementing optimum solutions including various public support measures for disaster-affected people after a fine-tuned analysis of the conditions surrounding each disaster-affected person—and whether they proactively took part in the efforts of local governments and other parties to promote extended restoration and revitalization in the disaster-affected areas. Further, as reconstruction demand gets into full swing, the FSA also checked whether each regional financial institution appropriately meets money demand toward restoration and reconstruction, and disaster-affected people’s rehabilitation of livelihoods and business operations.
- B. As a response to the so-called double loan problems, the FSA verified whether regional financial institutions are providing careful explanations to disaster-damaged companies about the roles and functions of the Corporation for Revitalizing Earthquake Affected Business, Prefectural Industrial Recovery Consultation Centers, and Prefectural Industrial Reconstruction Corporations, and consider the proactive utilization of these organizations along with disaster-damaged companies. In doing so, the FSA also verified whether regional financial institutions positively considered bringing applications for Credit Guarantee Association-guaranteed loans to these organizations with a view to supporting disaster-affected people.

Furthermore, the FSA checked whether regional financial institutions analyze further details of disaster-affected people’s situations, provide them with careful explanations about the advantages and effects of utilizing the Individual Debtor Guidelines, and proactively recommend utilization in accordance with their respective conditions.
- C. In order to encourage financial institutions, which received capital injection under the Act on Special Measures for Strengthening Financial Functions’ provision for earthquake-related special cases, to contribute to the reconstruction of victims’ businesses and lives on a continuing basis, including the active use of the Corporation for Revitalizing Earthquake Affected Business, Prefectural Industrial Recovery Consultation Centers, and Prefectural Industrial Reconstruction Corporations and the Individual Debtor Guidelines for Out-of-Court Workouts. The FSA properly followed up the implementation of business-enhancing plans of these financial

institutions.

- (2) Promotion of initiatives of new loans by financial institutions which puts emphasis on growth potential

The FSA encouraged the active involvement of regional financial institutions in the provision of new loans, by verifying their efforts to promote new loans through examination of 13 check points regarding the approach state of new loans leading to business improvement, business recovery, development and growth of their customer enterprises.

- (3) Deepen region-based relationship banking

Up to now, regional financial institutions have been making efforts to promote region-based relationship banking. They should continue and reinforce such efforts involving an entire organization, by setting up a business model looking ahead to the future, recognizing that region-based relationship banking is a way to contribute to users, the economy, and society in the relevant region, as well as improving their own financial profiles.

Based on the above, the authorities focused on the following points in checking regional financial institutions' region-based relationship banking through such measures as various hearing interviews, including those with top managers.

- A. For the purpose of sharing of knowledge and know-how about the initiatives of region-based relationship banking, the FSA held a symposium regarding region-based relationship banking in local finance bureaus across the country (11 locations). The FSA also conducted functional improvement in the symposium through the involvement of the top management of some regional financial institutions with "supporting roles of region-based relationship banking" at the symposium sponsored by local finance bureaus outside the main business areas. In addition, the management gave a keynote speech about the supports for SMEs (February to March 2014).
- B. The FSA honored eligible regional institutions for "especially advanced initiatives" and "preferable initiatives widely used." The FSA selected honored financial institutions who have continuously promoted the initiatives with "fulfillment of consulting functions for customers" and "active participation in overall regeneration in the region" on a medium- to long-term perspective (February to April 2014).

(4) Support for business improvement to SMEs

The FSA considered the program year 2013 crucial for financial institutions to start their full scale support for improvement of SMEs' business profiles, and reinforcement of business structures. Comprehensive measures as the exit strategy of the SME Act are being taken 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.

77. Risk management and stability of regional financial system

It is vital for regional financial institutions 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 regional financial institutions 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. Considering this, the FSA continued to analyze and supervise from the macro-prudential perspective, while enhancing its own risk sensitivity as a supervisor. On the other hand, the FSA encouraged voluntary efforts by individual financial institutions with focused attention on: (i) risk areas which should be focused on; (ii) improved risk management technique; and (iii) enhancement of financial foundations.

78. Improvement of customer protection and convenience for users

Improving customer protection and increasing convenience for users in financial institutions not only contributes 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. Based on the above points, the FSA inspected regional financial institutions with a focus on the following items: (i) ensuring business continuity; (ii) thorough management of information security; (iii) establishment of systems for people with disabilities; (iv) enhancement of the system for selling risky products; (v) enhancing the system for processing consultations and complaints from customers; and (vi) preventing abuse of financial functions.

79. Revision of Comprehensive Guidelines for Supervision of Small and Medium Enterprises

These supervisory guidelines were formulated on May 31, 2004, and then have been revised as needed, in order to respond appropriately to environmental changes and new issues. In the program year 2013, they were amended as follows.

80. Revision based on the recommendations of “Summary of discussions in the ‘experts’ meeting on the follow-up to the financial ADR system” (August 2, 2014)

The FSA made a revision to reflect the recommendations of “Summary of discussions in the ‘experts’ meeting on the follow-up to the financial ADR system” published on March 8, 2013 (establishment maintenance of framework for the contribution to the improvement of convenience for users in each financial institution) (applicable from August 2, 2013).

81. Revision pursuant to the amendment to administrative notice on the capital adequacy rules under domestic standards (November 22, 2013)

In response to the introduction of the new capital adequacy requirements (new domestic standards) that have been gradually applied from the end-March 2014 (promulgated March 8, 2013), the FSA made a revision to the supervisory guidelines and policies in consideration of the appropriateness and accuracy of equity capital (applicable from March 31, 2014).

82. Revision that reflects the application of the “Guidelines for Personal Guarantee Provided by Business Owners” (January 31, 2014)

In light of promoting active use of the guidelines by financial institutions and to familiarize and popularize them as lending practices, the FSA made a revision specifying the points for the establishment of a framework pursuant to the guidelines (applicable from February 1, 2014).

83. Revision pursuant to the amendment to administrative notice on the capital adequacy rules under domestic standards (third pillar) (February 18, 2014)

In response to the introduction of the new capital adequacy requirements (new domestic standards) that have been gradually applied from the end-March 2013 (promulgated March 8, 2013), the FSA made a revision on disclosure related to capital adequacy ratio (applicable from March 31, 2014).

84. Revision that reflects the review of restriction on holding of voting rights by a bank (so-called 5% rule) (March 31, 2014)

The Banking Act was revised to accommodate the Amended FIEA 2013. As a result, a revision was made so as to allow banks to flexibly provide capital. Accordingly, the FSA made a revision specifying the points for risk management to the supervisory guidelines and policies (applicable from April 1, 2014).

85. Revision that reflects the introduction of fit and proper requirements for auditors of banks (March 31, 2014)

The Banking Act was revised to accommodate the Amended FIEA 2013, with the introduction of fit and proper requirements for auditors and the audit committee members of banks. Accordingly, the FSA made a revision to the supervisory guidelines (applicable from April 1, 2014).

86. Revision that reflects the review of regulation on scope of a bank's subsidiary company concerning overseas M&As (March 31, 2014)

The Banking Act was revised to accommodate the Amended FIEA 2013. As a result, in the case of overseas M&As by banks, banks are allowed to hold the acquired foreign financial institution's subsidiary companies that do not fall on an eligible subsidiary company for a certain period. Accordingly, the FSA made a revision to the supervisory guidelines (applicable from April 1, 2014).

