

Outline of Basic Inspection Policy and Inspection Program for Business Year 2009

- * As a result of a series of regulatory reforms, including the revision of the Financial Instruments and Exchange Act, the scope of business operators subject to SESC's inspection has increased and expanded dramatically.
- * The inspections should be conducted in such a way as to respond to the current global financial crisis.



How SESC's Inspection Should Be

- Risk-based inspection taking into account the size and risk profiles of each business operator
 - Inspection that enhances financial instruments firms awareness of their role as gatekeepers who contribute to ensuring the fairness and soundness of financial and capital markets
 - Inspection that takes a proactive approach toward the emerging risks to prepare for the future
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- More Efficient and More Effective Inspection**
- [Efficient Inspection] An inspection is efficient when it harnesses and adds to the self-improvement efforts by financial instruments firms
- [Effective Inspection] An inspection is effective when it leads to sustainable improvement efforts in the firm's internal control systems
- * Initiatives for More Efficient and More Effective Inspection

 - Introduction of prior notice inspection, on a tentative basis
 - Enhanced dialogue during the on-site inspection, etc.

© Points to Consider Regarding Efficient and Effective Inspections

- 1) Taking the basic approach of verifying conducts in violation of laws and regulations, focus also on the verification of appropriateness of the internal control systems, etc. of financial instruments firms, which could possibly be a factor in causing violations, taking into account the size and characteristics of those firms
- 2) Take a sharper risk-focused approach in the selection of financial instruments firms to be inspected, as well as of areas to be inspected.
- 3) Put more emphasis on interactive dialogues with financial instruments firms.
- 4) Enhance transparency and predictability in the inspection process through the publication of the revised “Inspection Manuals for Financial Instruments Firms.”

[Other Agenda]

- In light of the recent subprime loan crisis, one of the SESC inspection’s focuses will thus be on the securitization process, namely underwriting examination, risk management, and other systems of financial instruments firms that arrange, underwrite, and market such securitized instruments.
- The Financial Instruments and Exchange Act (FIEA) was revised to relax the firewall regulations among securities firms, banks and other firms, on the condition that their internal control systems for managing conflict of interest be enhanced. The SESC will accordingly look into this new area of disciplines.
- The SESC’s inspections of globally operating financial instruments firms will pay due attention to the overall quality of the firms’ management of risk, including the financial soundness.

© Areas of Inspection Focus

- 1) Verification of market intermediary functions of financial instruments firms
- 2) Verification of risk management systems of financial instruments firms
 - ☞ Verification of risk management systems of globally operating financial instruments firms, including the IT operational risk and the financial soundness of financial instruments firms
 - ☞ Verification of risk management systems of financial instruments firms that are engaged in foreign exchange margin trading
- 3) Verification of the management of undisclosed corporate information (Prevention of unfair insider trading)
- 4) Verification concerning the appropriateness of asset management business
- 5) Verification of conduct that may hinder fair price formation
- 6) Verification concerning the state of soliciting investors and customer care
- 7) Verification for the appropriate exercise of SROs function
- 8) Verification concerning financial firms to be newly inspected, and new financial instruments
- 9) Improvement of problems identified in previous inspections

© Basic Inspection Program

- Type I Financial Instruments Business Operators, etc: 130 firms (including 110 firms to be inspected by the Local Financial Bureaus)
- Asset management firms and Investment advisories/agencies: 65 firms (including 35 firms to be inspected by the Local Financial Bureaus)
- Self regulatory organizations: To be inspected as needed
- Type II Financial Instruments Business Operators, etc.: To be inspected as needed