

**Tentative translation**  
**Only Japanese text is authentic**

# **Inspection Manual for Financial Instruments Business Operators**

**Executive Bureau, Securities and Exchange Surveillance Commission**  
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## (Contents)

<b>I. Basic Concept.....</b>	<b>- 1 -</b>
1. Background.....	- 1 -
2. Roles of the SESC and Ideal Status of Financial Instruments Business Operators, etc.....	- 2 -
(1) Business Management Systems.....	- 3 -
(2) Legal Compliance Systems .....	- 3 -
(3) Internal Control Systems .....	- 4 -
(4) Risk Management Systems.....	- 5 -
(5) Audit Systems.....	- 6 -
(6) Crisis Management Systems.....	- 7 -
3. Inspection Manual.....	- 7 -
<b>II. Inspection Items .....</b>	<b>- 10 -</b>
Definitions of terms, etc. contained in the Inspection Manual are as follows:.....	- 10 -
<b>II-1-1 Structures and Systems / Common Inspection Items .....</b>	<b>- 14 -</b>
1. Business Management Systems .....	- 14 -
(1) Check-and-Balance System.....	- 14 -
(2) Corporate Management Policy, etc.....	- 14 -
(3) Corporate Management System.....	- 15 -
(4) Board of Company Auditors, etc.....	- 15 -
(5) Board Minutes, etc.....	- 16 -
(6) Efforts for Business Operation .....	- 16 -
2. Legal Compliance System.....	- 17 -
(1) Efforts of Top Management.....	- 17 -
(2) Implementation Plan, Code of Conduct.....	- 18 -
(3) Setup of Divisions in charge of Laws and Regulations, etc.....	- 19 -
(4) Thoroughly Boosting Awareness of Legal Compliance .....	- 19 -
(5) Formulation of Internal Rules.....	- 20 -
3. Internal Control System .....	- 20 -
(1) Appointment of Personnel in Charge of Internal Control.....	- 20 -
(2) Roles of Personnel in Charge of Internal Control.....	- 21 -
(3) Roles, etc. of the Internal Control Division.....	- 21 -
(4) Management of Internal Control Operations.....	- 22 -
(5) Responses to Lawsuits, etc.....	- 23 -
(6) Protection of Customer Information.....	- 23 -
(7) Establishment of Administrative Division.....	- 24 -

(8) Roles of Administrative Division .....	- 24 -
(9) Development of Administrative Rules .....	- 25 -
(10) Management of Outsourcing .....	- 25 -
4. Audit System.....	- 25 -
(1) Establishment of Internal Audit Division .....	- 26 -
(2) The Position of Internal Audit .....	- 26 -
(3) Development of Internal Audit Rules, etc. ....	- 27 -
(4) Formulation of Internal Audit Plan, etc. ....	- 27 -
(5) Management of Internal Audit Operations .....	- 27 -
(6) Utilization of External Audit .....	- 28 -
(7) Improvement in Internal Audit Functions.....	- 29 -
(8) Handling of Audit Results .....	- 29 -
5. Crisis Management System.....	- 30 -

## **II-1-2. Structures and Systems / Inspection Items for Type I Financial Instruments**

<b>Business Operators.....</b>	<b>- 32 -</b>
1. Internal Control System .....	- 32 -
(1) Manager of Internal Control Division .....	- 32 -
(2) Development of Systems for Sales Management and Examination .....	- 33 -
(3) Development of Pre-underwriting Examination.....	- 34 -
(4) Development of Management Systems for Conflicts of Interest.....	- 35 -
(5) Development of Systems for Verifying Legal Compliance, etc. ....	- 36 -
(6) Status of Business Operation.....	- 37 -
(7) Development of Systems for Handling Troubles with Customers.....	- 39 -
(8) Separate Management .....	- 40 -
(9) Electronic Transactions (including PTS operation).....	- 42 -
(10) Information Management .....	- 44 -
2. Risk Management System.....	- 44 -
(1) Awareness and Roles of Directors, etc.....	- 44 -
(2) Development of Methods and Rules of Risk Management .....	- 46 -
(3) Awareness and Roles of a Manager of Risk Management Division .....	- 46 -
(4) Independence of Risk Management Division.....	- 47 -
3. System for Management Risks related to Capital Adequacy Requirements.....	- 48 -
(1) Awareness and Roles of Directors, etc. concerning Risks related to Capital Adequacy Requirements .....	- 48 -
(2) Roles of Personnel who manage the Capital-to-Risk Ratio.....	- 49 -
(3) Management of the Capital-to-Risk Ratio .....	- 50 -

(4) Awareness and Roles of Directors, etc. in relation to Credit Risks .....	- 50 -
(5) Implementation and Operation of Internal Rules .....	- 50 -
(6) System for Reporting and Communication .....	- 51 -
(7) Management of Market Risks.....	- 51 -
(8) Management of Credit Risks .....	- 52 -
(9) Management of Position Limits and Profit and Loss .....	- 53 -
(10) Management of Traders.....	- 55 -
(11) Account of Traded Financial Instruments .....	- 55 -
(12) Calculation of Market Prices .....	- 56 -
4. Operational Risk Management System .....	- 57 -
(1) Awareness and Roles of Directors, etc.....	- 57 -
(2) Development of Management System.....	- 57 -
5. Information Technology Risk Management System.....	- 58 -
(1) Awareness of IT Risks, etc.....	- 58 -
(2) Establishment of Appropriate IT Risk Management System.....	- 58 -
(3) Development of Safety Measures.....	- 59 -
(4) System Integration.....	- 63 -
(5) Responses at the time of a system failure.....	- 63 -
(6) Contingency Plan.....	- 64 -
(7) Management of Outsourcing .....	- 64 -
(8) System Audit .....	- 65 -
6. Other Risk Management Systems .....	- 66 -
(1) Awareness of Directors and Roles of the Board of Directors, etc.....	- 66 -
(2) Establishment of Appropriate Systems for Managing Funding Risks.....	- 67 -
(3) Information disclosure.....	- 68 -
(4) Group risk management .....	- 69 -
7. Systems for Audit, etc.....	- 69 -
8. Risk Management Systems of Securities Company Groups which Engage in Large-scale and Complex Businesses as a Group .....	- 70 -
(1) Market Risk Management System.....	- 72 -
(2) Liquidity Risk Management System .....	- 75 -
(3) Credit Risk Management System .....	- 78 -
(4) Operational Risk Management System .....	- 81 -
(5) IT Risk Management System.....	- 84 -
(6) Integrated Risk Management System .....	- 87 -
(7) Internal Audit System .....	- 90 -

9. Risk Management related to Consolidated Capital Adequacy Requirements for Special Financial Instruments Business Operators .....	- 93 -
(1) Awareness and Roles of Directors, etc. concerning Risks related to Consolidated Capital Adequacy Requirements.....	- 93 -
(2) Roles of Personnel who Manage the Consolidated Capital-to-Risk Ratio .....	- 94 -
(3) Management of the Consolidated Capital-to-Risk Ratio .....	- 94 -
10. Risk Management related to Consolidated Capital Adequacy Requirements of a Final Designated Parent Company .....	- 95 -
(1) Awareness and Roles of Directors, etc. concerning Risks related to Consolidated Capital Adequacy Requirements.....	- 95 -
(2) Roles of Personnel who Manage the Consolidated Capital-to-Risk Ratio .....	- 96 -
(3) Management of the Consolidated Capital-to-Risk Ratio .....	- 97 -
<b>II-1-3. Structures and Systems / Type II Financial Instruments Business Operators.....</b>	<b>- 98 -</b>
1. Internal Control System .....	- 98 -
(1) Awareness of Top Management .....	- 98 -
(2) Manager of Internal Control Division, etc.....	- 98 -
(3) Development of Systems for Verifying Legal Compliance .....	- 99 -
(4) Business Operation.....	- 100 -
(5) Development of Systems for Handling Troubles with Customers.....	- 101 -
(6) Electronic Transactions .....	- 101 -
2. Risk Management System.....	- 103 -
(1) Awareness and Roles of Directors, etc.....	- 103 -
(2) Development of Methods and Rules of Risk Management .....	- 104 -
(3) Awareness and Roles of a Manager of Risk Management Division .....	- 104 -
(4) Independence of Risk Management Division.....	- 105 -
3. Operational Risk Management System .....	- 106 -
(1) Awareness and Roles of Directors, etc.....	- 106 -
(2) Development of Management System.....	- 107 -
4. Information Technology Risk Management System.....	- 107 -
(1) Awareness of IT Risks, etc.....	- 107 -
(2) Establishment of Appropriate Information Technology Risk Management System....	- 108 -
(3) Development of Safety Measures.....	- 108 -
(4) System Integration.....	- 112 -
(5) Responses at the time of a system failure.....	- 112 -
(6) Contingency Plan.....	- 113 -
(7) Management of Outsourcing .....	- 113 -

(8) System Audit .....	- 114 -
5. Systems for Audit, etc.....	- 115 -
6. Individuals Engaged in Type II Financial Instruments Business .....	- 116 -
<b>II-1-4. Structures and Systems /Investment Advisory and Agency Business Operators.....</b>	<b>- 117 -</b>
1. Internal Control System .....	- 117 -
(1) Awareness of Top Management .....	- 117 -
(2) Manager of Internal Control Division, etc.....	- 117 -
(3) Development of Systems for Verifying Legal Compliance .....	- 118 -
(4) Development of Systems for Handling Troubles with Customers.....	- 119 -
2. Risk Management System.....	- 120 -
(1) Awareness and Roles of Directors, etc.....	- 120 -
(2) Development of Methods and Rules of Risk Management .....	- 121 -
(3) Awareness and Roles of a Manager of Risk Management Division .....	- 121 -
3. Operational Risk Management System .....	- 122 -
(1) Awareness and Roles of Directors, etc.....	- 122 -
(2) Development of Management System.....	- 123 -
4. Information Technology Risk Management System.....	- 124 -
(1) Awareness of IT Risks, etc.....	- 124 -
(2) Establishment of Appropriate Information Technology Risk Management System....	- 124 -
(3) Development of Safety Measures .....	- 124 -
(4) System Integration.....	- 128 -
(5) Responses at the time of a system failure .....	- 128 -
(6) Contingency Plan.....	- 129 -
(7) Management of Outsourcing .....	- 129 -
(8) System Audit .....	- 130 -
5. Systems for Audit, etc.....	- 131 -
6. Individuals Engaged in the Investment Advisory and Agency Business .....	- 132 -
<b>II-1-5. Structures and Systems /Investment Management Business Operators .....</b>	<b>- 133 -</b>
1. Internal Control System .....	- 133 -
(1) Awareness and Roles of Directors, etc.....	- 133 -
(2) Disclosure .....	- 135 -
(3) Internal Rules.....	- 135 -
(4) Management of Net Asset Value.....	- 137 -
(5) Investment Management System.....	- 137 -
(6) Real-estate Investment Management System .....	- 138 -
(7) Management of Re-entrustment of Investment .....	- 139 -

2. Risk Management System.....	- 140 -
(1) Awareness and Roles of Directors, etc.....	- 140 -
(2) Development of Methods and Rules of Risk Management.....	- 141 -
(3) Awareness and Roles of a Manager of Risk Management Division.....	- 141 -
(4) Independence of Risk Management Division.....	- 142 -
3. Operational Risk Management System.....	- 143 -
(1) Awareness and Roles of Directors, etc.....	- 143 -
(2) Development of Management System.....	- 143 -
4. Information Technology Risk Management System.....	- 144 -
(1) Awareness of IT Risks, etc.....	- 144 -
(2) Establishment of Appropriate Information Technology Risk Management System....	- 144 -
(3) Development of Safety Measures.....	- 145 -
(4) System Integration.....	- 148 -
(5) Responses at the Time of System Failures.....	- 149 -
(6) Contingency Plan.....	- 150 -
(7) Management of Outsourcing.....	- 150 -
(8) System Audit.....	- 151 -
5. Investment Risk Management System.....	- 152 -
(1) Awareness and Roles of Directors, etc.....	- 152 -
(2) Internal Rules.....	- 154 -
(3) Comprehension of Investment Risks.....	- 155 -
(4) Funding Management Associated with Investment.....	- 156 -
(5) Development of Management System.....	- 157 -
(6) Investment Risk Control.....	- 159 -
6. Group Risk Management.....	- 160 -
7. Systems for Audit, etc.....	- 160 -
<b>II-2-1. Business Operations / Common Inspection Items.....</b>	<b>- 162 -</b>
1. Checklist for Matters Related to the Basic Business Stance.....	- 162 -
2. Internal Control.....	- 163 -
(1) Verification of Basic Matters.....	- 163 -
(2) Verification of Solicitation.....	- 163 -
(3) Issue of Written Documents.....	- 164 -
(4) Inspection of Advertising, etc.....	- 166 -
3. Management of Customer Information.....	- 166 -
4. Verification at the Time of Transaction.....	- 167 -
5. Handling of Antisocial Forces.....	- 170 -

<b>II-2-2. Business Operations / Type I Financial Instruments Business Operators .....</b>	<b>- 172 -</b>
1. Business Stance and Other Matters.....	- 172 -
(1) Principle of Suitability.....	- 172 -
(2) The State of Solicitation .....	- 173 -
(3) Solicitation Materials.....	- 174 -
(4) Customer Care .....	- 174 -
(5) Measures to prevent adverse effects.....	- 175 -
2. Stock Sales .....	- 176 -
(1) The State of Transaction Execution.....	- 176 -
(2) Across-the-board, Intensive Sales.....	- 176 -
(3) Excessive Trading and Other Matters.....	- 177 -
(4) Dealing on Own Account .....	- 178 -
3. Debenture Business.....	- 179 -
(1) Assessment of Solicitation and Trading.....	- 179 -
(2) Excessive Trading and Other Matters.....	- 180 -
(3) Providing Information on Market Value.....	- 180 -
4. Investment Trust Business .....	- 180 -
(1) Assessment of Solicitation and Trading.....	- 180 -
(2) Excessive Trading and Other Matters.....	- 181 -
5. Derivatives business.....	- 182 -
(1) Assessment of Solicitation and Trading.....	- 182 -
(2) Excessive Trading and Other Matters.....	- 183 -
(3) Appropriateness of Solicitation Materials, etc.....	- 184 -
(4) Providing Information on Market Value.....	- 185 -
6. Underwriting business.....	- 186 -
7. Proprietary Trading System (PTS) Business.....	- 187 -
(1) Business Management.....	- 187 -
(2) System Management .....	- 187 -
(3) Customer Data Management.....	- 188 -
8. Electronic Financial Instruments Transactions Business .....	- 188 -
(1) Customer Management.....	- 188 -
(2) Security Measures .....	- 188 -
9. Separate Management .....	- 189 -
(1) Securities and Cash.....	- 189 -
(2) Storage Method (Securities).....	- 190 -
(3) Storage Method (Cash).....	- 190 -



(4) Money Earmarked for Customers pertaining to Credit Transactions and When-issued Transactions .....	- 191 -
(5) Money Earmarked for Customers Pertaining to Derivatives Market Transactions .....	- 192 -
(6) Verification of Outstanding Balance.....	- 193 -
10. Internal Control.....	- 194 -
(1) Legal Procedures .....	- 194 -
(2) Unfair Trade .....	- 194 -
(3) Modification of Agreements.....	- 195 -
(4) Suitability of Administrative Processes.....	- 195 -
(5) Inspection of Advertising.....	- 197 -
(6) Supervision of Financial Instruments Intermediary Service Provider.....	- 197 -
11. Property and Accounting.....	- 197 -
(1) Inspection Method for Calculation of Net Property Value .....	- 197 -
(2) Calculation Method for Net Property Value .....	- 202 -
12. Capital-to-Risk Ratio .....	- 202 -
(1) Core Capital.....	- 202 -
(2) Supplementary Capital .....	- 202 -
(3) Risk equivalent .....	- 203 -
(4) Calculation and Understanding of the Capital-To-Risk Ratio .....	- 203 -
(5) Report of Capital-To-Risk Ratio.....	- 203 -
13. Consolidated Capital-to-Risk Ratio of a Special Financial Instruments Business Operator.....	- 203 -
(1) Core Capital.....	- 203 -
(2) Supplementary Capital .....	- 204 -
(3) Risk Equivalentents.....	- 204 -
(4) Calculation and Understanding of the Consolidated Capital-to-Risk Ratio .....	- 204 -
(5) Report of Consolidated Capital-to-Risk Ratio, etc. ....	- 204 -
14. Consolidated Capital-to-Risk Ratio, etc. of Final Designated Parent Company.....	- 204 -
(1) Capital Stock .....	- 204 -
(2) Risk Equivalentents.....	- 205 -
(3) Calculation and Understanding of the Consolidated Capital-to-Risk Ratio .....	- 205 -
(4) Report of Consolidated Capital-to-Risk Ratio.....	- 205 -
<b>II-2-3. Business Operations / Type II Financial Instruments Business Operators.....</b>	<b>- 206 -</b>
1. Business Stance and Other Matters.....	- 206 -
(1) Principle of Suitability.....	- 206 -
(2) The State of Solicitation .....	- 207 -

(3) Solicitation Materials.....	- 208 -
(4) Measures to Prevent Internal Collusion.....	- 209 -
(5) Assessment of the Conditions of Transactions .....	- 209 -
(6) Excessive Trading.....	- 210 -
2. Electronic Financial Instruments Transactions Business .....	- 211 -
(1) Customer Management.....	- 211 -
(2) Security Measures .....	- 212 -
3. Internal Control .....	- 212 -
(1) Legal Procedures .....	- 212 -
(2) Unfair Trading .....	- 213 -
(3) Modification of the Terms of Agreement .....	- 213 -
(4) Suitability of Administrative Processes .....	- 213 -
(5) Inspection of Advertising.....	- 215 -
<b>II-2-4. Business Operations / Investment Advisory and Agency Business Operators.....</b>	<b>- 216 -</b>
1. Investment Advisory and Agency Business.....	- 216 -
(1) The State of Solicitation .....	- 216 -
(2) Assessment of the Conditions of Transactions .....	- 217 -
(3) Prohibited Acts .....	- 217 -
2. Internal Control .....	- 218 -
(1) Legal Procedures .....	- 218 -
(2) Suitability of Administrative Processes .....	- 218 -
<b>II-2-5. Business Operation / Investment Management Business Operators .....</b>	<b>- 220 -</b>
1. Investment Management Business.....	- 220 -
(1) Fund Management Planning.....	- 220 -
(2) Fund Management Appraisal.....	- 220 -
(3) Suitability of Fund Management .....	- 221 -
(4) Obligation of Explanation .....	- 225 -
(5) Real Estate Investment Trusts.....	- 226 -
(6) Investment Corporations .....	- 229 -
2. Internal Control .....	- 229 -
(1) The Status of Verifications of Daily Operations .....	- 229 -
(2) Modification of Terms and Conditions of Contract.....	- 230 -
(3) Other Conditions for Verification .....	- 231 -
3. Property and Accounting.....	- 232 -
(1) Inspection Method for Calculation of Net Property Value .....	- 232 -
(2) Calculation Method for Net Property Value .....	- 236 -

## **I. Basic Concept**

### **1. Background**

The role of the social security system has become more controversial due to the trends of the falling birthrate and an aging population, and the management of household assets has become more important, with an increase in household financial assets such as pensions and insurance. Furthermore, people have been shifting their assets from savings to investment. In this way, the Japanese economy has been changing significantly.

Apart from the traditional business operator engaged in face-to-face brokerage business, the services of financial instruments business operators have been diversifying into, for example, operators specialized in principal transactions, Internet financial service providers, operators exclusively handling derivatives and other complicated instruments, new entrants from different industries, and so on.

Furthermore, the fusion of services is advancing, as seen in the securitization of various assets, including real estate, and in the handling of financial instruments that are subject to other business acts beyond the framework of their business categories.

To respond to these changes, further cross-cutting regulations have been established in Europe and the U.S. While the globalization of financial and capital markets is advancing, the Financial Instruments and Exchange Act was developed by reorganizing the SEL and relevant laws. This law regulates wide-ranging financial instruments and their business operators in a comprehensive and cross-sectoral manner.

The purpose of the Financial Instruments and Exchange Act is “To ensure fairness in, inter alia, issuance of the securities and transactions of financial instruments, etc. and to facilitate the smooth distribution of securities, as well as to aim at fair price formation of financial instruments, etc. through the full utilization of functions of the capital market, thereby contributing to the sound development of the national economy and protection of investors”.

To achieve this purpose, the SESC is authorized to inspect financial instruments business operators, registered financial institutions and investment corporations (hereinafter referred to as “financial instruments business operators, etc.”). The SESC is required to fulfill the role of comprehending in detail the actual situation of the financial instruments business operator, etc. using this authority effectively.

## 2. Roles of the SESC and Ideal Status of Financial Instruments Business Operators, etc.

Formerly, since regulations on business operators dealing with financial instruments had been provided for in each law by business category, the SESC inspected and reviewed compliance with such laws. When recognizing a violation of laws, the SESC implemented such measures as recommending the Prime Minister (and the Commissioner of the FSA) to take appropriate actions and measures.

Previously, while some firms were operated under a registration system, as with securities and financial futures companies, other firms were subject to a licensing system, as with investment trust management companies and discretionary investment management businesses. In addition, when acting as a lead underwriter, securities companies were subject to licensing. In this way, the way of treating each business was varied.

Furthermore, when a securities company violated detailed regulations provided for in the SEL, requirements to impose administrative disciplinary actions on the company were applicable. However, when the case did not constitute a violation of the law but was problematic, said requirements were not applicable. Therefore, the SESC could only advise the securities company and the supervisory departments of the relevant authorities to contribute to building appropriate management systems.

Meanwhile, as for financial futures companies and investment trust management companies, there were general provisions in each business act stating that they would be ordered to improve business when hindering the public interest and failing to protect investors, even in cases where they are not violating the law.

In this recent revision of the law, all business operators dealing with financial instruments are regarded as financial instruments business operators, and are, in principle, subject to the registration system. Furthermore, as an administrative response, even if no violation of the law is involved, it has become possible to order them to take the actions necessary for changing the manner of business operation and improving their business operations and financial position under the Article 51 of the Financial Instruments and Exchange Act.

Based on the enforcement of the Financial Instruments and Exchange Act, the SESC considers it appropriate to improve the transparency of inspections by clarifying the ideal status of financial instruments business operators, etc., which inspectors should bear in mind, as stated below.

[Ideal Status of Financial Instruments Business Operators, etc.]

### (1) Business Management Systems

The financial instruments business operators, etc. should conduct business appropriately from the viewpoint of protecting investors and forming fair markets, which are recognized as the significant social responsibilities of main players in financial instruments markets. To be more specific, top management should fulfill individual roles adequately, establish an appropriate management policy, and reinforce supervision systems (systems for issuing instructions and reporting, etc.) and internal control systems, risk management systems, and so forth. Based on these, they should conduct business management in such a way as to properly utilize these functions and securely execute operations.

[Examples of specific measures]

- \* The respective roles of director, company auditor, operating officer, and their board meetings, etc. (hereinafter referred to as “officers, etc.”) should be clarified. Furthermore, a system should be established in which a mutual check-and-balance function works by the proper exercise of given authorities.
- \* The officers, etc. should recognize the significance of legal compliance, internal control, risk management and internal audit, formulate an appropriate management policy and familiarize all employees with it, and actively participate in business operations.
- \* The officers, etc. should establish reporting systems to comprehend business operation conditions and a highly independent auditing system to evaluate business operations, and verify whether or not internal controls are functioning appropriately.
- \* When the officers, etc. become aware, through internal audits, etc. conducted regularly or as needed, of problems in business operations including business management, they should take the initiative in establishing systems for correcting and improving these problems by sufficiently recognizing and understanding them.

### (2) Legal Compliance Systems

Financial instruments business operators, etc. should, by reinforcing legal compliance systems, make efforts to comply strictly with the law and should conduct sound and appropriate business operations from the viewpoint of ensuring investor confidence and fairness in financial instrument markets.

[Examples of specific measures]

- \* Establishment of an implementation plan and a code of conduct concerning legal compliance and familiarization of all officers and employees with them, confirmation of their implementation in daily business operations and evaluation with internal audits and the like regularly or as needed, and, if necessary, review of the implementation plan and the code of conduct
- \* Allocation of independent authority to personnel in charge of legal affairs, regular evaluation of effectiveness, by internal audits and the like, and enhancement of such systems assessed by external audits and other means as needed
- \* Reinforcement of systems to allow personnel in charge of legal affairs to accurately comprehend information on legal compliance and directly report it to top management

### (3) Internal Control Systems

Financial instruments business operators, etc. should develop internal control systems to confirm whether or not all operations, including customer management, management of sales representatives, transaction management and examination, are appropriately conducted, recognizing that their role is to run a business in a faithful and fair manner for investors.

[Examples of specific measures]

- \* Development of concrete systems for customer management, including meetings and discussions with customers when necessary, in such a way as to correctly identify customers, the actual status of transactions and so forth. This is conducted from the viewpoint of the prevention of money laundering and unfair trading, fulfillment of the obligation of verification at the time of transaction, and implementation of appropriate solicitation for investment in accordance with the Principle of Suitability.
- \* Comprehension of the conditions of solicitation for investment and transactions, etc. by sales representatives and the development of systems for taking necessary measures in order to prevent inappropriate solicitation for investment and unfair trading, etc. by sales representatives
- \* Development of systems for conducting appropriate transaction management and examinations by controlling important information concerning transactions and impacts on price formation, in order to prevent unfair trading and the like by sales representatives and customers
- \* (In case of those acting as a lead underwriter) Establishment of systems for

appropriate pre-underwriting examinations and enhancement of systems to encourage issuing companies to disclose information in a timely and precise manner, from the viewpoint of ensuring fairness and transparency in financial instrument markets

- \* (In case of investment management businesses or investment advisory and agency businesses) Verification of the appropriateness of asset management and advisory services and the development of systems for taking necessary measures, from the viewpoint of fulfilling the duty of loyalty and duty of due care of investors
- \* Verification of the appropriateness of routine operations and the development of systems for taking necessary measures
- \* Development of systems for regularly evaluating the effectiveness of each system related to internal control by internal audits and the like
- \* Development of systems to enable the personnel responsible for the internal control division to grasp accurate information on internal control and directly report it to top management

#### (4) Risk Management Systems

Financial instruments business operators, etc. should recognize that it is essential to accurately understand various potential risks in their business and appropriately control losses caused by the actualization of such risks in order to protect investors and stabilize financial systems. Based on such recognition, they should maintain the proper level of the Capital-to-Risk Ratio (only in case of Type I financial instruments business operators) and develop necessary risk management systems.

[Examples of specific measures]

- \* Establishment of risk management systems suitable for business contents by calculating risks appropriately and on a daily basis, and verification of whether or not the appropriate Capital-to-Risk Ratio is maintained
- \* Establishment and management of appropriate risk limits and position limits after accurately recognizing held positions, since market risks may be caused to change by various factors such as the price of securities held, interest rates and exchange rates
- \* Comprehension of appropriate credit limits for transaction counterparts even at the time of introduction of new products and new businesses, and sufficient implementation of internal verification, since counterparty risks may cause losses if the counterpart does not fulfill its obligation
- \* Clarification of the kind and locus of risks in each operation and specific reduction measures, since operational risks may occur in all operations

- \* Development of systems to carry out appropriate IT risk management, including the formulation of policies for the introduction of IT, its maintenance, and responses at the time of failures and disasters, while recognizing the importance of a safe and stable system of operation, from the standpoint of a smooth execution of functions
- \* Recognition of other risks in business operations (funding risks, etc.), their appropriate control, and development of systems for continuously assessing and reviewing such risks
- \* (In case of those running investment management businesses) Establishment of appropriate management systems for management risks while sufficiently recognizing that failing to provide the best asset management for an investor may lead to a violation of the law
- \* Securities company groups which engage in large-scale and complex businesses as a group should establish comprehensive and effective risk management systems on a group basis, in which they should develop appropriate business management, identify inherent risks of businesses conducted with group companies, and ascertain impacts on financial soundness.

#### (5) Audit Systems

Financial instruments business operators, etc. should recognize that appropriate and regular evaluation and improvement of legal compliance and the functions of each measure contributes to retaining the faith of investors. They should also develop systems for conducting internal or external audits for objective and strict evaluation.

[Examples of specific measures]

- \* Confirmation and evaluation of the status of all business operations, including internal control and risk management, regularly or when needed, by an internal audit division independent from other divisions (in the case that it is difficult to set up an independent internal audit division, measures should be taken to improve the objectivity of audits by company auditors) and development of systems to implement necessary improvements
- \* Actions to ensure the appropriateness of business operations in ways such as having important matters evaluated regularly through external audit, in addition to internal audits
- \* Development of systems to enable direct reporting on results of internal and external audits to top management



## (6) Crisis Management Systems

Financial instruments business operators, etc. should recognize that maintaining their functions as much as possible at the time of an unexpected crisis is linked to prevention of needless confusion in the market and in society. They should also develop crisis management systems to avert and prevent such confusion to the maximum extent possible.

[Examples of specific measures]

- \* Identification and recognition of risky elements and regularly conducted inspections and drills to avert and prevent crisis as a part of preventive measures
- \* Preparation of a crisis management manual containing a system for times of crises, for example, knowing how the situation stands, communication and information transmission, and the locus of responsibilities, and its review according to environmental changes, etc. in an attempt to maintain effectiveness

The measures for developing the above-mentioned systems were organized based on the Financial Instruments and Exchange Act, in response to changes in financial and capital markets, the principle of IOSCO, and the concept of “Comprehensive Guideline for Financial Instruments Business Supervision”. Financial instruments business operators, etc. should develop systems fundamentally in accordance with the ideal status stated above.

However, “examples of specific measures” does not include all matters, and the type and specific contents of business differ according to each financial instruments business operator. Therefore, appropriate management systems are expected to be established on the responsibility of the financial instruments business operators themselves, in consideration of their business’ features.

## 3. Inspection Manual

The SESC conducts inspections of financial instruments business operators, etc. based on the above-mentioned ideal status, etc. To respond to more complicated and diverse financial instruments business and the significantly increasing number of companies to be inspected, the “Inspection Manual” is continuously considered effective as a tool to enable an inspector to verify these situations.

Therefore, with the revision of the SEL (the enforcement of the Financial Instruments and Exchange Act), the Inspection Manual is also amended as stated in the Appendix.

Meanwhile, it goes without saying that inspectors’ creative ingenuity corresponding

to the business contents of an inspected company is essential.

The Inspection Manual consists of two parts, “Structures and Systems” and “Services and Operations”. Each part contains common inspection items and inspection items by service category.

“Structures and Systems” indicates examples of inspection items considered effective for comprehending the status of system improvements and risks in inspected business operators.

However, even in cases where the financial instruments business operators, etc. do not act in the manner stated in inspection items, it may be considered that they are developing management systems according to their service category and business contents in consideration of their features, on their own responsibilities. Therefore, it is necessary to request an adequate explanation on whether or not the systems in which the necessary internal control can function have been developed.

Furthermore, even if these systems have been developed, they are not necessarily considered acceptable. Since it is important to maintain the appropriateness of everyday business by having a working function for checking these systems, “Services and Operations” contains inspection items to confirm legal compliance of inspected business operators.

In actuality, the SESC implements inspections after allocating each inspector’s duties according to the business contents and organization of the business operator to be inspected. Subsequently, it is necessary to conduct verification efficiently and effectively in cooperation among inspectors, in such a way as to intensively verify the appropriateness of operations having insufficient related systems and to carefully review management systems to investigate causes of inappropriate operations.

Whatever the case, it is required to call on ingenuity in order to conduct efficient and effective verification in a manner that suits the business contents of the company to be inspected, which should be accurately comprehended beforehand. In addition, inspectors should pay attention so as not to make verification automatic and uniform simply by following the Inspection Manual, and should verify all items in the Inspection Manual, from the standpoint of implementation of in-depth inspections.

In evaluation of results of inspections, the attitude to always judge them in light of the aims of the law is required.

As previously stated, the Inspection Manual was formulated for use by inspectors as an inspection handbook. However, it can also be considered as a reference that business operators to be inspected can use, in recognition of their public nature and social

responsibility as financial instruments business operators, etc. for establishing internal systems to retain good faith and internal checking.

The Inspection Manual covers financial instruments business operators (Type I financial instruments business operators, Type II financial instruments business operators, investment advisory and agency businesses, investment management business operators), designated parent companies, registered financial institutions, and investment corporations. Since its scope ranges broadly from large companies to individual proprietorships under the Corporation Act, inspectors are required to use the Inspection Manual, omitting inspection items and making necessary replacement in accordance with actual conditions of the inspected company.

## II. Inspection Items

Creative ingenuity, which is based on inspectors' free ideas corresponding to the business contents, size, and organizational structure, etc. of business operators to be inspected is essential for inspecting financial instruments business operators, etc. As a "handbook" for inspectors to verify the appropriateness of management systems and business operations, based on the ideal status of financial instruments business operators, etc., items to be reviewed are stated below.

Inspection items in the Inspection Manual do not fall under the category of "regulations" or "instructions" by the SESC, but are examples of items considered effective for comprehending the actual conditions of business operators to be inspected.

As stated in "Securities Inspection Guidelines", since actual inspections need to be conducted efficiently and effectively, it is necessary to take care so as not to merely verify each item of the Inspection Manual automatically and uniformly.

Items which are not contained in the Inspection Manual but which are necessary for the comprehension of the actual conditions of business operators to be inspected in relation to systems and operations should be verified appropriately.

Definitions of terms, etc. contained in the Inspection Manual are as follows:

- (1) Terms concerning the officers, etc. are replaced as indicated in the table below. In cases where the replacement causes a problem, terms appropriate to the actual condition shall be used.

	Company with Committees	Investment Corporation	Registered Financial Institution
Representative director	Representative executive officer	Executive director	Replace terms according to actual conditions.
Director	Executive officer	Executive director	
Company auditor	Audit committee member	Supervisory director	
Board of directors	Board of directors	Board of directors	
Board of company auditors	Audit committee	Supervisory director	

- (2) **Financial instruments business operators** include Type I and II financial instruments business operators, investment management business operators, and investment advisory and agency business operators. Terms for registered financial institutions and Investment corporations shall be replaced appropriately.
- (3) **Laws and Regulations, etc.** include laws and articles of incorporation and rules of self-regulatory organizations, etc.
- (4) In case of a registered financial institution, inspection items pertaining to the business category corresponding to the business which it runs apply mutatis mutandis, except for items excluded from the application of laws and regulations, etc. In such cases, necessary items should be confirmed according to the actual conditions of the inspected business operator, in consideration of the fact that the main business is banking and other services.
- (5) In the case of investment corporations, since most of their operations are outsourced, necessary items should be confirmed according to the actual conditions of the inspected business operator.
- (6) **The Directors, etc.** include directors (including representative directors) and auditors
- (7) **The Board of Directors, etc.** include the board of directors and decision-making bodies related to business operation and execution.
- (8) **The Sales Division, etc.** includes divisions engaged in trading, asset management, advisory services and other financial instruments business, and departments engaged in planning, advertisement and the like.
- (9) **The Representatives of the Company** include directors (representative directors if those are the designated posts), and any person who has been designated as the representative of a company.
- (10) **The Board of Company Auditors, etc.** includes company auditors and the board of company auditors.
- (11) **“Internal Audits”** refers to the process of review of the appropriateness and effectiveness of the internal control system of all divisions and sales branches (hereinafter referred to as the audited divisions) by a division in charge of internal audits that is independent from the audited divisions (if it is difficult to set up an independent internal audit division, a company auditor who took actions to improve the objectivity of audits, etc.). This process includes not only detecting and pointing out problems with the audited divisions’ administrative processes, etc. but also evaluating the internal control system and proposing improvement measures.
- (12) **The Division in charge of laws and regulations, etc.** is the division that formulates internal rules concerning legal compliance and conducts training on the interpretation

- of laws and regulations, etc. and legal compliance.
- (13) ***Personnel in charge of Internal Control*** include employees who belonging to the internal control division and employees who are assigned to the Sales Division, etc. to manage and supervise business operations.
- (14) ***The Internal Control Division, etc.*** includes the internal control division and personnel in charge of internal control.
- (15) ***Inappropriate Incidents*** refer to violations of laws, the fact that the financial instruments business operators, etc., their officers and employees are accused, and affairs equivalent to the above-mentioned cases, which may hinder their business operation.
- (16) ***Spot Investigation*** refers to the checking of securities and deeds in custody against a book balance, etc.
- (17) With regard to ***administrative divisions***, their organization is not expected to be independent of other divisions, but it is important to clarify which divisions they are in charge of.
- (18) In the verification concerning management of outsourced operations, it is required to take into account the contents of outsourced operations and review the items that are necessary items for comprehension of the actual conditions.
- (19) ***“Risks related to Capital Adequacy Requirements”*** is a collective term including the following risks:
- Market risks and counterparty risks that underlie the calculation of the Capital-to-Risk Ratio
  - In case of comprehensive management of the above-mentioned risks, volatility risks of assets held (market risks) and risks that are caused by the default in performance of obligations by issuers of securities and business partners (credit risks)
  - Fundamental legal risks
- (20) ***“Risks related to Consolidated capital adequacy requirements”*** refers to each risk which forms the basis for calculation of the Consolidated Capital-to-Risk Ratio.
- (21) A person who manages the Capital-to-Risk Ratio or Consolidated Capital-to-Risk Ratio is not assumed to belong to the risk management division or to be independent from the accounting division, etc.
- (22) Inspections related to real-estate investment funds, etc. have the aim of understanding the actual conditions of execution of due process, implementation of information disclosure and efforts to prevent conflicts of interest in transactions, etc., which are essential for protecting investors and exercising the function of appropriately forming prices in real-estate markets. It should be noted that

inspections are not intended to influence individual real-estate prices, etc.

(23) Depending on the contents and methods of business and the like, it may be necessary to review additional matters apart from inspection items, or omit them.

(24) According to the actual conditions of inspected business operators, necessary replacement of defined terms should be applied. Of inspection items contained in “Services and Operations” of Type I financial instruments business operators, in the case of inspections of Financial Instruments Intermediary Service Providers, review items related to business attitude and solicitation for investment, etc. are used as a reference. In the case of inspections of those who have notified Specially Permitted Businesses for Qualified Institutional Investors, etc., review inspection items related to Investment Management Businesses are used as a reference.

## **II-1-1 Structures and Systems / Common Inspection Items**

Assuming the “Ideal Status of Financial Instruments Business Operators, etc.” suitable as major players on the financial instruments market, inspections of structures and systems are conducted with an eye to comprehending whether or not the financial instruments business operator has established structures and systems appropriate to its characteristics. Inspection is also aimed at comprehending whether or not a financial instruments business operator’s internal control is functioning properly.

### **1. Business Management Systems**

#### **(1) Check-and-Balance System**

- (i) Are the roles of directors, company auditors and their board meetings clearly defined based on laws, and disseminated to officers and employees?
- (ii) Do non-representative directors engage in substantive debate at meetings of the board of directors and perform their duties of making decisions concerning business execution and of supervising business execution in order to ensure appropriate business execution by exercising a check-and-balance system against the representative directors and preventing autocratic management?
- (iii) Do directors fully perform their duty of loyalty in their execution of office as a member of the board of directors?
- (iv) Do directors, etc. take appropriate actions based on laws and quickly implement measures necessary for further healthy business operations upon discovering violations of laws by other directors, etc.?
- (v) Do company auditors attend all meetings of the board of directors, and fulfill the oversight function in relation to legal compliance, internal control, risk management and other significant matters?
- (vi) Is there an established system in which an officer who judges that there are problems in the legality of acts committed by other officers or employees can consult and communicate with legal experts, etc.?

#### **(2) Corporate Management Policy, etc.**

- (i) Does the board of directors clearly establish a corporate management policy based on the entire image at which the financial instruments business operator should aim? Does it clearly formulate a corporate management plan in accordance with the corporate management policy and disseminate it throughout the institution?
- (ii) Does the board of directors regard the establishment of corporate ethics as an



important task, with emphasis on the social responsibilities of the financial instruments business operator who is a major player in the financial instruments market, and has it built a system to realize the establishment of corporate ethics?

- (iii) With activities to comply with laws being the most important issue in corporate management, does the financial instruments business operator formulate the underlying policy to practice said activities, have them decided and approved by the Board of Directors, etc., and familiarize officers and employees with them?
- (iv) Is the content of underlying policy to practice legal compliance based on the Ideal Status of Financial Instruments Business Operators, etc. according to features of their business operations? Are specific action guidelines and codes of conduct prepared based on said policy?
- (v) Does the financial instruments business operator clearly decide the strategic goals of the sales divisions, etc. in accordance with the corporate management policy, formulate appropriate methods of business operations, and familiarize officers and employees with them?
- (vi) Are the strategic goals of the Sales Division, etc. excessive in light of the company's size and the actual condition of sales?

### (3) Corporate Management System

- (i) Does the representative director understand the characteristics of various risks that the company has, appropriately allocate resources in accordance with the management strategy, and develop a system capable of controlling those situations flexibly?
- (ii) Does the board of directors recognize the significance of legal compliance, internal control, risk management and internal audits, etc., and establish an appropriate organizational system corresponding to the business of the company?
- (iii) Do directors, etc. ensure that there are a sufficient number of board members to accurately execute the financial instruments business as provided for by law? Particularly, do they ensure that there are personnel with knowledge and experiences concerning business operations, and take steps to remove personnel with unsatisfactory business management qualifications?

### (4) Board of Company Auditors, etc.

- (i) Do company auditors maintain their independence in accordance with the purpose of the system?
- (ii) Do company auditors appropriately exercise the wide-ranging authorities they have

been granted, and implement business audits in a timely and appropriate manner? (In the case of companies subject to restrictions on transfer of all shares, only accounting audits) Do they ensure that the necessary employees assist the Board of Company Auditors, etc.?

- (iii) Are accounting auditors used in order to allow the board of company auditors, etc. to fully function? Additionally, are legal offices used where necessary?
- (iv) Are company auditors aware of being independent agents? Do they default on active audits that are their responsibilities according to the organization of the board of company auditors?
- (v) Does the board of company auditors, etc. check whether or not the results of external audits are reasonable?
- (vi) Do company auditors audit legal compliance?

(5) Board Minutes, etc.

(i) Does the board of directors:

- A. record the minutes of board meetings in a timely manner?
- B. retain the minutes of board meetings for the statutory period?
- C. record the contents of the minutes of board meetings so that when combined with the raw data used therein, they are sufficient to be used to confirm matters reported to the board of directors and the details of approvals given and decisions made by the Board of Directors, etc..? Is it ensured that the raw data used at these meetings is stored for the same period of time as the minutes of board meetings are?

(ii) Does the Board of Directors, etc.. properly prepare and store not only the minutes of board meetings but also the minutes of other important meetings concerning business operations and the like?

(6) Efforts for Business Operation

- (i) Does the board of directors take appropriate measures based on adequate debate so as not to breach their duty of loyalty and duty of due care in the course of their duties?
- (ii) Does the board of directors discuss not only matters in relation to business development but also important items concerning internal control and various potential risks in business operations as a part of the agenda?
- (iii) Does the Board of Directors, etc.. develop systems for reporting to comprehend the status of business operations?
- (iv) Do directors actively participate in business operations? With regard to how to handle anti-social forces, do they fully understand that prohibiting association with

anti-social forces and excluding such forces firmly is vital for maintaining public confidence in the financial instruments business operators and securing the appropriateness and soundness of their business, and positively make efforts to do so?

In such a case, in light of the need and importance of an action to ban any relationship with anti-social forces organically, do they have the responsibility of responding which is not left solely to the relevant individuals or divisions but the management including directors appropriately involved in the situation? In addition, is there a policy calling for the corporate group as a whole, not just the involved Financial Instruments Business Operator alone, to take on an effort to prevent any relationship with anti-social forces?

- (v) Does the Board of Directors, etc.. endeavor to ensure the soundness of business in such a way, for example, as to develop training for officers and employees and internal communication systems?
- (vi) Does the Board of Directors, etc.. regard lawsuits involving considerable amounts of money and claims as risk factors?
- (vii) Does the Board of Directors, etc.. provide a definite policy for handling anti-social forces, methods of initial response to them and so on in the internal rules, etc. based on the “Guidelines to enable companies to prevent damages caused by antisocial forces” (agreement of cabinet meeting on crime countermeasures on June 19, 2007)?
- (viii) Does the board of directors establish highly independent auditing systems to assess the status of business operations?
- (ix) Does the board of directors take the initiative in making efforts to improve problems detected in audits, etc. (internal audits, external audits, and audits or tests by self-regulatory organizations)?

## 2. Legal Compliance System

### (1) Efforts of Top Management

- (i) Do directors take specific measures to enable employees to understand the directors’ stance on legal compliance?
- (ii) Does the board of directors handle violations of law in a fair, equal and firm manner?
- (iii) Are systems and methods of business operations appropriately in compliance with the laws and regulations, etc.?
- (iv) Does the Board of Directors, etc.. periodically review the effectiveness of measures

for legal compliance, and conduct necessary improvements?

- (v) Does the Board of Directors, etc.. provide disciplinary rules to impose strict and fair internal disciplinary actions on those who violated the laws? Do they also periodically verify their deterrent effects on violations of the law, and reflect the results in the criteria of disciplinary actions?

## (2) Implementation Plan, Code of Conduct

### (i) Implementation Plan

- A. Is the implementation plan concerning legal compliance (hereinafter referred to as the “compliance program”) established, determined or approved by the Board of Directors, etc., and disseminated to officers and employees?
- B. In establishing the compliance program, is the size and nature of the sales division, etc. taken into account? Are its implementation and effects reflected in the evaluation of business performance, personnel rating and the like?
- C. Are the authority and responsibilities of personnel who follow up on the progress and the achievement of the Compliance Program clear? Is the system developed and implemented so that the representative directors and/or directors can accurately comprehend and evaluate its progress and achievement?
- D. Is the compliance program regularly assessed by internal audits, etc.? Is it reviewed in a timely and reasonable manner?

### (ii) Code of Conduct

- A. Is there a code of conduct concerning legal compliance? (Hereinafter referred to as the “compliance manual”.) Was it determined or approved by the Board of Directors, etc.?
- B. Does the compliance manual comply with laws and regulations, etc.? Are the contents of the compliance manual appropriate and specific, taking into account the corporate climate, the organizational structure for business and actual business conditions, etc.?
- C. Do all officers and employees know of the existence and the contents of the compliance manual?
- D. Is the compliance manual periodically assessed by internal audits, etc.? Are its contents also reviewed in a timely and appropriate manner?
- E. In the formulation and amendment of the underlying policy for demonstrating legal compliance and of the compliance manual, are legal checks implemented by the division in charge of laws and regulations, etc. and, if necessary, by people such as lawyers? In addition, when starting new businesses and launching new products, are

the legal checks implemented with adequate verification of the characteristics of these businesses and products?

(3) Setup of Divisions in charge of Laws and Regulations, etc.

- (i) Is there an established system to manage all problems concerning legal compliance? Are the internal regulations provided for?
- (ii) Do directors, etc. in charge of personnel make efforts to ensure the appropriate number of capable personnel by considering divisions in charge of laws and regulations, etc. and the internal control division as equal to other sales divisions, etc.? Furthermore, do they manage them with interest, and appropriately assess them in performance evaluations and personnel ratings?
- (iii) Are appropriate systems and measures implemented in such a way, for example, as to ensure the independence of the division in charge of laws and regulations, etc. and the internal control division, and to grant the authority to exercise check-and-balance functions against the sales division, etc.? Is the effectiveness of said systems and measures periodically assessed by internal audits, etc.?
- (iv) Do personnel responsible for the division in charge of laws and regulations, etc. endeavor to grasp information on legal compliance, and report necessary information to the Board of Directors, etc..?

(4) Thoroughly Boosting Awareness of Legal Compliance

- (i) Does the representative director show his/her stance on addressing legal compliance on various occasions, such as a speech at the beginning of the year?
- (ii) Does the division in charge of laws and regulations, etc. and the internal control division organize laws and regulations, etc. to comply with cautionary statements from self-regulatory organizations, etc., and take appropriate measures to disseminate them to sales representatives? For example, do they take such measures as instructing and supervising administrators of the sales division, etc. in relation to methods of dissemination, and/or enabling sales representatives to understand further by using specific examples with internal distribution and circulars, training, meetings and so on?
- (iii) In order to boost employees' and officers' awareness of legal compliance, are effective measures taken in such a way as to implement training for each sales division concerning the laws and regulations, etc. that have direct impacts on relevant business operations? Do officers and administrators of the internal control division actively engage in the implementation of such measures, for example by participating

in said training as lecturers?

- (iv) Does the division in charge of laws and regulations, etc. comprehend and verify, in some way, the effects of training and meetings for sales representatives that will enable them to understand laws and regulations, etc. and be thoroughly aware of legal compliance?
- (v) In cases where an inappropriate incident was caused by officers' or employees' ignorance of or lack of understanding about laws and regulations, etc. and their lack of awareness of legal compliance, does the division in charge of laws and regulations, etc. recognize the actual conditions of said incident and take necessary actions?

#### (5) Formulation of Internal Rules

- (i) Are internal rules required by the articles of incorporation and the rules of self-regulatory organizations, etc. appropriately developed?
- (ii) When common rules that exist within the group company (especially rules provided by an overseas group company) are introduced, is it verified whether or not those rules are inappropriate or insufficient?
- (iii) When questions arise in the sales division, etc. in relation to interpretation of laws and internal rules, etc., do the internal rules clearly specify that checking with personnel in charge of laws and regulations, etc. is required? Does the sales division, etc. continue business according to their own interpretation?
- (iv) Are the internal rules reviewed in a timely manner in response to the revision of laws and regulations, etc. and environmental changes in organizations and business operations?

### 3. Internal Control System

#### (1) Appointment of Personnel in Charge of Internal Control

- (i) Are personnel in charge of internal control assigned to appropriate posts? Are areas of responsibilities and the division of roles clearly provided for in all divisions, including the internal control division?
- (ii) Is there a system in which personnel in charge of internal control assigned to the sales division, etc. can independently execute their duties? Is their authority clearly established? In addition, is the effectiveness of systems periodically assessed by internal audits, etc. in all divisions, including internal control divisions?

