

February 14, 2018

**Planning and Evaluation Division
Inspection Bureau
Financial Services Agency**

Submitted via email to: supervisory-approach@fsa.go.jp

RE: JFSA's Supervisory Approaches

Dear Sirs,

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

1. **General** - We support JFSA's initiative to evolve the supervisory approach to one that is based on substance over form, holistic assessment, forward looking analysis and pursuit of best practices. We also welcome the focus on issues of firm-wide priority, continuous monitoring (as opposed to periodic monitoring) and the retraining of supervisory staff to accumulate firmspecific knowledge and specialised analytical skills.
2. **Diversity of business models in asset management** - We also applaud JFSA's philosophy of "no one size fits all" and customising the supervisory approach to the individual firm. It is important to recognise that the asset management business model is fundamentally different than that of other financial institutions such as commercial banks , investment banks and insurance companies. Asset managers act on behalf of clients and receive stable fee-based income stream. They do not invest with their own balance sheets by engaging in principal trades with clients, nor do they guarantee investor principal or provide liquidity for funds. Even amongst asset managers there are many different business models. Some firms manage product and distribute directly to retail; others use an intermediated model; still others focus on managing for institutions; and there is the developing trend of using technological platforms or roboadvisors to offer investment products and advice. There are index, traditional active, and alternatives specialists; and many combinations. Hence we agree with the JFSA's proposal of developing specialised sector-specific and firm-specific knowledge amongst the supervisory staff so that they are able to focus their attention on the most relevant risks. To the extent that the JFSA draw upon industry expertise to help with the evolution of the supervisory approach, It is imperative that a diverse slate of private sector members are assembled. This will ensure FSA receives the benefit of different opinions to form a balanced view.
3. **Stress Test** - We note that in the consultation JFSA proposes the use of universal stress test to ensure soundness of the financial system as a whole.
 - a. We would like to point out that given the difference in the asset management business model vs those of other financial institutions as mentioned above, we do not believe that system-wise is appropriate for asset managers. Macro-prudential stress testing is more appropriate for banks where market and liquidity risks can create solvency issues, thereby generating systemic risk. Regulation of banks directly addresses the fact that government-insured deposits can backstop risky lending and create misaligned incentives, which may lead to excessive risk-taking and excessive leverage and reflects the critical role of banks in intermediating liquidity throughout the financial system. Asset managers do not benefit from any government guarantee or liquidity support, nor do they own the assets they manage or invest their capital in principal trades. Hence their risk profile is very different from that of other financial institutions.
 - b. In view of the variety of business models even within the asset management industry as discussed above, we also do not believe that firm-wide stress testing or stress testing

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across mutual funds is appropriate. As agents acting on behalf of clients, asset managers manage mutual funds and portfolios in accordance to the investment objectives and restrictions set by clients or the mutual fund constitutive documents. There is a wide range of strategies using different asset classes and instruments and it will be impossible to generalise about risks or flows across the various funds/portfolios under common scenarios. A more useful approach will be to conduct stress testing for individual funds using scenarios that are relevant to that investment strategy and asset class.

4. **Sharing of best practices in governance models** – we agree that JFSA's position as a supervisor of the entire financial sector endows it with insights of best practises across firms and across sectors of the industry. It will therefore be helpful for JFSA to share their regulatory interpretation and expectations of compliance standards with the financial situations. More importantly we believe JFSA can play a critical role in sharing best practices in setting the culture and implementing governance models which ultimately drive the conduct of firms. In our view, an effective culture and governance model should include the following 5 elements:
 - a. **Defining the culture** – the values, the principles and behaviours (e.g. customer-centric principles)
 - b. **Messaging the culture** – how the tone is set from the top and from the middle and communicated across the firm
 - c. **Influencing the culture** – how to influence the behaviour of employees and guide them to behave in a way which is consistent with the firm's desired culture. This will include compensation models that align interests (such as bonus deferral and long-term vesting), proper segregation of duties, policies to avoid conflict of interests, etc.
 - d. **Monitoring culture** - evaluate and report how in practice the firm's actions and those of employees aligned to the desired culture. This may include regular reports to senior management from control functions such as Legal & Compliance, Risk, Human Resources, Finance, Information Security and Internal Audit; periodic employee opinion surveys that include questions on the culture of the firm, thematic reviews by Risk and Controls teams, etc. Most important of all, having a robust risk management framework is key. This includes defining the various types of risk facing the firm, putting in place appropriate controls, ensuring independence of the risk management function, setting escalation policies, etc.
 - e. **Governing culture** – establish clear ownership and responsibilities for culture across the organisations and to ensure the implementation of policy. Culture and conduct should be a shared responsibility of all employees. At the same time it's preferable to establish accountability of senior management and the various lines of defences across the organisation.

Sharing best practices in governance models should not be confused with sharing business strategies and specific products across firms, as the latter are key to the competitive advantage and commercial success of the entities.

5. **Drawing expertise from the industry** – As the proposal is a major shift from the current supervisory approach, it will take some time to retrain staff so that they are equipped with the knowledge to assess what are sustainable business models. We therefore propose that the FSA continues its practice of consulting industry groups and trade associations on a regular basis on the changing business environment and practices. In particular FSA may want to set up working groups with members drawn from the private sector to work on individual regulatory themes. BlackRock is fully committed to supporting the JFSA by sharing our expertise.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

Norihiko Tsukada
Managing Director, Head of Compliance for Japan