87. Revision related to the response against anti-social forces (June 4, 2014)

Based on the "Encouraging the Efforts to Sever Relationships with Antisocial Groups" published by the FSA in December 2013, the FSA made a revision aimed at promoting efforts to sever relationships with antisocial groups (applicable from June 4, 2014).

88. Revision regarding the introduction of outside directors in listed banks (June 4 2014)

The FSA made a revision on two points in the case of listed banks: (i) at least one independent outside director is required; and (ii) a bank holding company specified as a global systemically important financial institution (G-SIFI) is urged to place a committee or to ensure the selection of independent outside director(s) for a regional financial institution owned by the above

holding companies, even if it is a non-listed company (applicable from June 4, 2014).

c. Developments regarding Supervision of Insurance Companies

89. Measures taken based on the Annual Supervisory Policy for Insurance Companies, etc. for Program Year 2013

In the program year 2013, the FSA supervised insurance companies focusing on the following priority areas: (i) appropriate fulfillment of guarantee and compensation functions; (ii) promoting sophisticated risk management; and (iii) improvement of customer protection and convenience for users.

90. Expected roles of insurance companies and basic concepts on supervision of financial institutions

To have “Better Regulation” become further embedded and deepened, the FSA took the following approaches: (i) financial supervision and administration with a high risk sensitivity; (ii) financial administration from a citizen’s and user’s point of view; (iii) supervisory response with a forward-looking perspective; and (iv) supervisory response which contributes to financial institutions’ improvement of their management and better business judgments.

91. Appropriate fulfillment of guarantee and compensation functions

Insurance companies play a key role in people’s lives and economic activities by providing insurance coverage against various risks, and thus they are expected to maintain financial soundness and operate their businesses appropriately.

The FSA placed importance on confirming whether an insurance company has an appropriate management system for insurance payment (including (i) insurance payment management system; (ii) claims guidance system; and (iii) initiatives from an insurance policyholders’ perspective). In addition, depending on the business scale, the FSA gave detailed actions based on each attribute of insurance companies for (i) insurance groups; (ii) small and medium-sized insurance companies; (iii) foreign insurance companies; (iv) low-cost, short term insurance providers; and (v) approved specified insurance providers.

92. 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. Insurance companies, in particular, are expected to function as providers of extensive protection and compensation to prepare against unexpected situations for their customers, and upon an event that requires an insurance claim, they are expected to fulfill their function

promptly and without fail. Therefore, it is important for each insurance company's management to fully provide their leadership, establish a solid organizational structure for their operations, strictly control customer information, and thoroughly protect customers in the process of solicitation and in making insurance payments.

In particular, nominal compliance with laws for customer protection is insufficient; insurance companies should fully understand the effects and purposes of specific laws, identify the compliance levels required by customers and society, and meet their expectations as highly public financial institutions that are expected to be reliable. Insurance companies should also recognize that complaints and requests for consultations from customers may provide them with opportunities to discover potential customer needs, and should respond to them appropriately and actively.

Based on the above points, the FSA inspected insurance companies with a focus on: (i) ensuring business continuity; (ii) thorough management of information security; (iii) development of proper management systems for selling insurance products (the confirmation of the insurance solicitation process and internal systems to manage and supervise insurance solicitors, over-the-counter sales at bank, insurance solicitation system that includes a careful approach to the aging customers, given the growing diversification of insurance product distribution channels and the expansion of insurance agents); (iv) enhancing systems for processing consultations and complaints from customers; (v) accelerating and ensuring effectiveness of product examinations; and (vi) preventing abuse of insurance.

93. Revision of Comprehensive Guidelines for Supervision of Insurance Companies

These guidelines for supervision were formulated on August 12, 2005, and have been revised as needed, in order to respond appropriately to environmental changes and new issues. In the program year 2013, the following revisions were made (94~99<sup>14</sup>).

94. Revision based on the recommendations of "Summary of discussions in the 'experts' meeting on the follow-up to the financial ADR system" (August 2, 2013)

The FSA made a revision to reflect the recommendations of "Summary of discussions in the 'experts' meeting on the follow-up to the financial ADR system" published on March 8, 2013 (establishment of framework for the

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<sup>14</sup> Following those revisions, items 94, 95 and 99 of the Inspection Manual for Insurance Companies were also revised.

contribution to the improvement of convenience for users in each financial institution) (applicable from August 2, 2013).

95. Revision due to reviews of the provisions for an enterprise risk management system and insurance solicitation system (February 28, 2014)

The FSA made the revision to incorporate the provision regarding enterprise risk management that reflects the revised Insurance Core Principles (ICPs) adopted by the International Association of Insurance Supervisors (IAIS) and to add points requiring attention regarding soliciting insurance to the aging customers (effective from February 28, 2014).

96. Revision to clarify the requirements for the employees of insurance agencies (March 18, 2014)

Based on the Report by the “Working Group on the Provision of Insurance Products/Services” of the Financial System Council, the FSA made the revision to clarify the requirements for the employees of insurance agencies before the review of the rules on soliciting insurance and sales (effective from March 18, 2014).

97. Revision that reflects the review of restriction on holding of voting rights by a bank (so-called 5% rule) (March 31, 2014)

The Banking Act was revised to accommodate the Amended FIEA 2013. As a result, a revision was made so as to allow banks to flexibly provide capital. Accordingly, the FSA made a revision specifying the points for risk management to the supervisory guidelines and policies (applicable from April 1, 2014).

98. Revision that reflects the introduction of fit and proper requirements for auditors of banks (March 31, 2014)

The Banking Act was revised to accommodate the Amended FIEA 2013, with the introduction of fit and proper requirements for auditors and the audit committee members of banks. Accordingly, the FSA made a revision to the supervisory guidelines (applicable from April 1, 2014).

99. Revision related to the response against antisocial groups (June 4, 2014)

Based on the “Encouraging the Efforts to Sever Relationships with Antisocial Groups” published by the FSA in December 2013, the FSA made a revision aimed at promoting efforts to sever relationships with antisocial groups (applicable from June 4, 2014).

d. Developments regarding Supervision of Financial Instruments Business Operators

100. Measures taken based on the Annual Supervisory Policy for Financial Instruments Business Operators, etc. for Program Year 2013

In the program year 2013, the FSA supervised financial instruments business operators based on “Basic Concepts on Future Supervision of Financial Institutions,” with the focus on basic financial supervision for the following three areas: (i) appropriate functioning of market intermediation; (ii) risk management and the stability of the financial system; and (iii) improving customer protection and convenience for users.

101. Environment surrounding financial and capital markets and basic concepts on future supervision of financial institutions

The FSA basically continued efforts to further embed and deepen “Better Regulation,” and placed emphasis on (i) financial supervision and administration with high risk sensitivity; (ii) financial administration from a citizen’s and user’s point of view; (iii) supervisory response with a forward-looking perspective; and (iv) supervisory response which contributes to financial instruments business operators’ improvement of their management and making better business judgments.