## (2) Roles of Personnel in Charge of Internal Control

- (i) Do personnel in charge of internal control make efforts to understand the acceptance and placement of orders, contracts and customer management by sales representatives, and transactions on sales representatives' own accounts?
- (ii) Do personnel in charge of internal control make efforts to manage and supervise sales representatives' solicitation of customers, by for example, checking them on a daily basis?
- (iii) When recognizing that a sales representative lacks awareness of legal compliance, do personnel in charge of internal control investigate the causes and consider and implement measures to improve the problem?
- (iv) When inappropriate incidents, etc. occur, do personnel in charge of internal control conduct an in-depth investigation on the facts and the processes and take appropriate actions after finding out the cause of occurrence? In such cases, do personnel in charge of internal control deal with the incidents in a faithful and prompt manner, for example, by visiting the customer?
- (v) Do personnel in charge of internal control analyze causes of occurrence of inappropriate incidents, inform the sales division, etc. of the results of analysis, and take quick measures against reoccurrence?

## (3) Roles, etc. of the Internal Control Division

- (i) Are the organizational structures related to internal control, the assignment of authority and the appointment of personnel, etc. appropriate, taking into account corporate business, size and so on? Are they functioning properly?
- (ii) Are areas of responsibility in each division engaged in internal control clearly defined? Is mutual cooperation among divisions closely maintained? In cases where adjustments among divisions are required, is the division of roles clarified in advance?
- (iii) Between the internal control division and the sales division, etc., are required items communicated, reported and discussed, and methods clearly determined?
- (iv) For cases in which a specific employee (including an administrator) is engaged in the same duty in the same department for a long period of time, are effective measures taken to prevent inappropriate incidents, in such a way, for example, as to have the employee leave his/her workplace for a certain period for consecutive leave, training, an internal temporary transfer, or a combination of these?
- (v) Is internal education for sales representatives, such as regular training, sufficiently implemented?

- (vi) Do directors and personnel responsible for the internal control division encourage officers and employees to participate in training held by self-regulatory organizations and other external organizations?
- (vii) When laws and internal rules, etc. are newly formulated or revised, does the internal control division, etc. review whether or not existing business operations conform to them? Do they also take actions if improvement is needed?

#### (4) Management of Internal Control Operations

- (i) Does the internal control division comprehend complaints and consultation by customers, and establish systems to respond to them appropriately?
- (ii) Does the internal control division implement appropriate verification after the occurrence of inappropriate incidents?
- (iii) Does the internal control division develop systems capable of quickly and accurately responding to the occurrence inappropriate incidents?
- (iv) Is there a system in which the occurrence of inappropriate incidents, by formulated and disseminated procedures, can be immediately reported to the internal control division by officers and employees (the perpetrator) at the time of the inappropriate incident? Especially, in the system, are significant problems that may impact business reported to the Board of Directors, etc.. without delay?
- (v) Does the person responsible for the internal control division provide the internal rules in relation to the preparation and storage of records on facts, processes and the like of inappropriate incidents that have occurred? Does he/she also thoroughly inform officers and employees of said rules?
- (vi) Is a system developed to assign the responsibility of concerned parties and to clarify oversight responsibility when the cause of occurrence is found out in an investigation on the inappropriate incident?
- (vii) Does the representative director engage actively in the formulation of preventive measures against a recurrence of inappropriate incidents, and make efforts to ensure their effectiveness? Do company auditors monitor whether or not the representative director appropriately executes said duty? In cases where the relevant inappropriate incident constitutes a violation of criminal laws, do the Board of Directors, etc.. adequately consider how to handle the incident, and appropriately respond to it?
- (viii) Does the internal control division appropriately respond to precautions and requests for investigation from self-regulatory organizations? Are relevant documents prepared and stored appropriately?
- (ix) Does the internal control division, etc. fully understand what kind of operations



sales division, etc. are conducting? Do they also conduct necessary checks, for example, of whether or not inappropriate operations are carried out without following usual methods of operation?

- (x) When discovering problems by verifying business operations of the sales division, etc., does the internal control division, etc. investigate the causes and take necessary actions?
- (xi) Are various materials for management to appropriately execute internal control operations prepared properly and used effectively? Are such materials also stored in an appropriate manner?

(5) Responses to Lawsuits, etc.

- (i) Are procedures to respond to lawsuits determined in preparation for cases in which a specific complaint or motion is filed? When its cause is found to fall under the category of a violation of the laws, is the lawsuit dealt with quickly in accordance with the procedures for inappropriate incidents?
- (ii) In the case that a lawsuit is filed, is it quickly reported to the internal control division, etc.? Does the manager of the internal control division report, in particular, problems which may have a significant impact on business to the Board of Directors, etc.. without delay?
- (iii) Are contents of lawsuits recorded in a register, etc., stored, and, in relation to responses to lawsuits, reported to the Board of Directors, etc.. if necessary?

(6) Protection of Customer Information

- (i) Has a manager of customer information been appointed?
- (ii) Does the manager of customer information identify customer information to be protected, formulate the internal rules stipulating the authority and responsibilities for information management, management methods, contact information, procedures for reporting and so on, and disseminate them to officers and employees with approval from the Board of Directors, etc., as recognizing the significance of information management?
- (iii) Does the manager of customer information regularly verify the management of customer information, and if necessary, review internal rules?
- (iv) In the internal rules, is it specified that, in cases where customer information is leaked, this fact should be reported to the manager of customer information and that efforts to identify leaked information and investigate the cause of the leak should be made?

- (v) Is there an established system in which, in cases where customer information is leaked, the manager of customer information endeavors to comprehend as many facts as possible, and quickly reports them to a manager of the internal control division and the Board of Directors, etc..?
- (vi) Does the manager of customer information investigate the causes of information leaks, etc., clarify responsibility, and quickly take preventive measures against reoccurrence?
- (vii) With regard to customer information leaks, etc., does the manager of customer information formulate procedures and methods in advance for responses to customers, disclosure of the facts, and reporting to the relevant authority?
- (viii) Is the system for protecting customer information evaluated by internal audits, etc. and improved where needed?
- (ix) In cases where operations involving customer information are outsourced, does an agreement with outsourcing contractors clearly stipulate restrictions on use for purposes other than the original intent, responses at a time when a problem occurs and the like, and that confidentiality be maintained? Is necessary management and oversight conducted with continuous monitoring?

#### (7) Establishment of Administrative Division

- (i) Is there a specific division for developing administrative rules, etc.?
- (ii) Is there a specific division for providing administrative guidance and training? Is there a system in which those functions can be sufficiently fulfilled?
- (iii) Is there a system in which the checks-and-balances function of the administrative division can be sufficiently fulfilled?

#### (8) Roles of Administrative Division

- (i) Does the administrative division have a system in place in which it is possible to respond to inquiries on administrative processing from the sales division, etc. quickly and accurately? Does it also preserve records on inquiries and answers which were deemed important?
- (ii) Are actions taken to constantly check administrative management systems of the sales division, etc.?
- (iii) Are measures taken to prevent dishonest acts by the head and other staff members of the sales division?
- (iv) Does the administrative division have an understanding of routine business operations in the sales division, etc. and have in place a system for providing

appropriate guidance in order to improve the level of administrative works of the sales division, etc.?

(9) Development of Administrative Rules

- (i) Are the administrative rules thoroughly in compliance with laws and regulations, etc.? Do administrative rules clearly stipulate procedures for handling cases which are not covered by the internal rules, and cases in which there are different possible interpretations concerning the internal rules (including reporting to a manager, etc.)?
- (ii) Are the administrative rules reviewed and improved as needed in consideration of the results of internal audits and of problems detected in inappropriate incidents, etc.?
- (iii) When laws and regulations, etc. are revised, are the administrative rules reviewed and improved where necessary in consideration of the contents of the revised laws and regulations, etc.?
- (iv) Do the administrative rules clearly stipulate procedures, such as recording the process of problems that have occurred, for handling, in particular, cash, checks, physical certificates, and important documents, as well as other necessary items?

(10) Management of Outsourcing

- (i) When a part of business operations is outsourced, is its appropriateness judged by fully considering laws and regulations, etc. and risks which may be associated with outsourcing? Are the process and results of such consideration recorded and stored?
- (ii) Has a person for appropriately managing outsourced operations been appointed?
- (iii) Has sufficient information been obtained on the implementation of internal and external audits, etc. in order to comprehend the situation of internal control by an outsourcing contractor and assess its effectiveness?
- (iv) In cases where problems are discovered in relation to outsourced business operations and outsourcing contractors, are corrective actions taken quickly?
- (v) Is there a contingency plan in order to respond to system failures which may occur at the outsourcing contractor's facilities, such as leaking of customer information and other troubles?
- (vi) Are measures taken to prepare for the possible bankruptcy of outsourcing contractors?

4. Audit System

(1) Establishment of Internal Audit Division

- (i) Does the board of directors recognize that internal audits are intended to verify the appropriateness and effectiveness of internal control systems (including risk management systems), and establish a system in which this function can be sufficiently fulfilled?
- (ii) Has the board of directors established effective internal audit systems, for example, by setting up a highly independent internal audit division which is free from interference from the sales division, etc., and appointing directors exclusively in charge of that division? Even if the business operator does not fall under the category of a large company under the Corporate Law, has it made efforts to establish effective audit systems, in such a way as to ensure the independence of personnel engaged in internal audit operations?
- (iii) Have the Board of Directors, etc.. assigned the appropriate number of personnel familiar with relevant operations to positions in the internal audit division so as to enable internal audits to function effectively?

(2) The Position of Internal Audit

- (i) Have the representative directors and the board of directors appropriately set up the objectives of internal audit under internal audit rules, etc.? In the course of performing the above duty, have they fully recognized that it is essential to establish an effective internal audit system corresponding to the types and levels of risks in order to obtain corporate profits and appropriately manage risks?
- (ii) Do the representative directors and the board of directors take measures to disseminate knowledge on the operations and authority, etc. of the internal audit division to all officers and employees?
- (iii) Are personnel engaged in internal audit operations authorized to obtain all materials considered necessary for the execution of their duties? In addition, are they authorized to interview and ask questions of all officers and employees considered necessary for executing their duties?
- (iv) Does the Board of Directors, etc.. take measures so that personnel in charge of internal audit operations are not concurrently engaged in other operations from the viewpoint of ensuring effectiveness? In the course of performing the above duty, does the board of directors fully recognize that it is essential to make all business operations of not only the sales division, etc. but also the internal control division subject to internal audits in order to maintain the appropriateness of business operations?

(3) Development of Internal Audit Rules, etc.

(i) Do the internal audit rules, etc. stipulate the following items?

- A. The purpose of internal audits
- B. Organizational independence
- C. The scope of business, authority and responsibility
- D. A system to obtain information, etc.
- E. A system for implementing internal audits
- F. A system for reporting results of audits

(ii) Are the internal audit rules, etc. approved by the Board of Directors, etc..?

(iii) Are the internal audit rules, etc. reviewed according to changes in the business environment?

(iv) Has the internal audit division prepared a guideline for implementing internal audit operations? Is the guideline determined or approved by the Board of Directors, etc., and reviewed when necessary?

(4) Formulation of Internal Audit Plan, etc.

(i) Does the internal audit division understand the management of risks in audited divisions, etc., and formulate efficient and effective internal audit plans corresponding to the type and level of risks?

(ii) Does the Board of Directors, etc.. determine and approve audit policy, priority items, and other basic matters of the internal audit plan based on an understanding of the kinds and levels of risk in audited divisions?

(iii) When serious business problems occur or business environments change, does the Board of Directors, etc. instruct the head of the internal audit division to change the audit policy, etc. as needed?

(5) Management of Internal Audit Operations

(i) Does the internal audit division endeavor to implement efficient and effective audits based on the internal audit plan?

(ii) Do internal audits verify the dissemination of knowledge on laws and regulations, etc. and items to consider to all officers and employees, in addition to legal compliance, the appropriateness of business operations and financial soundness.

(iii) Are business operations of consolidated subsidiaries and affiliates to which the equity method is applicable (hereinafter referred to as the "Consolidated Subsidiaries, etc.") included in the scope of audits within legal limits? With regard to business

operations of the consolidated subsidiaries, etc. and outsourced operations which cannot be subject to internal audits, is the management of divisions responsible for those operations audited? Furthermore, in cases where a parent company implements internal audits, are those audits appropriate and within legal limits?

- (iv) In implementing audits, does the internal audit division use the results of inspections conducted by audited divisions, etc.?
- (v) Do personnel engaged in internal audit operations accurately record the verified items and the problems that were found in internal audits?
- (vi) Do personnel engaged in internal audit operations prepare an internal audit report accurately reflecting the problems, etc. that were found in internal audits without delay?
- (vii) Does the head of the internal audit division attend meetings (various risk management committees, etc.) concerning internal control (including risk management) as needed?
- (viii) Does the internal audit division endeavor to realize fair internal audits in such a way, for example, as to avoid the consecutive engagement of the specific person in charge of internal audit operations in the same audit operation in the same audited division?
- (ix) Does the head of the internal audit division report major problems stated in an internal audit report to the representative directors and the board of directors without delay?
- (x) In cases where significant problems concerning internal control and insufficiency concerning risk management are detected in an internal inspection conducted by audited divisions, does the head of the internal audit division provide a system enabling the internal audit division to promptly comprehend those problems?

#### (6) Utilization of External Audit

- (i) Do the representative directors and the board of directors fully recognize that effective external audit by accounting auditors, etc. is essential in order to obtain company profits and appropriately manage risks?
- (ii) Does the board of directors take measures, apart from internal audit, such as using external experts in relation to operations, divisions and systems exposed to significant risks? Even if the business operator does not fall under the category of a large company under Corporation Law, does it consider the use of external audits according to characteristics of its business and implement them where necessary?
- (iii) In cases where the function of internal audits is reinforced and supplemented by

using external experts, does the board of directors itself closely examine and verify the contents and results of the audits?

- (iv) In implementing external audits, is the effectiveness of internal control systems and risk management systems audited? With regard to financial instruments business operators with overseas bases, are external audits for each overseas base implemented corresponding to the circumstances in each country? Are the results of such audits reported to the Board of Directors, etc. or the board of company auditors, etc. according to the contents of the audits? In addition, do the reports on results of audits contribute to ensuring the effectiveness of audits by company auditors?
- (v) Does the Board of Directors, etc. periodically review whether or not external audits are functioning effectively?
- (vi) Does the Board of Directors, etc. take measures necessary for establishing more effective audit systems with mutual cooperation between internal and external auditors?
- (vii) Does the Board of Directors, etc. have systems in place to improve problems pointed out by external auditors within a certain period of time? Do audited divisions, etc. improve those problems without delay, and, where needed, prepare an improvement plan, etc., taking into account the level of problem's importance? Does the internal audit division review the progress of improvement appropriately?

#### (7) Improvement in Internal Audit Functions

- (i) Does the Board of Directors, etc. regularly receive reports on internal audit operations, verify whether or not internal audits are functioning effectively, and take necessary measures?
- (ii) Does the head of the internal audit division take such measures as having personnel engaged in internal audit operations regularly participate in domestic and overseas training in order to improve their expertise?
- (iii) Does the Board of Directors, etc. assign internal auditors to an overseas base considered to potentially have risks over a certain size, who are independent from the head of that base, and have a system to receive reports on audits regularly in place?

#### (8) Handling of Audit Results

- (i) Do audited divisions, etc. improve problems pointed out in internal audit reports without delay, taking into account the level of importance of those problems, and prepare an improvement plan, etc. when needed? Does the internal audit division appropriately review the progress of improvement, and reflect it in the subsequent

internal audit plan?

- (ii) Receiving results of internal audits, do the representative directors and the board of directors take effective measures for improving problems recognized as having considerable impacts on business and those which the audited divisions, etc. are not thought to be able to handle alone?

#### 5. Crisis Management System

- (i) Does the board of directors appoint personnel responsible for dealing with incurred crises? In the course of this, do they also define events falling under the category of crises (for example, natural disasters [earthquakes, wind and flood damage, abnormal climate, epidemics, etc.], the cease of functions of social infrastructures [large scale power failures and communication failures, etc.], terrorism, interference by anti-social forces, kidnapping of an officer or an employee and the like)?
- (ii) Assuming the occurrence of a crisis, does the Board of Directors, etc. take appropriate countermeasures, such as by establishing a system to backup data on transactions, etc.? When it is difficult to develop such systems, do they consider specific measures to continue or resume business?
- (iii) Do personnel responsible for crisis countermeasures set up a task force promptly at the time of crisis, and have the authority to issue necessary instructions or orders to officers and employees?
- (iv) Do personnel responsible for crisis countermeasures formulate a crisis management manual, and disseminate it to all officers and employees with approval from the Board of Directors, etc.?
- (v) Does the crisis manual specify the following matters in preparation for the occurrence of crises?
- A. Matters concerning a task force
  - B. Matters concerning a system of responsibility
  - C. Matters concerning the collection of information
  - D. Systems for reporting and communication within the organization and to concerned parties corresponding to the level and type of crisis
  - E. Scope and methods of business continuity corresponding to the level and type of crisis
  - F. Matters concerning public announcement (the status of business continuity, response to customers, and the like)



- (vi) Do personnel responsible for crisis countermeasures make efforts to have officers and employees recognize the significance of regular inspections, etc., even in peace time, in order to avoid and prevent damages caused by crises to the maximum extent?
- (vii) Is the crisis management manual assessed in relation to its effectiveness by conducting regular drills, etc., and reviewed according to environmental changes when necessary?

## **II-1-2. Structures and Systems / Inspection Items for Type I Financial Instruments Business Operators**

The purpose of inspections concerning structures and systems of Type I financial instruments business operators is to confirm whether or not a Type I financial instrument business operator, as a market intermediary, has appropriate systems in place that allow the business operator to fulfill its roles and responsibilities. For that purpose, it is necessary to verify whether or not the internal control functions appropriately through an accurate understanding of legal compliance systems related to fair trading, internal control systems concerning separate management of customers' assets, various risk management systems such as a capital-to-risk ratio and internal audit systems for verifying and assessing those systems.

### **1. Internal Control System**

#### **(1) Manager of Internal Control Division**

- (i) Have the representative directors established a system to recognize important information on internal control in close cooperation with the manager of the internal control division? Has the manager of the internal control division established a system for communicating with and reporting to personnel in charge of internal control who belong to the sales division, etc., and constructed a system to comprehensively cover all information on internal control? Furthermore, does the manager clarify these systems, disseminate knowledge on them to all officers and employees, and verify the effectiveness of those functions?
- (ii) Does the manager of the internal control division continuously and accurately collect and handle information on compliance? Does he/she also take measures to improve awareness of all officers and employees on information regarding legal compliance through appropriate means and methods, and review and understand the level of awareness?
- (iii) Have personnel in charge of internal control of the sales division, etc. developed appropriate management systems including customer management, management of sales representatives in the sales division, etc.? Do they also fully recognize that they are responsible for improving inappropriate incidents and business operations in the sales division, etc. under their own direction and supervision, and establish a system to ensure the implementation of improvement?
- (iv) Do personnel in charge of internal control of the sales division, etc. inspect routine business operations in the sales division, etc. and give the necessary guidance?

(v) Do personnel in charge of internal control of the sales division, etc. report legal compliance and business operation, etc. of relevant divisions to the manager of the internal control division regularly and as needed?

(vi) Does the manager of the internal control division instruct managers of the sales division, etc. to appropriately educate sales representatives in ways corresponding to the levels of risk and the complexity of financial instruments which they handle?

## (2) Development of Systems for Sales Management and Examination

(i) In order to eliminate unfair transactions, such as insider trading and market manipulation, has the board of directors established a highly independent division to monitor, manage and examine unfair trading, and have they granted it necessary authorities and responsibilities?

(ii) Do managers of transaction management and examination divisions formulate internal rules stipulating the below-mentioned matters, and disseminate knowledge about the items necessary to prevent unfair transactions, such as insider trading and market manipulation, to all officers and employees with approval from the Board of Directors, etc.? Do the managers also review the internal rules appropriately when needed?

A. Matters concerning insider registration

B. Matters concerning the manner in which corporation information, including insider information, is handled

C. Matters concerning transactions by insiders, officers and employees

D. Matters concerning trading methods such as pyramiding (bear raids), manipulation for closing prices and so on

E. Matters concerning stocks subject to stable manipulation

F. Matters concerning criteria and methods of transaction management and examination, etc.

G. Matters concerning inquiries from the SESC and self-regulatory organizations

(iii) Do the managers of transaction management and examination divisions sufficiently educate employees to eliminate unfair transactions through the use of training, meetings, etc. for officers and employees?

(iv) Has the board of directors developed a system in which the internal audit division, etc. verifies transaction management and examination regularly or when needed and confirms whether or not they function appropriately, from the viewpoint of maintaining the appropriateness of transaction management and examination?

(v) With regard to the acceptance of orders from overseas affiliates and group

companies, has the board of directors established a transaction management system in which it is possible to quickly reply to inquiries from the SESC and self-regulatory organizations about the original trustor?

- (vi) When implementing an examination falling under the category of transaction management and examination provided in the internal rules, do the transaction management and examination divisions record its process, the methods of examination and results, and store them for verification in the future?
- (vii) When a suspected case of insider trading is confirmed, have the results of sales examination, including the contents of the measures if such measures were taken against said customer(s), been reported to the SESC and self-regulatory organizations?
- (viii) In cases where suspicious transactions, including as insider trading, are detected, do the transaction management and examination divisions verify their contents, even if they are orders accepted from overseas affiliates and group companies? When a customer defaults on delivery, do they investigate the cause and endeavor to prevent a recurrence?

### (3) Development of Pre-underwriting Examination

- (i) Has the board of directors of a financial instruments business operator engaged in underwriting business established sufficient and appropriate systems for pre-underwriting examinations so as not to underwrite issues without careful consideration, in full recognition of the responsibilities for selling underwritten financial instruments to customers and risks caused by it?
- (ii) Has the board of directors developed such systems as setting up a highly independent division for pre-underwriting examinations, and granted it the necessary authority?
- (iii) Has a manager of the pre-underwriting division formulated internal rules containing items necessary for pre-underwriting examinations (procedures of examination and items to be examined), and received approval from the Board of Directors, etc.?
- (iv) Does the Board of Directors, etc. respect the opinions of the pre-underwriting examination division in approving underwriting? Do they also provide a system in which decisions on underwriting are made after fully considering doubtful items pointed out in cases where questions arise?
- (v) Does the board of directors have systems in place for verifying the appropriateness of pre-underwriting examinations by the internal audit division, etc., in order to maintain strict examinations by the pre-underwriting examination division, etc.?

(4) Development of Management Systems for Conflicts of Interest

- (i) Has the Board of Directors, etc. established a section, etc. for the identification and management of those transactions that involve potential conflicts of interest, and that are undertaken within the Financial Instruments Business Operators or the Financial Institution Group in an integrated manner and ensured that customers' interests regarding financial instruments-related businesses are not damaged and that a manager or a section that is independent from sales divisions is organized? Has a manager or a section, etc. (hereafter referred to as the "conflicts of interest management section, etc.") been given the necessary authority and responsibility?
- (ii) Has the conflicts of interest management section etc. developed a system for both identifying transactions that involve potential conflicts of interest (including categorization) in advance, and for examining relevant business operations, including the introduction of new business operations, from the perspective of conflicts of interest?
- (iii) Has the conflicts of interest management section, etc. developed a system for examining and managing transactions that involve potential conflicts of interest in the ways described below (including a combination of them)?
  - A. Separate those divisions whose interaction could potentially create a conflict of interest, by blocking the flow of information.
  - B. For all transactions that involve a potential conflict of interest, revise the terms or methods of the transactions, or cancel the transactions.
  - C. Disclose potential conflicts of interest to customers.
- (iv) Has the conflicts of interest management section, etc. developed a policy for the implementation of measures related to identifying and managing transactions involving potential conflicts of interest—including those mentioned in sections (ii) and (iii) above? Has the management fully communicated the policy to all officers and employees? Has the outline of said policy been properly publicized in such a way that customers can recognize it?
- (v) Have the systems in sections (ii) and (iii) and the policy in (iv) above been developed while taking into account factors such as contents, scale, and the characteristics of the businesses of the Financial Instruments Business Operator or the Financial Institution Group?
- (vi) Does the conflicts of interest management section, etc. properly store records related to the identification and management of transactions that involve potential conflicts of interest?

(vii) Does the conflicts of interest management section, etc. either periodically or on a case-by-case basis, review whether the system for identifying and managing transactions that involve potential conflicts of interest is properly functioning and makes recommendations and suggestions for improvement to the Board of Directors, etc. as deemed necessary?

(5) Development of Systems for Verifying Legal Compliance, etc.

(i) Does the manager of the internal control division have the following systems in place from the viewpoint of the protection of public interest and investors?

A. A system for verifying the issuance of prospectuses and explanatory booklets of foreign securities

B. A system for conducting examinations of advertisement and materials for solicitation

C. A system for verifying the management of specific investors

D. A system for verifying the issuance of written documents before conclusion of agreements

E. A system for verifying the issuance of written documents at the time of conclusion of agreements, etc.

F. A system for verifying the appropriateness of treatment of accidents

G. A system for verifying ideal practices

H. A system for verifying conformity with measures to prevent harmful effects

I. A system for verifying compliance with regulations on short selling

J. A system for verifying the appropriateness of other business operations

(ii) In developing the above-mentioned systems, has the manager of the internal control division formulated internal rules and a management manual, etc. and received approval from the Board of Directors, etc.? In addition, does he/she determine the managers of each system and clarify their authorities and responsibilities?

(iii) Has the manager of the internal control division formulated internal rules, etc. containing the following matters concerning customer management, received approval from the Board of Directors, etc., and disseminated them to all officers and employees?

A. Matters concerning the preparation of customers cards, etc.

B. Matters concerning the criteria for starting transactions

C. Matters concerning insider registration

D. Matters concerning verification at the time of transaction and suspicious transactions, etc.

- E. Matters concerning the protection of personal information
  - F. Matters concerning reminders for customer management
  - G. Matters necessary for appropriate customer management
- (iv) Has the manager of the internal control division formulated internal rules containing the following matters concerning the management of sales representatives, received approval from the Board of Directors, etc. and disseminated them to all officers and employees?
- A. Matters concerning the registration of sales representatives
  - B. Matters concerning explanations given to customers
  - C. Matters concerning prohibited acts (especially matters concerning suitability and unfair transactions)
  - D. Matters concerning reporting and processing at the time of inappropriate incidents
  - E. Matters concerning private financial instruments transactions by officers and employees
  - F. Matters concerning internal disciplinary actions
  - G. Matters necessary for appropriate management of sales representatives
- (v) Does the manager of the internal control division grant the authority and responsibility for appropriate management based on internal rules concerning the above-mentioned systems to personnel in charge of internal control in the sales divisions, etc., and provide systems for reporting to the internal control division in cases where problems occur? Does he/she also monitor and verify the effectiveness of those systems, and review each system including internal rules, etc. when necessary?
- (vi) In addition to the above-mentioned matters, does the manager of the internal control division provide systems for appropriately managing various statutory management operations, such as books and disclosure materials related to business operations, reporting to the relevant authorities and notification forms, and enable them to function?
- (6) Status of Business Operation
- (i) Is there a system for confirming whether or not sales representatives comprehend the characteristics of financial instruments, and sufficiently explain them to customers?
  - (ii) Does the internal control division manage and instruct the sales division, etc. to appropriately conduct the following matters in compliance with laws, and with agreements and consent for opening accounts for margin transactions or OTC financial futures transactions?
    - Verification of customer identity,

- Management of the maintenance ratio of margin requirements and customer margin (hereinafter referred to as “customer deposits, etc.”),
- Treatment of credit limits and margin call/advance money after the fact. For example:
  - A. Upon opening accounts, are examinations strictly implemented in light of the principle of suitability concerning customer’s financial ability and contents of transactions?
  - B. Is the internal control division making efforts to recognize changes in customer’s identity, etc., and manage the latest information as data of customer cards, etc.?
  - C. Are preventive actions taken against the occurrence of margin calls/advance money, for example setting up alarm points to get customers’ attention based on the availability in the maintenance ratio of customer deposits and the contents of open interest/collateral, etc., and the cessation of new margin transactions?
  - D. Is the same stock as the one purchased pledged as collateral securities?
  - E. In cases where the loanable value of collateral securities is changed at its own discretion, does the internal control division inform a customer of the matter in advance, and keep contact with the customer for a certain period of time?
  - F. Does the internal control division permit the unjustified withdrawal of customer deposits, etc. which would cause its maintenance ratio to drop below the requirements?
  - G. In cases where the maintenance ratio of customer deposits, etc. drops below requirements, does the internal control division take such actions as receiving additional customer deposits promptly? Although the maintenance ratio is still below requirements, does it permit additional open interest?
  - H. When advance money to customers is incurred, are appropriate actions taken quickly and in compliance with the agreements and consents for opening accounts for margin transactions or for OTC financial futures transactions?
- (iii) Are procedures in preparation for cases of default on delivery by a customer provided for in advance? Does the internal control division appropriately handle customers who frequently neglect their obligations of delivery?
- (iv) Do personnel in charge of internal control understand transactions by traders, and constantly monitor them so as not to violate the laws? Do they pay attention to the following matters in relation to trading?
  - A. Are organizations which conduct transactions subject to traded instruments accounts (at least organizations with front-office functions) composed differently, in terms of structures and personnel, than organizations which conduct similar transactions but have different purposes in other accounts, as in an organization larger



than units such as an office, a section, or a group?

B. In books pertaining to traded instruments accounts, can trading and traded assets be clearly and separately managed from other transactions and assets?

- (v) In cases where transactions of currency-related derivatives or securities-related OTC derivatives are made with individuals, have systems been developed for conducting loss-cut transactions, such as setting a loss-cut level to prevent customer losses from exceeding deposited margins? In addition, have loss-cut transactions been conducted appropriately?
- (vi) Regarding the sales and other marketing activities of securitization products, has a system been developed that is in compliance with the voluntary regulations of the Japan Securities Dealers' Association, "the Regulations Concerning Distributions, etc. of Securitized Products," and does it make efforts to ensure the traceability of securitization products?
- (vii) When originating and underwriting securitization products, does it make efforts to sufficiently perform screening related to underwriting on product characteristics, etc., including the risk characteristics of underlying assets?
- (viii) Does the internal control division formulate effective preventive measures against recurrence of matters pointed out by the SESC and self-regulatory organizations, and review their improvement?

(7) Development of Systems for Handling Troubles with Customers

- (i) Does the Board of Directors, etc. sufficiently recognize that leaving troubles with customers unsolved may lead to inappropriate incidents, such as misappropriation by officers and employees and loss compensation? Furthermore, do they provide systems for quick and appropriate processing and responses, in such a way as to clearly determine divisions to respond to incurred troubles and its procedures?
- (ii) In cases of newly-handled high-risk derivatives, are preventive measures taken against troubles, for example, legally and technically checked by experts of risk management, the internal control division and legal divisions, and do they receive approval from the Board of Directors, etc.? Are financial instruments that may cause troubles developed, due to, for example, unsound requests from customers to develop high-risk derivatives?
- (iii) In training, etc., are employees instructed not to take on many complaints from customers?
- (iv) Does the division in charge of responses to trouble instruct the personnel in charge of internal control in the sales division, etc. to endeavor to comprehend the troubles

with customers that each sales representative has and to quickly report them to said division?

- (v) Does the division in charge of responses to trouble record in detail proposals from customers, the contents of investigations and the processing status, and appropriately store them to enable their later verification?

## (8) Separate Management

### (i) Awareness and Roles of the Board of Directors, etc.

- A. Does the board of directors recognize the significance of separate management of customer assets, understanding that this contributes to the protection of investors and the sound development of financial instruments markets?
- B. Does the board of directors provide a system in which separate management is conducted appropriately, for example, by clearly determining a division in charge of separate management of customer assets?
- C. Does the board of directors have systems in place for checking the credit standing of custodians into which customer assets are deposited, including third-party institutions of overseas custodians, etc. where needed?
- D. Does the Board of Directors, etc. regularly receive reports concerning separate management of customer assets?

### (ii) Development of Management Rules

- A. Does the division in charge of separate management provide management rules concerning separate management, and receive approval from the Board of Directors, etc.?
- B. Do the management rules concerning separate management specify calculation methods to evaluate assets for clear separate management between customers' assets and business operator's own assets and cash segregated as deposits for customers, the authority for final decisions, management methods and administrators?
- C. Does the division in charge of separate management review the management rules when needed?

### (iii) Management of assets held in trust by a business operator

- A. In cases where the business operator holds securities, etc. deposited from customers in its own trust, do the internal rules specify the regular implementation of spot inspections?
- B. Are spot inspections conducted by a division with high objectivity and of which independence is ensured, for example, the internal audit division?
- C. Does the manager of the division in charge of separate management take actions to

avoid the omission of inspections in ways such as being present at spot inspections?

D. In spot inspections, are all items examined in ways such as checking deposit ledgers and micro films, etc.?

E. Also with regard to securities, etc. submitted to an issuer (including stock transfer agents) for transfer, can the customer name, its stock name, volume, and the destination to which securities, etc. were submitted be immediately confirmed by the books, etc.?

F. Do personnel in charge of internal control in the sales division, etc. verify whether or not securities, etc. to be separately managed remain in the sales division, etc. for an extended period of time, and if they do so, analyze the cause and take appropriate measures? When becoming aware of the securities that have remained, do they also report it to the division in charge of separate management immediately?

G. In the withdrawal and the deposit of securities, are physical certificates of individual securities identified by using a deposit ledger, microfilm and so on? In addition, are strict procedures conducted to prevent accidents, etc.?

(iv) Security management

A. Is appropriate and sufficient management conducted regarding, for example, management of entry and departure and management of important keys, and are custodian institutions for securities, etc. clearly determined? In order to prevent theft, is a security organization developed, and is a security manager clearly determined?

B. Are sufficient disaster-prevention measures taken, for example by assigning a disaster-prevention manager to the custodian institutions for securities, etc.?

C. In cases where the transportation of securities is outsourced to a third party, are measures taken in the outsourcing contracts to preserve securities, etc. in relation to transportation?

D. When the balance of securities held in trust is in disaccord, is there a system in which this fact is quickly reported to a manager of custody, and the causes of occurrence are investigated immediately?

E. For cases in which the causes of disaccord cannot be discovered or in which serious problems are recognized, does the manager of custody immediately report these facts to the director in charge and to either the managers of the division in charge of separate management or to the internal control division?

(v) Cash segregated as deposits for customers

A. Do the internal rules give specified dates on which to base replacement of calculations and for replacement of cash segregated as deposits for customers, and is advance handling specified for cases in which those days fall on a holiday?

B. For cases in which disaccord between the book balance of cash segregated as deposits for customers and the balance of a trust bank account is found as a result of verification, is there a system for analyzing the causes?

C. When the causes of disaccord cannot be discovered, does the manager of the division in charge of separate management immediately report this fact to the director in charge and to the manager of the internal control division?

(vi) System support

A. Is the required system support established for calculation and management of trust assets such as securities held in trust and cash segregated as deposits for customers?

B. For cases in which system support is available, is legal compliance of the contents of the program verified and, if necessary, reviewed?

(vii) Other Management Systems for Separate Management

A. Does the manager of the division in charge of separate management report the implementation of separate management of customers' assets to the manager of the internal control division and the Board of Directors, etc.?

B. As for the implementation of separate management, is its appropriateness and effectiveness regularly assessed by internal audits, and evaluated by statutory external audits? When problems are recognized, are they improved quickly? In addition, are the management systems, including internal rules, reviewed promptly when necessary?

(9) Electronic Transactions (including PTS operation)

(i) Awareness and Roles of the Board of Directors, etc.

A. Does the Board of Directors, etc. understand the characteristics of electronic transactions and fully recognize matters to which they should respond when making electronic transactions?

B. In non-face-to-face transactions, given the possibility that problems could arise in relation to the explanation and provision of information at sales and solicitation, responses to troubles, involvement of third parties, and so on, does the Board of Directors, etc. understand such risks of electronic transactions, and recognize the significance of relevant risk management? Especially, does the director in charge recognize these risks in detail and have a deep understanding of them?

C. For electronic transactions, is there an established system for legal compliance, as with ordinary face-to-face transactions?

D. Does the Board of Directors, etc. have a clear policy for activities in relation to electronic transactions? Are the policy's activities in accordance with the company's

business plan?

E. In formulating the activity policy, are the services to be provided and the mechanical environments of electronic transactions (the size of the systems) taken into account?

F. In the activity policy, is it clearly stipulated that internal control and legal compliance that take into account the characteristics of electronic transactions are required?

G. Is the status of a company's business operations (for example, company outlook, organizational matters, financial position and so on) placed on its website?

(ii) Does the manager in charge of electronic transactions understand the characteristics of electronic transactions, recognize the necessity for management corresponding to those characteristics, and take measures to enable personnel in charge of internal control in each division to understand and recognize such knowledge? Furthermore, in preparation for occurrence of system failures, etc., are appropriate measures taken, in relation to a backup system, countermeasures, and reporting to the relevant authorities? For example, are a sufficient number of personnel assigned to a call center to respond to inquiries from customers?

(iii) Does the manager in charge of electronic transactions provide internal rules in consideration of the features of electronic transactions, such as not being face-to-face and having paperless transactions, and receive approval from the Board of Directors, etc.?

(iv) Does the manager in charge of electronic transactions disseminate the contents of internal rules to all officers and employees, especially to personnel engaged in electronic transaction operations?

(v) In operating electronic transactions, is the appropriate staffing implemented in such a way as to assign employees familiar with electronic transactions to positions in charge of internal control?

(vi) Does the division that handles problems review whether or not the contents of some complaints and other proposals include factors which may have considerable impacts on transactions by customers due to problems concerning computer systems?

(vii) Is there a system in which information on system failures and other factors which may have considerable impacts on transactions by customers can be quickly and accurately conveyed to customers?

(viii) Is there a system in which training for officers and employees can be conducted in relation to administrative works, systems, problems and laws which are particular to electronic transactions?

- (ix) Is there an established training system for fostering personnel familiar with business operations (including an administrative division)?
- (x) Are training and other means of education implemented in order to enable employees in a call center related to electronic transactions to learn and improve their knowledge about laws and electronic transactions?
- (xi) In the case of both provision of information by telephone, etc. and electronic transactions being conducted jointly with face-to-face transactions, is the customer management system for ordinary face-to-face transaction adopted?
- (xii) Are measures taken for regulated stocks and regulations in relation to transactions through stable manipulation in the financial instruments markets?
- (xiii) Is there a system in which transaction management and examinations, etc. can be appropriately implemented with an eye to preventing unfair trading through electronic transactions?
- (xiv) Are measures to identify the original trustor taken, in order to quickly respond to unfair trading and the like?

#### (10) Information Management

- (i) Has the board of directors determined basic policy concerning information management, disseminated it to all officers and employees, established a department in charge of information management, and developed a system for conducting appropriate information management?
- (ii) Has the manager in charge of information management determined methods and procedures for information management, identified information properties to be protected, and appropriately granted the authority to access such information?
- (iii) Is there a system in which investigations on unauthorized access and identification and tracing of information can be conducted? Have necessary preventive measures been implemented?
- (iv) In the event of accidents such as information leakage and deletion, is a system including reporting to the Board of Directors, etc., treatment and procedures developed, and are preventive measures against reoccurrence quickly implemented?

## 2. Risk Management System

### (1) Awareness and Roles of Directors, etc.

- (i) Do the representative directors and the board of directors fully recognize that the

disregard of risk management may have significant adverse effects on corporate business by impairing financial soundness and leading to collapse of corporate credit (reputation)?

- (ii) Does the board of directors clearly determine the strategic goals, such as the level of profits the company is aiming to earn or the extent to which it can take risks? Does the strategic goal of the sales division, etc. disregard risk management while placing too high of a priority on ensuring profits? In addition, is this goal disseminated within the organization? In particular, has the board of directors established a goal which prioritizes profits in the short-term without appropriate risk management, and a compensation system based on such a goal?
- (iii) Has the Board of Directors, etc. a clearly determined policy of risk management based on the strategic goal? Do they also take appropriate measures to disseminate the policy of risk management within the organization? Furthermore, does the Board of Directors, etc. review the policy of risk management periodically or when needed, for example when the strategic goal is changed?
- (iv) Does the director in charge understand the methods to measure, monitor and manage various risks, as well as the location and types of risks and their features? Furthermore, does he/she recognize the significance of risk management, and work toward a policy and specific measures aiming to develop and establish an appropriate risk management system?
- (v) Does the board of directors clearly recognize the types of risks that the company has, and establish a necessary risk management system?
- (vi) Has the board of directors developed a system for conducting management by the kind of risk and a system in which all risks can be integrally managed? In those systems, are functions such as a mutual checks-and-balances system fully used, in such a way, for example, as to separate the sales division, etc. and the risk management division? Is its organizational structure reviewed when needed, and improved according to changes in the strategic goal and advances in risk management methods?
- (vii) Does the Board of Directors, etc. regularly receive reports on risks? Do they reflect on and take advantage of the acquired risk information for the execution of business and the development of management systems?
- (viii) Does the Board of Directors, etc. clearly determine policies for cultivation of human resources familiar with business, assignment of specialized personnel, its lineup and personnel management, etc. in order to implement appropriate risk management?

- (ix) Does the Board of Directors, etc. clarify the authority and responsibility of the risk management division, and establish a system for conducting the development, readjustment and staffing of an organizational structure to conduct appropriate risk management?
- (x) Does the Board of Directors, etc. have an appropriate risk management system in place in accordance with the decided strategic goal and risk management policy?
- (xi) Does the Board of Directors, etc. provide systems for obtaining accurate information and conduct appropriate risk management even at the time of a crisis such as market collapse?
- (xii) Do company auditors always attend meetings of the Board of Directors, etc. concerning risk management?

## (2) Development of Methods and Rules of Risk Management

- (i) Has the manager of the risk management division established methods for measurement, monitoring and management corresponding to types of risks in accordance with the risk management policy, and provided internal rules for appropriate risk management with approval from the Board of Directors, etc.? Does he/she also make efforts to improve the risk management policy and rules for risk management in a timely and appropriate manner?
- (ii) Are the contents of risk management methods and internal rules appropriate in terms of the strategic goal of the sales division, etc. and the business and financial instruments that the company is handling? Is risk management operation incorporated as a part of routine operations?
- (iii) In cases where transactions of low-spread currency-related OTC derivatives or securities-related OTC derivative are provided, have appropriate risk management systems been developed, such as fully recognizing the risks of low-spread transactions and identifying the transaction volume and the transaction details as well as the impact on the business operator's own financial position, etc.?
- (iv) Do the internal rules for risk management specify the execution methods for each business operation, such as procedures, authority, necessary documents and contingency plans? Does the risk management division verify employees' compliance with the internal rules?

## (3) Awareness and Roles of a Manager of Risk Management Division

- (i) Does the manager of the risk management division recognize the significance of risk management, and accurately recognize the existence, types and characteristics of



risks? For cases in which the personnel in charge of risk management are assigned to each sales-related division, does he/she also implement appropriate measures to enable personnel to understand and recognize methods for measuring, monitoring and managing risks?

- (ii) Has the manager of the risk management division developed a system for conducting appropriate risk management in accordance with the risk management policy and the internal rules for risk management?
- (iii) Does the manager of the risk management division verify the effectiveness of risk management methods and organizations in a timely and appropriate manner, and review the risk management methods as necessary according to changes in markets, increases in risks, more complicated and diverse financial instruments which the company handles and so on?
- (iv) Does the manager of the risk management division consistently understand the kind of business operations and financial instruments which the sales division, etc. handles, and take measures to continuously identify risks and establish appropriate management methods? Particularly, when new business is launched or new financial instruments begin to be handled, does he/she give adequate consideration and implement measures in advance, for example, identifying risks and reinforcing the infrastructures necessary for management? In cases where identified risks are unmanageable, does the manager of the risk management division review and judge the business operations and financial instruments which the company handles?
- (v) Does the manager of the risk management division cultivate human resources with expertise based on the policy determined by the Board of Directors, etc., in such a way, for example, as to develop a training system to improve the ability of personnel in charge of risk management? Does he/she also take appropriate measures to ensure that the emphasis on risk management diffuses into the company?
- (vi) In case of exceeding risk limits, etc., does the manager of the risk management division implement such appropriate measures as reporting information to the Board of Directors, etc., with which decisions on the reduction of risks, the change of risk limits, or other items to be corrected can be quickly made?

#### (4) Independence of Risk Management Division

- (i) Have directors, etc. established a system which may cause conflicts of interest, for example, having officers and employees of the risk management division engaged in business operations of the sales division, etc.? Do other directors and auditors conduct sufficient surveillance so that such a system is not established?

- (ii) Does the risk management division report risk information through means including the preparation of plans and management situation of risk management systems in the entire organization to the representative directors and the Board of Directors, etc. regularly or when needed, based on the risk management policy and the internal rules for risk management, without being influenced by the sales division, etc.?
- (iii) Does the risk management division collect all risk information which may have serious impacts on business, and report it to the representative directors and the Board of Directors, etc. in an easy-to-understand and accurate manner so as to enable them to make appropriate assessments and judgments?
- (iv) Is there any established system in which independence may be hindered, in a way such as the director in charge of the risk management division concurrently serving in the sales division, etc.? In cases where the risk management division is not independent from the sales division, etc. and where the director in charge of the risk management division is concurrently serving as a director of the sales division, etc., is the form of the system adequately reasonable, and is the checks-and-balances function to conduct appropriate risk management working?
- (v) Does the risk management division verify whether or not instructions to the sales division, etc. are appropriately carried out?

### 3. System for Management Risks related to Capital Adequacy Requirements

#### (1) Awareness and Roles of Directors, etc. concerning Risks related to Capital Adequacy Requirements

- (i) Does the board of directors recognize that the capital-to-risk ratio is the most important index for measuring the soundness of financial instruments business operators, and understand the regulations related to the capital-to-risk ratio mentioned below?

[Rules pertaining to the Capital-to-Risk Ratio]

- A. Order for supervision in cases where the capital-to-risk ratio is less than 100%
- B. Obligation of maintaining 120%
- C. Notification in cases where the capital-to-risk ratio is less than 140%
- D. Obligation of public inspection

- (ii) Does the board of directors recognize that the accurate calculation of the capital-to-risk ratio is extremely important and develop an organization and procedures for its appropriate calculation?

- (iii) Does the board of directors understand whether the standard approach or internal control model-based approach is adopted to calculate the market risk equivalent amount for calculating the capital-to-risk ratio?
- (iv) Does the board of directors understand that internal advance money caused by payments to customers, accidents and the like would considerably influence the capital-to-risk ratio, and appropriately address its solution?
- (v) Does the director in charge of the division which manages the capital-to-risk ratio accurately comprehend, based on market risk equivalent amounts, the estimated daily level of the capital-to-risk ratio and the counterparty risk equivalent amounts relative to the level that requires notification of the relevant authority?
- (vi) Do the personnel who manage the capital-to-risk ratio implement measures to continuously collect all information necessary to calculate the amount of non-fixed capital and to calculate the equivalent amounts for market risk, counterparty risk, and basic risk?
- (vii) Is the management of the capital-to-risk ratio regularly assessed by internal audits? Is its management system also reviewed as needed?

## (2) Roles of Personnel who manage the Capital-to-Risk Ratio

- (i) Do the personnel who manage the capital-to-risk ratio formulate rules for market risk management which specify a method of understanding the position for calculating the adopted market risk equivalents, and a method of calculation for risks?, and receive approval from the Board of Directors, etc.?
- (ii) Does the person who manages the capital-to-risk ratio verify that the capital-to-risk ratio is calculated in compliance with the laws and regulations by using accurate financial and accounting data, such as an accurate list of the balances of main accounts?
- (iii) With regard to financial and accounting data such as a list of the balances of main accounts prepared by the accounting division, etc., does the person who manages the capital-to-risk ratio obtain accurate financial data for which deferred and accrued accounts were checked?
- (iv) Does the person who manages the capital-to-risk ratio appropriately comprehend changes in the capital-to-risk ratio, and its factors, and report these to the board of directors, etc. monthly?
- (v) Does the director in charge of the accounting division establish a system for continuously confirming and verifying details of assets in order to prevent manipulations to raise the capital-to-risk ratio in ways such as recording a fixed asset

as a current asset and intentionally undervaluing assets to be deducted with tentative liquidation and other means?

(3) Management of the Capital-to-Risk Ratio

- (i) In calculating the amount of market risk equivalent, does the business operator establish a calculation system and an internal management system and for the standard approach or internal control model-based approach? Does it also take measures to calculate accurate market risk equivalent amounts?
- (ii) When starting to handle a new product, is the market risk equivalent amount verified?
- (iii) If the market risk equivalent amount is calculated for each risk category separately, are personnel designated who comprehensively identify and manage the overall market risks?
- (iv) If a calculation method of market risk equivalent amount is selected by each business type, are personnel designated who comprehensively identify and manage the overall market risk? Is there a control system that enables those personnel to identify the market risk equivalent amount for each risk category?
- (v) For cases in which a financial instruments business operator is engaged in the underwriting business, is there a system in place for conducting appropriate risk management in relation to securities for the underwriting period?

(4) Awareness and Roles of Directors, etc. in relation to Credit Risks

- (i) Do directors understand methods for managing credit risks (including portfolio management) and monitoring methods, and understand the necessity of portfolio management, etc. in terms of credit risk management?
- (ii) Does the Board of Directors, etc. decide the policy of credit risk management based on the strategic goal? With regard to the basic policy concerning credit business, is the credit policy decided for management of credit risks?
- (iii) Does the Board of Directors, etc. receive reports on credit risks regularly, and verify compliance with the credit risk management policy based on acquired risk information?

(5) Implementation and Operation of Internal Rules

- (i) Does the manager of the risk management division develop rules for credit risk management with approval from the Board of Directors, etc. in accordance with the policy of credit risk management, and review said rules when needed? Do rules for

credit risk management specify targets of credit, credit limits (corporate total limits, limits by customer or business category, etc.), the criteria of credit rating, portfolio management, a guideline concerning collateral (appropriate collateral, evaluation methods and loanable value, etc.), authority to make final decisions, and the judgment policy, etc.

- (ii) For cases in which the personnel in charge of risk management are assigned to each sales-related division, does the risk management division confirm that those personnel in charge of risk management are appropriately managing credit risks in accordance with the risk management policy and rules for risk management? Does it also establish the required system support in order to accurately comprehend credit risks and conduct appropriate risk controls?

#### (6) System for Reporting and Communication

- (i) Does the risk management division accurately comprehend (or receive reports on) the status of market liquidity? Does it also report the status of market liquidity to the representative directors and the Board of Directors, etc.?
- (ii) When problems occur in terms of risk management, are those problems dealt with not only within the sales division, etc., but also reported to the risk management division quickly and accurately?
- (iii) Does the sales division, etc. report all information necessary for risk management to the risk management division quickly and accurately?
- (iv) In cases where the market division and the administrative division operate with multiple systems, does the risk management division obtain information on positions, etc. from both the market division and the administrative division? When there are differences in information obtained from both divisions, does it also investigate causes of such variance and establish a system for taking appropriate corrective actions? Furthermore, does the risk management division fulfill such roles as confirming whether or not appropriate arrangements are made for correction (not required in the case of operation with an integrated system), monitoring compliance with rules for managing position limits and loss control limits, etc., developing and operating systems in relation to risk management, collecting and processing information, and reporting to the Board of Directors, etc.?

#### (7) Management of Market Risks

- (i) Do the rules for market risk management clearly specify respective roles and authority in the market, administrative and risk management divisions, particularly in

relation to market transactions including derivatives?

- (ii) For managing market risks, is appropriate management conducted from the viewpoint of liquidity risks, in a way such as establishing position limits that take into account the variability of prices and interest rates with which capital-to-risk ratios are computed, the market size and liquidity, and so on?
- (iii) For cases in which there is a time lag between a transaction with customer and a covering transaction in OTC financial futures trading, is there a risk management system in preparation for rapid volatility in the market during such a time lag? Additionally, on the assumption of rapid fluctuations in the market during the period that trading cannot be implemented due to system failures between the business operator and a covering party which conducts covering transactions, is there a system for managing such risks?

#### (8) Management of Credit Risks

- (i) In the strategic goal of the sales division, etc., is credit risk management taken into account, for example, preventing situations in which credits are intensively provided to a specific risk category?
- (ii) For the introduction of new financial instruments or businesses, is there an established system in which evaluation and verification are conducted by the risk management division in advance, and opinions of the legal division, etc. are collected if necessary? Does the Board of Directors, etc. also provide a system in which the introduction of new financial instruments and businesses are to be approved in full consideration of the results of such evaluation and opinions?
- (iii) Does the risk management division verify whether or not instructions to the sales division, etc. are appropriately fulfilled, and whether risk distribution is conducted in such a way as to comply with credit limits?
- (iv) Are securities held appropriately managed in ways such as, for example, verifying portfolios by reasonably calculating the probability of defaults and the estimated amount of losses caused by such defaults? Is the credit standing of an entity to which credit is provided monitored properly?
- (v) In underwriting securities, are the financial conditions of issuers strictly examined in terms of credit risks?
- (vi) Are transactions related to foreign exchange, interest rates and shares appropriately treated?

For example:

- A. Are inspection items, such as the comprehension of financial positions and other

customer conditions, and the review of the details of transactions strictly considered and confirmed?

- B. Is the establishment and management of risk limits and responses at times of the limits being exceeded appropriately conducted?
- C. Is the establishment and management of credit limits and responses at times of the limits being exceeded appropriately conducted?
- D. Is the management of collateral appropriately conducted, including acquisition of collateral taking into account risk distribution, fair and appropriate assessment rules, and management of the maintenance ratio of customer deposits?
- E. With regard to OCT financial futures trading, is there an appropriate risk management system according to margin requirements (leverage)? Are loss-cut rules, in which transactions are automatically settled through counter deals in cases where customer loss exceeds a certain ratio, formulated and managed appropriately?

(vii) Is country risk management appropriately implemented?

For example:

- A. Is information on various countries collected, analyzed and considered?
- B. Are criteria for uniformly judging country risk and its level prepared, and regularly reviewed?
- C. Are credit limits set in accordance with the credit judgment criteria? Is compliance with the limits managed?

(viii) Are margin transactions by customers managed according to risk characteristics (for example, changing loanable value of collateral securities), in consideration of details of those transactions (establishment of repayment period, liquidity of open interest and collateral securities, and transactions in which the same stocks were purchased as collateral securities, etc.)?

(As for margin transactions by customers, see II-1-2 1.[5][ii])

(9) Management of Position Limits and Profit and Loss

- (i) Does the director in charge of risk management grant the authority to regulate position limits and loss control limits to the risk management division?
- (ii) Are the management rules for position limits, etc. and loss control limits strictly applied? When rules or operations are found to be problematic, are appropriate measures taken for improvement?
- (iii) Does the risk management division implement appropriate management in accordance with the basic concepts for establishing position limits, risk limits and other limits, as well as the established limits?

- (iv) Does the risk management division establish appropriate market risk limits corresponding to capacity and position limits in view of market liquidity, etc., and receive approval from the Board of Directors, etc. when necessary? Furthermore, are position limits reviewed due to changes in market environments, regularly or when needed?
- (v) Does the risk management division report the recognized status of positions to the Board of Directors, etc. when needed? Especially in cases where it is recognized that liquidity risks may be caused by trading financial instruments, in the case of exceeding position limits, or in preparation for bankruptcy or crisis, does the risk management division report such status to the Board of Directors, etc., and take appropriate measures?
- (vi) Does the risk management division comprehend the daily positions of each financial instrument, and monitor changes in the market size and credit standing?
- (vii) Do the representative directors and the board of directors take into account that the establishment of position limits (including limits according to interest sensitivity and notional principal, etc.), appropriate risk limits and loss control limits may have considerable impacts on business and financial positions?
- (viii) Are position limits established with approval from the Board of Directors, etc. based on the strategic goal and the risk management policy, taking into account the position in terms of business, risk management ability, profitability and personnel capability in the sales division, etc.? Additionally, are position limits reviewed when needed, and their compliance and profit and loss verified regularly?
- (ix) Has the risk management division established a system in which the compliance with established position limits, etc. can be constantly monitored? Does it also clearly provide a method of handling for cases of exceeded position limits including cases of errors in placement of orders, etc. in the internal rules, and disseminate it to all officers and employees?
- (x) Has the risk management division established systems for managing transactions and profits? Additionally, for example, has the risk management division established appropriate management systems in which, when interim profit and loss (including appraisal profit and loss) are abnormal in terms of trading volume and changes in average positions, the causes of the abnormal incidents are analyzed and it is confirmed whether or not such incidents were caused by deviation from various rules concerning risk management?
- (xi) Does the risk management division verify profit and loss in terms of the relationship with position limits? Does it also closely examine transactions before and



after the end of the fiscal year to check accounting manipulation and verify whether or not there is a delay in or acceleration in the recording of profits, deferred and brought-forward losses?

#### (10) Management of Traders

- (i) Is familiarity between the chief trader and personnel who manage contracts data, etc. creating a situation in which traders are allowed to directly engage in system operation and issue instructions with regard to accounts?
- (ii) Are there experienced traders so trusted personally by their superiors (directors in charge, etc.) that their conduct in transactions is regarded as unquestionable by other employees? Is the business operator aware that human risk increases when it depends too much on specific individuals and do personnel in charge of internal control conduct management so as to avoid such risk?
- (iii) Is at-home trading allowed only under restricted conditions for purposes such as avoiding risks related to off-hours trading? Are the maximum trading volume, the types of transactions and traders identified and managed (do the internal rules specify these items)?
- (iv) Does the business operator ensure a trading support system that enables mark-to-market evaluation of dealer-by-dealer (or unit-by-unit) positions and office-by-office positions with regard to all major financial instruments it handles on a day-to-day basis?

#### (11) Account of Traded Financial Instruments

In the financial instruments business operators engaged in trading, it is necessary for the Board of Directors, etc. to establish internal rules and enforce them on a continuous basis in order to eliminate arbitrariness and ensure transparency in segregated accounting. Does the business operator, at minimum, specify the following items? Does the business operator attach due importance to the internal rules and, when revising the rules, does it follow the same procedures as those followed when they were established?

- (i) Development of internal management systems concerning the accounting to segregate traded financial instruments accounts from other accounts, and clear internal rules
- (ii) Preparation of internal rules concerning accounting procedures for traded financial instruments accounts (accounting rules)
- (iii) Categories of transactions and properties subject to accounting procedures for traded financial instruments accounts, and calculation methods of relevant market

prices and amounts equivalent to profit and loss

(iv) Quantitative comprehension of business performance in relation to trading

(v) A ban on transfers between accounts

(12) Calculation of Market Prices

(i) Is there a management system for appropriately calculating market prices?

(ii) When the department engaged in trading calculates market prices, is the verification conducted by other independent departments, etc.?

(iii) Is there a system in which internal rules pertaining to calculation of market prices (hereinafter referred to as the “rules for calculation of market prices”) are provided and compliance with the rules verified?

(iv) With regard to traded financial instruments accounts, are the recognition of positions and market-value evaluation and the measurement of risk quantity implemented on a day-to-day basis?

(v) Are fundamental materials concerning the calculation of market prices, including market prices of securities at the end date of business year (the date of balance sheet) and information on market prices involved in the calculation of deemed profit and loss of derivatives trading, appropriately managed and stored based on the internal rules?

(vi) In order to ensure objectivity in the calculation of market prices, are the following items considered?

A. When it is necessary to change calculation methods due to institutional revision or the development of evaluation methods, are the rules for calculation of market prices quickly amended? Are the changes in the calculation methods also clarified?

B. As for price calculation of OTC derivatives transactions, are any measures taken to ensure fairness, for example:

a. appropriate calculation of prices by the market division,

b. confirmation by the risk management division,

c. checks by internal audits, and

d. checks by external auditors such as certificate public accountants?

C. Are the following items, provided for in the rules for calculation of market prices, complied with or continuously utilized?

a. kinds of basic data and their sources

b. date and time when the basic data is obtained

c. method for preparing yield curves using the basic data

d. method and period for retaining the basic data

D. With an eye to checking the fairness and validity of contents, are the rules for calculation of market prices approved by other organizations (for example, the risk management division) independent from the organizations which are engaged in the transactions subject to traded financial instruments accounts and those which develop financial instruments? Furthermore, is the operation of said rules checked regularly by the risk management division and the internal control division, etc. (excluding divisions which actually calculate market prices)?

#### 4. Operational Risk Management System

(1) Awareness and Roles of Directors, etc.

- (i) Do directors, etc. take appropriate measures, understanding that operational risks may exist in all operations and recognizing the importance of reducing operational risks? Do they also implement appropriate measures, fully recognizing that there is a possibility that they will not be free from their responsibility to customers, even if inappropriate incidents are related to outsourced operations?
- (ii) Do directors, etc. take appropriate measures, recognizing that they may provoke a scandal such as disrepute due to lawsuits and critical rumors caused by inappropriate incidents and other improper business operations? Particularly, are they fully aware of the possibility that a large amount of money could need to be raised and that heavy losses could be caused by errors in the placement of orders?
- (iii) Do directors, etc. fully understand the types and levels of risks that might be caused by the part of operations that is outsourced, and take appropriate measures to manage them? Do they also consider specific measures, understanding that the types and levels of risks vary depending on the selection of trustees and the contents of outsourcing contracts?

(2) Development of Management System

- (i) Does a manager in the risk management division recognize the importance of reducing operational risks, and take such appropriate measures as enabling other divisions, etc. to become aware of the importance of reducing operational risks and measures to do so? In addition, for the purpose of recognizing operational risks, does he/she analyze the potential size of operational loss and the possibility of its occurrence, and assess risks appropriately by, for example, quantifying the estimated amount of loss?

- (ii) Does the administrative division analyze the contents of business operations, locate operational risks, and provide internal rules to reduce those risks? Does it also have rules in preparation for mistakes in administrative processes? Particularly, does the division take measures so as to eliminate as many errors in the placement of orders as possible, for example, by establishing technical regulations and procedures for confirmation at the time of placing orders? Furthermore, does the administrative division formulate specific measures to reduce risks, including procedures for cancellation and dissolution, and methods for fund raising in preparation for the occurrence of errors in the placement of orders, and disseminate knowledge of such measures to all officers and employees?
- (iii) Is there a contractually established system which stipulates that risks of outsourced operations should be sufficiently controlled (systems for recognizing, assessing and reporting risks and relevant corrective actions, etc.)?
- (iv) Do personnel engaged in risk management check compliance with the internal rules and the appropriateness of operations in which there are risks?
- (v) Are measures implemented to ensure the effectiveness of examination and approval procedures while preventing situations in which persons in charge of examination and approval procedures conduct their duties as a mere formality or perfunctorily because of excessive workloads?
- (vi) Are cases that are not covered by the internal rules handled based on instructions issued by the internal control division in coordination with the administrative division and the relevant operational divisions?

#### 5. Information Technology Risk Management System

##### (1) Awareness of IT Risks, etc.

For financial instruments business in which computer systems play a primary role in the business infrastructure, does the Board of Directors, etc. recognize the types and natures of risks expected from the characteristics of computer systems, the environments of usage of IT in business, and the environments of computer system operation, etc., their influence at times when risks are actualized, and provide a management policy according to the level of influence?

##### (2) Establishment of Appropriate IT Risk Management System

- (i) Does the manager of the IT management division analyze the potential size of losses

in IT operation, and appropriately assess IT risks in a way such as, for example, quantifying estimated amounts of losses?

- (ii) Has the Board of Directors, etc. appropriately and clearly specified IT risk management policies? Do IT risk management policies include information security policy (basic policy to protect information assets of the organization appropriately) and a policy on the management of outsourcing? Also, based on management policies, has the board designated a particular department to control IT risk with clear roles, responsibilities and appropriate personnel, and established a system whereby the management can receive reports on control regularly or as needed?
- (iii) Does the manager of the IT management division formulate the management rules which provide specific management criteria and procedures in relation to the risks recognized by the company, receive approval from the Board of Directors, etc., and develop systems for conducting appropriate management as fitting the role of the division responsible for responding to IT risks?
- (iv) Has the Board of Directors, etc. developed a reporting system to understand problems concerning the risks recognized by the company, decided on guidelines for appropriate decision-making, and developed systems for quick responses according to said guidelines?
- (v) Has the Board of Directors, etc. developed systems for maintaining the effectiveness by reassessing risks, establishing appropriate organizations (roles, responsibilities and personnel) to respond to the reassessed risks, and reviewing the management rules, in accordance with changes in the company's surrounding environment?

### (3) Development of Safety Measures

#### (i) Development of Information Security Management System

A. Has the Board of Directors, etc. developed an information security management system to prevent leaks and inappropriate or illegal uses of information assets in computer systems, and to reduce the risk that financial instruments business operators and customers will incur loss? Has it assigned a department in charge of control information security with specific roles and responsibilities? Also, are operational rules developed in which types and locations of information assets that need to be controlled under the Information Security Management System are clarified?

B. Does the manager of the information security management division clarify a company-wide management system for information security, and taking into account risks, maintain an appropriate system of checks and balances against the responsible

division or person in charge of dealing with information assets?

- C. Does the manager of the information security management division formulate important information security management procedures, including those for outsourcing contractors, etc.? Does the manager verify their implementation status, to ensure their effectiveness?
- D. Is training on information security provided to all officers and employees (including contract employees, part time employees, etc.) and people engaged in operations of outsourcing contractors, etc., to enhance their awareness of information security, and to suppress and prevent improper acts? Are they thoroughly distributed periodically about internal rules, regulations, management procedures, etc.?
- E. Based on the risk situation, etc. of information assets, is appropriate access control implemented by physical security, such as equipment to prevent entry into buildings, and by logical security, such as user passwords for the computer system? Is this management situation inspected? Also, are records kept of access to the computer system, which has important information assets, and are they inspected for improper access or information leaks? Moreover, for a computer system with a large impact on customers and business operations, are the access records monitored and inspected as to whether the computer system is damaged by cyber attacks (note 1) or other trouble?
- F. In the case of problems occurring with information security related to computer system failures, accidents, crime, etc., does the financial instruments business operator, appropriately and according to the rules, recognize them, take care of its customers, take emergency measures, analyze causes of the problems, and implement measures to prevent a recurrence? Are the above measures reported to the board of directors periodically?
- G. In the case of problems occurring with information security related to computer system failures, accidents, crime, etc. does the Financial Instruments Business Operator disclose such fact in a timely manner to customers, etc.? Are appropriate responses taken? Is there reporting to the board of directors, etc. at the time of occurrence and when appropriate? Also, is there appropriate reporting to the relevant authorities?

(Note 1) A “cyber attack” is an intentional electronic attack via the information communication network, against a specific information system or the network itself, etc. Types of attacks include criminal acts, such as hacking, falsification or destruction of data, improper command execution, virus attacks, and Denial of Service (DoS) attacks. Same hereinafter.

(ii) Operation of computer systems and development of a maintenance system

- A. Does the manager of the IT management division recognize the types and natures of risks which may harm the operation of computer systems, and provide a management policy to prevent risks from coming into existence or to minimize influences from risks which were actualized, in order to enable computer systems that are used as business infrastructures to operate in a safe and stable manner?
- B. Does the manager of the IT management division determine the security management criteria based on the above-mentioned management policy, regularly inspect computer systems from the viewpoint of preventive maintenance, and retain its records?
- C. Does the manager of the IT management division control a management system to prevent the actualizing of risk, such as clarifying the roles and responsibilities of the IT management division based on the above-mentioned management policy, establishing a system of checks and balances between persons in charge of operating and developing computer systems, and appointing personnel with necessary expertise and skills concerning hardware, software, data and networks, etc. as security administrators? In the absence of appropriate personnel, has he/she put in place effective controls on the computer system, taking such measures as using external experts?
- D. Concerning the operating environment of computer systems including capacities and processing capabilities, etc. necessary for security management, does the financial instruments business operator develop internal rules and manuals which clarify items and procedures to check the environment and to handle problems? Are the rules and manuals appropriately reviewed to secure their effectiveness?
- E. Are inspections for security management regularly (annually, quarterly, monthly, daily, etc.) implemented based on the internal rules and manuals, etc.? Are such measures taken as storing records on the conditions of inspections and their results for later verification of their contents?

(iii) Planning of computer systems and provision for development management system

- A. In planning computer systems, is the purpose of usage for computer systems clarified based on the business plan and the basic policy of the organization?
- B. Is the plan for computer systems approved in accordance with the organizational decision-making procedures in the Board of Directors, etc.? For receiving approval, is information required to make this decision clearly indicated, including prospective effects, the time period of introduction, risks associated with introduction and necessary resources (the amount of investment and organizational systems, etc.).

Additionally, are procedures taken to enable the Board of Directors, etc. to have sufficient understanding and conduct the necessary discussion and consideration?

C. Is there a system for promoting safety measures in which not only the divisions that design and develop the computer systems but also divisions that will use them and are in charge of laws and regulations, etc. participate? Do personnel who have expertise and skills concerning computer systems and do those who are familiar with the business operations to be computerized also participate in said system? In the absence of the appropriate personnel, are such measures taken as using external experts to have the effective system put in place?

D. Are divisions that will use the computer systems and are in charge of laws and regulations, etc. involved in confirming and deciding specifications for the computer systems, and implementing and verifying acceptance tests? Also, when a computer system with large effects on customers and operations is migrated to a production environment, does the Board of Directors, etc. make the decision under rational criteria, based on a migration plan, etc.?

E. Are the standards for output of computer systems decided from their planning and the development? In addition, are the methods, procedures and criteria to review that output documented as a development manual, and distributed to all concerned parties?

F. In planning computer systems, is the introduction plan considered in recognition of the effects of the introduction of computer systems on business so as not to bring about confusion after the introduction? Is the schedule of introduction reasonable without putting too much priority on sales performance? Furthermore, are operation and management also discussed?

G. Is there a system in which the status of development can be continually known by checking management items in the development process in consideration of the characteristics of the computer systems to be developed and the expected risks associated with the development? On the assumption that the recognized risks will be actualized, are review systems, decision-making procedures and other policies clarified to respond to such risks?

H. For designing computer systems, are the qualities which should be included clarified in consideration of the degree of importance in the assumed usage and business environment, as well as quality characteristics, such as portability, reliability, efficiency, usability, availability of verification, ease of understanding, changeability and so forth? Additionally, are systems provided for feasible development of this, in ways such as considering measures to ensure these qualities?



- I. For adopting new technologies, are the results of adoption and its concerned risks recognized? As for technologies which have entered a phase of steady diffusion, are the support periods for the vendors which delivered the computer systems and the risk of obsolescence taken into account?
- J. Is there an established system under which the reporting system relating to the progress of development and budget and the qualities in each process is defined in order to collect appropriate information and make the necessary responses?

#### (4) System Integration

- (i) Does the Board of Directors, etc. sufficiently recognize the risks of system integration, develop management system for those risks, and disseminate the necessary information to all officers and employees?
- (ii) Is there a test system? Is the test plan suited to the system integration's developed contents?
- (iii) Even in cases of outsourcing operations, is there an established system in which the company itself is involved?
- (iv) Is assessment of computer systems by external auditors and other experts used to judge important items concerning system integration?
- (v) Has a contingency plan been developed to respond to unexpected occurrences?

#### (5) Responses at the time of a system failure

- (i) In preparation for the occurrence of system failures, are procedures and measures for recovery standardized, aiming at quick recovery from the viewpoint of the protection of public interests and investors? Is training for continuing business and conducting system recovery implemented on the assumption that system failures, etc. will occur in order to make said procedures and measures effective?
- (ii) Are personnel familiar with computer systems fostered in order to enable appropriate and quick responses at the time of system failures? In addition, are the necessary means of communication secured?
- (iii) In addition to the scope of information disclosure and its criteria, are other necessary procedures and processes decided so as not to cause unnecessary confusion among customers at the time of system failures, etc.?
- (iv) In the absence of personnel familiar with computer systems in the company, are appropriate measures taken, for example by concluding the necessary maintenance contracts with the vendors who delivered the computer systems?
- (v) Does the business operator make efforts to prevent the reoccurrence of a system

failure by taking measures for fundamental improvements? For that purpose, does it record the details of system failures, investigate their fundamental causes and consider countermeasures regularly or as needed in cooperation with the vendors who delivered the computer systems and other experts? Furthermore, does the financial instruments business operator execute measures to prevent recurrence, taking into account analysis of the overall occurrence situation and causes, etc.?

(vi) Is there a system for quickly reporting the occurrence of system failures, recovery, or the investigation of their causes, etc. to the relevant authorities?

#### (6) Contingency Plan

(i) On the assumption that system failures will occur, is an order of priority decided for all business operations in consideration of the necessity and the urgency of recovery? Are the target time, procedures and measures for recovery also clearly indicated, corresponding to levels and causes of failures, etc.? Also, are there specific response procedures and measures for cyber attacks, etc. including reporting to the relevant authorities and cooperation with related institutions, based on the established system to accurately understand the situation, and to prevent the expansion of damage by the attack?

(ii) Are the definitions of emergency situations, procedures for decision making, and the responsibility and roles, etc. of a substitute person in the absence of a person with decision-making authority clarified?

(iii) Is the effectiveness of the contingency plan verified by regularly conducting drills on the assumption that system failures will occur?

(iv) Is the contingency plan appropriately reviewed to reflect changes in the company's surrounding environment, organizational changes, and transfer of personnel?

(v) Are procedures and means decided to disclose information to customers at the time of emergency?

(vi) Are methods and procedures to confirm the safety of officers and employees formulated in consideration of wide-area disasters such as large scale earthquakes? Is a way of continuing business even if office facilities are not available taken into account?

#### (7) Management of Outsourcing (Note 2)

(Note 2) "Outsourcing" includes all contracts that make another party perform all or part of planning, development or operation of computer systems regarding which the Financial Instruments Business Operator should be aware of

system risks, regardless of the type or form of the contract (including cases in which a explicit contract is not entered into). Same hereinafter.

(i) Management system pertaining to outsourcing

- A. Are the purposes and effects of outsourcing clarified?
- B. Are the necessary measures also considered, in recognition of the risks associated with outsourcing?
- C. Are the operations to be outsourced, the roles and responsibility of the company, and the responsible department and the manager to respond to such risks defined?

(ii) Criteria to evaluate contractors and regular evaluation

- A. Have the criteria for selecting outsourcing contractors been decided? Are contractors selected based on the criteria of risk management?
- B. Have the criteria for evaluating contractors been decided? Are contractors evaluated based on these criteria from the viewpoint of risk management? Additionally, when problems are detected through analysis of the details of commissioned business, are the necessary actions taken?

(iii) Contracts with outsourcing contractors

In the contract, are the preservation of confidentiality, clauses for re-entrustment, the authority for auditing, the level of services, and dispute-settlement procedures clearly defined in recognition of risks associated with outsourcing?

(iv) Management of outsourced operations

- A. Does the business operator implement measures to prevent accidents and unfair acts by outsourcing contractors and to preserve confidentiality, and take necessary actions?
- B. As for outsourcing related to operation and maintenance, does the company confirm that the level of services specified in a contract is maintained?
- C. As for outsourcing related to development:
  - a. Are the required specifications approved by divisions that will use the systems clearly defined in writing, and presented to the outsourcing contractors?
  - b. Are necessary measures taken to know the quality and follow the progress?
  - c. Do divisions that will use the systems participate in acceptance inspections and define the inspection's conditions to confirm the quality?

(8) System Audit

(i) Implementation of System Audit

- A. Is there an established internal audit division which is independent from the systems division? In addition, are system audits periodically implemented by

personnel in charge of audits who are familiar with computer systems?

- B. In the absence of personnel in charge of audits who are familiar with computer systems in the corporate organization, are system audits implemented in ways such as using external experts? Even for cases in which external experts are used, is there an auditing system in which problems related to system risks recognized by the company can be identified, for the purpose of achieving continuous improvement?
- C. Have priority items for audits and an audit plan been decided based on the system risks recognized by the company? Subsequently, is the appropriate audit implemented in accordance with said items and plan?
- D. Does the company formulate the criteria concerning system audits, establish auditing methods corresponding to the types and nature of system risks recognized by the company, and conduct effective audits?
- E. Does the audit cover all business operations related to the system risks recognized by the company? Is the company's possible failure to be aware of risks investigated? Furthermore, is there a system in which results of audits can be quickly reported to the Board of Directors, etc.?

(ii) Correction of problems

Does the Board of Directors, etc. decide the policy for response to problems that were acknowledged in reports on the results of audits, make decisions necessary for correction, and issue necessary instructions to the relevant departments? Also, does the internal audit division appropriately review the progress of improvement for problems, then reflect it in the subsequent internal audit plan, and report to the Board of Directors, etc.?

## 6. Other Risk Management Systems

(1) Awareness of Directors and Roles of the Board of Directors, etc.

- (i) Does the board of directors take funding risks into account in deciding the strategic goal?
- (ii) Does the board of directors sufficiently understand the impacts on business from funding risks being actualized, and establish a system for appropriately managing funding risks?
- (iii) Does the Board of Directors, etc. decide the funding risk management policy based on the defined strategic goal, and have in place an appropriate system for managing funding risks?

- (iv) In order to appropriately manage funding risks, does the director in charge establish and review various limits, such as operation limits of traded financial instruments and other assets, as needed on the basis of business contents and the status of procurement, and report them to the Board of Directors, etc.? In addition, does the Board of Directors, etc. verify whether the matters stated in the reports comply with the funding risks management policy?
- (v) Does the Board of Directors, etc. recognize the importance of disclosing business contents and financial positions, and take measures for appropriate information disclosures?

## (2) Establishment of Appropriate Systems for Managing Funding Risks

- (i) Do funding risks management personnel develop rules for managing funding risks in which the scope of the manager's authority and a reporting system are clarified in accordance with the funding risk management policy, with approval from the Board of Directors, etc.? Is there an appropriate contingency plan based on business contents, etc.?
- (ii) Do funding risks management personnel appropriately manage funding risks in accordance with the risk management policy and the rules for risk management?
- (iii) Do funding risks management personnel collect and analyze information on prices of the company's stock and rumors, etc. which may have impacts on fund raising, and formulate countermeasures? When funding risks management is divided between personnel managing Japanese yen and foreign currencies domestically and abroad respectively, can individual funding risks be recognized and managed in a timely and appropriate manner?
- (iv) Do funding risks management personnel accurately comprehend the status of funding, including the amount of funds to be used and the amount possible to be raised, on the basis of reports from the sales division, etc.?
- (v) Do funding risks management personnel manage the following items as needed, recognize the impacts on funding at an early stage, and then prepare a funding table on a day-to-day basis and also a weekly outlook for funding in relation to Japanese yen and foreign currencies? Is intraday procurement of funds and collateral monitored appropriately?
  - A. Concentrated management of settlement date and amounts
  - B. Management of positions
  - C. Management of procurement of collateral
  - D. Management of cash (including ATM, etc.)

#### E. Management of funding by currency

Are monthly, quarterly and other medium- to long-term outlooks for funding prepared?

- (vi) For managing funding risks, is there a system in which influences on funding from changes in market environments can be recognized at an early stage, and the Board of Directors, etc. receive reports as needed? Furthermore, are the authority and systems provided to obtain information for funding risk management as needed?
- (vii) Do funding risks management personnel report the status of and the outlook for funding to the Board of Directors, etc. regularly or as needed?
- (viii) Does the sales division, etc. operate business according to the status of funding?
- (ix) Do funding risks management personnel ensure methods of procurement corresponding to the degree of tightness of funding (for example, in peace time, at a time when there is concern about financial collapse, at the time of crisis, etc.), and secure reserve assets for settlement? Is the balance of held assets, both domestic and foreign, which are saleable immediately or which can be used as collateral constantly known? Furthermore, are financing methods assuming a time of crisis secured, for example by setting borrowing limits to raise funds from private financial institutions, etc.? Especially, assuming a case in which it would be required to raise a large amount of funds due to errors in placement of orders, etc., are procurement limits understood? Also in case these limits are exceeded, are measures taken to minimize adverse effects on the financial system?

#### (3) Information disclosure

- (i) Do personnel in charge of information disclosure establish the system for verifying the accuracy of disclosed contents?
- (ii) Do personnel in charge of information disclosure take measures to conduct the appropriate segregated accounting and to understand objective market value from the viewpoint of accurate information disclosure?
- (iii) In disclosed materials, are the following items stated in relation to the management of disclosed information?
  - A. Criteria to assess traded financial instruments accounts and their evaluation methods
  - B. Framework of traded financial instruments accounts (specific financial instruments, and outline of business, etc.)
  - C. Financial information on traded financial instruments accounts (breakdown of profits and loss status, etc.)
  - D. Status of trading (contents, action policy, purpose of usage, details of risks, and risk

management system, etc.)

E. Items concerning amounts of contracts and market prices in trading (calculation methods of market prices, etc.)

(4) Group risk management

- (i) Do the directors of the financial instruments business operator develop systems that enable the risk management division to understand, manage and report the types and amount of risks existing in other companies within the group to the directors in a timely and appropriate manner, taking into account their impacts on the company?
- (ii) Does the Board of Directors, etc. understand the necessity of managing the financial instruments business operator and consolidated subsidiaries, etc. as a unit within legal limits in terms of management of credit risks, while integrating assets with credit risks and off-balance items?
- (iii) In cases where credit or funds are provided to consolidated subsidiaries, etc., are the management and checks-and-balances functions properly working, in such a way as to accurately recognize the impacts of consolidated subsidiaries' financial positions on the financial instruments business operator by reviewing their risks of holding and losses, including incurred losses, appraisal losses on securities, and details of operating loans?
- (iv) For managing funding risks, are the management and checks-and-balances functions properly working, in such a way as to accurately recognize the impacts of the deterioration of funding situations in consolidated subsidiaries on the financial instruments business operator on the basis of the business contents of those subsidiaries?

7. Systems for Audit, etc.

- (i) Does the Board of Directors, etc., based on the law, receive an appropriate evaluation by and reports from external auditors on the risk measurement process calculated with the internal control model method for separate management of customers' assets and calculation of the capital-to-risk ratio? Do they also have a system in place in which the appropriateness of all business operations is verified, assessed and reported to the Board of Directors, etc. by the internal audit division?
- (ii) Does the internal audit division confirm the guideline for implementation of self-inspections which was prepared by the sales division, etc.?

- (iii) Are self-inspections effectively implemented by the sales division, etc. based on the implementation guideline, etc.?
- (iv) Does the sales division, etc. report the results of self-inspections (including the frequency of mistakes in administrative processes, their severity, causes, improvement measures and results of improvement, etc.) to the internal control division, etc. regularly and as needed? Do they also provide a system in which problems which may have considerable impacts on business are reported to the Board of Directors, etc. as needed?
- (v) In order to ensure objectivity in calculating market prices, are the following items considered?
  - A. Is ensuring objectivity in calculating market prices included in the priority items of internal audits?
  - B. Are the internal checks-and-balances functions working effectively with such appropriate processing as calculation of market prices in accordance with rules?
- (vi) Are all operations pertaining to electronic transactions audited? With regard to outsourced operations which are not subject to internal audits, is management by the divisions responsible for said operations audited?

**8. Risk Management Systems of Securities Company Groups which Engage in Large-scale and Complex Businesses as a Group**

In cases where a securities company engages in large-scale and complex business combined with the parent company, subsidiaries or fellow subsidiaries of its group, financial and operational problems of each company in the group can bring about worse business results to that securities company group, and could consequently also impact investors and other market intermediaries, and moreover the entire financial system. Therefore, it is required for such securities company groups to develop, under appropriate business management, a comprehensive and effective risk management system on a group basis (from this viewpoint, consolidated capital adequacy requirements, etc. are introduced for Financial Instruments Business Operators of at least a certain size, in the Revised Financial Instruments and Exchange Act enforced in April 2011).

In inspections of such a securities company group, inspectors should verify the appropriateness of the risk management system on the entire group, from a forward looking perspective. However, check items in this section only show inspectors the



viewpoint for verifications and the inspected companies are not required to satisfy all these items. Also, in the verification of a risk management system, inspectors must be fully aware that it is built corresponding to the group's business strategy and types of operations, etc., understand the actual situation in the inspected company and sufficiently exchange views, to avoid falling into a mechanical and uniform verification.

Also, securities companies and deposit-taking institutions such as banks have different core businesses and risk profiles. Therefore, inspectors must keep in mind that securities companies and banks, etc. can have different risk management systems.

(Note 1) For the time being, the check items below apply for a securities company group that has a Special Financial Instruments Business Operator (signifies a "Special Financial Instruments Business Operator" stipulated in the Financial Instruments and Exchange Act, Article 57-2, Paragraph 2, and excludes a securities company which is a Japanese entity of a foreign holding company group as stipulated in the Guideline for Financial Conglomerate Supervision (hereinafter referred to as a "Foreign Holding Company Group")), and in which the group companies conduct large businesses that have the potential for serious impacts on the soundness of management for entire group.

(Note 2) In addition to Note 1, checkpoints in this section also apply to securities companies which are Japanese entities of internationally active Foreign Holding Company Groups, which have significant scales of staff and assets, and which develop a wide range of operations in Japan, when inspectors verify the risk management system for the Japanese entities. Even if policies and systems of risk management for such a Japanese entity are developed at the group headquarters, etc. located in a foreign country, inspectors shall verify whether the policies and systems are appropriate for the risk profile, etc. of the Japanese entity, and whether appropriate systems are developed in Japan with sufficient involvement by the headquarters. However, the inspector must understand the actual situation in the inspected business operator and have adequate discussion on each issue, in order to avoid falling into a mechanical and uniform verification.

(Note 3) In the check items below, the organization (or department) in the inspected securities company group which substantially controls group-wide risk management is referred to as the "Business Management Company." Inspectors should keep in mind that the risk management system of the

securities company group should be developed depending on its business strategy, type of business, risk profile, etc. and that the organization comprising the position of the “Business Management Company” could differ depending on the group, for example it could be the Final Designated Parent Company, Designated Parent Company, or Special Financial Instruments Business Operator.

## (1) Market Risk Management System

### (i) Development of Policy

- Development of market risk management policy and distribution to all concerned

Does the Business Management Company develop the market risk management policy for the entire group which reflects the locations, sizes, types and characteristics of market risks, taking into account strategic goals in accordance with the entire group’s management policy? Does it distribute the policy to the entire group, including overseas entities?

### (ii) Development of Internal Rules and Organizational System

#### A. Development of internal rules

Does the Business Management Company develop market risk management rules for the entire group which clarify rules on market risks, in accordance with the entire group’s market risk management policy? Does it distribute the rules to the entire group, including overseas entities?

#### B. Development of organizational and operational system

- a. Does the Business Management Company establish a division which is responsible for managing the market risks of the entire group (hereinafter, “Market Risk Management Division”), accurately understand the status of market risks of the entire group, including overseas entities, and develop a system to appropriately manage market risks in accordance with policy and rules for managing market risk?
- b. Does the Business Management Company allocate to the Market Risk Management Division adequate human resources with the necessary knowledge and experience, and grant to that staff the sufficient authority to fulfill their roles?
- c. Does the Business Management Company ensure that the Market Risk Management Division is independent from divisions in charge of market and

sales, and develop a system of checks and balances against such divisions? Also, does the Business Management Company have the Market Risk Management Division ensure the effectiveness of market risk management in the market and sales division?

- d. Does the Business Management Company appropriately monitor the status of compliance with and use of assigned limits in each group company, and provide appropriate instructions or suggestions in a regular and timely manner?
- e. Does the Business Management Company have each group company report and seek the approval of its market risk management status therefrom periodically and as needed?

#### C. Setting of limits

- a. Does the Business Management Company, in accordance with the policy and rules of market risk management, review the business of each group company, consider the strategic position, capital stock, profit plan, risk profile, etc. of each domestic and foreign entity or each division in the group, and set appropriate market risk limits (risk limits such as VaR limit, position limits and loss limits, etc.) for each business and risk category, etc.?
- b. Does the Business Management Company review the business of each group company, and adjust methods and allocation of the limits so that each group company takes a feasible amount of market risks compared to business strength (capital stock), periodically and as needed?

#### D. Monitoring of market risks

- a. Does the Business Management Company establish appropriate market risk measurement and analysis methods which are suitable for the size of business and the risk characteristics in the domestic and foreign entities of each group company? Does it periodically and appropriately analyze, measure and understand the market risks of the entire group?
- b. Does the Business Management Company understand the limitations and weaknesses of the market risk measurement and analysis methods described above, and appropriately understand the entire group's market risks, such as by supplementing these methods as needed?
- c. Does the Business Management Company ensure the reliability of its market risk measurement and analysis methods, by verifying the appropriateness of

methods to measure and analyze market risk, and taking necessary actions in order to match the risk profile of the entire group and market environment, etc., periodically and as needed?

- d. Does the Business Management Company appropriately comprehend the status of the market risks of the entire group under the stresses by stress testing based on appropriate scenarios, periodically and as needed?

(iii) Assessment and Improvement of Effectiveness

A. Analysis and assessment of market risk management

- a. Does the Business Management Company accurately analyze and assess the status of market risk management of the entire group, appropriately examine whether there are any problems or weaknesses to be improved in the market risk management system and appropriately verify their causes, based on all information concerning the status of market risk management, such as reports from each company, the results of audits by company auditors, the results of internal and external audits and the results of various investigations?
- b. Does the Business Management Company verify the effectiveness of the analysis and assessment process of market risk, and revise in a timely manner, based on reports and investigation results, etc. concerning the market risk management of the entire group, periodically and as needed?
- c. Does the Business Management Company verify whether the risk identification, the limit set, the scope, frequency and methods of measurement and analysis of the market risks of the entire group are appropriate for the management policy, its strategic goals, the scales and natures of the businesses and its risk profile, periodically and as needed?

B. Improvement

- a. Based on the results of the above analysis and verification, does the Business Management Company develop a system to implement timely and appropriate improvements for those problems and weaknesses, by developing and executing an improvement plan as needed?
- b. Does the Business Management Company verify the progress of improvement periodically and as needed, with timely and develop a system to make an appropriate follow-up?
- c. Does the Business Management Company verify the effectiveness of the

improvement process and make timely reviews, based on reports and investigations, etc. on the status of the entire group's market risk management, periodically and as needed?

## (2) Liquidity Risk Management System

### (i) Development of Policy

- Development of liquidity risk management policy and distribution to all concerned

Does the Business Management Company develop the liquidity risk management policy for the entire group which reflects the locations, sizes, types and characteristics of liquidity risks, taking into account strategic goals in accordance with the entire group's management policy? Does it distribute the policy to the entire group, including overseas entities?

### (ii) Development of Internal Rules and Organizational System

#### A. Development of internal rules

Does the Business Management Company develop liquidity risk management rules for the entire group which clarify rules on identification, evaluation, monitoring and control, etc. related to liquidity risks, in accordance with the entire group's liquidity risk management policy? Does it distribute the rules to the entire group, including overseas entities?

#### B. Development of organizational and operational system

- a. Does the Business Management Company establish a division which is responsible for managing the liquidity risks of the entire group (hereinafter, "Liquidity Risk Management Division"), accurately understand the status of liquidity risks of the entire group, including overseas entities, and develop a system to appropriately manage liquidity risks in accordance with policy and rules for managing liquidity risk?
- b. Does the Business Management Company allocate to the Liquidity Risk Management Division adequate human resources with the necessary knowledge and experience, and grant to that staff the sufficient authority to fulfill their roles?
- c. Does the Business Management Company ensure that the Liquidity Risk Management Division is independent from divisions in charge of market and sales, and develop a system of checks and balances against such divisions?

Also, does the Business Management Company have the Liquidity Risk Management Division ensure the effectiveness of liquidity risk management in the market and sales division?

- d. Does the Business Management Company appropriately monitor the status of compliance with and use of assigned limits in each group company, and provide appropriate instructions or suggestions in a regular and timely manner?
- e. Does the Business Management Company have each group company report and seek the approval of its liquidity risk management status therefrom periodically and as needed?

#### C. Setting of limits

- a. Does the Business Management Company, in accordance with the policy and rules of liquidity risk management, review the business of each group company, and set appropriate liquidity limits (finding gap limits, fundraising limits from the market, etc.) which are suitable for the size and characteristics of its business, risk profile, financial status and the fundraising capacity of each domestic or foreign entity or each division?
- b. Does the Business Management Company review the method of setting limits and the limits set, so that they reflect changes in its internal environment, such as the size and characteristics of its business, etc., and changes in its external environment, such as economy and market, and thereby suit the limits to the entire group's fundraising capacity, periodically and as needed?

#### D. Monitoring of liquidity risks, and fundraising strategy

- a. Does the Business Management Company establish a system to ensure the appropriate understanding of the structure of assets and liabilities (composition, characteristics and diversification), funding demand, current funding status (status of composition, characteristics and diversification of fundraising sources), and additional fundraising capacity (including consideration of the status of pledged assets, as well as legal, supervisory and practical restrictions on the lending of surplus funds among entities in the group, the possibility of acceptance as collateral to central banks, etc.) for each entity and each currency of the entire group, including overseas entities?

- b. Does the Business Management Company take necessary actions to periodically evaluate the level of funding which can be raised from each funding source, and diversify its funding sources and maturities, based on the status of the entire group's liquidity risks?

E. Implementation of stress testing and establishment of contingency funding plan

- a. Does the Business Management Company periodically identify latent liquidity risks of the entire group, including overseas entities, by doing stress tests which appropriately reflect the risk characteristics of the overseas entities, and the global market conditions? Also, are its stress scenarios based on the structural vulnerabilities and characteristics of the entire group?
- b. Does the Business Management Company, in accordance with the group's liquidity risk management policy, establish the classification for the urgent level of funding conditions of the entire group (for example, "normal", "needs care" and "crisis", etc.), and develop internal rules and procedures for method of controlling, reporting and getting approval in each level?
- c. Based on the results of stress testing, does the Business Management Company develop a contingency funding plan for a liquidity crisis, which specifies definite procedures to maintain enough liquidity under the stress condition in the funding market? Does the Business Management Company distribute it to the entire group, including overseas entities? Also, does the Business Management Company review and update it periodically?

(iii) Assessment and Improvement of Effectiveness

A. Analysis and assessment of liquidity risk management

- a. Does the Business Management Company accurately analyze and assess the status of liquidity risk management of the entire group, appropriately examine whether there are any problems or weaknesses to be improved in the liquidity risk management system and appropriately verify their causes, based on all information concerning the status of liquidity risk management, such as reports from each company, the results of audits by company auditors, the results of internal and external audits and the results of various investigations?
- b. Does the Business Management Company verify the effectiveness of the analysis and assessment process of liquidity risk, and revise in a timely

manner, based on reports and investigation results, etc. on the liquidity risk management of the entire group, periodically and as needed?

- c. Does the Business Management Company verify whether the risk identification, the limits set, and, the scope, frequency and methods of measurement and analysis of the liquidity risks of the entire group are appropriate for the business policy, its strategic goals, the scales and natures of the businesses, the balance of assets and liabilities, fundraising capacity, etc., periodically and as needed?

#### B. Improvement

- a. Based on the results of the above analysis and verification, does the Business Management Company develop a system to implement timely and appropriate improvements for those problems and weaknesses, by developing and executing an improvement plan as needed?
- b. Does the Business Management Company verify the progress of improvement periodically and as needed, with timely and develop a system to make an appropriate follow-up?
- c. Does the Business Management Company verify the effectiveness of the improvement process and make timely reviews, based on reports and investigation results, etc. on the status of the entire group's liquidity risk management, periodically and as needed?

### (3) Credit Risk Management System

#### (i) Development of Policy

- Development of credit risk management policy and distribution to all concerned

Does the Business Management Company develop the credit risk management policy for the entire group which reflects the locations, sizes, types and characteristics of credit risks, taking into account strategic goals in accordance with the entire group's management policy? Does it distribute the policy to the entire group, including overseas entities?

#### (ii) Development of Internal Rules and Organizational System

##### A. Development of internal rules

Does the Business Management Company develop credit risk management rules for the entire group which clarify rules on credit risks, in accordance with



the entire group's credit risk management policy? Does it distribute the rules to the entire group, including overseas entities?

B. Development of organizational and operational system

- a. Does the Business Management Company establish a division which is responsible for managing the credit risks of the entire group (hereinafter, "Credit Risk Management Division"), accurately understand the status of credit risks of the entire group, including overseas entities, and develop a system to appropriately manage credit risks in accordance with policy and rules for managing credit risk?
- b. Does the Business Management Company allocate to the Credit Risk Management Division adequate human resources with the necessary knowledge and experience, and grant to that staff the sufficient authority to fulfill their roles?
- c. Does the Business Management Company ensure that the Credit Risk Management Division is independent from divisions in charge of investment and asset management, market and sales, and develop a system of checks and balances against such divisions? Also, does the Business Management Company have the Credit Risk Management Division ensure the effectiveness of credit risk management in the investment and asset management division, market division and sales division?
- d. Does the Business Management Company appropriately monitor the status of compliance with and use of assigned limit in each group company, and provide appropriate instructions or suggestions in a regular and timely manner?
- e. Does the Business Management Company have each group company report and seek the approval of its credit risk management status therefrom periodically and as needed?

C. Setting of limits

- a. Does the Business Management Company, in accordance with the policy and rules of credit risk management, review the business of each group company, consider the strategic position, capital stock, profit plan, risk profile, etc. of each domestic and foreign entity or each division in the group, and set appropriate credit risk limits (by each counterparty, type and issuer, etc.) that are suitable for each business and product handled, and each location of credit risk?

- b. Does the Business Management Company review the business of each group company, and adjust methods and allocation of the limits so that each group company takes a feasible amount of credit risks compared to business strength (capital stock), periodically and as needed?

D. Monitoring of credit risks

- a. Does the Business Management Company establish appropriate credit risk measurement and analysis methods which are suitable for the size of businesses and the risk characteristics in the domestic and foreign entities of each group company? Does it periodically and appropriately analyze, measure and understand the credit risks of the entire group?
- b. Does the Business Management Company understand the limitations and weaknesses of the credit risk measurement and analysis methods described above, and appropriately understand the entire group's credit risks, such as by supplementing these methods as needed?
- c. Does the Business Management Company ensure the reliability of its credit risk measurement and analysis methods, by verifying the appropriateness of methods to measure and analyze credit risk, and taking necessary actions in order to match the risk profile of the entire group, changes in the credit status of counterparties and issuers, market environment, etc., periodically and as needed?
- d. Does the Business Management Company appropriately comprehend the status of the market risks of the entire group under the stresses by stress testing based on appropriate scenarios, periodically and as needed?
- e. In cases where the Business Management Company takes the internal credit rating approach in order to manage credit risks, such as measuring, analyzing and understanding the credit risks of the entire group, does it develop a system to verify that secures the suitability of the rating system in the view of the business characteristics and risk profile of the each group company periodically and as needed?

(iii) Assessment and Improvement of Effectiveness

A. Analysis and assessment of credit risk management

- a. Does the Business Management Company accurately analyze and assess the status of credit risk management of the entire group, appropriately examine whether there are any problems or weaknesses to be improved in the credit

risk management system and appropriately verify their causes, based on all information concerning the status of credit risk management, such as reports from each company, the results of audits by company auditors, the results of internal and external audits and the results of various investigations?

- b. Does the Business Management Company verify the effectiveness of analysis and assessment process of credit risk, and revise in a timely manner, based on reports and investigation results, etc. concerning the credit risk management of the entire group, periodically and as needed?

#### B. Improvement

- a. Based on the results of the above analysis and verification, does the Business Management Company develop a system to implement timely and appropriate improvements for those problems and weaknesses, by developing and executing an improvement plan as needed?
- b. Does the Business Management Company verify the progress of improvement periodically and as needed, with timely and develop a system to make an appropriate follow-up?
- c. Does the Business Management Company verify the effectiveness of the improvement process and make timely reviews, based on reports and investigations, etc. on the status of the entire group's credit risk management, periodically and as needed?