102. Appropriate performance of market intermediation functions

Financial instruments business operators play roles in enabling smooth transactions by serving as market intermediaries when investors and fundraisers access the market. These roles are the core roles that financial instruments business operators should play in the market, and financial instruments business operators are expected to assume the professional responsibility, recognizing the public nature of their roles. Financial instruments business operators are thus required to enhance investors’ confidence in Japan’s financial markets and contribute to the development of the financial market and Japanese economy by conducting highly reliable business operations with adequate user protection taken into account, by performing market intermediary functions adequately, and by making contributions to fair price formation for financial instruments.

The FSA supervised financial instruments business operators with particular attention paid to: (i) developing an internal control system to enable their appropriate performance of market intermediary functions; (ii) encouraging contributions to expanding the risk money supply for economic growth; (iii) establishing appropriate internal systems for Customer Solicitation and Explanation for the introduction of NISAs; (iv) strict management of customer information and corporate information; (v) preventing illegal

securities trading; and (vi) preventing inappropriate activities associated with benchmark interest rates.

#### 103. Risk management and stability of the financial system

Earnings of financial instruments business operators have improved recently, led by increasing fees/commissions and fund flows to investment trusts in the active stock market that started in November 2014. However, more attention should continuously be paid to the business environment and the financial market, including financial and economic trends overseas. Under these conditions, it is increasingly important for financial instruments business operators to achieve high quality risk management.

The FSA supervised financial instruments business operators with particular attention paid to: (i) facilitating integrated risk management for entire securities company groups; (ii) preparations for business risk at small and medium-sized securities companies (domestic and foreign), and investment management companies; and (iii) initiatives for monitoring various funds.

#### 104. Improvement of customer protection and convenience for users

Improvement of customer protection and convenience for users of financial institutions not only contributes to the development of a sound national economy, but also stabilizes the Japanese financial system by enhancing citizens' trust in financial institutions. Financial instruments business operators are expected to establish robust business operation systems under the management leadership, and ensure the protection of customers' interest and a sense of security and trust. Based on this, financial instruments business operators should accurately reflect customers' needs, endeavor to provide innovative financial products/services to enhance their competitiveness, and contribute to the sound growth of Japan's financial market.

Particularly, compliance regarding customer protection is not enough to be met just by formal observance of laws and regulations. Financial instruments business operators should fully understand the objectives of laws and regulations, and understand customers' requests and meet their expectations in a reliable manner as their functions have a highly public nature.

Considering the above points, the FSA supervised financial instruments business operators with the focus on: (i) sales systems; (ii) complaint and consultation handling system; (iii) business continuity (systems & BCP); (iv) discretionary investment business operators; (v) foreign currency margin transactions; (vi) Type II financial instruments business; (vii) credit rating agencies; and (viii) addressing financial crimes.

In doing so, the FSA respected the self-motivated efforts of each financial

instruments business operator and proceeded with supervision that places importance on incentives. In its supervision of financial instruments business operators, the FSA also paid attention to (i) under what kinds of management policies, what kinds of financial products and services financial instruments business operators are providing to customers with what kinds of profiles; (ii) whether there are warped incentives that may arise because financial instruments business operators are pursuing short-term profits or because they have conflicts of interest; and (iii) whether a system is developed to internally check (including by management) whether management policies are thoroughly implemented in a front office.

Further, in view of recent compliance issues such as the MRI problem, the FSA enhanced its risk-based supervisory approach by strengthening its monitoring system and improvement of information analysis by proper and effective uses of limited human resources.

105. Revision of Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.

These supervisory guidelines were formulated on September 30, 2007, and have been revised as needed in order to respond appropriately to environmental changes and new issues. In the program year 2013, they were amended as follows.

106. Revision that reflects the status of over-the-counter binary option transactions for individuals (July 3, 2013)

The FSA added material relating to products and customer management in accordance with the revision of the Cabinet Office Ordinance for over-the-counter binary option transactions for individuals. In addition, the FSA also added material on whether to comply with the provisions of the self-regulatory rules as “supervisory viewpoints” (effective from August 1, 2013).

107. Revision based on the recommendations of “Summary of discussions in the ‘experts’ meeting on the follow-up to the financial ADR system” (August 2, 2013)

The FSA made a revision to reflect the recommendations of “Summary of discussions in the ‘experts’ meeting on the follow-up to the financial ADR system” published on March 8, 2013 (establishment maintenance of framework for the contribution to the improvement of convenience for users in each financial institution) (applicable from August 2, 2013).

108. Revision that reflects the handling of slippage in currency-related

over-the-counter derivative transactions (August 9, 2013)

The FSA added symmetrical handling as a “supervisory viewpoint” for “slippage” in currency-related over-the-counter derivative transactions (the difference between the price indicated to the customer at order or designated by the customer at order and the actual contracted price). The FSA clarified that any profit or loss arising from slippage shall either both be passed on or neither passed on to each customer; passing only one of the two on to the customer shall not be permitted (effective from August 9, 2013).

109. NISA Revision due to the introduction of NISA (August 27, 2013)

Given that NISA is being introduced in January 2014, the FSA added points to pay attention to regarding soliciting sales of NISA (development of controls when sales representatives give an explanation of the product and provision of financial instruments in line with the design and purpose of the system) to ensure that NISA will be used in accordance with its institutional purpose to provide a buildup of assets to support households and expand the supply of funds for growing companies (effective from August 27, 2013).

110. Revision that reflects frequent problems regarding soliciting sales of financial instruments to elderly customers (December 16, 2013)

The FSA added points to pay attention to regarding soliciting sales of financial instruments to elderly customers (maintenance and compliance with internal rules in light of JSDA self-regulatory rules and follow-up for elderly customers after the sale of financial instruments) on the overall supervisory guidelines for financial instruments business operators (effective from December 16, 2013).

111. Revision due to the additional information to be included in pre-contract documents regarding equity dividend for investment corporations (February 14, 2014)

In accordance with the revision of the Cabinet Office Ordinance to the effect that the matter regarding money flow of investment corporations is included in pre-contract documents regarding the equity dividend of an investment corporation that are delivered in advance to each customer before the sale thereof, the FSA also added points to pay attention to regarding matters to be included in the pre-contract documents for equity interest for investment corporations in the overall supervisory guidelines for financial instruments business operators (effective from April 1, 2014).

112. Revision that reflects the “Recommendations for Vitalizing Financial and Capital Markets” published in December 2013 (March 7, 2014)

In response to the “Recommendations for Vitalizing Financial and Capital Markets” that was compiled by the Panel for Vitalizing Financial and Capital Markets in December 2013, the FSA added points to pay attention to when evaluating the performance of sales representatives (how much importance to attach to the sales commissions received) (effective from March 7, 2014).

113. Revision due to request to relax firewall regulations (March 28, 2014)

In response to the request to relax firewall regulations, the Cabinet Office Ordinance was revised (relaxation of written consent requirements relating to the communication of undisclosed customer information within the group of financial institutions). In response to this revision, the FSA added a flexible opt-out opportunity regarding undisclosed corporate customer information (system in which undisclosed customer information may be communicated within the group of financial institutions until the customer requests not to do so) on the overall supervisory guidelines for financial instruments business operators (effective from April 1, 2014).

114. Revision related to the response to anti-social forces (June 4, 2014)

Based on the “Encouraging the Efforts to Sever Relationships with Antisocial Groups” published by the FSA in December 2013, the FSA made a revision aimed at promoting efforts to sever relationships with antisocial groups (applicable from June 4, 2014).