#### (4) Operational Risk Management System

##### (i) Development of Policy

- Development of operational risk management system and distribution to all concerned

Does the Business Management Company develop the operational risk management policy for the entire group which reflects the locations, sizes, types and characteristics of operational risks, taking into account strategic goals in accordance with the entire group's management policy? Does it distribute the policy to the entire group, including overseas entities?

##### (ii) Development of Internal Rules and Organizational System

###### A. Development of internal rules

Does the Business Management Company develop operational risk management rules for the entire group which clarify rules on operational risks, in accordance with the entire group's operational risk management policy?

Does it distribute the rules to the entire group, including overseas entities?

B. Development of organizational and operational system

- a. Does the Business Management Company establish a division which is responsible for managing the operational risks of the entire group in a comprehensive manner (hereinafter, “Operational Risk Management Division”), accurately understand the status of operational risks of the entire group, including overseas entities, and develop a system to appropriately manage operational risks in accordance with policy and rules for managing operational risk?
- b. Does the Business Management Company allocate to the Operational Risk Management Division adequate human resources with the necessary knowledge and experience, and grant to that staff the sufficient authority to fulfill their roles?
- c. Does the Business Management Company ensure that the Operational Risk Management Division is independent from divisions in charge of administration, computer systems and other divisions to be checked by the Operational Risk Management Division, and develop a system of checks and balances against such divisions? Also, does the Business Management Company have the Operational Risk Management Division ensure the effectiveness of operational risk management in the administrative division, computer system division and other divisions to be checked by the Operational Risk Management Division?
- d. Does the Business Management Company appropriately monitor the status of operational risk in each group company, and provide appropriate instruction or suggestions in a regular and timely manner?
- e. Does the Business Management Company have each group company report and seek the approval of its operational risk management status therefrom periodically and as needed?

C. Monitoring of operational risks

- a. Does the Business Management Company, in accordance with the policy and rules for operational risk management, establish a system to appropriately evaluate operational risk of domestic and foreign entities or each division in the group, by considering the business in each group company, and using risk evaluation methods such as control self assessment?

- b. Does the Business Management Company develop a system to analyze the causes of operational risk loss events in the process of evaluating operational risks, and understand operational risks exhaustively and systematically?
- c. Does the Business Management Company establish appropriate methods for understanding operational risks, which are suitable for the risk characteristics and size of businesses in domestic and foreign entities of each group company? Does it periodically and appropriately analyze and understand the operational risks of the entire group?

(iii) Assessment and Improvement of Effectiveness

A. Analysis and assessment of operational risk management

- a. Does the Business Management Company accurately analyze and assess the status of operational risk management of the entire group, appropriately examine whether there are any problems or weaknesses to be improved in the market risk management system, and appropriately verify their causes, based on all information concerning the status of operational risk management, such as reports from each company, the results of audit by company auditors, the results of internal and external audits and the results of various investigations?
- b. Does the Business Management Company verify the effectiveness of analysis and assessment process of operational risk, and revise in a timely manner, based on reports and investigation results, etc. concerning the operational risk management of the entire group, periodically and as needed?

B. Improvement

- a. Based on the results of the above analysis and verification, does the Business Management Company develop a system to implement timely and appropriate improvements for those problems and weaknesses, by developing and executing an improvement plan as needed?
- b. Does the Business Management Company verify the progress of improvement periodically and as needed, with timely and develop a system to make an appropriate follow-up?
- c. Does the Business Management Company verify the effectiveness of the improvement process and make timely reviews, based on reports and investigation results, etc. on the status of the entire group's operational risk management, periodically and as needed?

## (5) IT Risk Management System

### (i) Development of Policy

- Development of IT risk management policy and distribution to all concerned
  - A. Does the Business Management Company develop the IT risk management policy of the entire group which reflects the locations, sizes, types and characteristics of IT risks, taking into account strategic goals in accordance with management policy of the entire group ? Does it distribute the policy to the entire group, including overseas entities? Also, does the IT risk management policy include an information security policy (a basic policy to appropriately protect the information assets of the organization) and management policy on outsourcing?
  - B. In developing the IT risk management policy, does the Business Management Company also consider risks accompanying changes in the information technology environment, as well as risks concerning different legal systems and business practices when the group has overseas affiliate companies or outsourcing contractors?

### (ii) Development of Internal Rules and Organizational System

#### A. Development of internal rules

Does the Business Management Company develop IT risk management rules for the entire group which clarify management procedures and methods, etc. related to IT risks, in accordance with the entire group's IT risk management policy? Does it distribute the rules to the entire group, including overseas entities?

#### B. Development of organizational and operational system

- a. Does the Business Management Company establish a division which is responsible for managing the IT risks of the entire group in a comprehensive manner (hereinafter, "IT Risk Management Division"), accurately understand the status of operational risks of the entire group, including overseas entities, and develop a system to appropriately manage IT risks in accordance with policy and rules for managing IT risk?
- b. Does the Business Management Company allocate to the IT Risk Management Division adequate human resources with the necessary knowledge and experience, and grant to that staff the sufficient authority to fulfill their roles?

- c. Does the Business Management Company ensure that the IT Risk Management Division is independent from divisions in charge of computer systems, administrative and other divisions to be checked by the IT Risk Management Division, and develop a system of checks and balances against such divisions? Also, does the Business Management Company have the IT Risk Management Division ensure the effectiveness of IT risk management in the computer system division, administrative division and other divisions to be checked by the IT Risk Management Division?
- d. Does the Business Management Company appropriately monitor the status of IT risks in each group company, and provide appropriate instruction or suggestions in a regular and timely manner?
- e. Does the Business Management Company have each group company report and seek the approval of its IT risk management status therefrom periodically and as needed?

#### C. Monitoring of IT risks

- a. Does the Business Management Company, in accordance with the policy and rules for IT risk management, establish a system to appropriately evaluate IT risks of domestic and foreign entities or each division in the group, by considering the business in each group company, and using risk evaluation methods such as control self assessment?
- b. Does the Business Management Company develop a system to analyze the causes of events, such as system failures and accidents of information security, in the process of evaluating IT risks, and to understand IT risks exhaustively and systematically?
- c. Does the Business Management Company establish appropriate methods for understanding IT risks, which are suitable for the risk characteristics and size of businesses in domestic and foreign entities of each group company? Does it periodically and appropriately analyze and understand the IT risks of the entire group?
- d. Does the Business Management Company confirm that necessary information to ensure the effectiveness of IT risk management is reported from each group company? Does the Business Management Company establish a system that enables it to implement appropriate decisions and actions in response to the following reports?
  - Information on results of evaluations of IT risks

- Information on responses to IT failures and improvement status, etc.
  - Information on responses to problems of information security and improvement status, etc.
  - Information on control status of outsourcing and audit reports of outsourcing contractors by external specialized institutions, etc.
  - Information on progress status and response to problems, etc. for major projects on computer system, including system integration
  - Reports on results of IT audits and follow-up audits, etc.
- e. To prevent the actualization of IT risks, does the Business Management Company clarify the matters, such as following examples, to which approvals are required by the Business Management Company?
- Launch of a large project which exceeds the set budget
  - Signing a new outsourcing contract over a certain size, etc.

(iii) Assessment and improvement of effectiveness

A. Analysis and assessment of IT risk management

- a. Does the Business Management Company accurately analyze and assess the status of IT risk management of the entire group, appropriately examine whether there are any problems or weaknesses to be improved in the IT risk management system and appropriately verify their causes, based on all information concerning the status of IT risk management, such as reports from each company, the results of audits by company auditors, the results of internal and external audits and the results of various investigations?
- b. Does the Business Management Company verify the effectiveness of analysis and assessment process of IT risk, and revise in a timely manner, based on reports and investigation results, etc. concerning the IT risk management of the entire group, periodically and as needed?
- c. Does the Business Management Company verify periodically and as needed whether each group company appropriately analyzes and assesses management status of important individual risks (\*), examines problems and weaknesses in the risk management system which should be improved, and verifies their causes?

(\*) An “important individual risk” signifies a risk which emerged through a system failure or an accident of information security with significant impact on the entire group which occurred in the past, or a significant risk which is identified by an audit of a possible actualization



concerning the IT risk management of the entire group.

B. Improvement

- a. Based on the results of the above analysis and verification, does the Business Management Company develop a system to implement timely and appropriate improvements for those problems and weaknesses, by developing and executing an improvement plan as needed?
- b. Does the Business Management Company verify the progress of improvement periodically and as needed, with timely and develop a system to make an appropriate follow-up?
- c. Does the Business Management Company verify the effectiveness of the improvement process and make timely reviews, based on reports and investigation results, etc. on the status of the entire group's IT risk management, periodically and as needed?
- d. Does the Business Management Company develop a system to monitor whether each group company executes improvements for those problems and system weaknesses, by formulating an improvement plan based on the results of verification of the status of management of significant individual risks? Also, does the Business Management Company develop a system to monitor whether each group company is verifying and following up on the state of progress in improvements, periodically and as needed?

(6) Integrated Risk Management System

(i) Development of Policy

- Development of integrated risk management system and distribution to all concerned

Does the Business Management Company develop the integrated risk management policy of the entire group, to comprehend and manage the location, size and characteristics of various risks holistically, taking into account strategic goals in accordance with the entire group's management policy? Does it distribute the policy to the entire group, including overseas entities?

(ii) Development of Internal Rules and Organizational System

A. Development of internal rules

Does the Business Management Company develop integrated risk

management rules for the entire group which clarify rules on integrated risks, in accordance with the entire group's integrated risk management policy? Does it distribute the rules to the entire group, including overseas entities?

B. Development of organizational and operational system

- a. Does the Business Management Company establish a division which is responsible for managing the integrated risks of the entire group (hereinafter, "Integrated Risk Management Division"), accurately understand the status of integrated risks of the entire group, including overseas entities, and develop a system to appropriately manage integrated risks in accordance with policy and rules of managing integrated risk?
- b. Does the Business Management Company allocate to the Integrated Risk Management Division adequate human resources with the necessary knowledge and experience, and grant to that staff the sufficient authority to fulfill their roles?
- c. Does the Business Management Company ensure that the Integrated Risk Management Division has a system of checks and balances against each group company? Also, does the Business Management Company have the Integrated Risk Management Division ensure the effectiveness of integrated risk management in each group company?
- d. Does the Business Management Company appropriately monitor the status of compliance with and use of limits in each group company, and provide appropriate instruction or suggestions in a regular and timely manner?
- e. Does the Business Management Company have each group company report information related to integrated risk management to the Business Management Company periodically and as needed?

C. Setting of limits

- a. Does the Business Management Company, in accordance with the policy and rules of integrated risk management, review the business of each group company, consider the strategic position, capital stock, profit plan and risk profile, etc. of each domestic and foreign entity or each division in the group, and set appropriate limits (economic capital, etc.) for each business and risk category, etc.?
- b. Does the Business Management Company review the business of each group company, and adjust methods and allocation of the limits so that the total

amount of risks are adequate compared to business strength (capital stock), periodically and as needed?

D. Monitoring of integrated risk management

- a. Does the Business Management Company establish appropriate evaluation and analysis methods for integrated risks, which are suitable for the size and risk characteristics of the business of each group company? Does it periodically and appropriately evaluate, analyze and understand the entire group's integrated risks?
- b. Does the Business Management Company understand the limitations and weaknesses of the evaluation and analysis methods for integrated risk, and appropriately understand the entire group's integrated risk, such as by supplementing these methods as needed?
- c. Does the Business Management Company ensure the reliability of its evaluation and analysis methods for integrated risks, by verifying the appropriateness of these methods for integrated risks, and taking necessary actions in order to match the risk profile and market environment, etc. of the entire group periodically and as needed?
- d. Does the Business Management Company appropriately comprehend and utilize the status of the market risks of the entire group under the stresses by stress testing based on appropriate scenarios, periodically and as needed?

(iii) Assessment and Improvement of Effectiveness

A. Analysis and assessment of integrated risk management

- a. Does the Business Management Company accurately analyze and assess the status of integrated risk management of the entire group, appropriately examine whether there are any problems or weaknesses to be improved in the integrated risk management system and appropriately verify their causes, based on all information concerning the status of integrated risk management, such as reports from each company, the results of audits by company auditors, the results of internal and external audits and the results of various investigations?
- b. Does the Business Management Company verify the effectiveness of analysis and assessment process of integrated risk, and revise in a timely manner based on reports and investigation results, etc. concerning the entire group's integrated risk management, periodically and as needed?

## B. Improvement

- a. Based on the results of the above analysis and verification, does the Business Management Company develop a system to implement timely and appropriate improvements for those problems and weaknesses, by developing and executing an improvement plan as needed?
- b. Does the Business Management Company verify the progress of improvement periodically and as needed, with timely and develop a system to make an appropriate follow-up?
- c. Does the Business Management Company verify the effectiveness of the improvement process and make timely reviews, based on reports and investigation results, etc. on the status of the entire group's integrated risk management, periodically and as needed?

## (7) Internal Audit System

### (i) Development of Policy

- Development of internal audit policy and distribution to all concerned

Based on strategic goals in accordance with the entire group's management policy, does the Business Management Company consider the size and characteristics of the group's business, regulations which apply to its businesses, and risk profile, etc., and develop the basic policy on internal audits (Internal Audit Policy) to ensure the effectiveness of internal audits of the entire group? Does it distribute the policy to the entire group, including overseas entities?

### (ii) Development of Internal Rules and Organizational System

#### A. Development of internal rules

Does the Business Management Company develop internal audit rules for the entire group which clarify rules on internal audit, in accordance with the entire group's Internal Audit Policy? Does it distribute the rules to the entire group, including overseas entities?

#### B. Development of organizational and operational system

- a. Does the Business Management Company establish an internal audit division in the Business Management Company and in each group company as needed, in order to verify the appropriateness and effectiveness of internal control systems for each business of the group, including large-scale and

complex businesses performed as a group? Does it develop a system to accurately understand and appropriately manage the status of internal audits of the entire group, including overseas entities?

- b. Does the Business Management Company develop a system that ensures an effective internal audit function for the entire group by providing the internal audit division of the Business Management Company with the authority to give directions and orders to the internal audit divisions in each group company, in order to secure the effectiveness of internal audits on each business of the group, including large-scale and complex businesses performed as a group?
- c. Does the Business Management Company develop a system to ensure the effectiveness of internal audits on each business of the group, including large-scale and complex businesses performed as a group by means of giving the authority to perform internal audits on such businesses to internal audit divisions in each group company?
- d. Does the Business Management Company allocate adequate human resources with the knowledge and experience needed to perform internal audits of each business of the group, including large-scale and complex ones performed as a group?
- e. Does the Business Management Company ensure that the internal audit division has independence from other business divisions, and that the operations, authorities, and responsibilities of the internal audit divisions are notified to each group company?
- f. Does the Business Management Company develop a system to have each group company report to the Business Management Company and seek the approval of the internal audit results therefrom periodically and as needed? In response, does the Business Management Company review whether the entire group's internal audit system is functioning effectively?
- g. Does the Business Management Company develop a system to take appropriate measures for problems found by the group's internal audits, such as by appropriately managing the improvement status?

C. Development of Internal Audit plan, etc.

- a. Does the Business Management Company develop a system to evaluate the entire group's risk status, and draft internal audit plans for efficient and effective internal audits which take into account the frequency and depth?

- b. Does the Business Management Company appropriately evaluate the risk status of the entire group, based on the size and characteristics of the entire group? Also, does it develop a system whereby the internal audit division does its own evaluations of the risk status from an independent standpoint, instead of relying on self evaluations of the audited divisions?
- c. Does the Business Management Company develop a system which enables timely revisions of the entire group's risk status, in response to changes in the external and internal business environment, and enables revisions of the internal audit plan as needed?

#### D. Audit execution

Does the Business Management Company establish a system to ensure audit quality? Specifically, is appropriate review conducted on each stage of the audit, such as planning and execution of a specific audit and reporting audit results, etc., by people with expertise in each audited business of the group, including large-scale and complex ones performed as a group?

#### (iii) Assessment and Improvement of Effectiveness

##### A. Analysis and assessment of internal audit system

- a. Does the Business Management Company accurately analyze and assess the status of internal audit of the entire group, appropriately examine whether there are any problems or weaknesses to be improved in the internal audit and appropriately verify their causes, based on all information concerning the status of internal audit situation, such as reports from each group company, the results of external audits and various investigations?
- b. Does the Business Management Company verify the effectiveness of the analysis and assessment process of internal audit, and revise in a timely manner, based on reports and investigation results, etc. concerning the status of internal audits of the entire group, periodically and as needed?

##### B. Improvement

- a. Based on the results of the above analysis and verification, does the Business Management Company develop a system to implement timely and appropriate improvements for those problems and weaknesses, by developing and executing an improvement plan as needed?
- b. Does the Business Management Company verify the progress of improvement periodically and as needed, with timely and develop a system

to make an appropriate follow-up?

- c. Does the Business Management Company verify the effectiveness of the improvement process and make timely reviews, based on reports and investigations, etc. on the status of the entire group's internal audits, periodically and as needed?

9. Risk Management related to Consolidated Capital Adequacy Requirements for  
Special Financial Instruments Business Operators

(1) Awareness and Roles of Directors, etc. concerning Risks related to Consolidated Capital Adequacy Requirements

- (i) Does the Board of Directors of a special financial instruments business operator (limited to the operator which has subsidiary entities, etc.; the same hereinafter; "Board of Directors" hereinafter in II-1-2, 9) recognize that the Consolidated Capital-to-Risk Ratio stipulated in Article 2 of "Establishment of standards on sufficiency of capital stock of a special financial instruments business operator and its subsidiary entities, etc., compared to the assets held thereby" (2010 FSA Regulatory Notice No.128; "Consolidated Capital-to-Risk Ratio" hereinafter in II-1-2, 9) is the most important index for measuring the soundness of a special financial instruments business operator and its subsidiary entities, etc.?
- (ii) Does the Board of Directors recognize that the accurate calculation of the Consolidated Capital-to-Risk Ratio is extremely important and develop an organization and procedures for proper calculation?
- (iii) Does the Board of Directors understand whether the standard approach or internal control model-based approach is adopted to calculate the market risk equivalent amount for calculating the Consolidated Capital-to-Risk Ratio?
- (iv) Does the director in charge of the division which manages the Consolidated Capital-to-Risk Ratio in a special financial instruments business operator ("Director" hereinafter in II-1-2, 9) accurately comprehend the level of Consolidated Capital-to-Risk Ratio of its company, compared to the level at which the relevant authority may impose supervisory orders, and to the level which must be maintained?
- (v) Do the personnel who manage the Consolidated Capital-to-Risk Ratio implement measures to continuously collect information necessary to calculate the amount of non-fixed capital and to calculate the equivalent amount of market

risk, counterparty risk and basic risk?

(vi) Is the management of the Consolidated Capital-to-Risk Ratio regularly assessed by internal audits? Is its management system also reviewed as needed?

(2) Roles of Personnel who Manage the Consolidated Capital-to-Risk Ratio

(i) Do the personnel who manage the Consolidated Capital-to-Risk Ratio formulate rules for market risk management which specify a method of understanding the position for calculating the adopted market risk equivalents and a method of calculation for risks, and receive approval from the Board of Directors, etc. of the special financial instruments business operator (“Board of Directors, etc.” hereinafter in II-1-2, 9)?

(ii) Does the person who manages the Consolidated Capital-to-Risk Ratio verify that the Consolidated Capital-to-Risk Ratio is calculated in compliance with the laws and regulations by using accurate financial and accounting data of the special financial instruments business operator and its subsidiary entities, etc.?

(iii) With regard to financial and accounting data for the special financial instruments business operator and its subsidiary entities, etc., does the person who manages the Consolidated Capital-to-Risk Ratio obtain accurate financial data for which deferred and accrued accounts were checked?

(iv) Does the person who manages the Consolidated Capital-to-Risk Ratio appropriately comprehend changes in the Consolidated Capital-to-Risk Ratio, and its factors, and report these to the Board of Directors, etc. periodically?

(v) Does the Director in charge of the accounting division establish a system to confirm and verify that the scope of consolidation is appropriate?

(3) Management of the Consolidated Capital-to-Risk Ratio

(i) In calculating the amount of market risk equivalents, does the special financial instruments business operator establish a calculation system and internal management system for the standard approach or internal control model-based approach? Does it also take measures to calculate accurate market risk equivalent amounts?

(ii) When starting to handle a new product, is the market risk equivalent amount verified?

(iii) If the market risk equivalent amount is calculated for each risk category separately, are personnel designated who comprehensively identify and manage the overall market risks?



- (iv) If a calculation method of market risk equivalent amount is selected by each business type, are personnel designated who comprehensively identify and manage the overall market risk? Is there a control system that enables those personnel to identify the market risk equivalent amount for each risk category?

10. Risk Management related to Consolidated Capital Adequacy Requirements of a  
Final Designated Parent Company

(1) Awareness and Roles of Directors, etc. concerning Risks related to Consolidated Capital Adequacy Requirements

- (i) Does the Board of Directors of a final designated parent company (“Board of Directors” hereinafter in II-1-2, 10) recognize that the Consolidated Capital-to-Risk Ratio stipulated in Article 2 of “Establishment of standards on sufficiency of capital stock of a final designated parent company and its subsidiary entities, etc. compared to the assets held thereby” (2010 FSA Regulatory Notice No.130; “Capital Adequacy Notice on Final Designated Parent Company” hereinafter) (“Consolidated Capital-to-Risk Ratio” hereinafter in II-1-2, 10) is a most important index for measuring the soundness of a final designated parent company and its subsidiary entities, etc.?
- (ii) Does the Board of Directors recognize that the accurate calculation of the Consolidated Capital-to-Risk Ratio is extremely important and develop an organization and procedures for its proper calculation?
- (iii) If the Consolidated Capital-to-Risk Ratio is calculated based on Article 3 of the Capital Adequacy Notice on Final Designated Parent Company, does the Board of Directors understand whether the standard approach or internal rating based approach is adopted to calculate total credit risk-weighted assets for the Consolidated Capital-to-Risk Ratio? Does it understand whether the standard approach or internal control model-based approach is adopted to calculate the amount of market risk equivalents? Does it understand whether the basic indicator approach, standardized approach, or advanced measurement approach is adopted to calculate the total amount of operational risk equivalents?
- (iv) If the Capital-to-Risk Ratio is calculated based on Article 4 of the Capital Adequacy Notice on Final Designated Parent Company, does the Board of Directors understand whether the standard approach or internal control model-based approach is adopted to calculate the market risk equivalent amount

of the Consolidated Capital-to-Risk Ratio?

- (v) Does the director in charge of the division which manages the Consolidated Capital-to-Risk Ratio in the final designated parent company (“Director” hereinafter in II-1-2, 10) accurately comprehend the level of Consolidated Capital-to-Risk Ratio of its group, compared to the level at which the relevant authority may impose supervisory orders and compared to the level which must be maintained?
- (vi) Do the personnel who manage the Consolidated Capital-to-Risk Ratio implement measures to continuously collect information necessary to calculate the amount of each risk equivalent, corresponding to the methods for calculating the Consolidated Capital-to-Risk Ratio?
- (vii) In evaluating the capital adequacy, does the Board of Directors analyze not only the quantity, but also the quality of the capital?
- (viii) Is the management of the Consolidated Capital-to-Risk Ratio regularly assessed by internal audits? Is its management system also reviewed as needed?

(2) Roles of Personnel who Manage the Consolidated Capital-to-Risk Ratio

- (i) Do the personnel who manage the Consolidated Capital-to-Risk Ratio formulate rules for market risk management which specify a method of understanding the position for calculating the adopted market risk equivalents, and a method of calculation for risks? Are the rules above approved by the Board of Directors, etc. of the final designated parent company (“Board of Directors, etc.” hereinafter in II-1-2, 10)?
- (ii) Does the person who manages the Consolidated Capital-to-Risk Ratio verify that the Consolidated Capital-to-Risk Ratio is calculated in compliance with the laws and regulations by using accurate financial and accounting data of the final designated parent company and its subsidiary entities, etc.?
- (iii) With regard to financial and accounting data for the final designated parent company and its subsidiary entities, etc., does the person who manages the Consolidated Capital-to-Risk Ratio obtain accurate financial data for which deferred and accrued accounts were checked?
- (iv) Does the person who manages the Consolidated Capital-to-Risk Ratio appropriately comprehend changes in the Consolidated Capital-to-Risk Ratio and its factors, and report these to the Board of Directors, etc. periodically?
- (v) Does the Director in charge of the accounting division establish a system to confirm and verify that the scope of consolidation is appropriate?

(3) Management of the Consolidated Capital-to-Risk Ratio

- (i) If the Consolidated Capital-to-Risk Ratio is calculated based on Article 3 of the Capital Adequacy Notice on Final Designated Parent Company, in calculating the total amount of market risk equivalents, does the final designated parent company establish a calculation system and internal management system for the standard approach or internal rating-based approach? Does it also take measures to calculate accurate market risk equivalent amounts?
- (ii) If the Consolidated Capital-to-Risk Ratio is calculated based on Article 4 of the Capital Adequacy Notice on Final Designated Parent Company, in calculating the amount of market risk equivalents, does the final designated parent company establish a calculation system and internal management system for the standard approach or internal control model-based approach? Does it also take measures to calculate accurate market risk equivalent amounts?
- (iii) When starting to handle a new product, are total market risk equivalents or market risk equivalents verified?
- (iv) If a calculation method of total market risk equivalent amount or market risk equivalent amount is selected by business type, location or risk category, are personnel designated who comprehensively identify and manage the overall market risk? Is there a control system that enables those personnel to identify the market risk equivalent amount?

### **II-1-3. Structures and Systems / Type II Financial Instruments Business Operators**

The purpose of inspections concerning the structures and systems of Type II financial instrument business operators is to comprehend the actual conditions regarding whether a company or an individual engaged in sales of investment trusts and deemed securities has established appropriate structures and systems to operate business as a financial instruments business operator in compliance with laws and regulations, etc.

#### **1. Internal Control System**

##### **(1) Awareness of Top Management**

- (i) Does the board of directors understand the laws and regulations, etc. with which they should comply?
- (ii) Does the board of directors put off fulfilling their responsibilities and role as a financial instruments business operator while placing priority on other business which they concurrently operate due to the types and characteristics of such business?
- (iii) Does the board of directors have in place a system for verifying the appropriateness of business, in order to comply with laws and regulations, etc.? Particularly, for cases in which financial instruments are sold using computer systems, is there a system in which verification that includes that of the management of computer systems is possible?

##### **(2) Manager of Internal Control Division, etc.**

- (i) Does the manager of the internal control division fulfill his/her duties including the development of internal controls?
- (ii) Do the representative directors establish a system for comprehending important information on internal controls in close cooperation with the manager of the internal control division? Does the manager of the internal control division establish communication and a reporting system between personnel in charge of internal control belonging to the sales division, etc., and develop a system for comprehending all information on internal control? Furthermore, does he/she clarify these systems, disseminate them to all officers and employees, and verify the effectiveness of those systems' functions?
- (iii) Does the manager of the internal control division constantly and accurately collect and comprehend information concerning compliance? Of this information, does he/she disseminate information concerning legal compliance to all officers and employees using appropriate means and methods, and confirm and know the status of

dissemination to officers and employees?

- (iv) Do personnel in charge of internal control in the sales division, etc. develop appropriate management systems for customer management, management of sales representatives, and so on, in the sales division, etc.? Additionally, do they fully recognize that they are responsible for improving inappropriate incidents and business operations which occurred in the sales division, etc. under their own direction and supervision, and establish a system for securing the implementation of such improvement activities?
- (v) Do personnel in charge of internal control in the sales division, etc. inspect routine operations in the sales division, etc. and issue the necessary instructions to them?
- (vi) Do personnel in charge of internal control in the sales division, etc. report legal compliance, business operations and other conditions to the manager of internal control division regularly and as needed?

### (3) Development of Systems for Verifying Legal Compliance

- (i) Does the manager of the internal control division have the following systems in place from the viewpoint of the protection of public interest and investors?
  - A. A system for verifying the issuance of prospectuses, etc.
  - B. A system for conducting examinations of advertisements and materials for solicitation
  - C. A system for verifying the management of specific investors
  - D. A system for verifying the issuance of written documents before conclusion of agreements
  - E. A system for verifying the issuance of written documents at the time of conclusion of agreements, etc.
  - F. A system for verifying the appropriateness of treatment of accidents
  - G. A system for verifying compliance with measures to prevent harmful effects
  - H. A system for verifying the appropriateness of other business operations
- (ii) In developing the above-mentioned systems, does the manager of the internal control division formulate internal rules and a management manual, etc. and receive approval from the Board of Directors, etc.? In addition, does he/she determine the manager for each system and clarify their authority and responsibilities?
- (iii) Does the manager of the internal control division formulate internal rules, etc. containing the following matters concerning customer management, receive approval from the Board of Directors, etc., and disseminate them to all officers and employees?

- A. Matters concerning the preparation of customers cards, etc.
  - B. Matters concerning the criteria to begin transactions
  - C. Matters concerning verification at the time of transaction and suspicious transactions, etc.
  - D. Matters concerning the protection of personal information
  - E. Matters necessary for appropriate customer management
- (iv) Does the manager of the internal control division formulate internal rules containing the following matters concerning the management of sales representatives, receive approval from the Board of Directors, etc. and disseminate them to all officers and employees?
- A. Matters concerning the registration of sales representatives
  - B. Matters concerning explanations to customers
  - C. Matters concerning prohibited acts (especially matters concerning suitability and unfair transactions)
  - D. Matters concerning reporting and processing at the time of inappropriate incidents
  - E. Matters concerning the trading of private financial instruments by officers and employees
  - F. Matters concerning internal disciplinary actions
  - G. Matters necessary for the appropriate management of sales representatives
- (v) Does the manager of the internal control division grant the authority and responsibility for appropriate management based on internal rules concerning the above-mentioned systems to personnel in charge of internal control in the sales divisions, etc., and provide systems for reporting to the internal control division in cases where problems occur? Does he/she also monitor and verify the effectiveness of those systems, and review each system including internal rules, etc. if necessary?
- (vi) In addition to the above-mentioned matters, does the manager of the internal control division develop a system in which various statutory management operations such as books and disclosure materials related to business operations, reporting to relevant authorities and notification forms are functional and appropriately managed?

(4) Business Operation

- (i) Is there a system by which it can be confirmed whether sales representatives comprehend the characteristics of financial instruments, and sufficiently explain them to customers?
- (ii) Does the internal control division implement strict examinations when opening transactions from the viewpoint of the principle of suitability concerning a customer's

financial means and the contents of transactions?

(5) Development of Systems for Handling Troubles with Customers

- (i) Does the Board of Directors, etc. sufficiently recognize that leaving problems with customers unsolved may lead to inappropriate incidents, such as misappropriation by officers and employees and loss compensation? Furthermore, do they provide systems for quick and appropriate processing and responses, in ways such as clearly delegating divisions to respond to problems incurred and the related procedures?
- (ii) Are employees instructed during training, etc. not to take on many complaints from customers?
- (iii) Does the division in charge of responding to troubles instruct the personnel in charge of internal control in the sales division, etc. to endeavor to comprehend troubles which each sales representative has with their customers and to quickly report them to said division?
- (iv) Does the division in charge of responding to troubles record in detail proposals from customers, the contents of investigations and the processing status, and appropriately store them to enable subsequent verification.

(6) Electronic Transactions

(i) Awareness and Roles of the Board of Directors, etc.

- A. Does the Board of Directors, etc. understand the characteristics of electronic transactions, and fully recognize matters to which they should respond when making electronic transactions?
- B. In non-face-to-face transactions, given the possibility of problems being actualized in relation to explanations and the provision of information at sales and solicitation, the handling of problems, involvement of third parties, and so on, does the Board of Directors, etc. understand such risks of electronic transactions, and recognize the significance of relevant risk management? Especially, does the director in charge deeply recognize and understand them?
- C. In electronic transactions, is there an established system for legal compliance, as with ordinary face-to-face transactions?
- D. Does the Board of Directors, etc. clarify policy for activities in relation to electronic transactions? Is that activity policy in accordance with the company's business plan?
- E. In formulating the activity policy, are the services to be provided and the mechanical environments of electronic transactions (the size of system) taken into account?

- F. In the activity policy, is it clearly stipulated that internal control and legal compliance that take into account the characteristics of electronic transactions are required?
- G. Is the status of a company's business operations (for example, company outlook, organizational matters, financial position and so on) placed on its website?
- (ii) Does the manager in charge of electronic transactions understand the characteristics of electronic transactions, recognize the necessity for management corresponding to those characteristics, and take measures to enable personnel in charge of internal control in each division to understand and recognize such knowledge? Furthermore, in preparation for occurrence of system failures, etc., are appropriate measures taken, in relation to a backup system, countermeasures, and reporting to the relevant authorities? For example, are a sufficient number of personnel assigned to a call center to respond to inquiries from customers?
- (iii) Does the manager in charge of electronic transactions provide internal rules in consideration of the features of electronic transactions, such as not being face-to-face and having paperless transactions, and receive approval from the Board of Directors, etc.?
- (iv) Does the manager in charge of electronic transactions disseminate the contents of internal rules to all officers and employees, especially to personnel engaged in electronic transaction operations?
- (v) In operating electronic transactions, is the appropriate staffing implemented in such a way as to assign employees familiar with electronic transactions to positions in charge of internal control?
- (vi) Does the division that handles problems review whether or not the contents of some complaints and other proposals include factors which may have considerable impacts on transactions by customers due to problems concerning computer systems?
- (vii) Is there a system in which information on system failures and other factors which may have considerable impacts on transactions by customers can be quickly and accurately conveyed to customers?
- (viii) Is there a system in which training for officers and employees can be conducted in relation to administrative works, systems, problems and laws which are particular to electronic transactions?
- (ix) Is there an established training system for fostering personnel familiar with business operations (including an administrative division)?
- (x) Are training and other means of education implemented in order to enable employees in a call center related to electronic transactions to learn and improve their



knowledge about laws and electronic transactions?

- (xi) In the case of both provision of information by telephone, etc. and electronic transactions being conducted jointly with face-to-face transactions, is the customer management system for ordinary face-to-face transaction adopted?

## 2. Risk Management System

(1) Awareness and Roles of Directors, etc.

- (i) Do the representative directors and the board of directors fully recognize that the disregard of risk management may have significant adverse effects on corporate business by impairing financial soundness and leading to a collapse of corporate credit (reputation)?
- (ii) Does the board of directors clearly determine the strategic goals, such as the level of profits the company is aiming to earn or the extent to which it can take risks? Does the strategic goal of the sales division, etc. disregard risk management while placing too high of a priority on ensuring profits? In addition, is this goal disseminated within the organization? In particular, has the board of directors established a goal which prioritizes profits in the short-term without appropriate risk management, and a compensation system based on such a goal?
- (iii) Has the Board of Directors, etc. a clearly determined policy of risk management based on the strategic goal? Do they also take appropriate measures to disseminate the policy of risk management within the organization? Furthermore, does the Board of Directors, etc. review the policy of risk management periodically or when needed, for example when the strategic goal is changed?
- (iv) Does the director in charge understand the methods to measure, monitor and manage various risks, as well as the location and types of risks and their features? Furthermore, does he/she recognize the significance of risk management, and work toward a policy and specific measures aiming to develop and establish an appropriate risk management system?
- (v) Does the board of directors clearly recognize the types of risks that the company has, and establish a necessary risk management system?
- (vi) Has the board of directors developed a system for conducting management by the kind of risk and a system in which all risks can be integrally managed? In those systems, are functions such as a mutual checks-and-balances system fully used, in

such a way, for example, as to separate the sales division, etc. and the risk management division? Is its organizational structure reviewed when needed, and improved according to changes in the strategic goal and advances in risk management methods?

- (vii) Does the Board of Directors, etc. regularly receive reports on risks? Do they reflect on and take advantage of the acquired risk information for the execution of business and the development of management systems?
- (viii) Does the Board of Directors, etc. clearly determine policies for cultivation of human resources familiar with business, assignment of specialized personnel, its lineup and personnel management, etc. in order to implement appropriate risk management?
- (ix) Does the Board of Directors, etc. clarify the authority and responsibility of the risk management division, and establish a system for conducting the development, readjustment and staffing of an organizational structure to conduct appropriate risk management?
- (x) Do company auditors always attend meetings of the Board of Directors, etc. concerning risk management?

## (2) Development of Methods and Rules of Risk Management

- (i) Has the manager of the risk management division established methods for measurement, monitoring and management corresponding to types of risks in accordance with the risk management policy, and provided internal rules for appropriate risk management with approval from the Board of Directors, etc.? Does he/she also make efforts to improve the risk management policy and rules for risk management in a timely and appropriate manner?
- (ii) Are the contents of risk management methods and internal rules appropriate in terms of the strategic goal of the sales division, etc. and the business and financial instruments that the company is handling? Is risk management operation incorporated as a part of routine operations?
- (iii) Do the internal rules for risk management specify the execution methods for each business operation, such as procedures, authority, necessary documents and contingency plans? Does the risk management division verify employees' compliance with the internal rules?

## (3) Awareness and Roles of a Manager of Risk Management Division

- (i) Does the manager of the risk management division recognize the significance of risk

management, and accurately recognize the existence, types and characteristics of risks? For cases in which the personnel in charge of risk management are assigned to each sales-related division, does he/she also implement appropriate measures to enable personnel to understand and recognize methods for measuring, monitoring and managing risks?

- (ii) Has the manager of the risk management division developed a system for conducting appropriate risk management in accordance with the risk management policy and the internal rules for risk management?
- (iii) Does the manager of the risk management division verify the effectiveness of risk management methods and organizations in a timely and appropriate manner, and review the risk management methods as necessary according to changes in markets, increases in risks, and the more complicated and diverse financial instruments which the company handles and so on?
- (iv) Does the manager of the risk management division consistently understand the kind of business operations and financial instruments which the sales division, etc. handles, and take measures to continuously identify risks and establish appropriate management methods? Particularly, when new business is launched or new financial instruments begin to be handled, does he/she give adequate consideration and implement measures in advance, for example, identifying risks and reinforcing the infrastructures necessary for management? In cases where identified risks are unmanageable, does the manager of the risk management division review and judge the business operations and financial instruments which the company handles?
- (v) Does the manager of the risk management division cultivate human resources with expertise based on the policy determined by the Board of Directors, etc., in such a way, for example, as to develop a training system to improve ability of personnel in charge of risk management? Does he/she also take appropriate measures to ensure that the emphasis on risk management diffuses into the company?

#### (4) Independence of Risk Management Division

- (i) Have directors, etc. established a system which may cause conflicts of interest, for example, having officers and employees of the risk management division engaged in business operations of the sales division, etc.? Do other directors and auditors conduct sufficient surveillance so that such a system is not established?
- (ii) Does the risk management division report risk information, including the preparation of plans and management situation of risk management systems in the entire organization, to the representative directors and the Board of Directors, etc.

regularly or when needed, based on the risk management policy and the internal rules for risk management, without being influenced by the sales division, etc.?

- (iii) Does the risk management division collect all risk information which may have serious impacts on business, and report it to the representative directors and the Board of Directors, etc. in an easy-to-understand and accurate manner so as to enable them to make appropriate assessments and judgments?
- (iv) Is there any established system in which independence may be hindered, in a way such as the director in charge of the risk management division concurrently serving in the sales division, etc.? In cases where the risk management division is not independent from the sales division, etc. and where the director in charge of the risk management division is concurrently serving as a director of the sales division, etc., is the form of the system adequately reasonable, and is the checks-and-balances function to conduct appropriate risk management working?
- (v) Does the risk management division verify whether or not instructions to the sales division, etc. are appropriately carried out?

### 3. Operational Risk Management System

(1) Awareness and Roles of Directors, etc.

- (i) Do directors, etc. take appropriate measures as understanding that operational risks may exist in all operations and recognizing the importance of reducing operational risks? Do they also implement appropriate measures as fully recognizing that there is a possibility that they will not be free from their responsibility to customers, even if inappropriate incidents are related to outsourced operations?
- (ii) Do directors, etc. take appropriate measures, including recognizing that they may provoke a scandal such as disrepute due to lawsuits and critical rumors caused by inappropriate incidents and other improper business operations? Particularly, are they fully aware of the possibility that a large amount of money could need to be raised and that heavy losses could be caused by errors in the placement of orders?
- (iii) Do directors, etc. fully understand the types and levels of risks that might be caused by the part of operations that is outsourced, and take appropriate measures to manage them? Do they also consider specific measures such as understanding that the types and levels of risks vary depending on the selection of trustees and the contents of outsourcing contracts?

## (2) Development of Management System

- (i) Does a manager in the risk management division recognize the importance of reducing operational risks, and take such appropriate measures as enabling other divisions, etc. to become aware of the importance of reducing operational risks and measures to do so? In addition, for the purpose of recognizing operational risks, does he/she analyze the potential size of operational loss and the possibility of its occurrence, and assess risks appropriately by, for example, quantifying the estimated amount of loss?
- (ii) Does the administrative division analyze the contents of business operations, locate operational risks, and provide internal rules to reduce those risks? Does it also have rules in preparation for mistakes in administrative processes? Particularly, does the division take measures so as to eliminate as many errors in the placement of orders as possible, for example, by establishing technical regulations and procedures for confirmation at the time of placing orders? Furthermore, does the administrative division formulate specific measures to reduce risks including procedures for cancellation and dissolution, and methods for fund-raising in preparation for the occurrence of errors in the placement of orders, and disseminate knowledge of such measures to all officers and employees?
- (iii) Is there a contractually established system which stipulates that risks of outsourced operations should be sufficiently controlled (systems for recognizing, assessing and reporting risks and relevant corrective actions, etc.)?
- (iv) Do personnel engaged in risk management check compliance with the internal rules and the appropriateness of operations in which there are risks?
- (v) Are measures implemented to ensure the effectiveness of examination and approval procedures while preventing situations in which persons in charge of examination and approval procedures conduct their duties as a mere formality or perfunctorily because of excessive workloads?
- (vi) Are cases that are not covered by the internal rules handled based on instructions issued by the internal control division in coordination with the administrative division and the relevant operational divisions?

## 4. Information Technology Risk Management System

### (1) Awareness of IT Risks, etc.

For financial instruments business in which computer systems play a primary role in

the business infrastructure, does the Board of Directors, etc. recognize the types and natures of risks expected from the characteristics of computer systems, the environments of usage of IT in business, and the environments of computer system operation, etc., their influence at times when risks are actualized, and provide a management policy according to the level of influence?

(2) Establishment of Appropriate Information Technology Risk Management System

- (i) Does the manager of the IT management division analyze the potential size of losses in IT operation, and appropriately assess IT risks in a way such as, for example, quantifying estimated amounts of losses?
- (ii) Has the board of directors, etc. appropriately and clearly specified IT risk management policies? Do IT risk management policies include information security policy (basic policy to protect information assets of the organization appropriately), and a policy on the management of outsourcing? Also, based on management policies, has the board designated a particular department to control IT risk with clear roles, responsibilities and appropriate personnel, and established a system whereby the management can receive report on control regularly or as needed?
- (iii) Does the manager of the IT management division formulate the management rules which provide specific management criteria and procedures in relation to the risks recognized by the company, receive approval from the Board of Directors, etc., and develop systems for conducting appropriate management that fits the role of the division responsible for responding to IT risks?
- (iv) Has the Board of Directors, etc. developed a reporting system to understand problems concerning the risks recognized by the company, decided on guidelines for appropriate decision-making, and developed systems for quick responses according to said guidelines?
- (v) Has the Board of Directors, etc. developed systems for maintaining the effectiveness by reassessing risks, establishing appropriate organizations (roles, responsibilities and personnel) to respond to the reassessed risks, and reviewing the management rules, in accordance with changes in the company's surrounding environment?

(3) Development of Safety Measures

(i) Development of Information Security Management System

- A. Has the Board of Directors, etc. developed an information security management system to prevent leaks and inappropriate or illegal uses of information assets in computer system, and to reduce the risk that financial instruments business operators

and customers will incur loss? Has it assigned a department in charge of control information security with specific roles and responsibilities? Also, are operational rules developed in which types and locations of information assets that need to be controlled under the Information Security Management System are clarified?

B. Does the manager of the information security management division clarify a company-wide management system for information security, and taking into account risks, maintain an appropriate system of checks and balances against the responsible division or person in charge of dealing with information assets?

C. Does the manager of the information security management division formulate important information security management procedures, including those for outsourcing contractors, etc.? Does the manager verify their implementation status, to ensure their effectiveness?

D. Is training on information security provided to all officers and employees (including contract employees, part time employees, etc.) and people engaged in operations of outsourcing contractors, etc., to enhance their awareness of information security, and to suppress and prevent improper acts? Are they thoroughly distributed periodically about internal rules, regulations, management procedures, etc.?

E. Based on the risk situation of information assets, is appropriate access control implemented via physical methods, such as equipment to prevent entry into buildings, and by logical security, such as user passwords for the computer system? Is the management situation being inspected? Also, are records kept of access to the computer system, which has important information assets, and are they inspected for improper access or information leaks? Moreover, for a computer system with a large impact on customers and business operations, are the access records monitored and inspected as to whether the computer system is damaged by cyber attacks or other trouble?

F. In the case of problems occurring with information security related to computer system failures, accidents, crime, etc., does the financial instruments business operator, appropriately and according to the rules, recognize them, take care of its customers, take emergency measures, analyze causes of the problems, and implement measures to prevent a recurrence? Are the above measures reported to the board of directors periodically?

G. In the case of problems occurring with information security related to computer system failures, accidents, crimes, etc. does the Financial Instruments Business Operator disclose such fact in a timely manner to customers, etc.? Are appropriate responses taken? Is there reporting to the board of directors, etc. at the time of

occurrence and when appropriate? Also, is there appropriate reporting to the relevant authorities?

(ii) Operation of computer systems and development of a maintenance system

A. Does the manager of the IT management division recognize the types and natures of risks which may harm the operation of computer systems, and provide a management policy to prevent risks from coming into existence or to minimize influences from risks which were actualized in order to enable computer systems that are used as business infrastructures to operate in a safe and stable manner?

B. Does the manager of the IT management division determine the security management criteria based on the above-mentioned management policy, regularly inspect computer systems from the viewpoint of preventive maintenance, and retain its records?

C. Does the manager of the IT management division control a management system to prevent the actualizing of risk, such as clarifying the roles and responsibilities of the IT management division based on the above-mentioned management policy, establishing a system of checks and balances between persons in charge of operating and developing computer systems, and appointing personnel with necessary expertise and skills concerning hardware, software, data and networks, etc. as security administrators? In the absence of appropriate personnel, has he/she put in place effective controls on the computer system, taking such measures as using external experts?

D. Concerning the operating environment of computer systems including capacities and processing capabilities, etc. necessary for security management, does the financial instruments business operator develop internal rules and manuals which clarify items and procedures to check the environment and to handle problems? Are the rules and manuals appropriately reviewed to secure their effectiveness?

E. Are inspections for security management regularly (annually, quarterly, monthly, daily, etc.) implemented based on the internal rules and manuals, etc.? Are such measures taken as storing records on the conditions of inspections and their results for later verification of their contents?

(iii) Planning of computer systems and provision for development management system

A. In planning computer systems, is the purpose of usage for computer systems clarified based on the business plan and the basic policy of the organization?

B. Is the plan for computer systems approved in accordance with the organizational decision-making procedures in the Board of Directors, etc.? For receiving approval, is information required to make this decision clearly indicated, including prospective



- effects, the time period of introduction, risks associated with introduction and necessary resources (the amount of investment and organizational systems, etc.)? Additionally, are procedures taken to enable the Board of Directors, etc. to have sufficient understanding and conduct the necessary discussion and consideration?
- C. Is there a system for promoting safety measures in which not only the divisions that design and develop the computer systems but also the divisions that will use them participate? Do personnel who have expertise and skills concerning computer systems and those who are familiar with the business operations to be computerized also participate in said system? In the absence of the appropriate personnel, are such measures taken as using external experts to have an effective system put in place?
- D. Are divisions that will use the computer systems involved in the confirming and deciding specifications for the computer systems, and implementing and verifying acceptance tests? Also, when a computer system with large effects on customers and operations is migrated to a production environment, does the Board of Directors, etc. make the decision under rational criteria, based on a migration plan, etc.?
- E. Are the standards for output of computer systems decided from their planning and the development? In addition, are the methods, procedures and criteria to review that output documented as a development manual, and distributed to all concerned parties?
- F. In planning computer systems, is the introduction plan considered in recognition of the effects of the introduction of computer systems on business so as not to bring about confusion after the introduction? Is the schedule of introduction reasonable without putting too much priority on sales performance? Furthermore, are operation and management also discussed?
- G. Is there a system in which the status of development can be continually known by checking management items in the development process in consideration of the characteristics of the computer systems to be developed and the expected risks associated with the development? On the assumption that the recognized risks will be actualized, are review systems, decision-making procedures and other policies clarified to respond to such risks?
- H. For designing computer systems, are the qualities which should be included clarified in consideration of the degree of importance in the assumed usage and business environment, as well as quality characteristics such as portability, reliability, efficiency, usability, availability of verification, ease of understanding, changeability and so forth? Additionally, are systems provided for feasible development of this, in ways such as considering measures to ensure these qualities?

- I. For adopting new technologies, are the results of adoption and its concerned risks recognized? As for technologies which have entered a phase of steady diffusion, are the support periods for the vendors which delivered the computer systems and the risk of obsolescence taken into account?
- J. Is there an established system under which the reporting system relating to the progress of development and budget and the qualities in each process is defined in order to collect appropriate information and make the necessary responses?

#### (4) System Integration

- (i) Does the Board of Directors, etc. sufficiently recognize the risks of system integration, develop management system for those risks, and disseminate the necessary information to all officers and employees?
- (ii) Is there a test system? Is the test plan suited to the system integration's developed contents?
- (iii) Even in cases of outsourcing operations, is there an established system in which the company itself is involved?
- (iv) Is assessment of computer systems by external auditors and other experts used to judge important items concerning system integration?
- (v) Has a contingency plan been developed to respond to unexpected occurrences?

#### (5) Responses at the time of a system failure

- (i) In preparation for the occurrence of system failures, are procedures and measures for recovery standardized, aiming at quick recovery from the viewpoint of the protection of public interests and investors? Is training for continuing business and conducting system recovery implemented on the assumption that system failures, etc. will occur, in order to make said procedures and measures effective?
- (ii) Are personnel familiar with computer systems fostered in order to enable appropriate and quick responses at the time of system failures? In addition, are the necessary means of communication secured?
- (iii) In addition to the scope of information disclosure and its criteria, are other necessary procedures and processes decided so as not to cause unnecessary confusion among customers at the time of system failures, etc.?
- (iv) In the absence of personnel familiar with computer systems in the company, are appropriate measures taken, for example by concluding the necessary maintenance contracts with the vendors who delivered the computer systems?
- (v) Does the business operator make efforts to prevent the reoccurrence of a system

failure by taking measures for fundamental improvements? For that purpose, does it record the details of system failures, investigate their fundamental causes and consider countermeasures regularly or as needed in cooperation with the vendors who delivered the computer systems and other experts? Furthermore, does the financial instruments business operator execute measures to prevent recurrence, taking into account analysis of the overall occurrence situation and causes, etc.?

(vi) Is there a system for quickly reporting the occurrence of system failures, recovery, or the investigation of their causes, etc. to the relevant authorities?

#### (6) Contingency Plan

(i) On the assumption that system failures will occur, is an order of priority decided for all business operations in consideration of the necessity and the urgency of recovery? Are the target time, procedures and measures for recovery also clearly indicated, corresponding to levels and causes of failures, etc.? Also, are there specific response procedures and measures for cyber attacks, etc., including reporting to the relevant authorities and cooperation with related institutions, based on the established system to accurately understand the situation, and to prevent expansion of damage by the attack?

(ii) Are the definitions of emergency situations, procedures for decision making, and the responsibility and roles, etc. of a substitute person in the absence of a person with decision-making authority clarified?

(iii) Is the effectiveness of the contingency plan verified by regularly conducting drills on the assumption that system failures will occur?

(iv) Is the contingency plan appropriately reviewed to reflect changes in the company's surrounding environment, organizational changes, and transfer of personnel?

(v) Are procedures and means decided to disclose information to customers at the time of emergency?

(vi) Are methods and procedures to confirm the safety of officers and employees formulated in consideration of wide-area disasters such as large scale earthquakes? Is a way of continuing business even if office facilities are not available taken into account?

#### (7) Management of Outsourcing

(i) Management system pertaining to outsourcing

A. Are the purposes and effects of outsourcing clarified?

B. Are the necessary measures also considered, in recognition of the risks associated

with outsourcing?

C. Are the operations to be outsourced, the roles and responsibility of the company, and the responsible department and the manager to respond to such risks defined?

(ii) Criteria to evaluate contractors and regular evaluation

A. Have the criteria for selecting outsourcing contractors been decided? Are contractors selected based on the criteria of risk management?

B. Have the criteria for evaluating contractors been decided? Are contractors evaluated based on these criteria from the viewpoint of risk management? Additionally, when problems are detected through analysis of the details of commissioned business, are the necessary actions taken?

(iii) Contracts with outsourcing contractors

In the contract, are the preservation of confidentiality, clauses for reassignment, the authority for auditing, the level of services, and dispute-settlement procedures clearly defined in recognition of risks associated with outsourcing?

(iv) Management of outsourced operations

A. Does the business operator implement measures to prevent accidents and unfair acts by outsourcing contractors and to preserve confidentiality, and take necessary actions?

B. As for outsourcing related to operation and maintenance, does the company confirm that the level of services specified in a contract is maintained?

C. As for outsourcing related to development:

a. Are the required specifications approved by divisions that will use the systems clearly defined in writing, and presented to the outsourcing contractors?

b. Are necessary measures taken to know the quality and follow the progress?

c. Do divisions that will use the systems participate in acceptance inspections and define the inspection's conditions to confirm the quality?

(8) System Audit

(i) Implementation of System Audit

A. Is there an established internal audit division which is independent from the systems division? In addition, are system audits periodically implemented by personnel in charge of audits who are familiar with computer systems?

B. In the absence of personnel in charge of audits who are familiar with computer systems in the corporate organization, are system audits implemented in ways such as using external experts? Even for cases in which external experts are used, is there an auditing system in which problems related to system risks recognized by the

company can be identified, for the purpose of achieving continuous improvement?

C. Have priority items for audits and an audit plan been decided based on the system risks recognized by the company? Subsequently, is the appropriate audit implemented in accordance with said items and plan?

D. Does the company formulate the criteria concerning system audits, establish auditing methods corresponding to the types and nature of system risks recognized by the company, and conduct effective audits?

E. Does the audit cover all business operations related to the system risks recognized by the company? Is the company's possible failure to be aware of risks investigated? Furthermore, is there a system in which results of audits can be quickly reported to the Board of Directors, etc.?

(ii) Correction of problems

Does the Board of Directors, etc. decide the policy for response to problems that were acknowledged in reports on the results of audits, make decisions necessary for correction, and issue necessary instructions to the relevant departments? Also, does the internal audit division appropriately review the progress of improvements and reflect it in the subsequent internal audit plan, and reported to the Board of Directors, etc.?

5. Systems for Audit, etc.

(i) Does the internal audit division confirm the guideline for implementation of self-inspections which was prepared by the sales division, etc.?

(ii) Are self-inspections effectively implemented by the sales division, etc. based on the implementation guideline, etc.?

(iii) Does the sales division, etc. report the results of self-inspections (including the frequency of mistakes in administrative processes, their severity, causes, improvement measures and results of improvement, etc.) to the internal control division, etc. regularly and as needed? Do they also provide a system in which problems which may have considerable impacts on business are reported to the Board of Directors, etc. as needed?

(iv) Are all operations pertaining to electronic transactions audited? With regard to outsourced operations which are not subject to internal audits, is management by the divisions responsible for said operations audited?

## 6. Individuals Engaged in Type II Financial Instruments Business

- (i) In cases of individuals engaged in type II financial instruments business, the application of the above-mentioned items (including common items) to systems and structures should be confirmed from the viewpoint of whether or not business is operated while taking necessary measures and making necessary judgments with sufficient awareness of problems.
- (ii) Does the business manager understand that, even if a deposit for operation is not contractually required, it may be necessary to deposit it immediately based on the order?
- (iii) Does the business manager consider measures to appropriately repay debts even if the amount of loss caused by mistakes in administrative processes and lawsuits exceeds the amount of deposits for operation?

## **II-1-4. Structures and Systems /Investment Advisory and Agency Business**

### **Operators**

The purpose of inspections concerning the structures and systems of investment advisory and agency business operators is to assess the actual conditions regarding whether a company or an individual that provides advice on the value of securities, etc. to customers has established appropriate structures and systems to operate business as an investment advisory and agency business operator in compliance with laws and regulations, etc.

When conducting the inspection, inspectors should keep in mind that the required level of structures and systems may vary depending on the actual business contents and methods of the investment advisory and agency business operator.

#### **1. Internal Control System**

##### **(1) Awareness of Top Management**

- (i) Do directors, etc. understand that legal compliance contributes to maintaining and improving the trust of customers, and make efforts for appropriate business management?
- (ii) Do directors, etc. put off fulfilling their responsibilities and role as a financial instruments business operator while placing priority on other business which they concurrently operate due to the types and characteristics of such business?
- (iii) Does the board of directors, etc. have in place a system for verifying the appropriateness of business, in order to comply with laws and regulations, etc.? Particularly, for cases in which advice on the value of securities, etc. is provided to customers using computer systems, is there a system in which verification that includes that of the management of computer systems is possible?
- (iv) Have the directors, etc. secured persons who have knowledge and experience on the values of securities and financial instruments for the positions of providing advice on investment decisions based on the analysis of the values, etc. of securities or financial instruments and other items?

##### **(2) Manager of Internal Control Division, etc.**

- (i) Does the manager of the internal control division fulfill his/her duties including the development of internal controls?
- (ii) Does the manager of the internal control division establish a system for comprehending important information on internal controls in close cooperation with

the representative directors, etc.?

- (iii) Does the manager of the internal control division constantly and accurately collect and comprehend information concerning compliance? Of this information, does he/she disseminate information concerning legal compliance to all officers and employees using appropriate means and methods, and confirm and know the status of dissemination to officers and employees?
- (iv) Does the manager of the internal control division develop appropriate management systems for customer management, management of sales representatives, and so on, in the sales division, etc.? Additionally, do they fully recognize that they are responsible for improving inappropriate incidents and business operations which occurred in the sales division, etc. under their own direction and supervision, and establish a system for securing the implementation of such improvement activities?
- (v) Does the manager of the internal control division inspect routine operations in the sales division, etc. and issue the necessary instructions to them?

### (3) Development of Systems for Verifying Legal Compliance

- (i) Does the manager of the internal control division have the following systems in place from the viewpoint of the protection of public interest and investors?
  - A. A system for conducting examinations of advertisement and materials for solicitation
  - B. A system for identifying customers who are specific investors
  - C. A system for verifying the issuance of written documents before conclusion of agreements
  - D. A system for verifying the issuance of written documents at the time of conclusion of agreements, etc.
  - E. A system for verifying the appropriateness of treatment of accidents
  - F. A system for verifying compliance with measures to prevent harmful effects
  - G. A system for verifying the solicitation and contents of advice
  - H. A system for verifying the appropriateness of other business operations
- (ii) In developing the above-mentioned systems, does the manager of the internal control division formulate internal rules and a management manual, etc. and receive approval from the Board of Directors, etc.? In addition, does he/she determine the manager for each system and clarify their authority and responsibilities?
- (iii) Does the manager of the internal control division formulate internal rules, etc. containing the following matters concerning customer management, receive approval from the Board of Directors, etc., and disseminate them to all officers and



employees?

- A. Matters concerning assessment of customer identity
- B. Matters concerning suspicious transactions, etc.
- C. Matters concerning the protection of personal information
- D. Matters necessary for appropriate customer management

(iv) Does the manager of the internal control division formulate internal rules containing the following matters concerning the management of sales representatives, receive approval from the Board of Directors, etc. and disseminate them to all officers and employees?

- A. Matters concerning prohibited acts
- B. Matters concerning a cooling-off system
- C. Matters concerning selection of financial instruments (suitability)
- D. Matters concerning solicitation and conclusion and termination of contracts, etc.
- E. Matters concerning agency and intermediary services
- F. Matters concerning reporting and processing at the time of inappropriate incidents
- G. Matters concerning private financial instruments transactions by officers and employees
- H. Matters concerning internal disciplinary actions
- I. Matters necessary for appropriate management of sales representatives

(v) Does the manager of the internal control division provide systems for reporting to the internal control division in cases where problems occur? Does he/she also monitor and verify the effectiveness of those systems, and review each system including internal rules, etc. if necessary?

(vi) In addition to the above-mentioned matters, does the manager of the internal control division develop a system in which various statutory management operations such as books and disclosure materials related to business operations, reporting to relevant authorities and notification forms are functional and appropriately managed?

#### (4) Development of Systems for Handling Troubles with Customers

(i) Does the Board of Directors, etc. sufficiently recognize that leaving problems with customers unsolved may lead to inappropriate incidents, such as loss compensation by officers and employees? Furthermore, do they provide systems for quick and appropriate processing and responses, in ways such as clearly delegating divisions to respond to problems incurred and the related procedures?

(ii) Are employees instructed by the directors, etc. during training, etc. not to take on many complaints from customers?

- (iii) Does the division in charge of responding to troubles instruct the sales representatives, etc. to endeavor to comprehend troubles which each sales representative has with their customers and to quickly report them to said division when troubles occur?
- (iv) Does the division in charge of responding to troubles record in detail proposals from customers, the contents of investigations and the processing status, and appropriately store them to enable subsequent verification.

## 2. Risk Management System

### (1) Awareness and Roles of Directors, etc.

- (i) Do the directors, etc. fully recognize that the disregard of risk management may have significant adverse effects on corporate business by impairing financial soundness and leading to a collapse of corporate credit (reputation)?
- (ii) Does the board of directors, etc. clearly determine the strategic goals, such as the level of profits the company is aiming to earn or the extent to which it can take risks? Does the strategic goal of the sales division, etc. disregard risk management while placing too high of a priority on ensuring profits? In addition, is this goal disseminated within the organization? In particular, has the board of directors, etc. established a goal which prioritizes profits in the short-term without appropriate risk management, and a compensation system based on such a goal?
- (iii) Has the Board of Directors, etc. a clearly determined policy of risk management based on the strategic goal? Do they also take appropriate measures to disseminate the policy of risk management within the organization? Furthermore, does the Board of Directors, etc. review the policy of risk management periodically or when needed, for example when the strategic goal is changed?
- (iv) Does the director, etc. in charge understand the methods to measure, monitor and manage various risks, as well as the location and types of risks and their features? Furthermore, does he/she recognize the significance of risk management, and work toward a policy and specific measures aiming to develop and establish an appropriate risk management system?
- (v) Does the board of directors, etc. clearly recognize the types of risks that the company has, and establish a necessary risk management system?
- (vi) Has the board of directors, etc. developed a system for conducting management by the kind of risk and a system in which all risks can be integrally managed? Also, is its

organizational structure reviewed when needed, and improved according to changes in the strategic goal and advances in risk management methods?

- (vii) Does the Board of Directors, etc. regularly receive reports on risks? Do they reflect on and take advantage of the acquired risk information for the execution of business and the development of management systems?
- (viii) Does the Board of Directors, etc. clearly determine policies for cultivation of human resources familiar with business, assignment of specialized personnel, its lineup and personnel management, etc. in order to implement appropriate risk management?
- (ix) Does the Board of Directors, etc. clarify the authority and responsibility of the risk management division, and establish a system for conducting the development, readjustment and staffing of an organizational structure to conduct appropriate risk management?
- (x) Do company auditors, etc. attend meetings of the Board of Directors, etc. concerning risk management?

## (2) Development of Methods and Rules of Risk Management

- (i) Has the manager of the risk management division established methods for measurement, monitoring and management corresponding to types of risks in accordance with the risk management policy, and provided internal rules for appropriate risk management with approval from the Board of Directors, etc.? Does he/she also make efforts to improve the risk management policy and rules for risk management in a timely and appropriate manner?
- (ii) Are the contents of risk management methods and internal rules appropriate in terms of the strategic goal of the sales division, etc. and the business that the company is handling? Is risk management operation incorporated as a part of routine operations?
- (iii) Do the internal rules for risk management specify the execution methods for each business operation, such as procedures, authority, necessary documents and contingency plans? Does the risk management division verify employees' compliance with the internal rules?

## (3) Awareness and Roles of a Manager of Risk Management Division

- (i) Does the manager of the risk management division recognize the significance of risk management, and accurately recognize the existence, types and characteristics of risks?
- (ii) Has the manager of the risk management division developed a system for

conducting appropriate risk management in accordance with the risk management policy and the internal rules for risk management?

- (iii) Does the manager of the risk management division verify the effectiveness of risk management methods and organizations in a timely and appropriate manner, and review the risk management methods as necessary according to changes in markets, increases in risks, and the more complicated and diverse financial instruments which the company handles and so on?
- (iv) Does the manager of the risk management division consistently understand the kind of business operations which the sales division, etc. handles, and take measures to continuously identify risks and establish appropriate management methods? Particularly, when new business is launched, does he/she give adequate consideration and implement measures in advance, for example, identifying risks and reinforcing the infrastructures necessary for management? In cases where identified risks are unmanageable, does the manager of the risk management division review and judge the business operations which the company handles?
- (v) Does the manager of the risk management division cultivate human resources with expertise based on the policy determined by the Board of Directors, etc., in such a way, for example, as to develop a training system to improve ability of personnel in charge of risk management? Does he/she also take appropriate measures to ensure that the emphasis on risk management diffuses into the company?
- (vi) Does the risk management division report risk information, including the preparation of plans and management situation of risk management systems in the entire organization, to the representative directors and the Board of Directors, etc. regularly or when needed, based on the risk management policy and the internal rules for risk management, without being influenced by the sales division, etc.?
- (vii) Does the risk management division collect all risk information which may have serious impacts on business, and report it to the representative directors and the Board of Directors, etc. in an easy-to-understand and accurate manner so as to enable them to make appropriate assessments and judgments?
- (viii) Does the risk management division verify whether or not instructions to the sales division, etc. are appropriately carried out?

### 3. Operational Risk Management System

(1) Awareness and Roles of Directors, etc.

- (i) Do directors, etc. take appropriate measures as understanding that operational risks

may exist in all operations and recognizing the importance of reducing operational risks? Do they also implement appropriate measures as fully recognizing that there is a possibility that they will not be free from their responsibility to customers, even if inappropriate incidents are related to outsourced operations?

- (ii) Do directors, etc. take appropriate measures, including recognizing that they may provoke a scandal such as disrepute due to lawsuits and critical rumors caused by inappropriate incidents and other improper business operations?
- (iii) Do directors, etc. fully understand the types and levels of risks that might be caused by the part of operations that is outsourced, and take appropriate measures to manage them? Do they also consider specific measures such as understanding that the types and levels of risks vary depending on the selection of trustees and the contents of outsourcing contracts?

## (2) Development of Management System

- (i) Does a manager in the risk management division recognize the importance of reducing operational risks, and take such appropriate measures as enabling other divisions, etc. to become aware of the importance of reducing operational risks and measures to do so? In addition, for the purpose of recognizing operational risks, does he/she analyze the potential size of operational loss and the possibility of its occurrence, and assess risks appropriately, etc.?
- (ii) Does the administrative division analyze the contents of business operations, locate operational risks, and provide internal rules to reduce those risks? Does it also have rules in preparation for mistakes in administrative processes?
- (iii) Is there a contractually established system which stipulates that risks of outsourced operations should be sufficiently controlled (systems for recognizing, assessing and reporting risks and relevant corrective actions, etc.)?
- (iv) Do personnel engaged in risk management check compliance with the internal rules and the appropriateness of operations in which there are risks?
- (v) Are measures implemented to ensure the effectiveness of examination and approval procedures while preventing situations in which persons in charge of examination and approval procedures conduct their duties as a mere formality or perfunctorily because of excessive workloads?
- (vi) Are cases that are not covered by the internal rules handled based on instructions issued by the internal control division in coordination with the administrative division and the relevant operational divisions?

#### 4. Information Technology Risk Management System

##### (1) Awareness of IT Risks, etc.

For financial instruments business in which computer systems play a primary role in the business infrastructure, does the Board of Directors, etc. recognize the types and natures of risks expected from the characteristics of computer systems, the environments of usage of IT in business, and the environments of computer system operation, etc., their influence at times when risks are actualized, and provide a management policy according to the level of influence?

##### (2) Establishment of Appropriate Information Technology Risk Management System

(i) Does the manager of the IT management division analyze the potential size of losses in IT operation, and appropriately assess IT risks?

(ii) Has the board of directors, etc. appropriately and clearly specified IT risk management policies? Do IT risk management policies include information security policy (basic policy to protect information assets of the organization appropriately), and a policy on the management of outsourcing? Also, based on management policies, has the board designated a particular department to control IT risk with clear roles and responsibilities and established a system whereby the management can receive report on control regularly or as needed?

(iii) Does the manager of the IT management division formulate the management rules which provide specific management criteria and procedures in relation to the risks recognized by the company, receive approval from the Board of Directors, etc., and develop systems for conducting appropriate management that fits the role of the division responsible for responding to IT risks?

(iv) Has the Board of Directors, etc. developed a reporting system to understand problems concerning the risks recognized by the company, decided on guidelines for appropriate decision-making, and developed systems for quick responses according to said guidelines?

(v) Has the Board of Directors, etc. developed systems for maintaining the effectiveness by reassessing risks, establishing appropriate organizations (roles and responsibilities, etc.) to respond to the reassessed risks, and reviewing the management rules, in accordance with changes in the company's surrounding environment?

##### (3) Development of Safety Measures

(i) Development of Information Security Management System

- A. Has the Board of Directors, etc. developed an information security management system to prevent leaks and inappropriate or illegal uses of information assets in computer system, and to reduce the risk that financial instruments business operators and customers will incur loss? Has it assigned a department in charge of control information security with specific roles and responsibilities? Also, are operational rules developed in which types and locations of information assets that need to be controlled under the Information Security Management System are clarified?
- B. Does the manager of the information security management division clarify a company-wide management system for information security, and taking into account risks, maintain an appropriate system of checks and balances against the responsible division or person in charge of dealing with information assets?
- C. Does the manager of the information security management division formulate important information security management procedures, including those for outsourcing contractors, etc.? Does the manager verify their implementation status, to ensure their effectiveness?
- D. Is training on information security provided to all officers and employees (including contract employees, part time employees, etc.) and people engaged in operations of outsourcing contractors, etc., to enhance their awareness of information security, and to suppress and prevent improper acts? Are they thoroughly distributed periodically about internal rules, regulations, management procedures, etc.?
- E. Based on the risk situation of information assets, is appropriate access control implemented via physical methods, such as equipment to prevent entry into buildings, and by logical security, such as user passwords for the computer system? Is the management situation being inspected? Also, are records kept of access to the computer system, which has important information assets, and are they inspected for improper access or information leaks? Moreover, for a computer system with a large impact on customers and business operations, are the access records monitored and inspected as to whether the computer system is damaged by cyber attacks or other trouble?
- F. In the case of problems occurring with information security related to computer system failures, accidents, crime, etc., does the financial instruments business operator, appropriately and according to the rules, recognize them, take care of its customers, take emergency measures, analyze causes of the problems, and implement measures to prevent a recurrence? Are the above measures reported to the board of directors periodically?
- G. In the case of problems occurring with information security related to computer

system failures, accidents, crimes, etc. does the Financial Instruments Business Operator disclose such fact in a timely manner to customers, etc.? Are appropriate responses taken? Is there reporting to the board of directors, etc. at the time of occurrence and when appropriate? Also, is there appropriate reporting to the relevant authorities?

(ii) Operation of computer systems and development of a maintenance system

A. Does the manager of the IT management division recognize the types and natures of risks which may harm the operation of computer systems, and provide a management policy to prevent risks from coming into existence or to minimize influences from risks which were actualized in order to enable computer systems that are used as business infrastructures to operate in a safe and stable manner?

B. Does the manager of the IT management division determine the security management criteria based on the above-mentioned management policy, regularly inspect computer systems from the viewpoint of preventive maintenance, and retain its records?

C. Does the manager of the IT management division control a management system to prevent the actualizing of risk, such as clarifying the roles and responsibilities of the IT management division based on the above-mentioned management policy, establishing a system of checks and balances between persons in charge of operating and developing computer systems, and appointing personnel with necessary expertise and skills concerning hardware, software, data and networks, etc. as security administrators? In the absence of appropriate personnel, has he/she put in place effective controls on the computer system, taking such measures as using external experts?

D. Concerning the operating environment of computer systems including capacities and processing capabilities, etc. necessary for security management, does the financial instruments business operator develop internal rules and manuals which clarify items and procedures to check the environment and to handle problems? Are the rules and manuals appropriately reviewed to secure their effectiveness?

E. Are inspections for security management regularly (annually, quarterly, monthly, daily, etc.) implemented based on the internal rules and manuals, etc.? Are such measures taken as storing records on the conditions of inspections and their results for later verification of their contents?

(iii) Planning of computer systems and provision for development management system

A. In planning computer systems, is the purpose of usage for computer systems clarified based on the business plan and the basic policy of the organization?



- B. Is the plan for computer systems approved in accordance with the organizational decision-making procedures in the Board of Directors, etc.? For receiving approval, is information required to make this decision clearly indicated, including prospective effects, the time period of introduction, risks associated with introduction and necessary resources (the amount of investment and organizational systems, etc.)? Additionally, are procedures taken to enable the Board of Directors, etc. to have sufficient understanding and conduct the necessary discussion and consideration?
- C. Is there a system for promoting safety measures in which not only the divisions that design and develop the computer systems but also the divisions that will use them participate? Do personnel who have expertise and skills concerning computer systems and those who are familiar with the business operations to be computerized also participate in said system? In the absence of the appropriate personnel, are such measures taken as using external experts to have an effective system put in place?
- D. Are divisions that will use the computer systems involved in the confirming and deciding specifications for the computer systems, and implementing and verifying acceptance tests? Also, when a computer system with large effects on customers and operations is migrated to a production environment, does the Board of Directors, etc. make the decision under rational criteria, based on a migration plan, etc.?
- E. Are the standards for output of computer systems decided from their planning and the development? In addition, are the methods, procedures and criteria to review that output documented as a development manual, and distributed to all concerned parties?
- F. In planning computer systems, is the introduction plan considered in recognition of the effects of the introduction of computer systems on business so as not to bring about confusion after the introduction? Is the schedule of introduction reasonable without putting too much priority on sales performance? Furthermore, are operation and management also discussed?
- G. Is there a system in which the status of development can be continually known by checking management items in the development process in consideration of the characteristics of the computer systems to be developed and the expected risks associated with the development? On the assumption that the recognized risks will be actualized, are review systems, decision-making procedures and other policies clarified to respond to such risks?
- H. For designing computer systems, are the qualities which should be included clarified in consideration of the degree of importance in the assumed usage and business environment, as well as quality characteristics such as portability, reliability,

efficiency, usability, availability of verification, ease of understanding, changeability and so forth? Additionally, are systems provided for feasible development of this, in ways such as considering measures to ensure these qualities?

I. For adopting new technologies, are the results of adoption and its concerned risks recognized? As for technologies which have entered a phase of steady diffusion, are the support periods for the vendors which delivered the computer systems and the risk of obsolescence taken into account?

J. Is there an established system under which the reporting system relating to the progress of development and budget and the qualities in each process is defined in order to collect appropriate information and make the necessary responses?

#### (4) System Integration

(i) Does the Board of Directors, etc. sufficiently recognize the risks of system integration, develop management system for those risks, and disseminate the necessary information to all officers and employees?

(ii) Is there a test system? Is the test plan suited to the system integration's developed contents?

(iii) Even in cases of outsourcing operations, is there an established system in which the company itself is involved?

(iv) Is assessment of computer systems by external auditors and other experts used to judge important items concerning system integration?

(v) Has a contingency plan been developed to respond to unexpected occurrences?

#### (5) Responses at the time of a system failure

(i) In preparation for the occurrence of system failures, are procedures and measures for recovery standardized, aiming at quick recovery from the viewpoint of the protection of public interests and investors? Is training for continuing business and conducting system recovery implemented on the assumption that system failures, etc. will occur, in order to make said procedures and measures effective?

(ii) Are personnel familiar with computer systems fostered in order to enable appropriate and quick responses at the time of system failures? In addition, are the necessary means of communication secured?

(iii) In addition to the scope of information disclosure and its criteria, are other necessary procedures and processes decided so as not to cause unnecessary confusion among customers at the time of system failures, etc.?

(iv) In the absence of personnel familiar with computer systems in the company, are

appropriate measures taken, for example by concluding the necessary maintenance contracts with the vendors who delivered the computer systems?

(v) Does the business operator make efforts to prevent the reoccurrence of a system failure by taking measures for fundamental improvements? For that purpose, does it record the details of system failures, investigate their fundamental causes and consider countermeasures regularly or as needed in cooperation with the vendors who delivered the computer systems and other experts? Furthermore, does the financial instruments business operator execute measures to prevent recurrence, taking into account analysis of the overall occurrence situation and causes, etc.?

(vi) Is there a system for quickly reporting the occurrence of system failures, recovery, or the investigation of their causes, etc. to the relevant authorities?

#### (6) Contingency Plan

(i) On the assumption that system failures will occur, is an order of priority decided for all business operations in consideration of the necessity and the urgency of recovery? Are the target time, procedures and measures for recovery also clearly indicated, corresponding to levels and causes of failures, etc.? Also, are there specific response procedures and measures for cyber attacks, etc., including reporting to the relevant authorities and cooperation with related institutions, based on the established system to accurately understand the situation, and to prevent expansion of damage by the attack?

(ii) Are the definitions of emergency situations, procedures for decision making, and the responsibility and roles, etc. of a substitute person in the absence of a person with decision-making authority clarified?

(iii) Is the effectiveness of the contingency plan verified by regularly conducting drills on the assumption that system failures will occur?

(iv) Is the contingency plan appropriately reviewed to reflect changes in the company's surrounding environment, organizational changes, and transfer of personnel?

(v) Are procedures and means decided to disclose information to customers at the time of emergency?

(vi) Are methods and procedures to confirm the safety of officers and employees formulated in consideration of wide-area disasters such as large scale earthquakes? Is a way of continuing business even if office facilities are not available taken into account?

#### (7) Management of Outsourcing

(i) Management system pertaining to outsourcing

- A. Are the purposes and effects of outsourcing clarified?
- B. Are the necessary measures also considered, in recognition of the risks associated with outsourcing?
- C. Are the operations to be outsourced, the roles and responsibility of the company, and the responsible department and the manager to respond to such risks defined?

(ii) Criteria to evaluate contractors and regular evaluation

- A. Have the criteria for selecting outsourcing contractors been decided? Are contractors selected based on the criteria of risk management?
- B. Have the criteria for evaluating contractors been decided? Are contractors evaluated based on these criteria from the viewpoint of risk management? Additionally, when problems are detected through analysis of the details of commissioned business, are the necessary actions taken?

(iii) Contracts with outsourcing contractors

In the contract, are the preservation of confidentiality, clauses for reassignment, the authority for auditing, the level of services, and dispute-settlement procedures clearly defined in recognition of risks associated with outsourcing?

(iv) Management of outsourced operations

- A. Does the business operator implement measures to prevent accidents and unfair acts by outsourcing contractors and to preserve confidentiality, and take necessary actions?
- B. As for outsourcing related to operation and maintenance, does the company confirm that the level of services specified in a contract is maintained?
- C. As for outsourcing related to development:
  - a. Are the required specifications approved by divisions that will use the systems clearly defined in writing, and presented to the outsourcing contractors?
  - b. Are necessary measures taken to know the quality and follow the progress?
  - c. Do divisions that will use the systems participate in acceptance inspections and define the inspection's conditions to confirm the quality?

(8) System Audit

(i) Implementation of System Audit

- A. Are system audits periodically implemented by personnel in charge of audits who are familiar with computer systems?
- B. In the absence of personnel in charge of audits who are familiar with computer systems in the corporate organization, are system audits implemented in ways such as

using external experts? Even for cases in which external experts are used, is there an auditing system in which problems related to system risks recognized by the company can be identified, for the purpose of achieving continuous improvement?

C. Have priority items for audits and an audit plan been decided based on the system risks recognized by the company? Subsequently, is the appropriate audit implemented in accordance with said items and plan?

D. Does the company formulate the criteria concerning system audits, establish auditing methods corresponding to the types and nature of system risks recognized by the company, and conduct effective audits?

E. Does the audit cover all business operations related to the system risks recognized by the company? Is the company's possible failure to be aware of risks investigated? Furthermore, is there a system in which results of audits can be quickly reported to the Board of Directors, etc.?

(ii) Correction of problems

Does the Board of Directors, etc. decide the policy for response to problems that were acknowledged in reports on the results of audits, make decisions necessary for correction, and issue necessary instructions to the relevant departments? Also, does the internal audit division appropriately review the progress of improvements and reflect it in the subsequent internal audit plan, and reported to the Board of Directors, etc.?

**5. Systems for Audit, etc.**

(i) Does the internal audit division confirm the guideline for implementation of self-inspections which was prepared by the sales division, etc.?

(ii) Are self-inspections effectively implemented by the sales division, etc. based on the implementation guideline, etc.?

(iii) Does the sales division, etc. report the results of self-inspections (including the frequency of mistakes in administrative processes, their severity, causes, improvement measures and results of improvement, etc.) to the internal control division, etc. regularly and as needed? Do they also provide a system in which problems which may have considerable impacts on business are reported to the Board of Directors, etc. as needed?

(iv) With regard to outsourced operations which are not subject to internal audits, is management by the divisions responsible for said operations audited?

## 6. Individuals Engaged in the Investment Advisory and Agency Business

- (i) In cases of an individual engaged in the investment advisory and agency business, the application of the above-mentioned items (including common items) to systems and structures should be confirmed from the viewpoint of whether or not business is operated by taking necessary measures and making necessary judgments with sufficient awareness of problems.
- (ii) Does a business manager understand that, even if a deposit for operation is not contractually required, it may be necessary to deposit it immediately based on the order?
- (iii) Does the business manager consider measures to appropriately repay debts even if the amount of loss caused by lawsuits, etc. exceeds the amount of deposits for operation?

## **II-1-5. Structures and Systems /Investment Management Business Operators**

The purpose of inspections concerning the structures and systems of investment management business operators is to confirm whether or not an investment management business operator appropriately engages in investment management business with due care of a prudent manager for right holders, and comprehends the actual conditions of collective investment schemes, including investment funds.

### **1. Internal Control System**

(1) Awareness and Roles of Directors, etc.

- (i) Have the representative directors established a system to recognize important information on internal control in close cooperation with the manager of the internal control division? Has the manager of the internal control division established a system for communicating with and reporting to personnel in charge of internal control who belong to the sales division, etc., and constructed a system to comprehensively cover all information on internal control? Furthermore, does the manager clarify these systems, disseminate knowledge on them to all officers and employees, and verify the effectiveness of those functions?
- (ii) Does the Board of Directors, etc. accurately assess the investment capability of the company itself, re-entrusted entities, and the like for setting up investment trusts or concluding discretionary investment agreements?
- (iii) Do directors:
  - A. understand that in running an investment management business, legal compliance contributes to maintaining and improving the confidence of rights holders?
  - B. recognize that in running an investment management business, they are responsible for eliminating conflicts-of-interest transactions and preventing unfair trading?
- (iv) Does the board of directors:
  - A. Clearly define the basic policy concerning ensuring the appropriateness of operations and the prevention of unfair trading in order to maintain confidence, taking into account the responsibility of investment management business operators for fulfilling important roles as main players on the financial instruments markets?
  - B. take measures to disseminate knowledge on the basic policy within the organization?
  - C. recognize that the Financial Instruments and Exchange Act is applicable to asset management related to foreign rights holders?
- (v) Do directors recognize that, even in case of outsourcing a part of operations

including re-entrustment of investment, the responsibility as an outsourcer lies with the investment management business operator?

(vi) Has the Board of Directors, etc.:

A. developed an organizational system for preventing conflicts of interest by clarifying the authority and division of roles for fund managers (personnel in charge of investment) and traders (executors of transactions)?

B. developed a system in which the necessary information, such as ratings, on financial instruments in which investment is to be made, can be appropriately obtained?

C. developed a system for checking the appropriateness of investment while collecting complaints about investment?

(vii) Has the Board of Directors, etc. developed a system for regularly receiving reports on investment management?

(viii) Do the representative directors receive reports on investment management when needed, apart from regular status reports?

**[Real-estate Investment Funds, etc.]**

(ix) In consideration of the feature of real-estate investment funds in which the funds of right holders are invested mainly in real estate and the outcomes of investment are distributed, does the Board of Directors, etc. understand the importance of protecting investors through ensuring the appropriateness of investments?

(x) Has the board of directors provided a system for checking evaluation methods and criteria for real estate specified in investment fund conditions, etc.?

(xi) Does the board of directors sufficiently understand the necessity of information disclosure concerning real estate for right holders, clearly decide the policy for provision of detailed information in a timely manner to prevent rights holders from making poor investment decisions, and have a system for information disclosure in place?

(xii) Has the board of directors clearly decided the basic policy in relation to investment targeting real estate?

(xiii) Is the basic policy reviewed according to changes in economic environments and real-estate markets?

(xiv) Does the Board of Directors, etc. formulate investment policies for individual real estate, etc. based on the basic policy?

**[Fund Investment]**

(xv) Does a business operator that executes business by consensus of partners, etc. recognize that it is responsible for adequately explaining to rights holders about



calculation and distribution methods for costs and compensation related to investment of funds, reallocation methods for rights in association with merging funds and other matters which may have impacts on investment assets?

- (xvi) Does a business operator who executes business by consensus of partners, etc. recognize the possibility of breach of fiduciary duty in cases of covering losses with investment assets in funds for errors caused by mistakes in administrative processes, etc.?

**[Investment Corporation]**

- (xvii) Does the board of directors recognize that it is prohibited from entrusting business to financial instruments business operators which have an interested relationship with supervising officers, and identify persons falling under this category?

- (xviii) Do executive directors and the board of directors of an investment corporation receive appropriate materials and adequate explanations from the investment management business operator that outsourced business?

(2) Disclosure

- (i) Does the board of directors have an organizational system in place, for example, for designating a responsible division and a manager in order to secure the accuracy of disclosure?
- (ii) Has the board of directors developed a system in which the responsible division can easily obtain the cooperation of concerned divisions for preparing disclosure materials?
- (iii) Do directors understand that investment decisions are made by rights holders on the basis of the disclosure materials, and recognize the importance of said materials?
- (iv) Do directors understand the legal regulations on disclosure?
- (v) With regard to disclosure about investment trusts, does the business operator make efforts to disclose information in an easy-to-understand and timely manner so as not to invite misunderstanding among rights holders?
- (vi) Is there an established system in which information is appropriately disclosed in full consideration of the purpose of statutory information disclosure?
- (vii) Do not only the division in charge of disclosure, but also the internal control division verify whether or not disclosure materials are prepared in compliance with laws and regulations, etc.? If necessary, is a legal office, etc. used?

(3) Internal Rules

- (i) Has the manager of the investment management division developed internal rules,

etc. in order to enhance an investment system suitable for internal rules for important matters concerning investment, verification rules concerning results of investment, and internal rules related to evaluation of investment assets and investment processes?

(ii) For cases in which benchmarks are adopted for asset management, are there internal rules which give a specific explanation about these benchmarks and other matters to rights holders?

(iii) Does the manager of the internal control division provide the following internal rules as needed in order to execute appropriate investment management, and receive approval from the Board of Directors, etc.? When the organizational structure is changed, are the internal rules quickly changed and disseminated within the company?

A. Internal rules for ensuring an investment policy consistent with the features of assets and the rationality of investment decisions

B. Management rules in relation to the execution of transactions, for example, formulation of criteria for selecting (evaluating) entities to which orders are forwarded taking into account capacity to execute transactions, capacity to provide information and so on

C. Internal rules for distributing acquired assets and trading costs in blanket orders

D. Internal rules for preventing market manipulation and unfair transactions, such as insider trading using corporate information

E. Rules for appropriate distribution of initial public offerings, etc.

F. Internal rules for disclosing sufficient information to rights holders on re-entrustment of investments of assets and other matters

G. Internal rules concerning private financial instruments trading by officers and employees

H. Internal rules concerning treatment of shareholder special benefits

I. Internal rules on legal compliance, for example, matters concerning the issuance of written documents, conformity with measures to prevent harmful effects, and matters concerning the prevention of conflicts of interest such as interfund transactions, etc.

J. Internal rules on reports and treatment at the time of inappropriate incidents

K. Internal rules on internal disciplinary actions

**[Real-estate Investment Funds, etc.]**

(iv) Do the internal rules specify the acquisition and sale of real estate in accordance with the basic policy for investment taking into account portfolios, due diligence and

compliance, etc.?

- (v) Does the manager of the internal control division provide the following internal rules as needed and receive approval from the Board of Directors, etc., in order to execute appropriate investment management? When the organizational structure is changed, are the internal rules quickly changed and disseminated to all officers and employees?
  - A. Internal rules concerning decisions of long-term repair plans for real estate, depreciation, and durable period
  - B. Internal rules concerning the retention of asset management plans and public inspections for rights holders
  - C. Internal rules for appropriate disclosure of information necessary for investment decisions by rights holders

#### (4) Management of Net Asset Value

- (i) Is appropriate system support conducted for calculation of base net asset values?
- (ii) When system support is conducted, are the contents of its program verified in relation to legal compliance, and reviewed if necessary?
- (iii) Can computer systems respond to investment schemes for investment assets?
- (iv) When net asset values change dramatically, is the cause of fluctuation identified? When situations that violate laws and regulations, etc. are found, are these situations reported to the internal control division and, if necessary, the Board of Directors, etc.?
- (v) Does the person who manages net asset values implement appropriate management in ways such as carrying out the verification necessary for calculating accurate net asset values every day?
- (vi) For cases in which net asset values are incorrectly calculated, are countermeasures formulated in advance?

#### (5) Investment Management System

- (i) Does the person who manages the status of investment recognize the importance of investment management and take appropriate measures to enable personnel in charge of internal control who are assigned to the sales division, etc. to understand the contents of investment management?
- (ii) Does the person who manages the status of investment:
  - A. conduct appropriate investment management on his/her own responsibility?
  - B. when serious defects are founded in investment, have a system in place for immediately reporting the situation to the board of directors and, if necessary, the

representative directors while maintaining contact with the manager of the internal control division? Has he/she also established a system for promptly taking necessary actions, considering investigation of causes and a policy for responding to such defects?

C. regularly report the implementation of investment management to the Board of Directors, etc.?

(iii) Is there an internal system for accurately evaluating assets incorporated in portfolios? Especially in cases where unlisted shares and bonds, etc. are incorporated in the portfolio, is there a system for recognizing the proper market values?

(iv) For cases in which investment is implemented through financial institutions, etc. and differences in the balance are discovered as the result of regular balance inquiries with the financial institutions, is there a system for quickly investigating causes and reporting the facts to the Board of Directors, etc. if necessary?

#### (6) Real-estate Investment Management System

(i) Does the person who manages the status of investment verify the management of real estate and the validity of transactions, and regularly report them to the Board of Directors, etc.?

(ii) Does the investment management division:

A. implement management based on asset management plans?

B. appropriately select and supervise management companies of real estate, etc.?

C. check whether or not real-estate leasing contracts are or have been appropriately concluded?

D. check whether or not orders for real estate repair work are or have been appropriately placed?

E. check whether or not contracts on real-estate insurance are or have been appropriately renewed?

(iii) In evaluating real estate, are measures taken to secure fairness, such as appraisal by many real-estate appraisers who are not stakeholders?

(iv) In acquiring real estate which a parent company or a subsidiary has, is there a system in which the validity of acquisition is verified and the appropriateness of decisions on prices of relevant real estates is secured?

(v) Are asset management plans for individual parcels of real estate prepared appropriately in accordance with rules of self-regulatory organizations?

(vi) Does the investment management division assess the types and levels of risks of real-estate investment?

- (vii) For acquiring real estate, does the investment management division appropriately investigate the profitability of real-estate investment (investment yields, etc.) and qualification of investment (portfolios, due diligence, compliance, etc.)? After the acquisition, are said items investigated regularly or as needed?
- (viii) For cases in which a certain parcel of real estate has become inconsistent with the investment requirements, does the investment management division consider its replacement and sale? Is the way of handling parcels of real estate which have become inconsistent with the investment requirements checked by the investment risk management division?
- (ix) Does the investment management division report the status of real-estate investment risks to the investment risk management division and other divisions regularly or as needed?
- (x) Does the investment management division report the status of parcels of real estate which have become inconsistent with the investment requirements to the Board of Directors, etc. regularly or as needed?

#### (7) Management of Re-entrustment of Investment

- (i) For selecting an entity to be re-entrusted, does the business operator confirm the superiority of investment performance, credit capability and systems for investment and asset management, and require the re-entrusted entity to disclose sufficient information on investment?
- (ii) In cases where investment is re-entrusted, can the operational status be explained to rights holders?
- (iii) For concluding an agreement with an entity to be re-entrusted, does the business operator define the scope of responsibility of said entity which may be caused by executing the agreement and other matters necessary for prevention of conflicts and corrective processes?
- (iv) Are instructions to the re-entrusted entity at odds with re-entrusted operations? Does the business operator have investment advisory and agency business operators place orders?
- (v) In cases where investment decisions are made at an overseas base, does the business operator ensure that local fund managers thoroughly understand and comply with laws and regulations, etc.?
- (vi) Is legal compliance of the re-entrusted entity effectively and regularly confirmed by internal audits, etc.?
- (vii) Does the business operator unreasonably continue the agreement although

investment performance of the re-entrusted entity is less than superior?

## 2. Risk Management System

(1) Awareness and Roles of Directors, etc.

- (i) Do the representative directors and the board of directors fully recognize that the disregard of risk management may have significant adverse effects on corporate business by impairing financial soundness and leading to a collapse of corporate credit (reputation)?
- (ii) Does the board of directors clearly determine the strategic goals, such as the level of profits the company is aiming to earn or the extent to which it can take risks? Does the strategic goal of each division, etc. disregard risk management while placing too high of a priority on ensuring profits? In addition, is this goal disseminated within the organization? In particular, has the board of directors established a goal which prioritizes profits in the short-term without appropriate risk management, and a compensation system based on such a goal?
- (iii) Has the Board of Directors, etc. a clearly determined policy of risk management based on the strategic goal? Do they also take appropriate measures to disseminate the policy of risk management within the organization? Furthermore, does the Board of Directors, etc. review the policy of risk management periodically or when needed, for example when the strategic goal is changed?
- (iv) Do directors understand the methods to measure, monitor and manage various risks, as well as the location and types of risks and their features? Furthermore, do they recognize the significance of risk management?
- (v) Does the board of directors clearly recognize the types of risks that the company has, and establish a necessary risk management system?
- (vi) Has the board of directors developed a system for conducting management by the kind of risk and a system in which all risks can be integrally managed? In those systems, are functions such as a mutual checks-and-balances system fully used, in such a way, for example, as to separate the sales division, etc. and the risk management division? Is its organizational structure reviewed when needed, and improved according to changes in the strategic goal and advances in risk management methods?
- (vii) Does the Board of Directors, etc. regularly receive reports on risks? Do they reflect on and take advantage of the acquired risk information for the execution of business

and the development of management systems?

- (viii) Does the Board of Directors, etc. clearly determine policies for cultivation of human resources familiar with business, assignment of specialized personnel, its lineup and personnel management, etc. in order to implement appropriate risk management?
- (ix) Does the Board of Directors, etc. clarify the authority and responsibility of the risk management division, and establish a system for conducting the development, readjustment and staffing of an organizational structure to conduct appropriate risk management?
- (x) Does the Board of Directors, etc. have an appropriate risk management system in place in accordance with the decided strategic goal and risk management policy?
- (xi) Do company auditors always attend meetings of the Board of Directors, etc. concerning risk management?

## (2) Development of Methods and Rules of Risk Management

- (i) Has the manager of the risk management division established methods for measurement, monitoring and management corresponding to types of risks in accordance with the risk management policy, and provided internal rules for appropriate risk management with approval from the Board of Directors, etc.? Does he/she also make efforts to improve the risk management policy and rules for risk management in a timely and appropriate manner?
- (ii) Are the contents of risk management methods and internal rules appropriate in terms of the strategic goal of the sales division, etc. and the business and financial instruments that the company is handling? Is risk management operation incorporated as a part of routine operations?
- (iii) Do the internal rules for risk management specify the execution methods for each business operation, such as procedures, authority, necessary documents and contingency plans? Does the risk management division verify employees' compliance with the internal rules?

## (3) Awareness and Roles of a Manager of Risk Management Division

- (i) Does the manager of the risk management division recognize the significance of risk management, and accurately recognize the existence, types and characteristics of risks? For cases in which the personnel in charge of risk management are assigned to each sales-related division, does he/she also implement appropriate measures to enable personnel to understand and recognize methods for measuring, monitoring and

managing risks?

- (ii) Has the manager of the risk management division developed a system for conducting appropriate risk management in accordance with the risk management policy and the internal rules for risk management?
- (iii) Does the manager of the risk management division verify the effectiveness of risk management methods and organizations in a timely and appropriate manner, and review the risk management methods as necessary according to changes in markets, increases in risks, and the more complicated and diverse financial instruments which the company handles and so on?
- (iv) Does the manager of the risk management division consistently understand the kind of business operations and financial instruments which the sales division, etc. handles, and take measures to continuously identify risks and establish appropriate management methods? Particularly, when new business is launched or new financial instruments begin to be handled, does he/she give adequate consideration and implement measures in advance, for example, identifying risks and reinforcing the infrastructures necessary for management? In cases where identified risks are unmanageable, does the manager of the risk management division review and judge the business operations and financial instruments which the company handles?
- (v) Does the manager of the risk management division cultivate human resources with expertise based on the policy determined by the Board of Directors, etc., in such a way, for example, as to develop a training system to improve ability of personnel in charge of risk management? Does he/she also take appropriate measures to ensure that the emphasis on risk management diffuses into the company?

#### (4) Independence of Risk Management Division

- (i) Have directors, etc. established a system which may cause conflicts of interest, for example, having officers and employees of the risk management division engaged in business operations of the sales division, etc.? Do other directors and auditors conduct sufficient surveillance so that such a system is not established?
- (ii) Does the risk management division report risk information, including the preparation of plans and management situation of risk management systems in the entire organization, to the representative directors and the Board of Directors, etc. regularly or when needed, based on the risk management policy and the internal rules for risk management without being influenced by the sales division, etc.?
- (iii) Does the risk management division collect all risk information which may have serious impacts on business, and report it to the representative directors and the



Board of Directors, etc. in an easy-to-understand and accurate manner so as to enable them to make appropriate assessments and judgments?

- (iv) Is there any established system in which independence may be hindered, in a way such as the director in charge of the risk management division concurrently serving in the sales division, etc.? In cases where the risk management division is not independent from the sales division, etc. and where the director in charge of the risk management division is concurrently serving as a director of the sales division, etc., is the form of the system adequately reasonable, and is the checks-and-balances function to conduct appropriate risk management working?
- (v) Does the risk management division verify whether or not instructions to the sales division, etc. are appropriately carried out?

### 3. Operational Risk Management System

#### (1) Awareness and Roles of Directors, etc.

- (i) Do directors, etc. take appropriate measures such as understanding that operational risks may exist in all operations and recognizing the importance of reducing operational risks? Do they also implement appropriate measures such as fully recognizing that there is a possibility that they will not be free from their responsibility to customers, even if inappropriate incidents are related to outsourced operations?
- (ii) Do directors, etc. take appropriate measures, including recognizing that they may provoke a scandal such as disrepute due to lawsuits and critical rumors caused by inappropriate incidents and other improper business operations?
- (iii) Do directors, etc. fully understand the types and levels of risks that might be caused by the part of operations that is outsourced, and take appropriate measures to manage them? Do they also consider specific measures as understanding that the types and levels of risks vary depending on the selection of trustees and the contents of outsourcing contracts?