115. Revision to clarify what dealings are classed as an unregistered business operator (June 27, 2014)

The FSA clarified what dealings are classed as Type I financial instruments business and what dealings are classed as Type II financial instruments business (effective from June 27, 2014).

## Box: Response to Anti-Social Forces

### - Circumstances

The Working Team on Comprehensive Measures against Funding Sources for Boryokudan (Organized Crime Groups) was established through alignment of the relevant ministries and agencies on July 21, 2006. The Working Team aims to examine comprehensive measures designed to exclude Boryokudan from public works and to cut off funding sources for Boryokudan from corporate activities. The measures are based on the “Action Plan to Create a Crime-Resistant Society,” which intends to restore the image of Japan as “the safest country in the world” (Ministerial Meeting Concerning Measures Against Crime in December 2003). The “Action Plan to Create a Crime-Resistant Society 2008” was formulated in December 2008 to take measures against Boryokudan by excluding Boryokudan and their peripheral persons from economic activities and to enhance anti-money laundering control in accordance with the result of FATF mutual evaluation. In addition, the strategy to “Make Japan the Safest Country in the World” (approved by the Cabinet in December 2013) also contains the purpose to exclude Boryokudan from corporate activities and private transactions and to enhance anti-money laundering control in accordance with the FATF recommendation.

The FSA has been working to implement the above objectives in cooperation with the relevant ministries and agencies.

### - The Working Team on Comprehensive Measures against Funding Sources for Boryokudan

On June 20, 2006, the Seventh Ministerial Meeting Concerning Measures against Crime gave instructions to establish a Working Team on Comprehensive Measures against Funding Sources for Boryokudan. On July 21, 2006, the relevant ministries and agencies jointly established a Working Team based on the above ministerial instruction. (It was renamed the Working Team on Comprehensive Measures against Boryokudan in July 2007.)

### - Exclusion of Boryokudan from corporate activities

(i) The Group to Exclude Boryokudan from Corporate Activities was established as a subordinate organization of the Working Team on Comprehensive Measures against Funding Sources for Boryokudan. This Group worked on formulating the basic principles and specific responses for companies to prevent damage from anti-social forces in its Guidelines on How Companies Prevent Damage from Anti-Social Forces (government guidelines). On June 19, 2007, the Guidelines were agreed upon at an executive meeting of the Ministerial Meeting Concerning Measures against Crime, and on July 3, 2007 they were reported to the ninth Ministerial Meeting Concerning Measures against Crime.

(ii) Based on the government’s policy, the FSA issued a request to the financial relevant industry group in July 2007, and revised the supervisory guidelines for each business category in March 2008. In December 2013, the FSA published measures in order to cut off relations with anti-social forces. In addition, in June 2014, the FSA amended the supervisory guidelines to promote preventive measures such as enhanced customer due diligence measures and information sharing among financial institutions belonging to the same financial group to avoid transactions with anti-social forces, and committed itself to eliminating anti-social forces from financial transactions.

(iii) The FSA has strengthened its cooperation to eliminate anti-social forces through the “Anti-Social Forces Intervention Exclusion Measures Council,” consisting of the FSA, the National Police Agency and the Japanese Bankers Association across the nation. The Bank and Police Liaison Council established at each prefecture plays a similar role at the local level.

The Japanese Bankers Association published reference examples of the Boryokudan exclusion clause (financing transactions in November 2008, and savings provisions in September 2009). In June 2011, the Japanese Bankers Association partially revised the reference examples to clarify the exclusion target in line with the actual activities of Boryokudan. Other industry associations also successively presented reference examples of the Boryokudan exclusion clause.

In April 2010, the Japanese Bankers Association put into operation a shared database of information on anti-social forces. In November 2013, the Association published “Approaches to Cutting Off Relations with Anti-Social Forces” to ensure that each member bank would terminate their relationships with anti-social forces when providing financial services through alliances with other institutions (for example, consumer credit companies).

(iv) The FSA has strengthened cooperation in order to eliminate anti-social forces through a Securities Safety Liaison Committee consisting of the FSA, the National Police Agency and the Japan Securities Dealers Association (JSDA) across the nation. The Securities Police Liaison Council established at each prefecture plays a similar role at the local level.

In addition, the JSDA was registered by the National Public Safety Commission as an “unfair request information management agency” as stipulated in the Act for the Prevention of Wrongful Acts by Members of Organized Crime Groups in March 2009 and it commenced the operations. In May 2010, the JSDA enacted self-regulatory rules imposing the mandatory introduction of the Boryokudan exclusion clause.

In April 2010, the JSDA asked the National Police Agency to provide a Boryokudan database so that it could use the information. In May 2010, the National Police Agency announced its policy to build a framework to provide such information. In February 2013, the Boryokudan database held by the National Police Agency was connected to the JSDA system, allowing the JSDA to query the National Police Agency’s database.

(v) In January 2012, the Life Insurance Association published a provisional example of policy conditions containing the Boryokudan exclusion clause, following consultations with the FSA, the National Police Agency and the Ministry of Justice. In November 2013, the Life Insurance Association also published “Initiatives Aimed at Eliminating Relationships with Anti-Social Forces.”

In April and July 2013, the Small Amount & Short Term Insurance Association of Japan and the General Insurance Association of Japan published a provisional example of policy conditions containing the Boryokudan exclusion clause respectively, following discussions with the FSA and National Police Agency. In addition, the General Insurance Association of Japan published “Strengthening Efforts to Eliminate Anti-Social Forces” in November 2013.

**Box: Designated Dispute Resolution Organizations**

In addition to the Financial Instruments and Exchange Act, the Finance Related Laws and Regulations (the Banking Act and the Insurance Business Act) provide a Financial ADR System (alternative dispute resolution system in the financial sector). This system aims to improve protection and convenience for financial services users through providing quick, simple, neutral and fair processing of complaints and resolution of conflicts, regarding problems with financial institutions. Each designated dispute resolution organization plays a core role in the financial ADR system. With this, the administrative agency has an effective framework to ensure neutrality and fairness by designating and overseeing designated dispute resolution organizations.

For the supervision of designated dispute resolution organizations, the FSA formulated Comprehensive Guidelines for Supervision of Designated Dispute Resolution Organizations (formulated on August 2, 2013). The FSA supervises designated dispute resolution organizations by assessing the adequacy of their operations including their management system, with the aim of ensuring improved reliability for users and consistent operations reflecting the characteristics of each organization.

As of June 2014, the following bodies are designated dispute resolution organizations.

(as of June 30, 2014)

Date Designated	Institution Name	Type of Business
2010.9.15	Japanese Bankers Association	<ul style="list-style-type: none"> <li>Banking services</li> <li>Norinchukin Bank's business</li> </ul>
2010.9.15	Trust Companies Association of Japan	<ul style="list-style-type: none"> <li>Trust business subject to dispute resolution procedure</li> <li>Specific concurrent business</li> </ul>
2010.9.15	The Life Insurance Association of Japan	<ul style="list-style-type: none"> <li>Life insurance services</li> <li>Foreign life insurance services</li> </ul>
2010.9.15	The General Insurance Association of Japan	<ul style="list-style-type: none"> <li>Non-life insurance services</li> <li>Foreign non-life insurance services</li> <li>Specified non-life insurance services</li> </ul>
2010.9.15	The Insurance Ombudsman	<ul style="list-style-type: none"> <li>Non-life insurance services</li> <li>Foreign non-life insurance services</li> <li>Specified non-life insurance services</li> <li>Insurance solicitation by insurance brokers</li> </ul>
2010.9.15	The Small Amount & Short Term Insurance Association of Japan	<ul style="list-style-type: none"> <li>Low-cost, short-term insurance services</li> </ul>
2010.9.15	Japan Financial Services Association	<ul style="list-style-type: none"> <li>Money lending operations</li> </ul>
2011.2.15	Financial Instruments Mediation Assistance Center	<ul style="list-style-type: none"> <li>Specified Type I Financial Instruments Transaction Services</li> </ul>

#### iv. Trends in the Development of International Relations

##### a. International Initiatives for the Prevention of Reoccurrence of a Financial Crisis

###### 116. Overview

The first G20 summit was held in Washington, D.C. in November 2008 in response to the Global Financial Crisis that erupted full-scale in the autumn of 2008. Since then, various issues on financial regulatory reforms have been discussed and agreed to prevent a recurrence of the financial crisis in a variety of forums, including the G20, the FSB (the Financial Stability Board), and standards setting bodies.

Since most of these agreements move into the implementation stage, coordination among the relevant authorities becomes an urgent task to avoid any market fragmentation arising from inconsistency of regulations. The FSA has actively participated in initiatives to address these challenges.

## b. Financial Supervisory International Organization

### 117. Overview

The FSA has actively participated in both sectoral and cross-sectoral international conferences in the financial field composed of the regulatory and supervisory authorities of each country in order to respond adequately to the activities of financial institutions and the internationalization of financial transactions. Specifically, the FSA has engaged in sectoral international conferences by international organizations including the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) as well as cross-sectoral international conferences by those including the FSB and the Joint Forum. These conferences formulate international supervisory rules regarding international principles, standards and guidelines for the supervision of financial institutions to promote the stability of the international financial system. Representing Japan, the FSA is committed to making a positive contribution in order to demonstrate international leadership.

#### Box: Bilateral cooperation frameworks in the securities field (As of June 2014)

Amid growing cross-border transactions with the ongoing integration of the securities markets in different countries, it is essential to enhance cooperation with the securities regulatory authorities in those countries in order to properly regulate and supervise securities markets and securities trading.

Up to now, the FSA has established cooperation frameworks in the securities fields with the China Securities Regulatory Commission (CSRC) (in 1997), the Monetary Authority of Singapore (MAS) (in 2001), the U.S. Securities and Exchange Commission (SEC) and the U.S. Commodity Futures Trading Commission (CFTC) (in 2002), the Australian Securities and Investments Commission (ASIC) (in 2004), the Securities and Futures Commission of Hong Kong (SFC) (in 2005), and the New Zealand Securities Commission (NZSC) (2006).

In January 2006, the FSA revised the framework with the U.S. Securities and Exchange Commission (SEC) and the U.S. Commodity Futures Trading Commission (CFTC) to add financial futures in the scope of cooperation.

In addition, the FSA has established cooperation frameworks with the European Securities and Markets Authority (ESMA) in the area of credit rating agencies (in 2011), with 29 securities regulatory authorities in the EU related to the supervision of funds and fund managers conducting their business on a cross-border basis (in 2013), and with the U.S. Commodity Futures Trading Commission (CFTC) in the supervision and oversight of regulated entities that operate on a cross-border basis in both Japan and the United States (in 2014).

### c. Other International Forums in the Financial Sector

#### 118. Overview

Since it is increasingly important to ensure the safety of the financial sector in terms of the potential impact on the macro economy, initiatives on financial administrations have been taken in international forums other than those composed of the regulatory authorities mentioned in the previous section. The World Trade Organization (WTO) has also started negotiations on liberalizing financial services trade. The FSA has been actively participating in these forums, including the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD) and the WTO, with the aim of reflecting the position of our country and contributing to stabilizing the international financial system and liberalizing financial services trade.

**Box: Progress of Negotiations over Economic Partnership Agreements Involving Japan (As of June 2014)**

#### - Bilateral EPA

The Economic Partnership Agreement (EPA) aims to promote the liberalization of the flow of goods, people, services, capital and information across the borders between two countries or areas with close economic relations to strengthen or unify the economic activities as a whole.

Japan has already concluded EPAs with Singapore (came into force in November 2002, and the Amending Protocol which came into force in September 2007), Mexico (came into force in April 2005), Malaysia (came into force in July 2006), Chile (came into force in September 2007), Thailand (came into force in November 2007), Indonesia (came into force in July 2008), Brunei (came into force in July 2008), the Philippines (came into force in December 2008), ASEAN (came into force in December 2008), Vietnam (came into force in October 2009), Switzerland (came into force in September 2009), India (came into force in August 2011), and Peru (came into force in March 2012). Currently, Japan is negotiating EPAs with Australia, the EU, ASEAN, Canada, Mongolia, Colombia, South Korea, and the Regional Comprehensive Economic Partnership (RCEP), and also negotiating a Free Trade Agreement (FTA) with China and South Korea (EPA negotiations with South Korea were suspended in 2004, and so were those with the Gulf Cooperation Council countries in 2009).

It was announced that Japan substantially agreed with Australia in April 2014, and agreed to start negotiations with Turkey at a top-level meeting in January 2014.

## APPENDIX I. Inquiries to the FSA

### i. Opening of the one-stop inquiry desk in English

The FSA opened the one-stop inquiry desk (emailed to: [equestion@fsa.go.jp](mailto:equestion@fsa.go.jp)) for inquiries in English concerning: (i) interpretations of laws and regulations; or (ii) specific procedures necessary to practice in the Japanese financial market. Since its establishment, the one-stop inquiry desk received 77 inquiries, 16 of which were replied to, by the end of the program year 2013. Forty out of 77 inquiries were related to fraudulent solicitation for investment in securities, five were concerning administrative procedures, six were regarding laws and regulations, and 26 were on other matters.

#### Box: Examples of the answers to the inquiries

- Setting up an alternative investment fund and offering foreign collective investment schemes (CIS) in Japan

Businesses offering foreign CIS to residents of Japan as private placements are required to register as a Type II Financial Instruments Business Operator or submit in advance a notification. It is advisable to consult with a Japanese-speaking attorney specialized in the Financial Instruments and Exchange Act (FIEA) and business procedures in Japan before the registration\*.

Specific procedures for registering as a Type II Financial Instruments Business Operator are as follows.

FIEA stipulates that a person (including an entity) who engages in self-offering of equity interest of collective investment scheme (fund) or manages invested or contributed assets is required to register as a Financial Instruments Business Operator (as a “Type II Financial Instruments Business Operator” for self-offering and “Investment Management Business Operator” for investment management).

Local finance bureaus are delegated with the authority to administer the above registration process. Usually, the applicant submits the required documents, via an attorney who is specialized in Japanese laws to the local finance bureau in advance for a preliminary review (the time required for a preliminary review differs on a case-by-case basis). After the preliminary review is completed and the required documents are formally accepted, the registration process will be completed within two months. In the registration process, the applicant is required to submit to the local finance bureau the certification documents, and the description of the funds.

If you have questions regarding the registration process, please contact Kanto Local Finance Bureau (the Local Finance Bureau in charge, if you have a physical office or an agent

in Tokyo). Kanto Local Finance Bureau will provide you necessary information on your request.