#### (2) Development of Management System

- (i) Does a manager in the risk management division recognize the importance of reducing operational risks, and take such appropriate measures as enabling other divisions, etc. to become aware of the importance of reducing operational risks and measures to do so? In addition, for the purpose of recognizing operational risks, does

he/she analyze the potential size of operational loss and the possibility of its occurrence, and assess risks appropriately by, for example, quantifying the estimated amount of loss?

- (ii) Does the administrative division analyze the contents of business operations, locate operational risks, and provide internal rules to reduce those risks? Does it also have rules in preparation for mistakes in administrative processes?
- (iii) When outsourcing is planned and implemented, does the business operator fully consider the contents and the scope of operations to be outsourced, the selection of outsourcing contractors, and the new risks which may be caused by outsourcing, and then formulate specific measures to manage risks?
- (iv) Is there a contractually established system which stipulates that risks of outsourced operations should be sufficiently controlled (systems for recognizing, assessing and reporting risks and relevant corrective actions, etc.)?
- (v) Do personnel engaged in risk management check compliance with the internal rules and the appropriateness of operations in which there are risks?
- (vi) Are measures implemented to ensure the effectiveness of examination and approval procedures while preventing situations in which persons in charge of examination and approval procedures conduct their duties as a mere formality or perfunctorily because of excessive workloads?
- (vii) Are cases that are not covered by the internal rules handled based on instructions issued by the internal control division in coordination with the administrative division and the relevant operational divisions?

#### 4. Information Technology Risk Management System

##### (1) Awareness of IT Risks, etc.

For financial instruments business in which computer systems play a primary role in the business infrastructure, does the Board of Directors, etc. recognize the types and natures of risks expected from the characteristics of computer systems, the environments of usage of IT in business, and the environments of computer system operation, etc., their influence at times when risks are actualized, and provide a management policy according to the level of influence?

##### (2) Establishment of Appropriate Information Technology Risk Management System

- (i) Does the manager of the IT management division analyze the potential size of losses

in IT operation, and appropriately assess IT risks in a way such as, for example, quantifying estimated amounts of losses?

- (ii) Has the Board of Directors, etc. appropriately and clearly specified IT risk management policy? Do IT risk management policies include information security policy (basic policy to protect information assets of the organization appropriately) and policy on management of outsourcing? And based on management policies, has the board designated particular department to control IT risk with clear roles, responsibilities and appropriate personnel, and established a reporting system for the management on its control regularly or as needed?
- (iii) Does the manager of the IT management division formulate the management rules which provide specific management criteria and procedures in relation to the risks recognized by the company, receive approval from the Board of Directors, etc., and develop systems for conducting appropriate management that fit the role of the division responsible for responding to IT risks?
- (iv) Has the Board of Directors, etc. developed a reporting system to understand problems concerning the risks recognized by the company, decided on guidelines for appropriate decision-making, and developed systems for quick responses according to said guidelines?
- (v) Has the Board of Directors, etc. developed systems for maintaining the effectiveness by reassessing risks, establishing appropriate organizations (roles, responsibilities and personnel) to respond to the reassessed risks, and reviewing the management rules, in accordance with changes in the company's surrounding environment?

### (3) Development of Safety Measures

#### (i) Development of Information Security Management System

A. Has the Board of Directors, etc. developed information security management systems to prevent leaks, inappropriate or illegal uses of information assets in computer system, and to reduce risks that financial instruments business operators and customers will incur loss? Has it assigned a department in charge of control information security with specific roles and responsibilities? Also, are operational rules developed in which types and locations of information assets that need to be controlled under the Information Security Management System are clarified?

B. Does the manager of the information security management division clarify a company-wide management system for information security, and taking into account risks, maintain an appropriate system of checks and balances against the responsible division or person in charge of dealing with information assets?

- C. Does the manager of the information security management division formulate important information security management procedures, including those for outsourcing contractors, etc.? Does the manager verify their implementation status, to ensure their effectiveness?
- D. Is training on information security provided to all officers and employees (including contract employees, part time employees, etc.) and people engaged in operations of outsourcing contractors, etc., to enhance their awareness of information security, and to suppress and prevent improper acts? Are they thoroughly distributed periodically about internal rules, regulations, management procedures, etc.
- E. Based on the risk situation of information assets, are appropriate access control implemented via physical methods such as equipment to prevent entry into buildings, and by logical methods such as user passwords for the computer system? Is this management situation inspected? Also, are access records to the computer system which has important information assets kept, and does it be inspected whether there are improper access or information leaks? Moreover, for a computer system with large impacts on customers and business operations, does it be inspected whether the computer system is damaged by cyber attacks or other trouble through monitoring the access records?
- F. In case of problems occurred on information security related to computer system failures, accidents, crimes, etc., does the financial instruments business operator, appropriately and according to the rules, recognize it, take care of their customers, take emergency measures, analyze causes of the problem, implement measures to prevent a recurrence? Do above measures reported to the board of directors periodically?
- G. In case of problems occurred on information security related to computer system failures, accidents, crimes, etc. does the Financial Instruments Business Operator disclosed in a timely manner to customers, etc.? Are appropriate responses taken? Is there reporting to the board of directors, etc. at the time of occurrence and when timely? Also, is there appropriate reporting to the relevant authorities?
- (ii) Operation of computer systems and development of a maintenance system
- A. Does the manager of the IT management division recognize the types and natures of risks which may harm the operation of computer systems, and provide a management policy to prevent risks from coming into existence or to minimize influences from risks which were actualized, in order to enable computer systems that are used as business infrastructures to operate in a safe and stable manner?
- B. Does the manager of the IT management division determine the security

management criteria based on the above-mentioned management policy, regularly inspect computer systems from the viewpoint of preventive maintenance, and retain its records?

C. Does the manager of the IT management division control a management system to prevent actualizing of risk, such as clarifying the roles and responsibilities of the IT management division based on the above-mentioned management policy, and establishing the system of checks and balances between persons in charge of operating and developing of computer systems, and appointing personnel with necessary expertise and skills concerning hardware, software, data and networks, etc. as security administrators? In the absence of appropriate personnel, has he/she put in place an effective control on computer system, taking such measures as using external experts?

D. Concerning to operating environment of computer systems including capacities and processing capabilities, etc. necessary for security management, does the financial instruments business operator develop internal rules and manuals which clarify items and procedures to check the environment and to handle with problems? Are the rules and manuals appropriately reviewed to secure their effectiveness?

E. Are inspections for security management regularly (annually, quarterly, monthly, daily, etc.) implemented based on the internal rules and manuals, etc.? Are such measures taken as storing records on the conditions of inspections and their results for later verification of their contents?

(iii) Planning of computer systems and provision for development management system

A. In planning computer systems, is the purpose of usage for computer systems clarified based on the business plan and the basic policy of the organization?

B. Is the plan for computer systems approved in accordance with the organizational decision-making procedures in the Board of Directors, etc.? For receiving approval, is information required to make this decision clearly indicated, including prospective effects, the time period of introduction, risks associated with introduction and necessary resources (the amount of investment and organizational systems, etc.). Additionally, are procedures taken to enable the Board of Directors, etc. to have sufficient understanding and conduct the necessary discussion and consideration?

C. Is there a system for promoting safety measures in which not only the divisions that design and develop the computer systems but also the divisions that will use them participate? Do personnel who have expertise and skills concerning computer systems and those who are familiar with the business operations to be computerized also participate in said system? In the absence of the appropriate personnel, are such

- measures taken as using external experts to have the effective system put in place?
- D. Are divisions that will use the computer systems involved in confirmation and decision of specifications for the computer systems, implementation of acceptance tests and verification? Also, when a computer system with large effects on customers and operations is migrated to production environment, does the Board of Directors, etc. decide under rational criteria, based on a migration plan, etc.?
  - E. Are the standards for output of computer systems decided from their planning and the development? In addition, are the methods, procedures and criteria to review that output documented as a development manual, and distributed to all concerned parties?
  - F. In planning computer systems, is the introduction plan considered in recognition of the effects of the introduction of computer systems on business so as not to bring about confusion after the introduction? Is the schedule of introduction reasonable without putting too much priority on sales performance? Furthermore, are operation and management also discussed?
  - G. Is there a system in which the status of development can be continually known by checking management items in the development process in consideration of the characteristics of the computer systems to be developed and the expected risks associated with the development? On the assumption that the recognized risks will be actualized, are review systems, decision-making procedures and other policies clarified to respond to such risks?
  - H. For designing computer systems, are the qualities which should be included clarified in consideration of the degree of importance in the assumed usage and business environment, as well as quality characteristics such as portability, reliability, efficiency, usability, availability of verification, ease of understanding, changeability and so forth? Additionally, are systems provided for the feasible development of this, in ways such as considering measures to ensure these qualities?
  - I. For adopting new technologies, are the results of adoption and its concerned risks recognized? As for technologies which have entered a phase of steady diffusion, are the support periods for the vendors which delivered the computer systems and the risk of obsolescence taken into account?
  - J. Is there an established system under which the reporting system relating to the progress of development and budget and the qualities in each process is defined in order to collect appropriate information and make the necessary responses?

#### (4) System Integration

- (i) Does the Board of Directors, etc. sufficiently recognize the risks of system integration, develop management system for those risks, and disseminate the necessary information to all officers and employees?
- (ii) Is there a test system? Is the test plan suited to the system integration's developed contents?
- (iii) Even in cases of outsourcing operations, is there an established system in which the company itself is involved?
- (iv) Is assessment of computer systems by external auditors and other experts used to judge important items concerning system integration?
- (v) Has a contingency plan been developed to respond to unexpected occurrences?

#### (5) Responses at the Time of System Failures

- (i) In preparation for the occurrence of system failures, are procedures and measures for recovery standardized, aiming at quick recovery from the viewpoint of the protection of public interests and investors? Is training for continuing business and conducting system recovery implemented on the assumption that system failures, etc. will occur, in order to make said procedures and measures effective?
- (ii) Are personnel familiar with computer systems fostered in order to enable appropriate and quick responses at the time of system failures? In addition, are the necessary means of communication secured?
- (iii) In addition to the scope of information disclosure and its criteria, are other necessary procedures and processes decided so as not to cause unnecessary confusion among right holders at the time of system failures, etc.?
- (iv) In the absence of personnel familiar with computer systems in the company, are appropriate measures taken, for example by concluding the necessary maintenance contracts with the vendors who delivered the computer systems?
- (v) Does the business operator make efforts to prevent the reoccurrence of system failures by taking measures for fundamental improvements? For that purpose, does it record the details of system failures, investigate their fundamental causes and consider countermeasures regularly or as needed in cooperation with the vendors who delivered the computer systems and other experts? Furthermore, does the financial instruments business operators execute measures to prevent recurrence, taking into account analysis of the overall occurrence situation and causes, etc.?
- (vi) Is there a system for quickly reporting the occurrence of system failures, recovery, or the investigation of their causes, etc. to the relevant authorities?

## (6) Contingency Plan

- (i) On the assumption that system failures will occur, is the order of priority decided for all business operations in consideration of the necessity and the urgency of recovery? Are the target time, procedures and measures for recovery also clearly indicated, corresponding to levels and causes of failures, etc.? Also, are there specific response procedures and measures for cyber attacks, etc. including reporting to the relevant authorities and cooperation with related institutions, based on the established system to accurately understand the situation, and to prevent expansion of damage by the attack?
- (ii) Are the definitions of emergency situations, procedures for decision making, and the responsibility and roles, etc. of a substitute person in the absence of a person with decision-making authority clarified?
- (iii) Is the effectiveness of the contingency plan verified by regularly conducting drills on the assumption that system failures will occur?
- (iv) Is the contingency plan appropriately reviewed to reflect changes in the company's surrounding environment, organizational changes, and transfer of personnel?
- (v) Are procedures and means decided to disclose information to customers at the time of emergency?
- (vi) Are methods and procedures to confirm the safety of officers and employees formulated in consideration of wide-area disasters such as large scale earthquakes? Is a way of continuing business even if office facilities are not available taken into account?

## (7) Management of Outsourcing

- (i) Management system pertaining to outsourcing
  - A. Are the purposes and effects of outsourcing clarified?
  - B. Are the necessary measures also considered, in recognition of the risks associated with outsourcing?
  - C. Are the operations to be outsourced, the roles and responsibility of the company, and the responsible department and the manager to respond to such risks defined?
- (ii) Criteria to evaluate contractors and regular evaluation
  - A. Have the criteria for selecting outsourcing contractors been decided? Are contractors selected based on the criteria of risk management?
  - B. Have the criteria for evaluating contractors been decided? Are contractors evaluated based on these criteria from the viewpoint of risk management? Additionally, when problems are detected through analysis of the details of commissioned business, are



the necessary actions taken?

(iii) Contracts with outsourcing contractors

In the contract, are the preservation of confidentiality, clauses for reconignment, the authority for auditing, the level of services, and dispute-settlement procedures clearly defined in recognition of risks associated with outsourcing?

(iv) Management of outsourced operations

- A. Does the business operator implement measures to prevent accidents and unfair acts by outsourcing contractors and to preserve confidentiality, and take necessary actions?
- B. As for outsourcing related to operation and maintenance, does the company confirm that the level of services specified in a contract is maintained?
- C. As for outsourcing related to development:
  - a. Are the required specifications approved by divisions that will use the systems clearly defined in writing, and presented to the outsourcing contractors?
  - b. Are necessary measures taken to know the quality and follow the progress?
  - c. Do divisions that will use the systems participate in acceptance inspections and define the inspection's conditions to confirm the quality?

(8) System Audit

(i) Implementation of System Audit

- A. Is there an established internal audit division which is independent from the systems division? In addition, are system audits periodically implemented by personnel in charge of audits who are familiar with computer systems?
- B. In the absence of personnel in charge of audits who are familiar with computer systems in the corporate organization, are system audits implemented in ways such as using external experts? Even for cases in which external experts are used, is there an auditing system in which problems related to system risks recognized by the company can be identified, for the purpose of achieving continuous improvement?
- C. Have priority items for audits and an audit plan been decided based on the system risks recognized by the company? Subsequently, is the appropriate audit implemented in accordance with said items and plan?
- D. Does the company formulate the criteria concerning system audits, establish auditing methods corresponding to the types and nature of system risks recognized by the company, and conduct effective audits?
- E. Does the audit cover all business operations related to the system risks recognized by the company? Is the company's possible failure to be aware of risks investigated?

Furthermore, is there a system in which results of audits can be quickly reported to the Board of Directors, etc.?

(ii) Correction of problems

Does the Board of Directors, etc. decide the policy for response to problems which were acknowledged in reports on the results of audits, make decisions necessary for correction, and issue necessary instructions to the relevant departments? Also, does the internal audit division appropriately review the progress of improvement and reflect it in the subsequent internal audit plan, and reported to the Board of Directors, etc.?

## 5. Investment Risk Management System

(1) Awareness and Roles of Directors, etc.

- (i) Do directors, etc. recognize the significance of securing the best practices in relation to management of investment assets from the viewpoint of fiduciary responsibility?
- (ii) Does the director in charge understand the location and types of risks involved in asset management and methods for measuring, monitoring and managing various risks, and recognize the importance of risk management?
- (iii) Does the Board of Directors, etc. determine the investment policy in relation to investment assets based on risk tolerance and features of investment assets, their own investment capacity and risk management ability, etc.?
- (iv) Does the Board of Directors, etc. determine the goals of investment based on the investment policy for investment assets?
- (v) Has the Board of Directors, etc. developed a system for managing investment risks in accordance with the determined investment policy for investment assets and the goals of investment, etc.?
- (vi) Is a checks-and-balances function ensured in ways, for example, such as establishing the division which manages investment risks as independent from the investment division and the management division?
- (vii) Does the Board of Directors, etc. regularly receive reports on the best practices concerning asset management and risks, and take measures to utilize obtained information on risks for executing business and developing management systems?
- (viii) For introducing a new investment method, does the Board of Directors, etc. consider its appropriateness taking into account the investment policy, features and risk tolerance of invested assets and risk management methods?

(ix) Has the Board of Directors, etc. established the investment risk management division to appropriately manage the examination, monitoring and analysis of investment, and clearly defined its authority and responsibility? Is there an established system that may hinder independence such as by a director in charge of the investment risk management division concurrently serving in the investment division? For cases in which the investment risk management division cannot be independent from the investment division and in which the director in charge of the investment risk management division is forced to concurrently serve as director of the investment division, is the form of its system sufficiently reasonable? In addition, is the checks-and-balances function for conducting appropriate risk management working?

**[Real Estate Investment Funds, etc.]**

(x) Do the board of directors and the manager of the investment risk management division understand that real estate investment involves the following risks?

A. Risks pertaining to the design of financial instruments

- a. Risks concerning selection of real estate in which to invest (regional distribution, concentration of tenants and lending a whole building)
- b. Risks of bankruptcy of investment companies

B. Risks concerning stakeholders

- a. Risks concerning conflicts of interest, such as leasing, management, repair and so on of invested real estates
- b. Risks concerning the ability of a person who is entrusted with management of real estate in which investment is made
- c. Risks concerning bankruptcy of business partners of real estate in which investment is made

C. Risks concerning real estate

- a. Risks concerning liquidity of real estate
- b. Risks of changes in income from lease (change and moving out of tenants)
- c. Risks of changes in maintenance costs
- d. Risks concerning defects and flaws (with or without guarantee against defects, etc.)
- e. Risks in relation to rights and obligations (condo or sectional ownership, and tenancy, etc.)
- f. Risks concerning appraisal
- g. Risks of damage, loss or deterioration of buildings due to accidents and disasters
- h. Risks of changes in laws (projects of environment, architecture and city, etc.)

(2) Internal Rules

- (i) For investment of assets, does the manager of the investment risk management division provide the following internal rules to manage investment risks, receive approval from the Board of Directors, etc., and review these rules as needed?
- A. Internal rules concerning the limits of incorporated assets and loss control limits in accordance with features of investment assets
  - B. Internal rules concerning methods to manage various investment risks (measurement, monitoring and management)
  - C. Internal rules concerning bond lending, foreign exchange transactions, derivatives trading and the like
  - D. Internal rules concerning the risk management method for assets of which disposal is difficult due to their low liquidity and those for which market prices cannot be objectively calculated
  - E. Internal rules concerning items to be considered and approval procedures for cases in which a new investment method is introduced
  - F. Internal rules concerning investment risk management methods for cases in which investment is further outsourced
- (ii) Are the internal rules in relation to execution limits of derivatives transactions and an investment policy provided with approval from the Board of Directors, etc.? Are there systems for verification and reporting to the Board of Directors, etc. for cases of executing derivatives transactions?

**[Real Estate Investment Funds, etc.]**

- (iii) Does the manager of the investment risk management division provide clear internal rules for appropriate management of real estate investment risks based on the basic policy?
- (iv) Has the investment risk management division developed the rules for real estate investment risk management which specify the criteria of acquisition and sale and the examination procedures, etc. based on the basic policy, taking into account the profitability of investment (investment yields, etc.) and the qualification of investment (portfolios, due diligence, compliance, etc.) with approval from the Board of Directors, etc.? In addition, are these rules reviewed regularly and when needed?
- (v) For managing real estate, etc., has the investment risk management division developed rules for managing real estate investment risks which specify the following matters with approval from the Board of Directors, etc.? Does the division also review these rules as needed?
- A. Asset management plans for individual real estate investment funds, etc. in which

real estate evaluation methods, the criteria for replacement of real estate, and long-term repair plans for real estate are provided for

- B. The criteria for selection of real estate management companies
- C. The criteria for real estate lease agreements
- D. The criteria for placing orders for repair work of real estate, etc.
- E. The criteria for renewal of real estate insurance contracts

### (3) Comprehension of Investment Risks

- (i) Does the investment risk management division fully assess all risks involved in investment of assets?
- (ii) In cases where asset investment is re-entrusted, is the status of asset investment by the re-entrusted entity assessed?
- (iii) Does the investment risk management division clearly assess risks in relation to assets with market risks and credit risks?
- (iv) For risks assessment, are appropriate numerical values assessed by, for example, investigating and analyzing marketability, liquidity and rating, etc.?

#### **[Real Estate Investment Funds, etc. (due diligence of real estate, etc.)]**

- (v) Does the investment risk management division assess the appropriate value of LTV (Loan to Value) in real estate investment, etc.?
- (vi) Are results of prior investigations on details of real estate and risks based on that investigation sufficiently assessed?
- (vii) Are estimates of costs for various repair work and renewal investigated appropriately, and reflected in appraisal prices of real estate in consideration of the significant impacts on future cash flow?
- (viii) When the DCF method (the method to calculate the value based on cash flow) is adopted to evaluate real estate, are the following matters adequately confirmed? In addition, are records on confirmed matters stored?
  - A. The validity of applied values (in particular, ones based on future forecasts) and the grounds for decision
  - B. The validity and the grounds for decision of an entire scenario
  - C. Comparison between the results of applying the DCF method and other methods and means
- (ix) Does the investment risk management division assess PML (Probable Maximum Loss) presenting asset values of real estate against the risk of earthquakes with the Engineering Report (hereinafter referred to as the “ER”)?
- (x) With regard to the personnel who prepare the ER and real-estate appraisers, are third

parties ensured through selection on the basis of objective criteria?

(xi) Is necessary information provided to the personnel who prepare the ER and real-estate appraisers in recognition of the extreme importance of appropriately providing the information necessary for appraisal on request for the preparation of ERs and real-estate appraisal? Additionally, is the provision of information, etc. appropriately managed?

(xii) Upon accepting the ER which the business operator requested be prepared, is the ER confirmed from the following viewpoints, together with the required verification of the situation reflected in the provided information?

A. Are investigations on soil contamination and toxic substances carried out if necessary? Are their results secured by objective evidence?

B. With regard to the estimation of costs for various repair work and renewal for individual parts of buildings, is it confirmed for what kind of repair work the costs are calculated, and what kinds of evidence the calculation is based on?

C. Is the verification of legal compliance of investigated properties conducted in terms of not only laws but also ordinances such as district plans when necessary?

(xiii) Upon accepting the appraisal report from the real-estate appraiser whom the business operator requested to make the appraisal, is that report confirmed from the following viewpoints, together with the required verification of the situation reflected in the provided information?

A. Is the concept of the ER sufficiently being considered and reflected? Are reasons and grounds for failure to reflect some matters confirmed?

B. For cases using the DCF method, is the validity of revenues and expenditures in the future and the capacity operation rate, etc. verified with the estimation based on objective data? Furthermore, as for the estimation of underlying discount rates and terminal rates, is the validity of their levels verified?

C. Are matters which may have impacts on the liquidity of parcels of real estate themselves and cash flow created by real estate investigated if necessary?

(xiv) On deciding acquisition costs and selling prices without using contents stated in the ER and the appraisal report based on results of due diligence, is the validity of the adopted numerical values verified, and is that evidence recorded and stored?

#### (4) Funding Management Associated with Investment

(i) When funds are borrowed for the purpose of procuring cancel returns, etc. of investment funds, is the credit standing of a lender adequately considered? In addition,

on concluding a contract on borrowing, are the contents of the contract, such as the amount of money, interest rate, and period fully reviewed?

(ii) For managing investment funds:

A. is information such as rumors which may influence right holders' conduct, for example, cancellation of funds, conversion to cash and the like collected and analyzed? Are countermeasures against them also formulated?

B. are countermeasures (contingency plans) formulated to prepare for unexpected mass cancellation before maturity and conversion to cash, etc.? Are those measures reviewed in response to environmental changes?

(iii) Is funding management appropriately conducted so as not to be forced to raise funds at a high cost? In disposing of assets incorporated in funds, are liquidity risks managed to prevent a situation in which conversion to cash under disadvantageous conditions would cause a decrease in performance?

(iv) Do funding management personnel manage cash positions concerning investment assets on a day-to-day basis?

(v) In case of selling assets of the same stock in high volume at once, do funding management personnel recognize that significant market liquidity risks may be caused, and issue instructions to execute transactions taking in to account the influences of such risks?

(vi) Do funding management personnel accurately assess (or receive reports on) the market liquidity, and report it to the representative directors and the Board of Directors, etc. when necessary?

(5) Development of Management System

(i) Has the manager of the investment risk management division established methods for measurement, monitoring and management corresponding to risks, such as recognizing the importance of investment risk management and the location and types of investment risks? Has he/she also taken appropriate measures to enable other divisions to understand and recognize the contents of those methods?

(ii) Does the manager of the investment risk management division implement management based on the policies and internal rules for investment risk management?

(iii) Does the investment risk management division appropriately monitor and manage whether or not the investment division, etc. complies with the provided internal rules?

(iv) Does the investment risk management division report the status of risks to the

Board of Directors, etc. regularly and when needed without being influenced by the investment division, etc.?

- (v) In cases where it is necessary to hold a large amount of foreign currencies for investment, is appropriate management conducted taking into account exchange risks and costs?
- (vi) Does the business operator continuously assess the results of costs for executing transactions, and consider the minimization of such costs?
- (vii) Does the manager of the investment risk management division constantly analyze changes in market environment, reflect them in the methods for risk management, and appropriately report matters which may have impacts on management of investment assets to the Board of Directors, etc.?
- (viii) For managing investment risks, does the business operator not only focus on risks of individual assets and financial instruments composing investment assets, but also manage risks of an entire portfolio?
- (ix) For evaluating credit risks of securities, is information collected on not only pro forma standards for rating but also on changes in the business environments of issuers?

Additionally, is there a system in which quick responses are available for cases in which the securities are disqualified from being invested in? (Excluding investment with index)

- (x) For loans of securities and bond lending, are credit limits, transaction limits, acceptance of collateral and so on by a business partner provided for in internal rules and appropriately managed?
- (xi) When unexpected risks are actualized, is there a system in which quick responses are possible?
- (xii) Are appropriate market prices calculated based on laws and regulations, etc. and the “Accounting Standards for Financial Instruments” published by the Business Accounting Council, from the viewpoint of ensuring the objectivity of calculation of market prices?
- (xiii) Has the manager of the investment risk management division developed a system for confirming whether or not market prices are calculated in accordance with the internal rules? Are such market prices periodically verified and evaluated by internal audits, etc.?
- (xiv) With regards to assets for which market prices cannot be calculated in an objective manner, is the validity of holding such assets fully considered based on the investment policy, etc.?



**[Real Estate Investment Funds, etc.]**

(xv) In the examination of acquisition or sale of real estate, does the investment risk management division sufficiently consider compliance with the criteria for acquisition or sale and the validity of acquisition costs and selling prices?

**(6) Investment Risk Control**

(i) Are stocks composing a portfolio and tracking errors, etc. continuously checked?

(ii) Is the use of derivatives in accordance with the investment policy?

(iii) For conducting derivatives transactions, is appropriateness concerning contracts such as type, transaction volume, period, etc. checked for each business partner? For evaluating credit risks of business partners, does the business operator fully consider external information on ratings, etc., and when needed, review transaction limits, etc.?

(iv) Does the business operator clearly define certain evaluation criteria in relation to brokers' credit capacity, ability to execute transactions, administrative capabilities, ability for research and the like in the internal rules, and select brokers in accordance with said criteria? Does the business operator also periodically review the evaluation of brokers?

(v) Are entities which make business inquiries reviewed?

(vi) Are brokers selected in consideration of the following matters?

A. Is there a system in which massive buying and selling orders can be securely executed?

B. Can transactions be executed at the intended time and value?

C. Can off-hours trading and overseas trading be executed?

D. For cases in which mistakes in administrative processes and other problems occur, is there a system in which measures are quickly taken corresponding to each problem, in order to resolve them?

E. Is confidentiality ensured in relation to contents of transactions?

(vii) In concluding contracts, are legal checks by legal personnel or external experts, etc. conducted when needed?

(viii) Does the investment risk management division verify compliance with loss control limits and other internal rules on a day-to-day basis? In case of exceeding said limits, is it confirmed whether or not relevant procedures are appropriately implemented in accordance with the internal rules?

## 6. Group Risk Management

- (i) When the company falls under the category of a financial instrument business operator constituting a financial conglomerate, or the category of a member of a financial instrument business group which is developing business internationally, does the Board of Directors, etc. sufficiently recognize the impacts of other group companies' financial conditions on their own company? Do they also formulate methods for collecting necessary information and managing risks in the entire group?
- (ii) Even if the company does not fall under the category of a corporate group constituting a financial conglomerate, is there a system in which the risk management division understands and manages the types and levels of various risks existing in affiliated companies in a timely and appropriate manner, taking into account their impact on the company?
- (iii) For managing funding risks, are the management and checks-and-balances functions properly working, in such a way as to accurately recognize the impacts of the deterioration of funding situations in consolidated subsidiaries on the financial instruments business operator on the basis of the business contents of those subsidiaries?

## 7. Systems for Audit, etc.

- (i) Does the internal audit division confirm the guideline for implementation of self-inspections which was prepared by the sales division, etc.?
- (ii) Are self-inspections effectively implemented by the sales division, etc. based on the implementation guideline, etc.?
- (iii) Does the sales division, etc. report the results of self-inspections (including the frequency of mistakes in administrative processes, their severity, causes, improvement measures and results of improvement, etc.) to the internal control division, etc. regularly and as needed? Do they also provide a system in which problems which may have considerable impacts on business are reported to the Board of Directors, etc. as needed?
- (iv) Does the internal control division verify whether or not business is appropriately operated based on laws, investment trust conditions, the investment company code, operation plans and so on, and report the results of verification to the Board of Directors, etc.?

(v) Does the internal control division regard the highly objective calculation of market prices as a priority item of audit?

## **II-2-1. Business Operations / Common Inspection Items**

Inspection of actual business operations is executed to identify the characteristics and directions in the business operations of the financial instruments business operator and, at the same time, to determine whether operations are conducted in a manner befitting a major player on the financial instruments market and in compliance with laws and regulations, and to assess conditions for the purpose of uncovering and identifying fundamental issues and their causes.

### **1. Checklist for Matters Related to the Basic Business Stance**

(1) The following points will be examined in order to assess the actual conditions of business operation:

- (i) Does the business operator comply faithfully with laws and regulations?
- (ii) Is the business stance appropriate vis-à-vis the business organization, business policy, etc.?
- (iii) What are the problem areas in business activities and what are their causes? Regarding the causes of problems, is the actual state of systems of the business operator under inspection verified in order to assess and identify fundamental problems in business management?

(2) In checking the key points in the checklist, the following items are to be examined and used as reference in the inspection policy.

- (i) Are the type, scale and characteristics of the business operation, as well as its workflow, identified to examine, based on the findings, whether business operation is run in line with the business operator's management policy and other policies?
- (ii) Are numerical indicators showing characteristics and directions in business activity assessed to examine, based on the findings, what the business stance is of the business operator in question?
- (iii) Are the business policy and business promotion measures (such as specific business commands, business performance evaluation, etc.) appropriate?
- (iv) Do these deviate from or fail to be congruous with the actual state of business activity?

Moreover, are these the cause of problems related to the business stance?

(3) Based on investment relations promotion literature, sales planning data and business meeting minutes and other records, what business activities are being conducted?

## 2. Internal Control

### (1) Verification of Basic Matters

- (i) Do items shown in the registration form and accompanying documents match the actual state of operation of the financial instruments business operator?
- (ii) Are reports to administrative authorities, such as reports of changes in business operation, etc., being submitted correctly and appropriately? Also, are there errors in the submitted information?
- (iii) Are employees who have been transferred to other companies within the corporate group made to continue performing their duties previously done at the business operator?
- (iv) Are documents related to the business operation and other substantiating documents, such as business transaction records, etc., being produced and stored appropriately, in compliance with internal rules and with laws and regulations?
- (v) Are payments to customers resulting from errors in administrative process, etc. that are charged against revenues processed appropriately? Are customer losses being inappropriately covered and compensated with other expense items, etc.?
- (vi) Is employment in managerial or other important posts conducted with appropriate study into the background of the person in question and with checks to confirm that conditions for registration rejection specified in laws and regulations do not apply?
- (vii) Do the personnel in charge of internal control make active use of transaction records, contracts and other documents related to business operation appropriately to conduct daily verification of business activities?
- (viii) Are procedures for obtaining approval and licensing executed pursuant to laws and regulations?
- (ix) Are signs posted at each place of business or office in locations clearly visible to the public? Moreover, do all places of business or offices comply with laws and regulations and have explanatory literature available for viewing by the public?

### (2) Verification of Solicitation

- (i) Does the business operator commit unfair or illegal acts during solicitation, such as providing false information or failing to provide necessary information?
- (ii) Does the business operator issue arbitrary judgments on uncertain issues or information that may mislead the customer to believe its veracity?
- (iii) Does the business operator delegate customer solicitations to third parties other

than those serving as intermediaries or agents for the business operation, in non-compliance with laws and regulations?

- (iv) Does the business operator use descriptions or expressions that are either misleading or contrary to the facts regarding the description of method of business operation, including the financial strength and credit standing, of the financial instruments business operator?
- (v) Does the business operator offer promises of special benefits, such as total or partial coverage of losses sustained by the customer or provision of property-related benefits?

### (3) Issue of Written Documents

- (i) Does the business operator issue appropriate written documents pursuant to the Financial Instruments and Exchange Act prior to conclusion of contracts with its customers? (Pre-Contract Documents)
- (ii) Upon issue of pre-contract documents, does the business operator provide explanation regarding items found in said documents to the customer in question, with attention to the extent of knowledge of said customer and in accordance with the objective of concluding a contract?
- (iii) When intending to conclude a sales contract on interests in a collective investment scheme other than a fund which mainly invests in securities or derivative transactions (business fund), does the business operator appropriately verify the status of separate management between customers' assets and the funds' own assets? Does the business operator provide pre-contract documents that specify the location of the separated account of customers' assets, the status of separate management between customers' assets and the funds' own assets, and the method of confirming that status, to customers?
- (iv) Does the business operator issue appropriate written documents pursuant to the Financial Instruments and Exchange Act at conclusion of contract with the customer?
- (v) Does the business operator appropriately keep records of the written documents issued to customers, pursuant to the Financial Instruments and Exchange Act, as well as copies of the issued documents?
- (vi) If the business operator receives an application for a contract for a financial instruments transaction from a professional investor (excluding qualified institutional investors, the State and Bank of Japan) and if a contract belonging to the category of the contract necessary for the financial instruments transaction in question had not been concluded in the past, does said operator notify said professional investor that

the investor may request to be deemed an ordinary customer?

- (vii) Does the business operator approve said request by a professional investor (excluding qualified institutional investors, the Government, and the Bank of Japan) deemed an ordinary customer prior to either soliciting the conclusion of a contract for a financial instruments transaction or prior to concluding such a contract?

Furthermore, does the financial instruments business operator comply with laws and regulations for deeming a professional investor (excluding qualified institutional investors, the Government, and the Bank of Japan) an ordinary investor for the type of contract in which the requested contract belongs, when either soliciting to conclude or concluding the said contract?

- (viii) If a business operator receives and approves a request from an incorporated entity (excluding professional investors) to deem the entity a professional investor, does said operator obtain written consent in advance from said entity?

Furthermore, does the financial instruments business operator comply with laws and regulations on the deadlines for deeming an incorporated entity (excluding professional investors) a professional investor and on the type of contract in which the requested contract belongs when either soliciting to conclude or concluding the said contract?

- (ix) If a business operator receives and accepts a request from a private individual to deem said individual a professional investor, does the operator issue written documents showing the information specified in the Financial Instruments and Exchange Act and confirm that said individual meets the requirements?

Furthermore, does the financial instruments business operator comply with laws and regulations on the deadlines for deeming a private individual as a professional investor and on the type of contract in which the contract pertaining to the application belongs, when either soliciting to conclude or concluding the said contract?

- (x) Does the business operator appropriately notify its customers, in advance and in writing, prior to the allotment of new shares, etc. that in cases where an investor has conducted short selling during the period between the announcement of capital increase and the decision of the issue price of the new shares, etc., the borrowing position concerning the short selling shall not be settled by the new shares, etc. which the relevant investor acquired in accordance with the capital increase?

- (xi) Does the business operator explain the financial ADR system in issuing pre-contract documents?

In addition, does the business operator provide sincere support in cases where a complaint has been made by a customer, and does it take appropriate measures by

explaining the financial ADR system again in cases where a customer's understanding cannot be acquired or where it is difficult to determine the amount of damages, through dialogue between the parties?

(4) Inspection of Advertising, etc.

(i) Does advertising show the registered trade name, name and registration number of the financial instruments business operator, as well as important matters that are likely to impact customers' judgment?

(ii) Does information shown in advertising comply with laws and regulations, not making any indications that are significantly contradictory to facts or seriously misleading?

(iii) Is information provided to the customer inspected by the personnel in charge of inspecting advertisements or the division in charge of legal affairs for appropriateness of content? Furthermore, is the content of advertising impartial, pertinent and based on accurate information?

(iv) Is information provided to the customer stored for verification on a later date? For example, is information transmitted by e-mail or posted on webpages stored appropriately?

### 3. Management of Customer Information

(i) Is information related to customer transactions managed appropriately?

(ii) Is customer information managed centrally through the relevant business division, with measures implemented to prevent information leakage or misuse through access control and other restrictions, and are the conditions of information use examined and verified?

(iii) When customer information is used for purposes exceeding the initial objectives of use or when provided to any third party, is written customer consent obtained? Also, is said written consent stored appropriately?

(iv) Is confidential and financial customer information, as well as customers' personal information as private individuals, handled with caution and under strict control?

Is confidential information acquired, used or provided to a third party other than when authorized by law?

(v) If personal information is obtained, is the individual in question notified promptly of the purpose of use of that information or are announcements to this effect made on



- websites and other media, for instances in which the purpose of use of personal information has not been announced publicly in advance?
- (vi) Are contracts concluded with each employee (including officers, part-time workers and temporary workers) to prohibit disclosure of personal information obtained in the course of duty to any third party or use of such information for purposes other than the prescribed objective of use, both during employment and after severance?
  - (vii) If complaints are received regarding the use of personal information, is the nature of the complaint investigated within a rational length of time for prompt and appropriate handling of the problem?
  - (viii) In case of leakage of personal information or other incidents, are the following measures implemented?
    - A. Prompt notification of the individual involved regarding the facts related to the incident
    - B. Report of the incident to the internal control division and board of directors and other management bodies
    - C. Immediate report to the administrative authorities
    - D. Immediate announcement of the facts and prevention measures and other action to be taken, executed from the perspective of preventing secondary damages
  - (iv) Do the internal control division and other divisions of the business operator monitor financial instruments intermediary service providers and other outside contractors' execution of appropriate customer information management and take appropriate measures in case of disclosure or leakage of customer information?

#### 4. Verification at the Time of Transaction

- (i) Is the customer management system developed adequately, such as by implementing thorough verification at the time of transaction, in order to take appropriate action against involvement in terrorist funds and to prevent money laundering?
- (ii) Is a system of reporting, such as establishment of a division to supervise customer management, established and in place?
- (iii) Are the following items taken into account in implementing verification at the time of transaction?
  - A. When implementing verification at the time of transaction for an incorporated entity, are the identification matters of the officer in charge of corporate transactions verified?

- B. In transactions through a representative, are the identification matters of the representative verified in addition to implementing verification at the time of transaction for the customer?
- C. In order to confirm whether there are transactions for which there is an especially strong necessity for conducting rigid customer management as mentioned below, is the verification conducted appropriately, for example, by checking periodically whether the same telephone number or e-mail address is used by several customers or not?
- a. A transaction in the case where a counterparty to the transaction is suspected of impersonating a customer, etc., or representative, etc., for whom related verification at the time of the transaction is conducted.
  - b. A transaction with a customer, etc., who is suspected of having falsified matters subject to related verification at the time of transaction when such verification has been made.
  - c. A transaction, etc., with a customer, etc., who resides or is located in a country or region in which the establishment of a system to prevent the transfer or criminal proceeds (as specified under Article 12.2 of the Order for Enforcement of the Act on Prevention of Transfer of Criminal Proceeds) is not considered sufficient.
- D. When conducting transactions for which there is especially a strong necessity for conducting rigid customer management as mentioned below, whether (re-)verification at the time of transaction is made in a proper manner, for example, a customer's identification matters are verified not only in a normal way but also in a more rigid way in which customer identification documents or supplementary documents are additionally received. When verification of the status of assets and income is obligated, whether such verification is made in a proper manner.
- E. Even if the verification at the time of transaction is completed by the head office or branch office, subsidiary or corporate group member company located overseas, is verification at the time of transaction executed as prescribed under laws and regulations for opening an account in Japan?
- (iv) Is verification at the time of transaction executed through methods that comply with laws and regulations, such as by employing registered mail and other nontransferable mail?
  - (v) Is the customer management method made known and passed among employees and other personnel? Are measures implemented, such as production and distribution of a manual to employees or training programs organized on a regular basis?
  - (vi) Are records related to verification at the time of transaction for customers and

records of transactions with the customer produced promptly and stored appropriately for the length of time prescribed by laws and regulations?

- (vii) Has the executive officer or other managerial employee set up a division or appointed personnel to take charge of suspicious transactions and created a management system for accurate reporting of suspicious transactions?
  - (viii) Has the division or personnel in charge of suspicious transactions created a reporting system, based on the production of manuals and other documents and with a precise understanding of the scope of criminal proceeds prescribed in the "Law for Prevention of Transfer of Criminal Proceeds", and has it made efforts to disseminate this information to executive officers, such as by presenting cases classified as suspicious transactions?
  - (iv) Does the division or personnel in charge of suspicious transactions promptly report information on cases related to suspicious transactions received from executive officers to the administrative authorities?
  - (x) Does the supervisory division for customer management execute ex-post facto verification to make sure there are no omissions in the reporting of suspicious transactions to the administrative authorities?
  - (xi) If the division or personnel in charge of suspicious transactions believe that a transaction is suspicious, is action taken promptly and appropriately as needed, to keep the customer in question and other related parties unaware that the transaction and the account in question have been reported and disclosed to administrative authorities?
  - (xii) Is internal audit executed on a regular basis to determine the business operator's customer management system?
  - (xiii) Whether overseas offices (branches, subsidiaries, etc.) have a control environment for properly implementing countermeasures against terrorism financing and money laundering.
    - A. Whether overseas offices make efforts to properly implement countermeasures against terrorism financing and money laundering at the same level as in Japan to the extent permitted by applicable local laws and regulations, etc.
- (Note) In particular, overseas offices located in countries or regions where the FATF Recommendations are not applied or not fully applied must know that they are required to take countermeasures at the same level as in Japan.
- B. If the local obligation to implement countermeasures against terrorism financing and money laundering is stricter than in Japan, whether overseas offices make efforts to implement such stricter local countermeasures.

C. If overseas offices cannot implement appropriate countermeasures against terrorism financing and money laundering at the same level as in Japan because such countermeasures are prohibited by local applicable laws and regulations, etc., whether overseas offices make efforts to immediately provide information on the following to the Financial Services Agency or the Local Finance Bureau that has jurisdiction over the region where the head office is located:

- The country or region concerned;
- Specific reasons for the inability to implement appropriate countermeasures against terrorism financing or money laundering;
- If alternative measures are taken to prevent use for terrorism financing or money laundering, the particulars thereof.

#### 5. Handling of Antisocial Forces

- (i) Does the business operator have a division in charge of supervising responses to ban any relationship with anti-social forces (hereinafter referred to as the "anti-social forces response division) so as to develop a centralized control environment for preventing anti-social forces from inflicting damage, and is this division properly functioning?
- (ii) Does the anti-social force response division take measures to ban any relations with anti-social forces by, for example, developing a manual for dealing with anti-social forces, providing ongoing training, fostering cooperative relationships with external expert organizations such as the police, the National Center for the Elimination of Boryokudan, lawyers (hereinafter referred to as "external expert organizations") on an ongoing basis?
- (iii) Does the anti-social force response division actively collect and analyse information on anti-social forces, and share the information within the group while making active use of external expert organizations. In addition, does the division appropriately develop a database to manage such information in a centralized manner and update it (i.e., addition, deletion or change of information in the database)?
- (iv) Does the business operator ban allowing anti-social forces to become a counterparty to a transaction by conducting appropriate advance screening using information on such forces and make sure provisions regarding the exclusion of "boryokudan" crime syndicates are introduced in all contracts and terms of transactions?
- (v) Does the business operator organize a structure to conduct an appropriate follow-up

review on existing contracts?

(vi) Does the business operator take measures to terminate transactions with anti-social forces as follows?

A. Establishing a system under which information confirming the existence of a transaction with anti-social forces is swiftly and appropriately reported to the management, including directors, etc., via the anti-social forces response division, and have the operator respond to the situation under appropriate directions and involvement by the management.

B. Communicating regularly with external expert organizations and promoting efforts to eliminate any transactions with anti-social forces.

C. Taking measures to prevent the provision of benefits to anti-social forces, such as terminating relationships with such forces when the business operator learns through a follow-up review after initiating transaction that the counterparty is a member of an anti-social force.

D. Developing a structure to prevent providing funds or engaging in inappropriate or unusual transactions for whatever reason if the counterparty has been found to be an anti-social force.

(vii) In case anti-social forces make unreasonable demands, does the operator have a system under which the information is swiftly and appropriately reported to the management, including directors, etc., via the anti-social forces response division, and does the operator respond to the situation under appropriate directions and involvement by the management? In addition, does the operator actively consult external expert organizations?

## **II-2-2. Business Operations / Type I Financial Instruments Business Operators**

Inspection of actual business operations of a Type I financial instruments business is executed to evaluate whether such a financial instruments business, which provides customers with stocks and other readily marketable, highly liquid securities, as well as with high-risk financial instruments such as market transactions of derivatives, and which at the same time is entrusted with deposits of money or securities from the customers, is fulfilling its duties and roles appropriately, in order to make a thorough investigation into violations of laws and regulations and to foster the protection of investors and the public interest.

### **1. Business Stance and Other Matters**

#### **(1) Principle of Suitability**

(i) Are investment solicitations to customers conducted by sales personnel from the perspective of investor protection, including careful attention to the attributes and investment objectives of the customer?

(ii) Are customer attributes, such as the investment inclinations and experience of the customer, managed and kept appropriately in customer cards and other documents?

Does the business operator make efforts to conduct investment solicitation in an appropriate manner suited to customer attributes, such as by identifying changes in the customer's investment objectives and inclinations, and when the details of such changes have been confirmed by the customer, making changes to the registered details on the customer card, etc. in a timely manner and sharing the changed details with the customer?

(iii) Is the customer solicited to invest in products that do not suit the investment inclinations and the characteristics of said customer's funds? For instance, is the customer solicited to make transactions aimed at short-term capital gain (high-risk investments) when the customer is seeking stable yields, such as revenue from retirement funds?

Is sales management conducted carefully by adopting a system of management approval when selling high-risk instruments, such as multi-currency funds, to customers who value the safety of principal?

(iv) Are solicitations conducted frequently and consecutively to a customer who does not possess additional funds?

(v) Are complex products being offered to customers with little investment experience?

## (2) The State of Solicitation

- (i) Are customers given an explanation of a product (its basic characteristics, description of risks and others) that will allow them to gain adequate understanding of the product? For example, does the business operator have reference materials ready to provide adequate explanation of the characteristics of the product, as well as the terms of transaction, when soliciting a customer to make an investment? Or, has the operator produced materials that show a number of products to enable the customer to make choices?
- (ii) Does the business operator emphasize only the benefits of investment and provide inadequate explanation of the disadvantages, such as risks?
- (iii) Does the business operator solicit customers to switch from one type of investment to another that is not beneficial in terms of the cost incurred in switching investments?
- (iv) Is the reason for recommendation arbitrary or subjective by nature?
- (v) In cases where a sudden change in market trends or an event having a material impact on markets has had a serious impact on the net asset value of an investment trust, does the business operator make efforts to provide information to customers in a timely and appropriate manner, and provide them with careful support for their investment decisions?
- (vi) Are there other inadequacies in explanations regarding matters that are vital to making investment decisions?
- (vii) Is a customer solicited to invest by offering the customer information related to business enterprises?
- (viii) When receiving an order from a customer for transactions of securities or for over-the-counter transactions of derivatives, does the business operator present the conditions of transaction to the customer explicitly and in advance?
- (ix) In conducting transactions with a customer, does the business operator provide adequate and appropriate explanation regarding the product and check, for example, the receipt of a written statement from the customer acknowledging that explanation was received?
- (x) Does the business operator offer a customer benefits related to property or make a third party provide such benefits, in order to provide additional benefits or to compensate for losses?
- (xi) Does the business operator engage in transactions that lack economic rationality or in solicitation activities that violate laws and regulations?

### (3) Solicitation Materials

- (i) In soliciting investment by customers, does the business operator issue the explanatory materials that are required to be issued under the Financial Instruments and Exchange Act and do so in compliance with the rules? Are explanations given without any misleading or false impressions?
- (ii) Upon issue of explanatory materials to the customer as required under the Financial Instruments and Exchange Act, does the business operator check to ensure that there are no omissions, by cross-checking against the material issue ledger?
- (iii) Does the business operator avoid infringement of laws and regulations by sending disclosure materials to the customer by post or other means and re-sending said materials without delay if they are found not to have arrived at the customer's contact address?
- (iv) Are the following matters taken into account, especially regarding prospectuses?
  - A. Does the business operator solicit customers by using a prospectus before the securities registration statement takes effect? (A preliminary offering circular may be used.)
  - B. When using a preliminary offering circular in solicitation, does the business operator understand that there is a lapse in time before the securities registration statement takes effect?
  - C. When a transaction is concluded, is the prospectus issued before the purchase of securities by the customer, even when a preliminary offering circular has been used in solicitation? If it is to be sent by post, is it sent in time to arrive at the location of the customer before purchase takes place?
  - D. In case the prospectus is issued by employing an electronic data processing system, does the issue satisfy the requirements specified by laws and regulations?
  - E. If a customer requests issue of a prospectus, is it issued appropriately?
- (v) Can false or misleading descriptions be found in the investment solicitation materials? For example, is information in the materials arbitrary in its description? Also, do personnel in charge of internal control conduct inspection adequately?
- (vi) When soliciting qualified institutional investors, are documents regarding restriction on resale and other matters issued to such investors?