Also, please note that, the Type II Financial Instruments Business Operators are required fulfill the following requirements: i) join the industry association and abide by its self-regulatory rules, or ii) prepare in-house rules consistent with the association's self-regulations and maintain a system to abide by the rules. The revision will also require Type II Financial Instruments Business Operators to establish a physical office or have an agent in Japan.

- Registration requirements to be an investment advisor

If a person (including entities) provides advice to his/her clients such as,

- Developing individualized investment portfolios for clients based on financial circumstances
- Recommending diversified investment instruments
- Portfolio management and re-balancing
- Recommending closing positions and opening new positions,

he/she is required to register as an investment advisory business. A person who receives remuneration for his/her investment advice to the customer based on the contract should be registered as an investment advisory business with the Local Finance Bureau with jurisdiction over the area where the person's office is located.

It is required to establish an appropriate organizational structure for an Investment Advisory Business. For example, 1) the board members and executive officers should fully understand the FIEA and have enough knowledge and experience to operate a fair and appropriate investment advisory business, 2) the company should employ those who could provide investment advice based on sufficient knowledge and experience as an advisory business operator regarding securities, and 3) the company should prepare and keep books and documents.

The violation of the law in relation to investment advisory business shall be charged with imprisonment for five years at most or a fine of JPY 5 million at most, or both (FIEA Article 197 (2) (x) (d).)

## ii. Prior Confirmation Procedures on the Application of Laws and Regulations (“No Action Letter” System)

The Japanese Government introduced a “no action letter” system based on March 27, 2001 Cabinet Decision entitled “Regarding the Introduction of Prior Confirmation Procedures on the Application of Laws and Regulations by Administrative Agencies.”

The Cabinet Decision stated that, “With respect to fields experiencing the risk creation of new industries and new products and services, including information technology and finance, in order to increase a private enterprise’s ability to predict whether a certain action would conflict with laws and regulations, administrative agencies will arrange so that a private-sector enterprise can inquire in advance as to the relationship between the action concerned and the provisions of certain laws and regulations. In addition, in order to ensure the fairness of administration and promote the increase of transparency, the contents of the inquiry concerned and the administrative agencies’ responses will be made public.” To this end, the Cabinet established guidelines with regard to the above fields, “...for procedures in which a private enterprise, etc. confirms in advance with the administrative agency having jurisdiction to enforce certain laws and regulations whether specific actions in connection with business activities that the enterprise, etc. seeks to realize are subject to the provisions of the regulations concerned, such agency responds, and the response is made public.”

Based on this Cabinet decision, the FSA introduced a no action letter system on July 16, 2001. The system was last revised on July 2, 2007.

This current no action letter system is detailed below.

### 1. Subject

#### (1) Scope of the FSA No Action Letter System

The scope of the FSA no action letter procedures covers inquiries from an individual or a private-sector enterprise subject to laws and any regulations over which the FSA has jurisdiction. The inquiries are categorized into the following patterns:

- (i) Inquires where the provision concerned determines the basis for disposition of an application (this means an application as specified in Article 2, Item 3 of the Administrative Procedures Law (Law No. 88, promulgated November 12, 1993)) and the act of violating the provision concerned is subject to penal provisions; or
- (ii) Inquires where the provision concerned determines the basis for identifying activities that require the notification of certain matters to administrative agencies and the act of violating the provision concerned is subject to penal provisions; or
- (iii) Inquires where the provision concerned determines the basis for unfavorable disposition (this means an unfavorable disposition as specified in Article 2, Item 4 of the Administrative Procedures Law); or

(iv) Inquires where the provision concerned imposes obligations on private companies or restricts their rights directly, with or without unfavorable disposition, where the FSA finds it necessary.

## (2) Publication of Subject Laws and Regulations

The FSA maintains on its website a list of its sections and the laws and regulations for which each section has jurisdiction. The FSA revises this list to reflect recent information.

## 2. Inquiries

### (1) Contact Point for Submission

Inquiries may be submitted to the Coordination Division of the Supervisory Bureau. In cases where the inquiry is submitted to a local Finance Bureau, the Bureau will forward the inquiry to the Coordination Division of the Supervisory Bureau by fax, etc. immediately. The Coordination Division has to immediately accept the inquiry if it meets the requirements, and forward it to the section that has jurisdiction over the regulation in question.

### (2) Scope of Eligible Inquirers

The following individuals or entities may submit an inquiry to the FSA:

- (i) The individual or legal entity (corporation or industry association/foundation) planning to introduce a new product or service and wishing to inquire about the applicability of the laws and regulations discussed in part 1; and
- (ii) A lawyer or other specialist representing the individual or entity planning to introduce a new product or service.

In addition to submitting an inquiry that meets the requirements discussed in part 2.(3) below, an inquirer need also agree to the publication of the content of the inquiry, and the response thereto.

### (Caution)

In cases where the inquirer is a legal entity, the inquiry needs to be made in the name of an executive officer of that entity. When an inquiry is submitted by a lawyer or other specialist on behalf of a client, the inquiry needs also include the submission of a power of attorney letter. If that client is a corporation, the power of attorney needs to be made under the name of an executive officer of that entity.

An inquiry could be made in joint names of specialists and corporation. In such a case, it is not necessary to submit a power of attorney letter.

“Lawyer or other specialist” refers to lawyers, CPAs, etc. or those possessing a high level of specialized knowledge with regard to the subject of the inquiry under

Japan's jurisdiction.

### (3) Inquiry Content

All inquiries need to be submitted in writing in Japanese (including electronic means) and need to meet the following requirements:

- (i) A description of the individual, specific facts relating to actions the enterprise seeks to take in the future;
- (ii) Specific indication of the provisions of laws and regulations among those made public, per section 1.(2) above, on the FSA website, or government orders based on those laws and regulations, with respect to which the inquirer wishes to determine applicability to its prospective action;
- (iii) A statement from the inquirer agreeing to the contents of its inquiry and the response thereto being made public; and
- (iv) The inquirer's clearly stated opinion concerning the applicability of the provisions of laws and regulations specified in 2.(3)(ii) above, and the basis for this opinion.

### (4) Submission of Additions and Corrections to Inquiries

The FSA may, if necessary, request that the inquirer submit additional or corrected documents in cases in which the content of a written inquiry is insufficient, or it is necessary to confirm the identity of the inquirer. The inquirer will only be asked for additional paper work that is demand essential to meet the requirements for the FSA.

## **3. Responses**

### (1) Response Timeframe

In principle, the Director of the section that has jurisdiction over the regulation in question will issue a response to an inquiry within 30 days of the arrival of a written inquiry at the contact point. However, in the following exceptional cases, the timeframe will be extended. The FSA is required to ensure that the response time, including the period for submitting additional or corrected documents, is as short as possible.

- (i) In cases in which the inquiry involves advanced finance techniques or technology, and for which a response requires careful judgment, the FSA will issue a response within 60 days (in principle) of the initial receipt of the inquiry.
- (ii) In cases in which the quantity of inquiries exceeds the specific section's capacity to issue timely responses, a response will be issued within a reasonable time period exceeding 30 days.
- (iii) In cases in which the regulations/laws in question are jointly administered by the FSA and another government agency, a response will be issued within 60 days (in

principle) of the initial receipt of the inquiry.