### (4) Customer Care

- (i) Does the business operator conduct business in good faith and with fairness to the customer?
- (ii) In case of an accident such as an error in administrative processes, is the customer



informed of the fact accurately, and is appropriate action taken promptly to restore or revise the transaction properly, along with an effort to prevent problems?

(5) Measures to prevent adverse effects

- (i) In transactions with a parent juridical person or subsidiary juridical person, is transaction conducted under terms that differ from those of a regular transaction?
- (ii) When soliciting a customer who has been granted credit from a parent juridical person or subsidiary juridical person on condition that a transaction is conducted, is solicitation done with awareness of this fact?
- (iii) Does the business operator subscribe to securities of an issuing company that has liabilities owed to the parent juridical person or subsidiary juridical person? Are procured funds appropriated for repayment to the parent juridical person or subsidiary juridical person? When soliciting customer investment, is the customer solicited to invest with the business operator's knowledge of these facts but without informing the customer?
- (iv) Whether non-public information pertaining to an issuer, etc. is exchanged with a parent juridical person, etc., or with subsidiary juridical persons, etc. (excluding cases where the issuer, etc. has agreed in writing, and other cases in which it is allowed by applicable laws and regulations) and when non-public information pertaining to a corporate customer is exchanged with a parent juridical person, etc., or with subsidiary juridical persons, etc. ensuring the provision of an opportunity for the corporate customer to opt-out (i.e., after receiving notification in advance that non-public information will be shared, if the corporate customer does not wish the information to be shared, then the corporate customer requests that the information will not be supplied to a parent juridical person, etc., or subsidiary juridical persons, etc. The same shall apply hereafter.) Whether an opportunity for the corporate customer to determine whether to opt-out or not is properly provided by taking such measures as listed below:
  - A. Adopt means to ensure that the corporate customer can clearly recognize the opportunity to opt-out, including the notification in writing of this opt out opportunity.
  - B. Provide in the notification of the opt out opportunity the explicit information necessary for the corporate customer to determine whether to opt out or not, including the provision of information such as both the scope of the parent juridical person and the subsidiary juridical persons with whom non-public information is exchanged and the purposes of the use of non-public information by recipients.

- (v) Has the business operator done anything else that violates regulations on preventive measures against adverse effects specified in laws and regulations?

## 2. Stock Sales

### (1) The State of Transaction Execution

- (i) Are there transactions that may be perceived as problematic in terms of price formation? For example, are market prices affected by a high level of trading? Is price formation affected by continuous pyramiding or bear raids? Are closing prices being manipulated? Are there other transactions recognized to be indicative of market manipulation?
- (ii) Are problems found in the relationship between customer transaction and personal trading by the sales personnel?
- (iii) Are there any suspicious deposits, withdrawals or other movement of securities or money?
- (iv) Are transactions conducted in compliance with a policy established in advance and in ways that are deemed the best possible?
- (v) Are reports of short selling at the exchanges executed appropriately? Are there omissions in reports and applications? Are transactions conducted in compliance with laws and regulations, especially regarding sales on loan stocks and the sale of more than 50 units of shares?
- (vi) Does the short selling price violate laws and regulations?
- (vii) Are there transactions conducted by using information from connections with privately held incorporated entities or special information obtained in the course of duty?
- (viii) Are there transactions conducted based on the account of a customer without the said customer's consent?
- (ix) Are transactions employing net settlement in violation of laws and regulations tolerated?
- (x) Are there other transactions regarding stock trading conducted in violation of laws and regulations?

### (2) Across-the-board, Intensive Sales

In order to identify stocks that are characterized by high trading volume by the operator and that are intensely purchased by specific sales organizations, blocs or by

all business offices and to inspect for evidence of across-the-board and excessive solicitations to a large number of customers in a way that is likely to affect fair price formation for specific stocks, the following matters are to be verified:

- (i) Are there stocks that are being sold or bought intensively by specific business offices or sales personnel? In such a case, what kinds of investment solicitations are being executed?
- (ii) How are decisions made on stocks recommended at the head office or other business offices? What solicitation materials are being produced for them?
- (iii) Are problems found in the reasons for recommendation?
- (iv) Are intensive sales organized to get rid of stocks held by specific customers or the operator's own account?
- (v) Is there any instance of orders having identical placement time and terms?
- (vi) Is there any transaction in which order time and agreement time are reverse in order, making it a purchase that was based on pending sales?
- (vii) After receiving a purchase order from a customer, does the operator solicit said customer to sell stocks held by the customer?
- (viii) Is there inordinate concentration of third-party payments to cover purchases or shortfalls in guaranteed deposits for specific stocks? Also, to what extent have improvements been made?
- (ix) Are there instances of specific stocks being purchased for a number of customers, followed by offsetting trade resulting in losses in a short period of time and later switching to other specific stocks?
- (x) Are there concentrations of agreement modification, agreement rejection, etc., on specific stocks?

### (3) Excessive Trading and Other Matters

Based on materials on internal control and major accounts, transactions of inordinate frequency or excessive volume vis-à-vis the customer fund capacity and customers with peculiarities vis-à-vis their respective fund characteristics and customer attributes are to be selected and verified regarding the following matters:

- (i) Have there been excessive solicitations to the customer, overlooking a customer's fund capacity and fund attributes?
- (ii) Are there suspicious transactions in terms of a customer's fund attributes and transaction flow?
- (iii) Are there suspicious transactions in terms of order time, with attention to customer attributes?

- (iv) Are there peculiarities in the state of transactions for specific stocks? Are there transactions that appear to be aimed at churning? Is there deliberate price formation activity? In such cases, what kind of investment solicitation is being executed?
- (v) What is the ratio of trade volume for customers engaged in frequent trading, compared to trading volume for the business office or the sales personnel?
- (vi) Is there a trend of dependence on trading by specific customers? Are there transactions that are unauthorized or transactions by sales personnel disguised as conducted for customers?
- (vii) In case of trading loss (valuation loss) resulting from churning, does the customer approve of the trade results? Moreover, are there disputes with customers?
- (viii) Are there third-party payments to specific customers or noticeable shortfalls in guaranteed deposits for credit transactions or in guaranteed deposit levels?
- (ix) Does a single person receive orders from a number of customers at an identical time? Are there signs of artificiality in agreement conclusions in terms of order time?
- (x) Are there signs of synchronous action in stocks regarding transactions for a number of clients by an identical person?

#### (4) Dealing on Own Account

In order to determine whether there are inappropriate dealings in the operator's own account in relation transactions for customers, the following matters are to be verified:

- (i) Are the operator's own dealings conducted in compliance with laws and regulations?
- (ii) Does the operator engage in trade that is adverse to the interests of the customer vis-à-vis trade commissioned by the customers?
- (iii) Has the operator bought stocks based on pending sales and later moved them to customer accounts?
- (iv) Are there inappropriate transfers of transactions to the operator's own account?
- (v) Are there instances of transactions anticipated to produce profits being moved to specific agency transactions?
- (vi) Are there transactions that inappropriately make use of information regarding incorporated entities or information regarding customer transactions?
- (vii) Are there transactions that inappropriately make use of a parent juridical person or subsidiary juridical person or a financial instruments business operator with which the operator has an affiliation or friendly ties, in order to conceal one's own transaction methods?
- (viii) Are there transactions conducted at inappropriate price levels in off-floor trading

or off-exchange trading?

- (ix) Is the operator involved in inappropriate stock price formation for specific stocks, such as finance stocks?
- (x) Are there transactions that are likely to cause problems in terms of price stabilization period?

### 3. Debenture Business

#### (1) Assessment of Solicitation and Trading

The state of customer transactions regarding the following matters is to be verified in order to identify whether there are inappropriate transaction issues:

- (i) Are there instances of rollover between debentures with identical product characteristics, and is the rollover reasonable?

Also, are there loss cuts immediately before redemption, frequent loss cuts or roll-overs with small profit margin?

- (ii) Are there transactions that intentionally circumvent internal transaction regulations (such as short-term trading)?

- (iii) Are transaction prices appropriate? Are price calculations reasonable, especially for stocks with low ratings or stocks with wide spreads?

- (iv) Are there transactions that are in effect trades in profits and losses between the operator and its customer?

- (v) For bonds with share options:

A. are there inappropriate transactions that are conducted across-the-board and intensively during a period of time?

B. are there transactions that have been moved after purchase based on pending sales?

C. are corrections of mistakes processed appropriately?

D. are there transactions that are likely to become problems in terms of price formation?

E. are there inappropriate movements of transactions between the operator's own account and agency transactions that may be deemed as provision of profit?

- (vi) Are there transactions conducted under a product scheme that may be deemed as special provision of profit? Also, does the operator offer products that include default assets?

- (vii) Are there solicitations of more than 50 customers in a private placement (excluding private placements for qualified institutional investors)?

## (2) Excessive Trading and Other Matters

Based on materials on internal control and major accounts, transactions of inordinate frequency or excessive volume vis-à-vis the customer fund capacity and customers with peculiarities vis-à-vis their respective fund characteristics and customer attributes are to be selected and verified regarding the following matters:

- (i) Have there been excessive solicitations to the customer, overlooking a customer's fund capacity and fund attributes?
- (ii) Are there suspicious transactions in terms of a customer's fund attributes and transaction flow?
- (iii) Are there suspicious transactions in terms of order time, with attention to customer attributes?
- (iv) Are there transactions that are unauthorized or transactions by sales personnel disguised as having been conducted for customers?
- (v) Are there disputes with the customer?
- (vi) Are there other inappropriate solicitations or transactions in debenture transactions with customers?

## (3) Providing Information on Market Value

- (i) Is information on market value appropriate for a customer's position provided regularly and as need arises after sale, upon request from the customer?
- (ii) Is information on market value made clear as to what precisely market value represents?
- (iii) In providing customers with information on market value and other information, are measures being implemented, such as verification by the risk management division?

## 4. Investment Trust Business

### (1) Assessment of Solicitation and Trading

The state of customer transactions regarding the following matters is to be verified in order to identify whether there are inappropriate transaction issues:

- (i) Is there a sudden increase in investment funds immediately before a deadline, through roll-over from other products?
- (ii) Are there roll-overs from other products or is there switching between investment trusts with identical product characteristics that lack economic reasonableness? Also, are there frequent loss cuts or roll-overs with small profit margins?

- (iii) Are there transactions that intentionally circumvent internal transaction regulations (such as short-term trading)?
- (iv) Are customers given explanations of products for which switching is possible? Also, are there any inappropriate transactions?
- (v) Are customers given appropriate explanations regarding preferential measures applied to fees charged for switching investment trust redemption? Also, are customers required to cover unnecessary charges?
- (vi) Are there transactions employing a product scheme that may be deemed as a special provision of profit?
- (vii) Is the customer notified in writing of any major changes in the terms of investment trust agreement, in order to prevent misunderstanding?
- (viii) Are customers given easy-to-understand explanations regarding dividends on investment trusts to the effect that all or part of the dividends may correspond to a partial repayment of principal? Also, are customers not given inappropriate explanations such as that dividends are like interest on deposits?
- (ix) Given that multi-currency funds involve not only the risk that the asset price will fluctuate but also the complex risk of exchange-rate fluctuation, does the business operator take such measures as explaining the product characteristics and risk profile to the customer in a way that he/she can understand, receiving a written confirmation to the effect that he/she has understood the contents explained, and keeping it when making an investment solicitation to a customer who has no experience in investing in multi-currency funds,?

## (2) Excessive Trading and Other Matters

Based on materials on internal control and major accounts, transactions of inordinate frequency or excessive volume vis-à-vis the customer fund capacity and customers with peculiarities vis-à-vis their respective fund characteristics and customer attributes are to be selected and verified regarding the following matters:

- (i) Have there been excessive solicitations to a customer, overlooking the customer's fund capacity and fund attributes?
- (ii) Are there suspicious transactions in terms of customer fund attributes and transaction flow?
- (iii) Are there suspicious transactions in terms of order time, with attention to customer attributes?
- (iv) Have intensive sales campaigns been organized based on allocation of sales quota to business offices and personnel?

- (v) Are there peculiarities in the state of transactions for specific stocks? Are there stocks for which just switching takes place frequently? In such cases, what kind of investment solicitation is being executed?
- (vi) What is the percentage of purchase orders made by customers who are frequently switching among the public offerings by business offices and personnel?
- (vii) Is there a trend of dependence on sales to specific customers? Are there transactions that are unauthorized or transactions by sales personnel disguised as having been conducted for customers?
- (viii) In case of loss resulting from frequent switching, does the customer approve of the trade results? Moreover, are there disputes with customers?
- (ix) Are there other inappropriate solicitations or transactions in investment trust offerings to customers?

## 5. Derivatives business

### (1) Assessment of Solicitation and Trading

- (i) Is the transaction price appropriate? Is price calculation reasonable?
- (ii) In market transactions of derivatives:
  - A. are there any inappropriate transactions that are conducted across-the-board and intensively during a period of time?
  - B. are there transactions that have been moved after purchase based on pending sales?
  - C. are corrections of mistakes processed appropriately?
  - D. are there inappropriate movements of transactions between the operator's own account and agency transactions that may be deemed as a provision of profit?
- (iii) Does the operator engage in sales of derivatives and other products that are not economically reasonable, in order to manipulate the settlement of customer accounts?
- (iv) Are derivatives and other products sold to customers who are judged to be appropriate for such products in terms of customer investment incentive, experience and attributes such as state of assets?
- (v) Does the operator solicit matched orders and hedged trading with underlying assets that lack economic reasonableness?
- (vi) Regarding over-the-counter transactions of derivatives (restricted to forward contracts and over-the-counter option trading) and market transaction of derivatives (restricted to futures trading and option trading), does the operator immediately issue a written receipt indicating deposit of cash margin by the customer?



- (vii) Does the operator engage in solicitation of over-the-counter transactions of derivatives (restricted to those regulated under laws and regulations) by making telephone sales calls or by paying visits to customers who have not requested such solicitation?
- (viii) In soliciting market transactions of derivatives (restricted to those regulated under laws and regulations), does the operator confirm the customer's intent to accept the solicitation? Also, does the operator continue to solicit after such a customer has expressed lack of interest in concluding agreements?
- (ix) In over-the-counter financial futures transactions, does the operator provide, upon request from the customer, appropriate explanation regarding trading with partners in a cover transaction, actions in case of rapid changes in the market, an indication of whether the operator engages in its own transactions, and the status of asset management by category?
- (x) Regarding sales of complex structured bonds and investment trusts similar to OTC derivative transactions, does the operator verify whether such financial products are suitable (reasonable basis suitability) to be sold to investors, based on the Japan Securities Dealers Association (JSDA) self-regulatory rules “Regulation Concerning Solicitation for Investments and Management of Customers, etc., by Association Members”? Also, based on these rules, does the operator appropriately formulate criteria for starting solicitations corresponding to the product’s risk characteristics and customer’s nature, and conduct proper solicitation according to those criteria?

## (2) Excessive Trading and Other Matters

Based on materials on internal control and major accounts, transactions of inordinate frequency or excessive volume vis-à-vis the customer fund capacity and customers with peculiarities vis-à-vis their respective fund characteristics and customer attributes are to be selected and verified regarding the following matters:

- (i) Have there been excessive solicitations to a customer, overlooking customer fund capacity and fund attributes?
- (ii) Are there suspicious transactions in terms of customer fund attributes and transaction flow?
- (iii) Are there suspicious transactions in terms of order time, with attention to customer attributes?
- (iv) Are there advance payments to specific customers or noticeable shortfalls in margin deposit or in maintenance ratio?

(3) Appropriateness of Solicitation Materials, etc.

- (i) When intending to conclude sales contracts of derivative transactions (including cases of sale of complex structured bonds and investment trusts similar to OTC derivatives), based on the JSDA self-regulatory rules “Regulation Concerning Solicitation for Investments and Management of Customers, etc., by Association Members” and on the Financial Futures Association of Japan self-regulatory rules “Financial Futures Transactions Business Handling Rules,” does the business operator appropriately call attention to the customer by providing a simple document which is easily understood and written in large letters (calling-attention notice), and which includes: a) Eligibility of uninvited solicitation regulations, b) Warning about risks, and c) Method to contact the designated alternative dispute resolution institution, etc. if a dispute arises and by explaining in a suitable manner for the customer’s characteristics, etc? Also, is there a system which enables the appropriate verifying of the status of this execution?
- (ii) With respect to the accountability of over-the-counter derivatives business operators that trade in currency options, interest rate swaps, etc., the following items, etc. shall be inspected.
- A. When the business operator intends to enter into a contract for over-the-counter derivatives transactions (including cases where it conducts sales of complex structured bonds and investment trusts that are similar to over-the-counter derivatives transactions; the same shall apply in B through G below), does it provide full and appropriate explanations about the maximum anticipated loss assuming the worst-case scenario regarding the level of financial indices and so forth (e.g. levels of volatility as well as interest rates at home and abroad) that are used for said over-the-counter derivatives transactions, by issuing a document which gives specific and easy-to-understand explanations?
- B. When the business operator intends to enter into a contract for over-the-counter derivatives transactions, does it provide full and appropriate explanations about the tentatively calculated amount of the settlement money on cancellation assuming the worst-case scenario regarding the levels, etc. of financial indices and so forth (e.g. levels of volatility as well as interest rates at home and abroad) that are used for said over-the-counter derivatives transactions, by issuing a document which gives specific and easy-to-understand explanations?
- C. Is the worst-case scenario regarding the levels, etc. of financial indices and so forth as mentioned in A and B above, based on reasonable assumptions such as data in times of stress in the past?

- D. Is the level, etc. of financial indices and so forth used in the calculation mentioned in A and B above, reviewed in a timely and appropriate manner, based on the changes in the market environment, etc.?
- E. Does the business operator practically check the amount of loss and amount of settlement money on cancellation that are acceptable to the customer in over-the-counter derivatives transactions, and compare them to the maximum anticipated loss and the amount of settlement money on cancellation? Furthermore, even in cases that do not amount to the worst-case scenario, if it is probable that the customer would suffer a loss greater than that acceptable, does the business operator explain it to the customer in a way that he/she can understand?
- F. Given that the maximum anticipated loss and the amount of settlement money on cancellation are important factors for customers to make decisions in transactions, does the business operator indicate the maximum anticipated loss or the amount of settlement money on cancellation to them in a way that makes clear the maximum anticipated loss or the amount of settlement money on cancellation that may be incurred in the transactions themselves? For example, in cases where other transactions closely related to the relevant transactions are conducted due to the customer's specific circumstances, does the business operator seek to clarify the maximum anticipated loss or the amount of settlement money on cancellation pertaining to said other transactions, by making a separate statement therefor?
- G. When intending to conclude sales contracts for OTC derivative transactions, based on the JSDA self-regulatory rules "Regulations Concerning Solicitation for Investments and Management of Customers, etc., by Association Members" and on the Financial Futures Association of Japan self-regulatory rules "Financial Futures Transactions Business Handling Rules," does the business operator receive written confirmations in order to confirm with customers that they understand the important information concerning that transaction, and that they make the transaction by their own decision and on their own responsibility?

#### (4) Providing Information on Market Value

- (i) Is information on market value of derivatives appropriate for the customer's position provided regularly and as need arises after sale, upon request from the customer?
- (ii) Is information on market value made clear as to what precisely market value represents?
- (iii) In providing customers with information on market value and other information, are measures being implemented such as verification by the risk management division?

## 6. Underwriting business

The following matters are verified in order to identify whether there are inappropriate transaction issues:

- (i) When financing, is there involvement of relevant parties in inappropriate price formation?
- (ii) Are there instances of transaction cancellation at inappropriate prices?
- (iii) Are there cases of advance payments in sales offerings?
- (iv) Are there instances of sales to prospective customers being switched to other customers at a later date?
- (v) Is there business activity that may be found to be problematic, caused by unreasonable sales to fill subscription quotas?
- (vi) Are there transactions that appear to be providing profits to customers, by making use of initial public offerings that are highly likely to rise in value?
- (vii) Is the distribution of initial public offerings executed fairly in accordance with the internal regulations?
- (viii) Are there personnel in underwriting, corporate affairs and other divisions who may have leaked or made unfair use of information related to incorporated entities obtained in the course of duty?
- (ix) Does the operator grant credit to customers, such as offering loans for purchase payment, in marketing underwritten securities before six months have passed since becoming an underwriter?
- (x) Does the operator issue overstatement of taxable income to secure allocation quotas or to submit statements unsubstantiated by customer demand, when subscription or sales price is to be determined by book building?
- (xi) If a prehearing is to be conducted on subscription to securities issued by listed companies, does the operator provide information related to the company regarding the subscription in question to parties targeted for investigation, without implementing measures prescribed in laws and regulations?
- (xii) Are moving strike convertible bonds (MSCB) handled appropriately in compliance with laws and regulations? Also, does the operator request the issuer to disclose matters that are important to the customer and existing stockholders (uses or procured funds, etc.) appropriately?
- (xiii) In underwriting inspection, is inspection conducted appropriately in compliance with laws and regulations, as well as internal regulations? Also, are personnel who execute underwriting inspection involved in business activities to promote

underwriting?

- (xiv) In making underwriting decisions, are impartial opinions on underwriting inspection applied appropriately?

## 7. Proprietary Trading System (PTS) Business

### (1) Business Management

- (i) In giving explanations of PTS business to customers, is adequate explanation on the following matters given in advance?
- A. The method of determining sales prices
  - B. Transaction rules from order to agreement conclusion and settlement
  - C. Handling in case of settlement failure
  - D. The possibility of agreement at the indicated price
- (ii) The following matters are to be confirmed regarding the internal control system for PTS business:
- A. Is the personnel in charge of PTS management a person with more than five years of experience in financial instruments transactions as a general rule, and does the division to conduct the business operation have the necessary organization and man power to execute the operation?
  - B. Is the verification at the time of transaction for the customer executed in PTS business?
  - C. In PTS business, are appropriate trade management and inspection in place in order to prevent insider trading and other transactions that impede fairness?

### (2) System Management

The following matters regarding assurance of safety and reliability of system load and other aspects of PTS business are to be confirmed:

- (i) Has adequate and reasonable capacity been guaranteed for the system to handle the projected volume of orders and agreements in the future?
- (ii) Have tests been conducted sufficiently based on the aforementioned projections?
- (iii) Are surveillance methods and systems for prevention and early detection of system overload and failure functioning adequately?
- (iv) Are methods to be implemented in case of system problems (methods of explanation and ways of contacting customers) appropriate?
- (v) Is the system made in duplicate (backup system)?

(vi) Has a system been evaluated by a third party (external organization) regarding the aforementioned matters to confirm safety and reliability in system capacity and other features.

### (3) Customer Data Management

The following matters regarding maintenance of confidentiality of customer transaction data employed in PTS business are to be confirmed:

- (i) Are persons engaged in business activities in the PTS business division separated clearly from those of other divisions?
- (ii) Do persons engaged in PTS business do so by making use of information related to other business operations or do persons engaged in other business operations make use of information related to PTS business?
- (iii) Are measures to prevent leakage of customer transaction data implemented securely and precisely?

## 8. Electronic Financial Instruments Transactions Business

### (1) Customer Management

- (i) Are inspection standards for account opening appropriate? Also, is inspection conducted appropriately?
- (ii) In view of the fact that electronic transactions are not conducted on a person-to-person basis, is the verification at the time of transaction executed appropriately?
- (iii) Are requests and collection of documents concerning verification at the time of transaction executed appropriately?
- (iv) Are customer attributes such as occupation, investment experience, knowledge and asset status assessed appropriately, with development of customer cards and other documents? Are account openings authorized without sufficient verification of necessary information related to customer attributes? Is data updated with assessment of status of changes in customer attributes?
- (v) In starting business transactions, are documents and explanatory materials issued and verification documents collected appropriately, as required under laws and regulations?

### (2) Security Measures

- (i) Are measures implemented for assurance of transaction security, such as a system designed to reject order issues without entry of the customer's personal identification number?
- (ii) In transactions with private customers, is the system designed to enable easy checking and reconfirmation of errors in input when the customer places an order? For example, are measures implemented so that the system will not accept an order unless executing a necessary operation on the "confirmation screen"?
- (iii) Is there a check system to prevent excess in transaction value, reflecting customer attributes and the nature of the product in question? For example, are limits for transaction value for a single day in place and, if transaction value exceeds the limit, does the system lock the transaction?
- (iv) In order to protect the user from unauthorized use, are there measures implemented to create functions in which the user is able to verify their own status of use?
- (v) In order to assure appropriate decision-making by the customer in concluding agreements, are the contact address (e-mail address) and other methods of communication shown explicitly on the screen? Also, is the customer provided the opportunity to inquire of the operator regarding information provided?
- (vi) Are measures implemented to prevent misunderstandings regarding the service provider, caused by hyperlinks?
- (vii) Does the operator not only provide information related to the transaction but also warn users regarding the presence of risks not found in other forms of transaction? Also, has the operator established a policy on distribution of responsibility in case of system failure (including terms of immunity), in order to avert outbreaks of problems to the greatest possible extent, and provide explicit information to the user prior to the start of the business transaction?
- (viii) Does the operator prepare for system failure or problems and take action to inform the user of methods of communication employing media other than the Internet? In such a case, is this indicated on the screen where transaction is executed?

## 9. Separate Management

### (1) Securities and Cash

- (i) Excluding securities separated in compliance with laws and regulations and securities that the financial instruments business operator is able to use under contract, does the business operator manage securities deposited by a customer on said

customer's account separately from securities held by the operator?

- (ii) Regarding securities and cash deposited by customers for financial instruments transactions and securities and cash belonging to the customer's account (securities that have been furnished as collateral under the provision of Article 43-4 of the Financial Instruments and Exchange Act [excluding securities that the financial instruments business operator may use under contract]), does the business operator keep an amount equivalent to the value of such securities and cash to be reimbursed to the customers as money earmarked for customers, in case of termination of financial instruments business?

Also, is the value of securities held as funds earmarked for customers calculated at market value?

## (2) Storage Method (Securities)

- (i) Except in mixed storage, are the securities of customers stored in a location clearly set apart from the storage location for other securities, including in the case of storage by a third party? Also, are the securities of customers organized by customer or by securities code number in order to make them immediately identifiable in storage?

- (ii) In case of mixed storage, is the storage location for securities of all the customers separated clearly from storage location for other securities? Also, are securities of all the customers made immediately identifiable with methods such as classification by the financial instrument business operator account and the account for customers, and are the shares of each customer made immediately identifiable through the ledgers and records of the business operator?

Moreover, for securities that are owned jointly by the business operator and customers or other parties, is the share of each customer made immediately identifiable in the ledgers and records of the business operator?

## (3) Storage Method (Cash)

Is money earmarked for customers entrusted as follows?

- (i) Is the financial instruments business operator designated as consignor, is the trust company or financial institution engaged in trust business designated as trustee and are the customers of the financial instruments business designated as beneficiaries of the principal?
- (ii) Is a trust administrator appointed by the financial instruments business operator? Also, if the business operator concludes trust contracts with a number of trustee organizations, is the same trust administrator appointed for all concluded contracts?



- (iii) If the business operator applies as the notifying financial instruments business operator under the provisions of Article 79-54 of the Financial Instruments and Exchange Act, is an investor protection fund designated as trust administration as a general rule?
- (iv) Are the types of trust contracts money trusts, securities trusts and comprehensive trusts, and is management of these trusts conducted according to the management method prescribed in laws and regulations?
- (v) Is the necessary value of money earmarked for customers for each customer and of the total customer fund calculated on a daily basis?
- (vi) Is replacement of necessary money earmarked for customers made by setting standard dates for calculation of differences for more than one day per week and compensating for shortfalls within three business days from the day following such a standard date?
- (vii) Is the necessary value of money earmarked for customers the value as of the standard date for calculation of differences? (Not the outstanding average for the week.)
- (viii) Is the assessed value of securities in trust made appropriately in compliance with laws and regulations, with valuation as a general rule on the standard date for calculation of differences?
- (ix) If the financial instruments business operator classifies as a notifying financial instruments business operator, does said operator issue instructions on management to the trust company or financial institution engaged in trust business? (Excluding special cases when approved by the investor protection fund.)

(4) Money Earmarked for Customers pertaining to Credit Transactions and When-issued Transactions

- (i) Are cash deposits entrusted for credit transactions, as well as the current value equivalent of marketable securities held as a guarantee for credit transactions furnished as repeat collateral, including additional guarantees, covered in the calculation of money earmarked for customers' money?

(Outline of Separate Management by a Financial Instruments Business Operator in Credit Transactions)

Item	Separate management
Cash as collateral	Unnecessary
Stock certificates as collateral	Unnecessary

Cash held as guarantee in credit transaction (Including additional guarantee)	Trust	
Marketable securities held as guarantee for credit transaction (Including additional guarantee)	Held in kind Held as repeat collateral Held as guarantee collateral Collateral for main office	Separate management Money trust Money trust Money trust
Credit transaction valuation profit	Unnecessary	

Note: Money trust is not necessary for guarantee collateral and main office collateral that satisfy requirements of Cabinet Ordinance.

(ii) Are securities held for when-issued transactions and guarantee money received included in the trust for money earmarked for customers?

(5) Money Earmarked for Customers Pertaining to Derivatives Market Transactions

(i) In market transactions of derivatives (restricted to transaction of securities-related derivatives; and same for [ii]), is cash held as initial margin and agent margin or are marketable securities entrusted to cover the difference managed separately as customer assets? (Separate management not necessary in case of direct deposit.)

(ii) Are valuation profits pertaining to market transactions of derivatives included in the calculation of money earmarked for customers?

(Outline of Separate Management by a Financial Instruments Business Operator in Market Transactions of Derivatives)

Item	Separate management
Cash held as initial margin and agent margin	Money trust
Portion of aforementioned cash deposited directly to the exchange	Unnecessary
Marketable securities held as margin in case of deposit to cover difference	Necessary
Portion of aforementioned securities deposited directly to the exchange	Unnecessary
Cash margin & agent margin from customer held as customer losses	Unnecessary
Valuation profits from futures trading	Money trust
Valuation profits from option trading	Unnecessary

Note: Trust is not necessary for valuation profits from option trading because they are unrealized.

(iii) Are guarantees pertaining to securities-related derivative transactions (excluding those which make an agreement with Type I financial instruments business operators, etc.) treated as follows?

A. Are they entrusted to trust companies or financial institutions that engage in trust business?

B. Are the value of the customer-segregated funds for each customer and the necessary value of the total customer-segregated funds calculated on a daily basis?

C. In cases where the assessed value of the trust principal is less than the necessary value of the customer-segregated funds, is the shortfall added to the trust property within two business days from the day following such a standard date?

(iv) Are guarantees pertaining to currency-related derivative transactions (excluding those which make agreement with Type I financial instruments business operators, etc.) treated as follows?

A. Are they entrusted with trust companies or with financial institutions which engage in trust business?

B. Are the value of the customer-segregated funds for each customer and the necessary value of the total customer-segregated funds calculated on a daily basis?

C. In cases where the assessed value of the trust principal is less than the necessary value of the customer-segregated funds, is the shortfall added to the trust property within two business days from the day following such a standard date?

#### (6) Verification of Outstanding Balance

(i) Is outstanding balance verified on a regular basis between the intermediary financial instruments business operator and the main office financial instruments business operator?

(ii) Are appropriate storage contracts concluded with third-party organizations (including foreign storage organization) in compliance with the Cabinet Ordinance on financial instruments business?

(iii) In case of transactions of stocks held in storage by a third-party organization in Japan, does the business operator check the outstanding balance after each change and check the total outstanding balance by verifying the outstanding balance on the records and outstanding balance at the storage organizations, including foreign storage organizations, at least once a month?

In addition, are these managed separately and appropriately, such as money and

securities taken out by sales personnel for delivery to the customer being returned to the account of the customer in question, when brought back due to absence of the customer and other conditions?

- (iv) Are the targets for and methods of calculation for money earmarked for customers defined clearly, and is the accuracy of calculation data checked?
- (v) Are the targets and the methods of calculation for money earmarked for customers defined clearly in management regulations, and is the accuracy of calculation data checked?
- (vi) Is the outstanding balance at the trust bank where money earmarked for customers is entrusted checked against the outstanding balance on the deposit ledger at least once a week?
- (vii) Is the state of separate management of customer assets audited by a certified public accountant (including a foreign certified public accountant) or auditing firm on a regular basis at least once a year?

## 10. Internal Control

### (1) Legal Procedures

- (i) Are measures implemented thoroughly for prohibiting outside business activities by unregistered personnel and preventing solicitation and entrustment activities prior to registration?
- (ii) Are the procedures for registration of outside sales personnel, as well as modification and cancellation of registration, executed appropriately in compliance with laws and regulations?
- (iii) Are the production, storage and submission of records and documents related to business activity executed appropriately in compliance with laws and regulations?
- (iv) Are procedures for licensing, approval and reporting prescribed by laws and regulations executed appropriately?

### (2) Unfair Trade

- (i) Are checks conducted appropriately to prevent unfair trading?
- (ii) In order to prevent insider trading and other unfair trading by customers, is exhaustive action taken on internal personnel registration and data management, and are the checks necessary at order acceptance conducted appropriately?
- (iii) Are customer trading motives assessed accurately through monitoring and other

means, as need arises, based on concrete methods established for assessment of customer trading trends in products and methods and forms of transaction?

- (iv) Is the division in charge of transaction management securing fairness in customer transactions by conducting appropriate sampling of stocks based on concrete sampling standards developed with attention to fluctuations in rates, the business operator's market involvement rate and involvement in closing price values?
- (v) In order to eliminate unfair trade, such as deliberate market value formation, does the division in charge of transaction management implement appropriate actions, such as making inquiries, issuing warnings or terminating business with customers regarding sampled stocks?

### (3) Modification of Agreements

- (i) Are modifications of agreements processed appropriately?
- (ii) Are there items, such as administrative processing error, that the business operator has committed that may become problematic?
- (iii) Are modifications in agreements caused by administrative processing errors executed appropriately by identifying clearly the reason for modification, and are they retained for confirmation at a later date?
- (iv) What is the current state of securities accidents, disputes with customers or occurrence of modifications of agreements? Are they inclined to occur at specific offices or be committed by specific persons?
- (v) Are scandals reported to the administrative authorities and confirmation applications submitted in compliance with laws and regulations? Also, are they processed appropriately inside the organization?
- (vi) Do the personnel in charge of internal control confirm that modification or cancellation of a transaction is processed appropriately according to internal rules?

### (4) Suitability of Administrative Processes

- (i) Does the division in charge of financial instruments transaction administration handle processing of each transaction according to regulations and manuals? For example:
  - A. Is an order invoice produced at the time of order acceptance as a general rule?
  - B. If errors or differences are found when cross checking the business operator's transaction records with the agreement data obtained from the transaction partner, is the cause of the problem investigated without delay and modified based on methods established in advance?

- C. Are documents describing the details of the transaction produced accurately for all transactions and issued to the partner in trade?
- D. Are the procedures for transaction processing, securities settlement and financial settlement executed appropriately under supervision of the officer in charge of internal control?
- E. Are deposits and securities held in storage cross checked with a third-party organization appropriately?
- (ii) Do the personnel in charge of internal control appropriately verify that details of transactions conducted on a daily basis in business divisions are recorded accurately? (For example, by checking the outstanding balance of cash and securities and checking items in order invoices and contracts.)
- (iii) In the daily verification of transaction details, do personnel in charge of internal control conduct adequate research and verification on the reasons, background, processing methods and other matters, especially those related to exceptional transactions conducted outside internal regulations, and keep accurate records of such transactions?
- (iv) Do personnel in charge of internal control appropriately review the status of verification at the time of transaction at account opening, the handling of miswritten documents, the management of important documents, records of agreement modifications, the handling of notes, checks and money transfers, and the status of production and issuance of transaction reports?
- (v) Are verification documents collected from customers, letters of consent on re-mortgaging securities, letters of agreement on sharing undisclosed information pertaining to measures to prevent impediments and letters of agreement pertaining to the use of personal data for purposes other than the objective, as well as provision to third parties, managed appropriately?
- (vi) Does the officer in charge of the transaction execution division confirm the content of the order, if it exceeds a certain scale, so as to prevent erroneous content in order acceptance or issues for transactions of securities at the financial commodity exchange, and issue approval to lift the border restrictions, if deemed appropriate, in order to fulfill his/her responsibility as a managerial officer?
- (vii) In addition to refusal to conduct transactions with antisocial forces, if an existing customer is found to be a member of an antisocial force, are business relations terminated as expeditiously as is possible?
- (viii) If securities held by the business operator on the customer's account or securities received as deposit from the customer are to be furnished as collateral or loaned to

another party, does the business operator obtain consent in writing from the customer?

- (ix) Are customer orders confirmed as being executed in accordance with the best possible policy of execution?
- (x) When receiving an order for a customer concerning listed securities, does the business operator confirm with the customer in advance that a document describing the best possible policy of execution has been issued in writing?

#### (5) Inspection of Advertising

- (i) Are personnel appointed to conduct inspection of advertising (personnel in charge of inspection of advertising)? Also, do said personnel also check advertising organized by a single business division or by employees?
- (ii) Is advertising verified for compliance with regulations prescribed by the self-regulating body and at the same time cross checked by personnel in charge of inspection of advertising in advance, in case of possible violation of said regulations?

#### (6) Supervision of Financial Instruments Intermediary Service Provider

- (i) Are the specific methods for handling investments solicitations required of financial instruments intermediary service providers disseminated and ingrained in such providers?
- (ii) Are the standards for handling customer information required of financial instruments intermediary service providers disseminated and ingrained in such providers?
- (iii) Does the division in charge of internal control assess the state of consumer attributes and the state of consumer data management by the said intermediary service providers and, when necessary, verify that solicitations are organized appropriately with attention to customer attributes?
- (iv) Do personnel in charge of internal control and others work to understand real conditions regarding investments solicitations by financial instruments intermediary service providers by conducting interviews with customers if necessary, and implement appropriate measures?

## 11. Property and Accounting

### (1) Inspection Method for Calculation of Net Property Value

In calculating net property value, the inspector is to verify whether the financial instruments business operator has entered assets, liabilities and profits/losses in financial documents on the standard date in accordance with corporate accounting standards that are recognized widely as fair and reasonable and, while paying due attention to possible omissions in the assets and liabilities accounts or presence of accounts not entered in the records, to calculate net property value by finalizing financial figures that reflect real conditions at the point of calculation, based on asset and liability valuation and other methods.

(i) Modification of accounts

Each account title in the balance sheet and profit/loss statement is verified, with correction of accounting errors, adjustment in compensatory offset account processing and other fair modifications in accounting for the financial instruments business operator processed as modification of accounts.

Net property value calculated from figures in each account title after modification is defined as "net property value (standard value)."

(ii) Calculation of net property value

By making adjustments in "net property value (standard value)" after valuation and modification processing, the "net property value (appraised value)" is established.

In calculating net property value, financial and other documents are checked to see whether accounting is executed properly in accordance with the Companies Act and accounting standards generally recognized to be fair and reasonable. If accounting is not processed properly, necessary modifications are to be made.

(iii) Valuation

With classification of monetary liabilities through valuation of assets and liabilities, valuation of securities and valuation of other assets, those without asset value and those with extremely small asset value based on a comprehensive assessment of various conditions are to be determined and removed from net property value.

Other corrections are to be finalized.

Each account title in the balance sheet and profit/loss statement is to be verified, and accounts for which the core capital level is modified by increasing or decreasing either assets or liabilities are to be processed as "other corrections."

(iv) Monetary claims

Are monetary claims such as third-party payments and loans classified by the state of customer finances, business performance and other factors, based on the available information and materials? Is allowance for doubtful accounts to be deducted from



monetary claims entered based on rational estimation of future losses?

Specifically, these are to be classified into general claims, doubtful claims, bankruptcy reorganization claims and others in accordance with the Accounting Standards for Financial Instruments (Accounting Standards Board of Japan), with monetary claims valued with calculation of the allowance for doubtful accounts for each claim category.

Margin trading loans may be classified as general claims if consignment guarantee money required by the general standards for trustee agreements is maintained as of the standard date.

Payments made for customers are calculated rationally to determine the amount projected to be uncollectible for each customer, with attention to said customer's financial strength, state of repayment and intention to repay. It is not appropriate to exclude these payments from doubtful claims on grounds that the claim in question is being disputed in a court of law or that the claim is a small sum.

Are claims against consolidated subsidiaries based not on the net property value in the profit/loss statement but on real net property value, including unrealized losses or profits on assets owned? In case of a decline in asset worth and the possibility of the claim in question becoming unrecoverable, is calculation of the amount expected to be unrecoverable based on proper decision-making? In this case, is the net property value calculation based on measures, such as self-assessment and charge-off/reserve, and implemented based on the Financial Inspection Manual for valuation of assets, including business loans held by the consolidated subsidiary, from the viewpoint that such a subsidiary engaged in money lending is required, to an extent, to execute claims management equivalent to banks and other financial institutions and to practice strict claims classification?

(v) Securities

Inspection into securities looks into whether they are classified into securities for sale, debenture held to maturity, stocks of subsidiaries and affiliated companies and other securities in accordance to the Accounting Standards for Financial Instruments and whether appraised value and valuation difference are calculated for each category.

A. Securities for sale

Value is to be determined at market value. Valuation difference is to be handled as current profits or losses.

B. Debenture held to maturity

Value is to be determined as cost at acquisition.

However, value is to be assessed by the amortized cost method if debenture was

acquired at a value higher or lower than face value and interest adjustment is found to be necessary in view of the difference between the acquisition value and debenture value.

C. Stocks of subsidiaries and affiliated companies

Value is to be determined as cost at acquisition.

D. Other securities

Value is to be determined at market value. Valuation difference is to be processed in any of the following ways based on the reversal method.

- a. The sum total of the valuation difference is entered as net assets.
- b. Valuation difference for stocks whose market value exceeds acquisition cost are entered as net assets, and valuation difference for stocks whose market value falls below acquisition cost are handled as current losses.

Moreover, deferred tax accounting applies on valuation difference entered as net assets. Such valuation difference is to be classified as other surpluses in net assets.

E. Securities without market value

- a. Value of debenture is to be determined by calculation based on acquisition cost or employing the amortized cost method, based on the value of the claim.
- b. Securities other than debenture are to be appraised at acquisition cost.

F. In case of a significant decline in market value

Should there be significant decline in market value or in value based on rational appraisal (i.e., market value) of securities (including stocks of subsidiaries and affiliated companies) other than securities held for sale, said market value is to be determined as appraised value, except when recovery of value appears to be possible, and the valuation difference is to be handled as current losses.

In case of a significant decline in the real value of stocks without market value (including stocks of subsidiaries and affiliated companies), due to deterioration in the financial status of the issuing company, the value is to be reduced accordingly, and the valuation difference is to be handled as current losses.

Because a debenture without market value is to reflect the value of the monetary claim, reduction in the value of such a debenture is to be determined by calculating the total loan loss from the claim based on the amortized cost method.

G. Market transactions of derivatives

Net claims and liabilities resulting from derivatives transactions are to be appraised at market value as a general rule. Valuation difference should be handled as current loss or profit, except when hedge accounting is applied and the carry-over of profit/loss is approved.

Claims and liabilities resulting from transactions with derivatives listed in the exchange are to be appraised at the final price in the said exchange on the day each claim is to be calculated or at equivalent value calculated rationally.

In case of derivatives that are not listed and have no market value, the value is to be calculated rationally at a level equivalent to market value, if any.

In case of derivatives for which fair appraisal value is extremely difficult to determine, the acquisition value is determined as appraisal value.

(vi) Third-party payments and advance payments

Are payments classified as expenses for a past period of time, as of the standard date, deducted from net property value?

(vii) Sundry receivables and accrued profits

Are such receivables valued with attention to asset characteristics and corresponding to the level of risk in decline or recovery in value?

(viii) Other liquid assets

Liquid assets other than the above are to be appraised as a rule at book value.

However, if there was a significant decline in the market value of the liquid asset in question and it appears to be highly unlikely that said value will recover to book value, is the market value in question determined as appraised value and the valuation difference deducted from net property value?

(ix) Fixed assets (excluding the above)

If recovery of the investment value is believed unlikely for tangible fixed assets, intangible fixed assets, investments and other assets (excluding financial assets, deferred income tax assets and long-term pre-paid interests) due to decline in profit performance of the asset, impairment accounting is to be executed in accordance with the Accounting Standards for Impairment of Fixed Assets.

(x) Deferred assets

Appraisal value is to be book value as the general rule.

However, in case of shortfall in depreciation for the deferred asset in question, is the value from which the depreciation shortfall is deducted determined as the appraisal value, and is the depreciation shortfall in question deducted from the net property value?

(xi) Reserves

A. Financial instruments transaction liability reserves

Are the reserves calculated based on the provisions of the Cabinet Office Ordinance on the Financial Instruments and Exchange Act and Financial Instruments Businesses?

## B. Other reserves

Are they calculated based on accounting standards recognized generally as fair and reasonable?

### (xii) Accruals (excluding allowances for doubtful claims)

Are they calculated based on accounting standards recognized generally as fair and reasonable?

## (2) Calculation Method for Net Property Value

The net property value is to be calculated by valuation of assets and liabilities with appraisal of assets and liabilities, followed by deduction of the total value of the amount to be entered as liabilities (excluding the total value of the amounts listed below) from the total value of the amount to be entered as assets in the profit/loss statement.

### (i) Financial instruments transaction liability reserves

(ii) Allowance or reserve with profit retention characteristics or reserve fund characteristics, classified under allowance or reserve required to be entered as liabilities under provisions of laws and regulations governing other businesses of the operator.

## 12. Capital-to-Risk Ratio

### (1) Core Capital

(i) Do account items required for calculation of capital stock, such as capital, deposits for subscriptions to new share, capital surpluses and profit surpluses, match with accounting books and ledgers and with the list of balances for principal accounts?

(ii) Is market value appraised properly based on the operator's own established "market value calculation manual" based on internal regulations, in order to assure objectivity in market value calculation? Also, are revisions made in said manual based on internal regulations, in case of change in calculation methods as required by changes in legal framework or development of valuation methods?

### (2) Supplementary Capital

(i) Are financial instruments transaction liability reserves and general allowance for loan losses calculated properly, and do they match those on the books and in documents related to the business?

- (ii) In calculating short-term subordinated debts or long-term subordinated debts, are reports submitted to the Director General of the Financial Services Agency, and are there special provisions in the contract stating that the principal for short-term subordinated debts and interests on long-term subordinated debts will not be paid if the capital-to-risk ratio falls below 120%?
- (iii) Are valuation losses and profits pertaining to other securities, not only securities entered in trading accounts and securities products, appraised accurately?

(3) Risk equivalent

In calculating the amount equivalent to risk value, is it calculated appropriately as provided for by the Commissioner of the Financial Services Agency (FSA)?

(4) Calculation and Understanding of the Capital-To-Risk Ratio

Does the division in charge of capital-to-risk ratio management calculate the amount equivalent to market risk and counterparty risk for each business day and report the information to directors, etc. appropriately?

(5) Report of Capital-To-Risk Ratio

Is the capital-to-risk ratio as of end of each month reported to the administrative authorities by the 20th of the following month? Furthermore, in case the capital-to-risk ratio falls below 140%, is this fact reported to the administrative authorities immediately, and at the same time is a report as provided for by the Cabinet Office Ordinance produced for each business day and submitted to the administrative authorities without delay?

**13. Consolidated Capital-to-Risk Ratio of a Special Financial Instruments Business**

**Operator**

(1) Core Capital

- (i) Do account items required for the calculation of capital stock, such as capital, deposits for subscriptions to new shares, capital surplus, profit surpluses, match with the consolidated financial statements, etc.?
- (ii) In order to ensure objective market value calculation, are pricing models (evaluation model) and market value pricing results verified by a division independent from the markets division? Also, is the validity of pricing models, etc. verified theoretically or

empirically, and reviewed, periodically and as needed?

(2) Supplementary Capital

- (i) Are financial instruments transaction liability reserves and general allowance for loan losses calculated properly, and do they match those on the books and in documents related to the business?
- (ii) In calculating short term subordinated debts or long term subordinated debts, is it calculated appropriately as provided for by the FSA Commissioner?
- (iii) Are valuation losses and profits pertaining to other securities, not only securities entered in trading accounts and securities products, appraised accurately?

(3) Risk Equivalents

In calculating the amount equivalent to risk value, is it calculated appropriately as provided for by the FSA Commissioner?

(4) Calculation and Understanding of the Consolidated Capital-to-Risk Ratio

Does the division in charge of managing the Consolidated Capital-to-Risk Ratio of a special financial instruments business operator calculate the amount equivalent to market risk and counterparty risk and report the information to directors, etc., appropriately?

(5) Report of Consolidated Capital-to-Risk Ratio, etc.

Is the document on the state of soundness of the management of the special financial instruments business operator, which includes the description regarding its Consolidated Capital-to-Risk Ratio, etc., reported to the administrative authority quarterly?

**14. Consolidated Capital-to-Risk Ratio, etc. of Final Designated Parent Company**

(1) Capital Stock

- (i) If calculating the Consolidated Capital-to-Risk Ratio based on Article 3 of the Capital Adequacy Notice on Final Designated Parent Company, do the account items required for calculation of capital stock, such as basic items, supplemental items and semi-supplemental items match the consolidated financial statements, etc.? Similarly, if calculating the Consolidated Capital-to-Risk Ratio based on Article 4 of that Notice,

do the account items for calculation of capital stock, such as capital, deposits for subscriptions to new shares, capital surplus, profit surpluses, etc. match the consolidated financial statements, etc.?

- (ii) In order to ensure objective market value calculation, are pricing models (evaluation model) and market value pricing results verified by a division independent from the markets division? Also, is the validity of pricing models, etc. verified theoretically or empirically, and reviewed periodically and as needed?