In cases of above 2.(4), in which corrected or additional information was requested of the inquirer, the days involved in gathering this additional information **will not** be counted in the 30 day time period.

If the FSA cannot issue a response to an inquiry within 30 days, the FSA will notify the inquirer of the reason for the delay and the expected time of response.

#### (2) Respondent

The FSA response will be issued by the Director of the section that has jurisdiction over the law or regulation in question.

#### (3) Method of Response

Responses to an inquiry will be made in writing in Japanese. However, the foregoing should not apply in cases where the inquirer agrees to receive a verbal response.

In Responses, both the opinion on whether or not the laws and regulations mentioned in the inquiry are applicable, and the basis for that opinion, are clearly stated, and the following cautions are attached.

(Caution): A written response

- should contain a clear statement to the effect that the response in question;
- is made from the position of having jurisdiction to enforce the laws and regulations (provisions) subject to the inquiry;
- is premised only on the facts as presented by the inquirer;
- is made only with respect to the relationship of the prospective business activities to the laws and regulations (provisions) subject to the inquiry;
- indicates the FSA's opinion as of that present time;
- may be different in cases in which: the facts differ from what was presented in the inquiry; related facts exist that were not presented in the inquiry; the related laws and regulations are changed; etc.; and
- cannot bind the determination of any investigative agency or the finding of any court, including the application of penal provisions.

#### (4) Cases of No Response

In the following cases, the Director of the relevant FSA section receiving an inquiry may elect not to respond to the inquiry. In the event no response is made to an inquiry for any of the reasons, the Director of the relevant FSA section notifies the

inquirer without delay that no response is made to the inquiry, and indicates the reason for the decision not to respond:

- (i) The inquiry contains insufficient or unclear factual information upon which to base a decision;
- (ii) The inquiry concerns independent private sector rules or arrangements;
- (iii) The inquiry involves cases on which the FSA has already publicly and clearly stated its opinion by announcement or detailed regulations;
- (iv) The inquiry is substantively the same as a previous inquiry to which the FSA has already posted a public response on its website;
- (v) The inquiry regards circumstances for which the inquirer is currently under legal investigation, etc., or in which a law actually is being enforced; and
- (vi) The inquiry relates to a similar matter which is being contested legally (a lawsuit; a statement of complaint under the Administrative Complaint Investigation Law; or a statement of complaint under another law).

#### (5) Withdrawal of an Inquiry

The Director of the relevant FSA section will not respond to an inquiry, if, prior to the issuance of a response, the inquirer requests that the inquiry be withdrawn. When the inquirer requests that the inquiry be withdrawn, the guidelines below regarding publication are not applicable.

### **4. Method of Publication of Inquiries and Responses**

As a general rule, the contents of its inquiry and the response thereto should be posted on the FSA website within 30 days of the issuance of the response.

However, in cases in which the inquirer, in a supplementary note, requests a delay in publication of the inquiry and response within a certain period of time, offers reasonable grounds for such a delay, and specifies a time when publication will be possible, upon confirmation of the reason for the requested delay, the FSA may delay the publication of the inquiry and response. In such cases, the delay in publication may not necessarily last as long as the inquirer requests. The publication may be delayed only as long as the rationale provided by the inquirer for the delay continues to apply.

The FSA may make the inquiry and response public provided it has given prior notification to the inquirer. In a case where an inquiry or the response thereto contains information that falls under the category of an event of non-disclosure as prescribed in the Law Concerning the Disclosure of Information Retained by Administrative Agencies (Law No. 42, promulgated May 14, 1999) the FSA may, as necessary, withhold such information from disclosure.

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Above section 4. revised and enforced July 4, 2003.

Above section 3.(3),(5) revised and enforced May 14, 2004.

Above sections 2.(3), and 3(1),(3),(4) revised and enforced October 7, 2005.

Above sections 1.(1), 2.(1),(2),(3),(4),3.(1) and 4 revised and enforced July 2, 2007.

### iii. Written Inquiry Process for financial industry participants (regarding General Interpretations of Laws and Regulations)

#### - Scope of Inquirers

Inquirers need to be business operators/business groups to which the laws and regulations under the FSA's jurisdiction are directly applicable.

#### - Subject of Inquiries

An inquiry is to satisfy all of the following requirements in order to be subject to the said process:

- (i) Asking about the general interpretation of the law or regulation, not asking whether a law or regulation is applicable to a specific transaction. (Not eligible for the application of the Prior Confirmation Procedures on the Application of Laws and Regulations ("No Action Letter" System).);
- (ii) Not seeking factual recognition;
- (iii) Asking about transactions and other matters which are common to business operators to which the laws and regulations under the FSA's jurisdiction are directly applicable and which a number of business operators are expected to inquire into; and
- (iv) Not asking about points that are clear in light of the Guideline for Administrative Processes and other publicly-available materials.

#### - Method of Inquiry

The specific inquiry method through the said process is as follows:

- (i) Inquiries should be made in writing in Japanese (including electronic means) to the Director of the relevant FSA division with jurisdiction over the law or regulation in question.
- (ii) The written inquiry form is expected to clearly indicate that the following items are specified therein. In addition to the written inquiry, the inquirer may be asked to submit additional or corrected documents, if necessary, in order to clarify the contents of the inquiry and judge whether it meets the criteria specified in "Subject of Inquiries" above.
  - a. The legal provision which the inquiry concerns and specific points of issue;
  - b. The inquirer's opinion concerning the inquired points of issue and the basis thereof; and
  - c. A statement from the inquirer agreeing to have the contents of the inquiry and the response thereto made public.

- Method of Response

The Director of the relevant FSA division will endeavor to reply to the inquirer within two months in principle of the arrival of a written inquiry. In cases where it is not possible to reply within two months, the Director will provide the reason for the delay and the expected date of reply to the inquirer.

- Method of Publication

After a response is provided to the inquirer, the inquiry and the response will be immediately posted on the FSA website. (The names of the inquirer and the Director of the relevant division will not be disclosed.)

- Number of Responses to Date

The total number of response to date since the introduction of the system is four (one inquiry in the program year 2013).

- Other Points of Attention upon Use

- a. Relationship to the “No Action Letter” System

Inquiries regarding specific cases to which the “No Action Letter” System (Prior Confirmation Procedures on the Application of Laws and Regulations by Administrative Agencies) is applicable are not subject to this process.

- b. Scope of the Responses

Responses will express general interpretations of the law and regulation in question at the time of inquiry, and do not provide judgment regarding the application of the law or regulation to a specific case. Furthermore, they do not have binding power on the judgment of the investigative and/or judicial authorities.

APPENDIX II. Enforcement Measures

i. Financial Administrative Actions

- Basic Concepts of Administrative Actions

The FSA takes strict and appropriate administrative actions<sup>15</sup> under clear rules if it objectively confirms that a serious problem has arisen in user protection or in ensuring fairness in the market through on-site inspections, collection of reports and other supervisory methods.

In March 2007, the FSA published “Administrative Actions in the Financial Sector” to make clear the basic principle of administrative actions. In April 2008, the FSA made a revision reflecting the spirit of “Principles in the Financial Services Industry (hereinafter, “Principles”).” This revision made it clear that alleviation of administrative actions might be made in a case where each financial institution makes voluntary responses accurately, reflecting the spirit of the Principles.

Box: Statistics of administrative actions in the program year 2013 (by business category)

The number of implementations of administrative actions by business category<sup>16</sup> in the program year 2013 is as follows<sup>17</sup>:

1. Banks	5	[1]
2. Cooperative structured financial institutions	1	[0]
3. Financial instruments business operators	43	[19]
4. Insurance companies	0	[0]
5. Money lenders	0	[0]
6. Specific Purpose Companies	0	[0]
7. Issuers of prepaid payment instruments	0	[0]
8. Fund transfer business operators	0	[0]

<sup>15</sup> “Administrative Actions” in this section refers to adverse dispositions (recommendation, order for business improvement, correction order, warning, order to change plans, instruction for business improvement, order for business suspension, rescission of registration, rescission of permission, order for business discontinuance, order to dismiss officers, etc.), which the FSA and Local Finance Bureaus have issued or published.

<sup>16</sup> The breakdown of “business category” in this section is: banks (major banks (including bank holding companies), branches of foreign banks, other banks (including Japan Post Bank), regional banks (including bank holding companies), trust companies, and bank agents), cooperative structured financial institutions (credit unions, credit associations, labor banks, and agricultural or fishery-related banks), financial instruments business operators (Type I financial instruments business operators, Type II financial instruments business operators, investment advisory and agency business operators, investment management business operators, investment corporations, financial instruments intermediary service providers, securities finance companies, registered financial institutions, and credit rating agencies) and insurance companies (life insurance companies (including Japan Post Insurance), non-life insurance companies, specified insurance operators, low-cost, short-term insurance providers, life insurance solicitors, non-life insurance agents).

<sup>17</sup> Figures in brackets represent the number of business suspension orders.

## ii. Administrative Monetary Penalty

### - Background to the Administrative Monetary Penalty System

A monetary penalty system was introduced to prevent illegal acts undermining the confidence in the securities markets in April 2005. The system imposes monetary penalties as an administrative action on persons who engage in an illegal act under the Financial Instruments and Exchange Act.

Furthermore, a monetary penalty system against certified public accountants and audit firms for attestation of false statements stipulated in the Certified Public Accountants Act was introduced in April 2008.

#### Box: Acts of violation that are subject to the monetary penalty system

##### - Financial Instruments and Exchange Act

###### (i) Market misconduct

Insider trading, market manipulation (e.g., wash trading, and illegal stabilizing of stock transactions), spreading rumors or use of fraudulent means

###### (ii) No submission of or false statements in securities registration statements, etc., for public offering and secondary distribution

###### (iii) No submission of or false statements in annual securities reports, etc., which should be submitted each program year

###### (iv) No implementation of advertisement for commencement of TOB, or false statements in tender offer notifications, etc.

###### (v) No submission of or false statements in large-shareholding reports, etc.

###### (vi) No submission of or false statements in “specified securities information,” or provision of false information concerning issuers in markets intended for professional investors

###### (vii) Acts that facilitate the submission of false disclosure statements, etc.

###### (viii) Acts of communicating non-public information and soliciting to trade (amended in June 2013, enforced in April 2014)

##### - Certified Public Accountants Act

###### (i) When an employee of an audit firm (or a certified public accountant) attests to, with intent, financial documents containing false information, errors or omissions as those containing no false information, errors or omissions.

###### (ii) When an employee of an audit firm (or a certified public accountant) attests to, without due care, financial documents containing material false information, errors or omissions as those containing no material false information, errors or omissions.

On April 1, 2005, the FSA launched the appointment of administrative law judges.

The FSA, at the same time, established the Trial Procedures Office to operate the administrative monetary penalty system.

- Process for the Issuance of Administrative Monetary Penalty Payment Order

a. Financial Instruments and Exchange Act

- (i) If the Securities and Exchange Surveillance Commission (SESC) deems that there has been an act of violation of the law or regulations subject to an administrative monetary penalty, the SESC makes a recommendation to the FSA Commissioner for the issuance of an administrative monetary penalty payment order.
- (ii) Following the recommendation, the FSA Commissioner decides on the commencement of trial procedures.
- (iii) Administrative law judges prepare a draft decision concerning the order of payment of an administrative monetary penalty following the completion of the trial procedures, and submit it to the FSA Commissioner.
- (iv) The FSA Commissioner decides and issues the Order of Payment of Administrative Monetary Penalty in accordance with the draft decision.

b. Certified Public Accountants Act

- (i) If the FSA Commissioner deems that there has been attestation of false documents that is subject to an administrative monetary penalty, the Commissioner decides on the commencement of trial procedures.
- (ii) Administrative law judges prepare a draft decision concerning the order of payment of an administrative monetary penalty following the completion of the trial procedures, and submit it to the FSA Commissioner.
- (iii) The FSA Commissioner decides and issues the Order of Payment of Administrative Monetary Penalty in accordance with the draft decision.

- The Number of Order of Payment of Administrative Monetary Penalty Issued

In the program year 2013, the FSA Commissioner issued order of payment of administrative monetary penalty against 40 cases of market misconduct and eight cases of false disclosure.

## Order of Payment of Administrative Monetary Penalty Issued to Date

- Cases violating the Financial Instruments and Exchange Act

Program Year	Market Misconduct	False Disclosure, etc.	Total
Prior to program year 2006	18	4	22
program year 2007	21	10	31
program year 2008	15	11	26
program year 2009	42	9	51
program year 2010	20	23	43
program year 2011	25	14	39
program year 2012	29	9	38
program year 2013	40	8	48

- Cases violating the Certified Public Accountants Act

There has been no issuance of an order of payment of administrative monetary penalty since the introduction of the administrative penalty system in April 2008.

### Record of Trial Procedure Dates<sup>18</sup>

- Market manipulation concerning shares of Mimaki Engineering Co., Ltd.  
(Case No. 38; 2012)

February 5, 2013 Decision on Commencement of Trial Procedures

September 12, 2013 Trial

December 10, 2013 Administrative Monetary Penalty Payment Order

- Market manipulation concerning shares of Fullcast Technology Co., Ltd.  
(Case No. 12; 2013)

June 27, 2013 Decision on Commencement of Trial Procedures

November 20, 2013 Trial

January 23, 2014 Administrative Monetary Penalty Payment Order

- Insider trading concerning shares of OST Japan Group Inc. by a person receiving information from a party under negotiation to conclude a contract with a tender offeror

(Case No. 23; 2013)

October 29, 2013 Decision on Commencement of Trial Procedures

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<sup>18</sup> Cases listed are those for which trials had been held and trial procedures completed in the program year 2013.

January 10, 2014 Trial  
February 28, 2014 Administrative Monetary Penalty Payment Order

- Insider trading by a person receiving information from another person under negotiation to conclude a contract with OKWave

(Case No. 16; 2013)

August 30, 2013 Decision on Commencement of Trial Procedures  
February 13, 2014 Trial  
April 18, 2014 Administrative Monetary Penalty Payment Order

- False statement in annual securities reports of Japan Wind Development Co., Ltd.

(Case No. 41; 2012)

March 29, 2013 Decision on Commencement of Trial Procedures  
March 26, 2014 First trial  
April 22, 2014 Second trial  
August 28, 2014 Administrative Monetary Penalty Payment Order