## (2) Risk Equivalents

In calculating the amount equivalent to risk value, is it calculated appropriately as provided for by the FSA Commissioner?

## (3) Calculation and Understanding of the Consolidated Capital-to-Risk Ratio

Does the division in charge of managing the Consolidated Capital-to-Risk Ratio of a final designated parent company appropriately calculate the necessary risk equivalents and report to the directors, etc.? Necessary risk equivalents refer to credit risk-weighted assets, market risk equivalents and operational risk equivalents, when calculating the Consolidated Capital-to-Risk Ratio based on Article 3 of the Capital Adequacy Notice on Final Designated Parent Company, and refer to market risk equivalents and counterparty risk equivalents, when calculating that Ratio based on Article 4 of that Notice.

## (4) Report of Consolidated Capital-to-Risk Ratio

Is the document on the state of soundness of the management of the final designated parent company, in which includes the description regarding its Consolidated Capital-to-Risk Ratio, etc., reported to the administrative authority quarterly?

### **II-2-3. Business Operations / Type II Financial Instruments Business Operators**

Inspection of actual business operations of a Type II financial instruments business is executed to evaluate whether such a financial instruments business, which provides customers with investment trust beneficiary securities, mortgage securities, securities equivalents and other securities with low liquidity and marketability, as well as derivatives not related to securities, is fulfilling its duties and role as a market intermediary appropriately, and to accurately assess whether there are improprieties in the state of business operations, in order to thoroughly investigate violations of laws and regulations and to foster protection of investors and the public interest.

#### **1. Business Stance and Other Matters**

##### **(1) Principle of Suitability**

(i) Are investment solicitations to customers conducted by sales personnel from the perspective of investor protection, including careful attention to the attributes and investment objectives of the customer?

(ii) Are customer attributes, such as the investment inclinations and experience of the customer, managed and kept appropriately in customer cards and other documents?

Does the business operator make efforts to conduct investment solicitation in an appropriate manner suited to customer attributes, such as by identifying changes in the customer's investment objectives and inclinations, and when the details of such changes have been confirmed by the customer, making changes to the registered details on the customer card, etc. in a timely manner and sharing the changed details with the customer?

(iii) Is the customer solicited to invest in products that do not suit the investment inclinations and the characteristics of said customer's funds? For instance, is the customer solicited to make transactions aimed at short-term capital gain (high-risk investments) when the customer is seeking stable yields as revenue from retirement funds?

Is sales management conducted carefully by adopting a system of management approval when selling high-risk instruments, such as multi-currency funds, to customers who value the safety of principal?

(iv) Are solicitations conducted frequently and consecutively to a customer who does not possess additional funds?

(v) Are complex products being offered to customers with little investment experience?

(vi) Are derivatives transactions aimed at customers with knowledge, experience and



property suitable for the nature of the product?

(2) The State of Solicitation

- (i) Are customers given an explanation of a product (its basic characteristics, description of risks and others) that will allow them to gain adequate understanding of the product? For example, does the business operator have reference materials ready to provide adequate explanation of the characteristics of the product, as well as the terms of transaction, when soliciting a customer to make an investment? Or, has the operator produced materials that show a number of products to enable the customer to make choices?
- (ii) Does the business operator emphasize only the benefits of investment and provide inadequate explanation of the disadvantages, such as risks?
- (iii) Does the business operator solicit customers to switch from one type of investment to another that is not beneficial in terms of the cost incurred in switching investments?
- (iv) Is the reason for recommendation arbitrary or subjective by nature?
- (v) In cases where a sudden change in market trends or an event having a material impact on markets has had a serious impact on the net asset value of an investment trust, does the business operator make efforts to provide information to customers in a timely and appropriate manner, and provide them with careful support for their investment decisions?
- (vi) Are there other inadequacies in explanations regarding matters that are vital to making investment decisions?
- (vii) When receiving an order from a customer for transaction of derivatives, does the business operator present to the customer the conditions of transaction explicitly and in advance?
- (viii) In conducting transactions with a customer, does the business operator provide adequate and appropriate explanation regarding the product and check, for example, the receipt of a written statement from the customer acknowledging that explanation was received?
- (ix) Does the business operator offer a customer benefits related to property or make a third party provide such benefits, in order to provide additional benefits or to compensate for losses?
- (x) Does the business operator engage in transactions that lack economic rationality or in solicitation activities that violate laws and regulations?
- (xi) Does the operator organize adequate training for personnel conducting sales and

solicitations in order to conduct such activities appropriately? Moreover, are there personnel who have not been trained to engage in such sales and solicitation activities but are assigned to sales and solicitations to customers?

(3) Solicitation Materials

- (i) In soliciting investment by customers, does the business operator issue the explanatory materials that are required to be issued under the Financial Instruments and Exchange Act and do so in compliance with the rules? Are explanations given without any misleading or false impressions?
- (ii) Upon issue of explanatory materials to the customer as required under the Financial Instruments and Exchange Act, does the business operator check to ensure that there are no omissions, by cross-checking against the material issue ledger?
- (iii) Does the business operator avoid infringement of laws and regulations by sending disclosure materials to the customer by post or other means and re-sending said materials without delay if they are found not to have arrived at the customer's contact address?
- (iv) Are the following matters taken into account, especially regarding prospectuses?
  - A. Does the business operator solicit customers by using a prospectus before the securities registration statement takes effect? (A preliminary offering circular may be used.)
  - B. Does the content of the preliminary offering circular match that of the securities application form?
  - C. When using a preliminary offering circular in solicitation, does the business operator understand that there is a lapse in time before the securities registration statement takes effect?
  - D. When a transaction is concluded, is the prospectus issued before the purchase of a beneficiary certificate by the customer, even when a preliminary offering circular has been used in solicitation? If it is to be sent by post, is it sent in time to arrive at the location of the customer before purchase takes place?
  - E. In case the prospectus is issued by employing an electronic data processing system, does the issue satisfy the requirements specified by laws and regulations?
  - F. If a customer requests issue of a prospectus, is it issued appropriately?
- (v) Can false or misleading descriptions be found in the investment solicitation materials? For example, is information in the materials arbitrary in its description? Also, do the personnel in charge of internal control conduct inspection adequately?
- (vi) When soliciting qualified institutional investors, are documents regarding restriction

on resale and other matters issued to such investors?

- (vii) When offering market transactions of derivatives to customers with little transaction experience, does the operator provide adequate explanation to the customer, employing methods including issue of documents indicating summary description of the transaction, matters related to the risk of losses from such transactions and other items that require customer attention, including examples of products and their risks (not only the best-case scenario but also projected maximum losses in a worst-case scenario)?

Particularly for cases in which the customer is offered products for which said customer must bear the risks, does the operator obtain customer confirmation of having received explanation from the operator as needed?

#### (4) Measures to Prevent Internal Collusion

- (i) In transactions with a parent juridical person or subsidiary juridical person, is transaction conducted under terms that differ from those of a regular transaction?
- (ii) When soliciting a customer who has been granted credit from a parent juridical person or subsidiary juridical person on condition that a transaction is conducted, is solicitation done with awareness of this fact?
- (iii) Is undisclosed information regarding the issuing party given to or received from the parent juridical person or subsidiary juridical person (except when a written letter of consent has been presented by the issuing party)?
- (iv) Has the business operator done anything else that violates regulations on preventive measures against adverse effects specified in laws and regulations?

#### (5) Assessment of the Conditions of Transactions

The state of customer transactions regarding the following matters is verified in order to identify whether there are inappropriate business issues:

- (i) Are there transactions that intentionally circumvent internal transaction regulations (such as short-term trading)?
- (ii) Are customers given an appropriate explanation regarding preferential measures applied to fees charged for switching investment trust redemption? Also, are customers required to cover unnecessary charges?
- (iii) Are there transactions employing a product scheme that may be deemed as a special provision of profit?
- (iv) Is the customer notified in writing of any major changes in the terms of the investment trust agreement, in order to prevent misunderstanding?

- (v) In market transactions of derivatives,
  - A. are there any inappropriate transactions that are conducted across-the-board and intensively during a period of time?
  - B. are there transactions that have been moved after purchase based on pending sales?
  - C. are corrections of mistakes processed appropriately?
  - D. are there inappropriate movements of transactions between the operator's own account and agency transactions that may be deemed as a provision of profit?
- (vi) Are derivatives and other products sold to customers who are judged to be appropriate for such products in terms of the customer's investment incentives, experience and attributes, such as state of assets?
- (vii) In soliciting market transactions of derivatives (restricted to those regulated under laws and regulations), does the operator confirm the customer's intention to accept the solicitation? Also, does the operator continue to solicit after such a customer has expressed lack of interest in concluding agreements?

#### (6) Excessive Trading

Based on materials on internal control and major accounts, transactions of inordinate frequency or excessive volume vis-à-vis the customer fund capacity and customers with peculiarities vis-à-vis their respective fund characteristics and customer attributes are selected and verified regarding the following matters:

- (i) Have there been excessive solicitations to the customer, overlooking the customer's fund capacity and fund attributes?
- (ii) Are there suspicious transactions in terms of customer fund attributes and transaction flow?
- (iii) Are there suspicious transactions in terms of order times, with attention paid to customer attributes?
- (iv) Have intensive sales campaigns been organized, based on the allocation of sales quotas to business offices and personnel?
- (v) Are there peculiarities in the state of transactions for specific stocks? Are there stocks for which switching takes place frequently? In such cases, what kind of investment solicitation is being executed?
- (vi) Is there a trend of dependence on sales to specific customers? Are there transactions that are unauthorized or transactions by sales personnel disguised as being conducted for customers?
- (vii) In case of losses resulting from frequent switching, does the customer approve of the trade results? Moreover, are there disputes with customers?

- (viii) Are customers given easy-to-understand explanations regarding dividends on investment trusts to the effect that all or part of the dividends may correspond to a partial repayment of principal? Also, are customers not given inappropriate explanations such as that dividends are like interest on deposits?
- (ix) Given that multi-currency funds involve not only the risk that the asset price will fluctuate but also the complex risk of exchange-rate fluctuation, does the business operator take such measures as explaining the product characteristics and risk profile to the customer in a way that he/she can understand, receiving a written confirmation to the effect that he/she has understood the contents explained, and keeping it when making an investment solicitation to a customer that has no experience in investing in multi-currency funds?
- (x) Are there other inappropriate solicitations and transactions?
- (xi) In case of trading loss (valuation loss) resulting from churning, does the customer approve of the trade results? Moreover, are there disputes with customers?
- (xii) Are there payments in lieu of customers or noticeable shortfalls in warranty deposits received or in warranty deposit levels for specific customers?

## 2. Electronic Financial Instruments Transactions Business

### (1) Customer Management

- (i) Are inspection standards for account opening appropriate? Also, is inspection conducted appropriately?
- (ii) In view of the fact that electronic transactions are not conducted on a person-to-person basis, is the verification at the time of transaction executed appropriately?
- (iii) Are requests and collection of documents concerning verification at the time of transaction executed appropriately?
- (iv) Are customer attributes such as occupation, investment experience, knowledge and asset status assessed appropriately, with development of customer cards and other documents? Are account openings authorized without sufficient verification of necessary information related to customer attributes? Is data updated with an assessment of the status of changes in customer attributes?
- (v) In starting business transactions, are documents and explanatory materials issued and verification documents collected appropriately, as required under laws and regulations?

## (2) Security Measures

- (i) Are measures implemented for assurance of transaction security, such as a system designed to reject orders issued without entry of the customer's personal identification number?
- (ii) In transactions with private customers, is the system designed to enable easy checking and reconfirmation of errors in input when the customer places an order? For example, are measures implemented so that the system will not accept an order unless executing a necessary operation on the “confirmation screen”?
- (iii) Is there a check system to prevent excess in transaction value, reflecting customer attributes and the nature of the product in question? For example, are limits in transaction value for a single day in place and, if transaction value exceeds the limit, does the system lock the transaction?
- (iv) In order to protect the user from unauthorized use, are there measures implemented to create functions in which the user is able to verify their own status of use?
- (v) In order to assure appropriate decision-making by the customer in concluding agreements, is the contact address (e-mail address) and other methods of communication shown explicitly on the screen? Also, is the customer provided with the opportunity to inquire with the operator regarding information provided?
- (vi) Are measures implemented to prevent misunderstandings regarding the service provider, caused by hyperlinks?
- (vii) Does the operator not only provide information related to the transaction but also warn users regarding the presence of risks not found in other forms of transaction? Also, has the operator established a policy on distribution of responsibility in case of system failure (including terms of immunity), in order to avert the outbreak of problems to the greatest possible extent, and provided explicit information to the user prior to the start of business transaction?
- (viii) Does the operator prepare for system failure or problems and take action to inform the user of methods of communication employing media other than the Internet? In such a case, is this indicated on the screen where transactions are executed?

## 3. Internal Control

### (1) Legal Procedures

- (i) Does the individual engaged in Type II financial instruments business entrust a deposit for operation to the deposit office nearest to his/her principal business office

or place of business and at the same time notify the administrative authorities of the deposit prior to commencing business operation?

- (ii) Are production, storage and submission of records and documents related to business activity executed appropriately in compliance with laws and regulations?
- (iii) Are procedures for approval prescribed by laws and regulations, and are procedures for applications and reports executed appropriately?
- (iv) If engaging in solicitation of contracts on securities equivalents (restricted to rights specified in each paragraph under Subsection 2 of Article 2 of the Act), has the operator reported to the administrative authorities the information indicated in the written documents to be issued prior to the conclusion of a contract?

## (2) Unfair Trading

- (i) Are checks conducted appropriately to prevent unfair trading?
- (ii) Is the customer's trading motive assessed accurately through monitoring and other means, as necessary, based on concrete methods established for the assessment of customer trading trends in products and methods and forms of transactions?

## (3) Modification of the Terms of Agreement

- (i) Are modifications of agreements processed appropriately?
- (ii) Are there items, such as administrative processing errors, that the business operator has committed that may become problematic?
- (iii) Are modifications in agreements that are caused by administrative processing error executed appropriately by clearly identifying the reason for modification, and are they kept for confirmation at a later date?
- (iv) What is the current state of securities accidents, disputes with customers or occurrence of modifications in agreements? Are they inclined to occur at specific offices or be committed by specific persons?
- (v) Are scandals reported to the administrative authorities and confirmation applications submitted in compliance with laws and regulations? Also, are they processed appropriately inside the organization?
- (vi) Do the personnel in charge of internal control confirm that modification or cancellation of transactions is processed appropriately according to the internal rules?

## (4) Suitability of Administrative Processes

- (i) Does the division in charge of financial instruments transaction administration handle processing of each transaction according to regulations and manuals? For

example:

- A. Is an order invoice produced at the time of order acceptance as a general rule?
  - B. If errors or differences are found when cross checking the transaction record at the business operator against agreement data obtained from the transaction partner, is the cause of the problem investigated without delay and modified based on a previously established method?
  - C. Are documents describing the details of transactions produced accurately for all transactions and issued to the partner in trade?
- (ii) Do personnel in charge of internal control appropriately verify that details of transactions conducted on a daily basis in business divisions are recorded accurately? (For example, by checking the outstanding balance of cash and securities and checking items in order invoices and contracts.)
  - (iii) In the daily verification of transaction details, do personnel in charge of internal control conduct adequate research and verification on the reasons, background, processing methods and other matters, especially those related to exceptional transactions conducted outside internal regulations and do they keep accurate records of such transactions?
  - (iv) Do personnel in charge of internal control appropriately review the status of verification at the time of transaction at account opening, the handling of miswritten documents, the management of important documents, records of agreement modifications, the handling of notes, checks and money transfers, and the status of production and issuance of transaction reports?
  - (v) Are verification documents collected from customers, letters of consent on remortgaging securities, letters of agreement on sharing customer information pertaining to measures to prevent adverse effects and letters of agreement pertaining to the use of personal data for purposes other than the objective, as well as provision to third parties, managed appropriately?
  - (vi) Does the officer in charge of the transaction execution division confirm the content of the order, if it exceeds a certain scale, in order to prevent erroneous content in order acceptance or issue for market transactions of derivatives and issue approval to lift the order restrictions, if deemed appropriate, in order to fulfill his/her responsibility as a managerial officer?
  - (vii) In addition to refusal to conduct transactions with antisocial forces, if an existing customer is discovered to be a member of an antisocial force, are business relations terminated as expeditiously as possible?
  - (viii) Has the operator received deposits in money or securities from the customer?



- (ix) In trading securities equivalents, is the right in question or money contributed confirmed as being managed separately from the assets of the party engaging in business to which the said investment was made?
- (x) Is money received temporarily from the customer as a deposit managed separately from the operator's own assets?

(5) Inspection of Advertising

- (i) Are personnel appointed to conduct an inspection of advertising (personnel in charge of inspection of advertising)? Also, do said personnel also check advertising organized by a single business division or by employees?
- (ii) Is advertising verified for compliance with regulations prescribed by the self-regulating body and at the same time cross checked by personnel in charge of inspection of advertising in advance, in case of possible violation of said regulations?

## **II-2-4. Business Operations / Investment Advisory and Agency Business Operators**

Inspection of business operations of an investment advisory and agency business is executed in order to evaluate whether such a business, which is required to provide advice in good faith on the value of securities and financial instruments, is fulfilling its duties and role, and in order to foster protection of investors and the public interest through a thorough investigation into deeds that are in violation of laws and regulations.

### **1. Investment Advisory and Agency Business**

#### **(1) The State of Solicitation**

- (i) Has the operator engaged in solicitation with unfair approaches, such as raising consulting fees, in the face of dissatisfaction expressed by an existing customer regarding advice received?
- (ii) Does the operator indicate that it neither engages in financial instruments transactions nor accepts monetary or securities deposits from the customer?
- (iii) Does the operator properly show information on the cooling-off period in documents that are required to be issued to the customer?
- (iv) If a customer requests cooling-off cancellation, does the operator handle it correctly as required by laws and regulations? Also, are documents regarding contract cancellation kept in storage?
- (v) Are there instances of the operator deferring a request from a customer during the cooling-off period (period of 10 days starting from the date of receipt by the customer of documents on contract conclusion; and hereinafter the same) and not returning investment advisory fees?
- (vi) In cooling-off cancellation, does the operator demand the customer to compensate for damages or pay penalties exceeding the amount prescribed by law?  
Also, does the operator return any advance payment received as fees pertaining to a financial instrument transaction contract to the customer?
- (vii) Is information on cancellation of a contract after the cooling-off period indicated properly in the investment advisory contract? Also, is it handled properly?
- (viii) When concluding or canceling an investment advisory contract, has the operator employed fraudulent means or committed assault or intimidation?
- (ix) When soliciting a customer, has the operator offered the customer the promise of covering their losses in whole or in part, or of providing property benefits?
- (x) Has the operator misled a customer in its solicitations, such as through production of advertising material on past advisory achievements that is significantly different from

the truth?

(2) Assessment of the Conditions of Transactions

The state of customer transactions regarding the following matters is verified in order to identify whether there are inappropriate transaction issues.

- (i) Has the operator provided consulting service that is different in content from that described in the investment advisory contract?
- (ii) In offering advice on securities issued by a parent or subsidiary juridical person or by the operator itself, does the said operator explicitly inform the customer of this fact and state the reason?
- (iii) Has the operator provided consulting on a scale and frequency deemed unnecessary regarding specific securities?
- (iv) Has the operator provided continuous consulting on transactions that are deemed as having artificially maintained fixed stock price levels, pushed up stock prices, market-on-close ordering, fixed closing prices and other manipulative actions?
- (v) Has the operator offered advice with intent to conduct a transaction among customers that would harm a particular customer's interests in favor of the interests of another customer?
- (vi) Has the operator given unjustifiable advice regarding a particular financial instrument for the purpose of securing the interest of the operator, etc. or a third party other than the relevant customer?
- (vii) Has the operator advised that a transaction be conducted under terms and conditions that are different from the ordinary terms and conditions and which are detrimental to the customer's interests?
- (viii) Has the operator advised that a transaction, unnecessary considering the policy and value of the transaction or market conditions, be conducted, in order to promote the interests of the operator's business operations in two or more categories or in other categories, or to promote the interests of a parent or subsidiary juridical person?
- (ix) Has the operator handled customers unfairly in the execution of contracts, such as by offering preferential treatment to specific customers?

(3) Prohibited Acts

- (i) Has the operator conducted sales and purchases of securities on its own account by utilizing information regarding transactions conducted by a customer to whom the operator offers investment consulting?
- (ii) Has the operator engaged in financial instruments transactions, such as the sale and

- purchase of securities, either with the operator's own customer as the partner in transaction or for the customer?
- (iii) Has the operator loaned either money or securities to a customer? Also, has the operator engaged an intermediary, a brokerage or agency services for monetary or securities loans by a third party to its customer?
  - (iv) Is there a conflict of interest with the customer regarding the sale or purchase of securities either held by the operator or by its parent or subsidiary juridical person?
  - (v) Has the operator committed other acts that are in violation of the provisions on prohibited acts in Article 41-2 of the Financial Instruments and Exchange Act?
  - (vi) Does the operator make deductions in investment advisory fees corresponding to the losses made by a customer?
  - (vii) Does the operator promote a customer to a membership rank that requires higher investment advisory fees, by employing misleading expressions (such as providing information with greater benefits than under the existing contract)?

## 2. Internal Control

### (1) Legal Procedures

- (i) Does the party engaged in investment advisory and agency business entrust a deposit for operation to the deposit office nearest to his/her principal business office or place of business and at the same time notify the administrative authorities of the deposit prior to commencing business operations?
- (ii) Are production, storage and submission of records and documents related to business activity executed appropriately in compliance with laws and regulations?
- (iii) Are procedures for approval prescribed by laws and regulations, and are procedures for applications and reports executed appropriately?

### (2) Suitability of Administrative Processes

- (i) Are the state of legal compliance, reasons for contract cancellation and other matters verified for customers who have canceled their investment advisory contracts prior to contract expiration?
- (ii) If the operator is engaged in consulting that focuses on specific securities, is the content of such consulting verified appropriately?
- (iii) Regarding investment advisory contracts with a parent or subsidiary juridical person, does the operator receive investment advisory fees corresponding to the state

of business management at the said juridical person, without indicating in writing the amount of compensation and date of payment per contract at the conclusion of said contract? For example, are there adjustments made to prevent losses for said juridical person?

- (iv) Does the operator respond in good faith to complaints from a customer? Also, are the conditions and results of complaint handling recorded and kept for verification at a later date?
- (v) Are advisory records pertaining to investment advisory contracts kept appropriately and put in storage? Also, are materials that provide substantiation for investment advice kept appropriately in storage?
- (vi) If an investment advisory contract is maintained with a customer who has not paid advisory fees for a long period of time, are the reasons for nonpayment and contents of investment advice provided appropriate?
- (vii) Has the operator received deposits in money or securities from the customer? Also, has the operator entrusted deposits of money or securities belonging to the customer to a party with close ties to said operator?

## **II-2-5. Business Operation / Investment Management Business Operators**

Inspection of business operations of an investment management business is executed to evaluate whether such a business, which is required to provide good faith management of funds belonging to investors and right holders, is fulfilling its duties and role, and to foster protection of investors and the public interest through a thorough investigation into deeds that are in violation of laws and regulations.

### **1. Investment Management Business**

#### **(1) Fund Management Planning**

- (i) In managing assets for a customer, does the fund manager produce a fund management plan in advance and have the plan approved by the personnel in charge of the fund management division? Also, is management executed by giving instructions based on the fund management plan?
- (ii) When modifying the fund management plan and giving instructions on sales or purchases based on the modified plan, does the fund manager state the reason for the changes, and has the personnel in charge of the fund management division granted approval?
- (iii) Are the fund management plan and the record of plan revision history stored for the period of time prescribed in internal regulations?
- (iv) Is fund management executed according to the terms and conditions of the investment trust or the discretionary investment contract, even when there is a change in the fund manager?

#### **(2) Fund Management Appraisal**

- (i) Is appraisal of investment property (hereinafter referred to as "fund management appraisal") conducted by a division separate from the fund management division?
- (ii) Is fund management appraisal executed not only to examine the profit rate but also to check whether management is being conducted according to the terms and conditions of discretionary investment contracts, investment trust contracts and investment corporation contracts?
- (iii) If benchmarks are established, are factors in the profit rate analyzed precisely through comparison with the benchmarks?
- (iv) Is fund management appraisal executed in accordance with appraisal standards and management performance standards?
- (v) Is management performance that is affected by revision of a contract caused by

errors in administrative processes or cancellation of orders?

- (vi) Is management performance of discretionary investment contracts worsened by frequent changes in management style?

### (3) Suitability of Fund Management

#### (i) Fairness in Transaction

A. Are portfolios in compliance with laws and regulations used in fund management?

For example, in investment trust management:

- a. Does the rate of money deducted from proceeds exceed the allocation limit?
  - b. Does it exceed the allocation limit by issue?
  - c. Does the deduction of stocks issued by a single incorporated entity exceed 50%?
  - d. If the amount that corresponds to risk calculated with a method that is rational and in compliance with laws and regulations is to exceed the net value of the investment property, are derivatives transactions conducted or continuing to be conducted?
  - e. Regarding investment property for which the purpose of derivatives transactions is limited to hedging risks, is sale or purchase conducted within the scope of said purpose?
- B. Is the following information collected to examine the stock value formation?
- a. Market trends when a large order is placed
  - b. Stocks with the largest traded volume in the company
  - c. Stocks for which trading volume of the company is the largest
  - d. Stocks with trade restrictions or warnings by the stock exchange regarding stocks to be added to investment property
- C. Are transactions such as the following, which affect the stock price, conducted for stocks included in the investment property?
- a. Are orders placed continuously and in large volume in order to manipulate stock prices to very high or very low levels?
  - b. Are orders placed to buy or sell in large volume in comparison to the most recent buy or sell volume?
  - c. Have orders been placed repeatedly to purchase nearly all of the stocks with a small trade volume?
  - d. Have orders been placed for large volume purchase at lower quotation?
  - e. Have orders been placed repeatedly to purchase stocks with small trade volume based on the co-index?
  - f. Have orders been placed to buy at market-on-close?

- g. Have orders been placed to buy continuously, apparently to manipulate the closing price?
  - h. Have orders been placed to buy or to sell in large volume immediately before closing?
  - i. Have orders been placed to buy finance stocks handled by financial instruments business operators that are deemed to be a parent or subsidiary juridical person at current market value (excluding at opening session) or to buy at continuous or closing sessions in order to set a new high or a new low for the stock?
  - D. If buying or selling securities issued by a listed company that has disclosed important information, is the transaction conducted prior to the disclosure as insider trading, making use of said important information?
  - E. From the perspective of assuring management in good faith, are records kept for off-market transactions for domestic and foreign debentures requiring inquiries? Also, can problems be found in the price?
  - F. Is the transaction price appropriate in the sale or purchase of unlisted securities?
  - G. Can problems be found in the change in outstanding volume of debentures that have not been appraised at market value, due to such securities being unlisted?
  - H. Has the value of unlisted debentures been reduced or upgraded without justifiable reason?
  - I. Has fund management performance been upgraded or reduced, for example, with attention to the market value of redeemable funds, through structured bonds and futures trading?
  - J. If there was an acquisition or transfer of ownership of specified assets (lands, buildings, or rights including lease rights or superficies rights pertaining thereto) in investment assets, has an investment management company had a real estate appraiser who is not an interested party, etc. investigate the value of the specified assets in question pursuant to the provisions of Cabinet Office Ordinance?
  - K. If there was an acquisition or transfer of ownership of specified assets (excluding the specified assets as mentioned in J. above and the assets specified by Cabinet Office Ordinance including listed securities) in investment assets, has an investment management company had a person who is not the investment management company, an interested party, etc. thereof, or a trustee company and who is specified by a Cabinet Order investigate the value of the specified assets in question?
- (ii) Conflict of interests between investment properties
- A. If a transaction is conducted when a conflict of interests is likely, have documents indicating matters pertaining to the transaction in question been issued to the



beneficiary?

- B. When placing a bulk order related to a number of investment properties, is compliance assured for the following matters?
  - a. Are the fund management division and ordering division separate?
  - b. Are records kept, such as by entering into the order invoice the time of sale or purchase order from the fund management division to the ordering division, or the time of receipt of the sale or purchase order by the ordering division and volume of distribution to various investment trusts?
- C. Are transactions of an investment property used as a hedge for another investment property? Also, are sale or purchase orders being placed continuously with an investment property in order to increase the price of stocks held in large volume by another investment property or to increase the net asset value of an investment property approaching redemption?
- D. Is distribution of the initial public offering for investment properties executed in accordance with internal regulations and is fairness among investment properties maintained? Also, is distribution executed deliberately to improve the management performance of a specific fund?
- E. Is stock moved to another investment property after conclusion of an agreement?

(iii) Conflict of interest with a parent juridical person or a subsidiary juridical person

- A. Excluding index management operation, is inclusion of securities issues by a parent or subsidiary juridical person into investment property examined from the standpoint of potential problems in the reasons for such inclusion?
- B. Is there a transaction with a parent or subsidiary juridical person which unilaterally benefits said juridical person?
- C. Is the selection of the financial instruments business operator that receives the order conducted in compliance with selection standards established by the organization, without regard to the presence of affiliation or friendly ties? Also, are orders placed with due care and reflecting the sales value of the beneficiary securities of the financial instruments business operator?
- D. When selecting a financial instruments business operator to receive the order, is there any special benefit received from the said operator?
- E. Is an account rebalanced (investments switched) in order to realize the earnings forecast of the financial instruments business operator with whom the company has affiliation or friendly ties?
- F. In the sale or purchase of stocks for which an affiliated or friendly financial

instruments business operator is manager, are problems found in such a sale or purchase between the date of announcement and the date when the price is set?

G. Has the operator placed a sale or purchase order in response to a request from an issuing company for which an affiliated or friendly financial instruments business operator serves as manager?

(iv) Other Conflicts of Interests

A. Are operations other than financial instruments business and holding the office of director or other posts at another company affecting the management of investment properties?

B. In privately placed investment trusts, have securities held by a parent or subsidiary juridical person or a rights holder been purchased with investment property in exchange for sale to the rights holder?

C. If the sale or purchase of stock by a fund manager with his/her own account and the sale or purchase of the same stock with an investment property he/she is managing takes place, is the sale/purchase in question proper and sound? Also, has there been front running or other improper sales or purchases?

(v) Fund management control

A. Does the history of orders placed with a financial instruments business operator show unnecessary sales or purchases or churning in a short span of time and without economic rationality?

B. Does the operator have a firm understanding of the volume of stocks held as investment property by the entire organization and at the same time submit a report on large-volume holdings by the date prescribed by laws and regulations?

C. Are problems found in the management of investment property that has shown rapid improvement or declines in management performance or in the standard value immediately before the redemption date?

D. Are problems found in the sale or purchase of investment property for which day trading earnings continue or in investment property for which day trading losses continue?

E. Regarding investment property for which specific stocks are purchased or sold in large volumes, are the reasons for the transaction, the purchasing or selling parties, the methods of sale or purchase and the sale or purchase prices proper and beyond doubt? Also, can problems be found in the change in outstanding balance?

F. Is the price researched properly upon inclusion in assets?

G. Can problems be found in the proposal for products when setting up a privately placed investment trust? Also, is price research conducted appropriately and can

problems be found in asset appraisal after addition of assets to a privately placed investment trust?

- H. Are losses compensated under the account titles of miscellaneous losses or business entertainment expenses in a discretionary investment contract?
- I. Are large-scale cross transactions or acquisitions of public offerings being recorded to trace and identify the reasons for the sale or purchase and its process?
- J. Are there instances of frequent sale or purchase orders placed from the investment property of a single fund manager without any justifiable reason?
- K. Are modifications of agreements processed appropriately?

(vi) Exercising Voting Rights

- A. In exercising voting rights, are records of the action kept?
- B. Is each item of the agenda studied and are stockholder voting rights exercised appropriately in a way that fosters an increase in investment earnings?
- C. In the case of investment in an incorporated entity that appears to underperform significantly vis-à-vis its competitors in terms of investment earnings, are procedures established to exercise stockholder voting rights properly?
- D. Can problems be found in the exercising of voting rights for securities held in an investment property from the standpoint of the direction and management records?
- E. Does the discretionary investment contract give voting exercise directions based on the principle objective of entrustment? If directions are given, are they recorded properly in the direction and management records? Also, are directions given for the purpose of promoting the interests of a third party other than the operator and its rights holders?

(4) Obligation of Explanation

- (i) Are management reports produced in accordance with laws and regulations and issued to rights holders?
- (ii) Is adequate explanation given on the asset management history of the operator engaged in selling investment trust securities?
- (iii) Are special provisions related to asset management under the discretionary investment contract specified in the contract and other documents? Also, are the terms and conditions on important provisions related to management written so as not to invite misunderstanding?
- (iv) Are documents recording the investment trust contract and others issued to the rights holder? (Excluding cases in which items to be indicated in such documents are found in the prospectus)

- (v) If important modifications are to be made in the investment trust contract or if it is to be merged into an investment trust by instruction of the trustor, is the decision approved in writing, except in cases which are exempted under laws and regulations? Also, are beneficiaries notified in writing of the changes and other information no later than two weeks prior to the date of resolution?
- (vi) When canceling an investment trust contract, is the decision made in writing, except in cases which are exempted under laws and regulations? Also, are beneficiaries notified in writing of the reason for cancellation and other information no later than two weeks prior to the resolution date?
- (vii) Regarding an investment trust for which the investment management company conducts investment, at the time of occurrence of sudden changes in market trends or of an event having a material impact on markets, does the company promptly prepare a report on the status, etc. of investment and provide it to the financial instruments business operator, etc. engaged in the sales of the investment trust in question?

#### (5) Real Estate Investment Trusts

##### (i) Conflicts of Interest

- A. Regarding a transaction that is likely to obstruct the fiduciary duty of loyalty of the investment management business or to cause a conflict of interest between said business and an investment corporation, are the books and records pertaining to the transaction in question produced according to internal regulations, in order to assure its propriety?
- B. Does the representative director, director or an officer in charge of supervising management verify the content of transactions that are likely to cause conflicts of interest with an investment corporation, such as those shown below, and protect the interests of the investment corporation?

##### **[Conflicts of Interest Related to Sales or Purchases]**

- a. Is property held by a parent or subsidiary juridical person added into the assets of the investment corporation at a price higher than the optimal price level?
- b. Is property that is held by a parent or subsidiary juridical person and that does not satisfy the acquisition standards of the said juridical person added into the assets of the investment corporation?
- c. Is property mediated by a parent or subsidiary juridical person added into the assets of the investment corporation at a price higher than the optimal price level?
- d. Is property acquired at a price higher than the optimal price level for the purpose of gaining management compensation?

- e. Are unnecessary sales and purchases conducted repeatedly or is unnecessary sale or purchase mediation entrusted to a parent or subsidiary juridical person for the purpose of gaining brokerage fees as a real estate agent?
- f. Are properties acquired in packages that include properties not satisfying acquisition standards?
- g. Is the investment corporation made to purchase real estate that does not provide benefits to the said corporation, in order to increase the value of adjoining properties?
- h. Is action taken to pursue unfair benefits for one investment corporation at the expense of another, such as making one investment corporation purchase property that does not provide benefits, in order to increase the value of the property purchased by another investment corporation?
- i. Are opportunities for property sales decreased for an investment corporation, such as by placing priority on the sale of property held by a parent or subsidiary juridical person, when a similar property is to be sold by the investment corporation?
- j. In the case of a condominium sale project conducted by a parent or subsidiary juridical person, is action taken to impede the interests of an investment corporation by adding unsold units into the assets of the said corporation?

**[Conflicts of Interest Related to Commissions and Charges]**

- a. In the appointment of a management company for real estate and other properties, is the parent or subsidiary juridical person appointed preferentially and without any justifiable reason, or is the contract concluded at a compensation level higher than normal?
- b. In the case of sales or purchases of assets of an investment corporation with a third party, is action taken that impedes the interests of said corporation, such as requiring brokerage fees and other commission that is basically not necessary by unnecessarily appointing the parent or subsidiary juridical person as the broker?

**[Conflicts of Interest Related to Tenants]**

- a. In the case of tenant brokerage, is higher priority placed on introducing tenants to stockholders than to the investment corporation?
- b. In a transaction between investment corporations, have there been sales or transfers of ownership of property held by one party or its tenants to the other party at unfair terms and conditions?
- c. Regarding tenant brokerage companies, are instructions issued to prioritize tenants introduced by a parent or subsidiary juridical person over tenants from other

brokers without a justifiable reason?

d. Is a parent or subsidiary juridical person accepted unfairly as a tenant at a lease fee that is higher or lower than the normal level?

C. In appointing a tenant brokerage company, is a parent or subsidiary juridical person appointed preferentially without a justifiable reason?

D. In the sale or purchase of property between an investment corporation and a third-party or in an independent lease transaction, are transactions conducted with the investment corporation becoming party or proxy in the sale or purchase transaction without approval of the investment corporation and at terms and conditions in the transaction that are disadvantageous to the said corporation and benefiting either the tenant or a third party?

(ii) Investment Management Control

A. Are key money and other income, amortization costs and other expenses and deposits such as guarantee money accounted for appropriately? Also, are they checked appropriately?

B. In borrowing funds, is attention paid to the impact on financial affairs, such as the value of the loan, the interest rate and the payment period? Also, are checks conducted on whether attention is paid to such factors?

C. If there was an acquisition or transfer of ownership of specified assets (lands, buildings or rights including lease rights or superficies rights pertaining thereto) by an investment corporation investing assets, has an asset management company had a real estate appraiser who is not an interested party, etc. investigate the value of the specified assets in question pursuant to the provisions of Cabinet Office Ordinance?

D. If there was an acquisition or transfer of ownership of specified assets (excluding the specified assets as mentioned in C above and the assets specified by Cabinet Office Ordinance, including listed securities) by an investment corporation investing assets, has an asset management company had a person who is not the investment corporation, asset management company (including the interested party, etc. thereof) thereof, or trustee company and who is specified by a Cabinet Order investigate the value of the specified assets in question?

E. Are documents explicitly indicating the sale or purchase of real estate and other properties on one's own account issued to the investment corporation at least once every three months?

(iii) Obligation of Explanation

A. Is the information necessary for right holders to make investment decisions disclosed as is required, based on information disclosure regulations established by

- the investment company, for the purpose of investor protection?
- B. In the case of transactions with a parent or subsidiary juridical person, is information disclosed actively, such as by issuing documents indicating the details and reasons for the transaction to rights holders and the investment corporation?
  - C. In the case of losses or damages sustained on a managed property due to natural disasters or transfer of ownership, in the case of acquisition of a large property or in the case of differences arising in final profits or losses or in dividends, are the relevant information and reasons disclosed in a timely fashion?
  - D. If the annual rent of the principal tenants cannot be disclosed due to a compelling reason, is this fact disclosed so as not to mislead investment decisions by rights holders?

#### (6) Investment Corporations

Does the financial instruments business operator engaged in asset management on consignment from a registered investment corporation comply with the laws and regulations that apply to Type II financial instruments business operators when handling solicitations for investment corporation bonds and investment units issued by said corporation?

## 2. Internal Control

### (1) The Status of Verifications of Daily Operations

- (i) Do personnel in charge of internal control properly verify that ledgers and other documents related to business operations, including order invoices, are entered correctly and stored appropriately?
- (ii) If errors or differences are found when cross checking the transaction records held by the business operator against the agreement data obtained from the transaction partner, is the cause of the problem investigated without delay and modified based on a method established in advance?
- (iii) Regarding the handling of internal administrative operations, is attention paid, for example, to the following?
  - A. In the daily verification of transaction details, do personnel in charge of internal control conduct adequate research and verification on the reasons, background, processing methods and other matters, especially those related to exceptional transactions conducted outside internal regulations, and do they keep accurate

records of such transactions?

B. Is the standard value calculated accurately on a daily basis? Also, is its accuracy verified?

C. Is the input data used in standard value calculation checked against input results?

(iv) Is investment management conducted by executing transactions that are unnecessary in view of the investment management business policy, the value in investment property or the conditions in the market, in order to promote the interests of the parent or subsidiary juridical person?

(v) If differences are found in assets included in a property as a result of a transaction, are the day-to-day changes in the stock where the differences were found examined, and the unit price and outstanding balance for each stock checked regularly against the books and other records of the asset maintenance company?

(vi) Is the scope of the parent or subsidiary juridical person assessed accurately?

(vii) Do personnel in charge of internal control verify that the pre-contract documents of a discretionary investment contract or other contracts appropriately show the information that is prescribed by laws and regulations?

(viii) Has the operator received deposits in money or securities from the rights holder? Also, has the operator entrusted deposits of money or securities belonging to the customer to a party with close ties to said operator?

(ix) Has the operator loaned either money or securities to a rights holder? Also, has the operator engaged an intermediary, brokerage or agency services for a monetary or securities loan by a third party to the right holder?

(x) Is there a conflict of interest with the rights holder regarding the sale or purchase of securities held by the operator and by its parent company or subsidiary juridical person?

(xi) Is the report on investment property management issued appropriately to the rights holders in compliance with laws and regulations? Also, is said report submitted to the administrative authorities without delay, in compliance with laws and regulations?

## (2) Modification of Terms and Conditions of Contract

(i) Are modifications in the agreement which were caused by administrative processing errors executed appropriately by clearly identifying the reason for modification, and is a system in place for confirmation of the modification in question at a later date?

(ii) Do personnel in charge of internal control confirm that modification or cancellation of a transaction is processed appropriately according to internal rules?

(iii) Are modifications executed accurately, based on the development of administrative



manuals pertaining to modification of the standard value that come as a result of input errors or other administrative processing errors?

- (iv) Is it noted that, should administrative processing errors result in damage to the rights holder or investment property and compensation not be provided for such damage, there is a possibility of falling into the category of a violation of the fiduciary obligation of loyalty?

Also, is it noted that if such an error was made by a service subcontractor, it is equivalent to not providing compensation for damages by the investment management business with a fiduciary obligation of loyalty to rights holders?

- (v) Does the personnel in charge of internal control examine whether order placement is conducted appropriately? For example, are errors in orders handled according to internal regulations?

### (3) Other Conditions for Verification

- (i) Are signs placed at locations that are highly visible to the public at each business office or place of business? Also, are the signs written in characters that are highly readable?

- (ii) Are provisions of laws and regulations followed faithfully in the investment trust contracts, business reports and securities application forms, and are such documents submitted to the administrative authorities? Also, does a manager examine information in documents to be submitted and manage conditions of document submissions appropriately?

In cases of modification, as well as cancellation of investment trust contracts, are the administrative authorities notified in advance?

- (iii) In advertising investment trusts, are personnel who inspect advertisements (personnel in charge of advertising inspection) appointed? Also, do said personnel also check advertising that is organized by a single business division or by employees?

- (iv) Is advertising verified for compliance with regulations prescribed by the self-regulating body and at the same time cross checked by the personnel in charge of advertising inspection in advance, if there is possibility of violation of said regulations?

- (v) Are books and records regarding investment properties produced? Also, are such documents kept for the number of years prescribed by law?

- (vi) Regarding its investment management business operations (excluding the conclusion of discretionary investment contracts), are investment properties

belonging to the business operator managed separately from other investment properties?

### 3. Property and Accounting

#### (1) Inspection Method for Calculation of Net Property Value

In calculating net property value, the inspector is to verify whether the financial instruments business operator has entered assets, liabilities and profits/losses in financial documents on the standard date in accordance with the corporate accounting standards that are recognized widely as fair and reasonable, while paying due attention to possible omissions in the assets and liabilities accounts or the presence of accounts that are not entered in the records, and is to calculate net property value by finalizing financial figures that reflect real conditions at the point of calculation, based on asset and liability valuation and other methods.

##### (i) Modification of accounts

Each account title in the balance sheet and profit/loss statement is verified, with correction of accounting errors, adjustment in compensatory offset account processing and other fair modifications in accounting for the financial instruments business operator processed as modification of accounts.

Net property value calculated from figures in each account title after modification is defined as "net property value (standard value)."

##### (ii) Calculation of net property value

By making adjustments in "net property value (standard value)" after valuation and modification processing, the "net property value (appraised value)" is established.

In calculating net property value, financial and other documents are checked to see whether accounting is executed properly in accordance with the Companies Act and accounting standards are generally recognized to be fair and reasonable. If accounting is not processed properly, necessary modifications are made.

##### (iii) Valuation

With classification of monetary liabilities through valuation of assets and liabilities, valuation of securities and valuation of other assets, those without asset value and those with extremely small asset value based on a comprehensive assessment of various conditions are determined and removed from net property value.

Other corrections are finalized.

Each account title in the balance sheet and profit/loss statement is verified, and

accounts for which the core capital level is modified by increasing or decreasing either assets or liabilities are processed as “other corrections.”

(iv) Monetary claims

Are monetary claims, such as third-party payments, and loans classified by the state of finances of the right holder, business performance and other factors, based on the available information and materials? Is allowance for doubtful accounts to be deducted from monetary claims entered based on rational estimation of future losses? Specifically, these are classified into general claims, doubtful claims, bankruptcy reorganization claims and others in accordance with the Accounting Standards for Financial Instruments (Accounting Standards Board of Japan), with monetary claims valued with calculation of the allowance for doubtful accounts for each claim category.

Are claims against consolidated subsidiaries based not on the net property value in the profit/loss statement but on real net property value, including unrealized losses or profits on assets owned? In case of a decline in asset worth and the possibility of the claim in question becoming unrecoverable, is calculation of the amount expected to be unrecoverable based on proper decision-making? In this case, is the net property value calculation based on measures, such as self-assessment and charge-off/reserve, and implemented based on the Financial Inspection Manual for valuation of assets, such as business loans held by the consolidated subsidiary, from the viewpoint that such a subsidiary engaged in money lending is required, to an extent, to execute claims management equivalent to banks and other financial institutions and to practice strict claims classification?

(v) Securities

Are securities classified into securities for sale, debentures held to maturity, stocks of subsidiaries and affiliated companies and other securities in accordance with the Accounting Standards for Financial Instruments, and are appraised value and valuation difference calculated for each category?

A. Securities for sale

Value is determined at market value. Valuation difference is handled as current profits or losses.

B. Debenture held to maturity

Value is determined at historical cost.

However, if debenture was acquired at a value higher or lower than face value and the difference between the acquisition value and debenture value is recognized as an adjustment in interest rates, the value assessed with amortized cost method will be

established as the appraised value.

C. Stocks of subsidiaries and affiliated companies

Value is determined at historical cost.

D. Other securities

Value is determined at market value. Valuation difference is processed in either of the following ways based on the reversal method.

- a. The sum total of the valuation difference is entered as net assets.
- b. Valuation difference for stocks whose market value exceeds acquisition cost are entered as net assets, and valuation difference for stocks whose market value falls below acquisition cost are handled as current losses. Moreover, deferred tax accounting applies to valuation difference entered as capital. Such valuation difference is classified as other surpluses in capital.

E. Securities without market value

- a. Value of debenture is determined by calculation based on acquisition cost or employing the amortized cost method, based on the value of the claim.
- b. Securities other than debenture are appraised at acquisition cost.

F. In case of significant decline in market value

Should there be significant decline in market value or in value based on rational appraisal (i.e., market value) of securities (including stocks of subsidiaries and affiliated companies) other than securities held for sale, said market value is to be determined as appraised value, except when a recovery of value appears to be possible, and the valuation difference is to be handled as current losses.

In case of a significant decline in the real value of stocks without market value (including stocks of subsidiaries and affiliated companies), due to deterioration in the financial status of the issuing company, the value is reduced accordingly, and the valuation difference is handled as current losses.

Because a debenture without market value is to reflect the value of the monetary claim, reduction in the value of such a debenture is determined by calculating the total loan loss from the claim based on the amortized cost method.

G. Market transactions of derivatives

Net claims and liabilities resulting from derivatives transactions are to be appraised at market value as a general rule. Valuation difference should be handled as current loss or profit, except when hedge accounting is applied and carry-over of profit/loss is approved.

Claims and liabilities resulting from market transactions of derivatives are to be appraised at the final price in the said exchange on the day each claim is to be

calculated or at equivalent value calculated rationally.

In case of over-the-counter derivatives, the value is calculated rationally at a level equivalent to market value, if any such value exists.

In case of derivatives for which fair appraisal value is extremely difficult to determine, the acquisition value is determined as appraisal value.

(vi) Third-party payments and advance payments

Are payments to be classified as expenses for a past period of time, as of the standard date, deducted from net property value?

(vii) Sundry receivables and accrued profits

Are such receivables valued with attention to asset characteristics and corresponding to the level of risk of decline or recovery in value?

(viii) Other liquid assets

Liquid assets other than the above are to be appraised as a rule at book value.

However, if there was a significant decline in the market value of the liquid asset in question vis-à-vis book value and it appears highly unlikely that said value will recover to book value, is the market value in question determined as appraised value and the valuation difference deducted from net property value?

(ix) Fixed assets (excluding the above)

If recovery of the investment value is believed unlikely for tangible fixed assets, intangible fixed assets, investments and other assets (excluding financial assets, deferred income tax assets and long-term pre-paid interests) due to decline in profit performance of the asset, impairment accounting is executed in accordance with the Accounting Standards for Impairment of Fixed Assets.

(x) Deferred assets

Appraisal value is to be book value as the general rule.

However, in case of shortfall in depreciation for the deferred asset in question, is the value from which the depreciation shortfall is deducted determined as the appraisal value, and is the depreciation shortfall in question deducted from the net property value?

(xi) Reserves

Are they calculated based on accounting standards recognized generally as fair and reasonable?

(xii) Accruals (excluding allowances for doubtful claims)

Are they calculated based on accounting standards recognized generally as fair and reasonable?

## (2) Calculation Method for Net Property Value

The net property value is calculated with assets and liabilities by deducting the total value of the amount to be entered as liabilities (excluding the total value of the amounts listed below) from the total value of the amount to be entered as assets in the profit/loss statement.

If there are allowances or reserves with profit retention characteristics or reserve fund characteristics, they are required to be entered as liabilities under the provision of laws and regulations governing other businesses of the operator.