

# Strategy & Policy of the SESC 2017-2019

## - Building on a Quarter-Century of Achievement -

20/January/2017

Securities and Exchange Surveillance Commission

### Mission

1. Ensuring market integrity/protection of investors
2. Contributing to sound development of markets
3. Contributing to sustainable economic growth

### SESC's Vision on Market Integrity

- Compliance with rules and trust from all market participants –  
<Key elements>

1. Proper disclosure by listed companies and issuers
2. Appropriate conduct and practices by market intermediaries
3. Self-discipline by all market participants
4. Effective market oversight with a high degree of professionalism

### Values

1. Fairness:  
Fair and independent oversight
2. Accountability:  
Holistic and root-cause analysis coupled with public outreach
3. Forward-looking Perspective:  
Early detection of signs of market misconduct
4. Effectiveness and Efficiency:  
Effective use of resources
5. Strong Collaboration:  
Working closely with SROs and other competent authorities, both domestic and overseas
6. Commitment to Excellence:  
Committing to achieve highest standards of oversight

## Environmental Scan

The SESC was established in 1992 with the aim of ensuring market integrity and protection of investors. In 2017, the SESC celebrates its 25th anniversary. During this past quarter-century, the SESC has made significant progress in enhancing market integrity and trust from all market participants through various measures; i.e. criminal enforcement against material market abuse which the SESC was empowered from the beginning, as well as additional powers and efforts including a development of examination/investigation for administrative monetary penalty system, an IT and HR development in response to increasingly complex securities markets and transactions; and an enhanced cooperation with competent authorities both domestic and overseas.

In the meantime, the environment surrounding the SESC has significantly changed as follows:

- **Global Macroeconomic Uncertainties:** Uncertainties over the global economy, including possible impact of Brexit, have been increasing.
- **Increasing Market Globalization:** Increasing volume of cross-border transactions and market globalization (e.g., acceleration of overseas business expansion by Japanese companies, increase in overseas investment by Japanese institutional investors, and significant presence of overseas investors in the Japanese market) has made the Japanese market more connected and volatile to the global macro-economic developments and events overseas.
- **Further Advancement of Information Technology:** The market structure has significantly changed with the development of IT technology. Rapid growth of high-speed algorithmic trading and recent development of FinTech<sup>1</sup> could make further changes and innovations in the markets. At the same time, threats of cyber-attacks against the financial system have been growing.

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<sup>1</sup> “FinTech” is a coined word that combines “Finance” and “Technology,” referring mainly to innovative IT-based financial services.

- **Effective Deployment of Household Financial Assets:** In Japan, the Financial Services Agency (FSA) has been taking a number of measures to promote effective deployment of huge financial assets of the Japanese households under the aging population. The SESC contributes to such initiatives through making the markets reliable for investors.

The SESC, at the beginning of its 9th term, has set out the following strategic objectives to achieve its mission under the changing environment, both domestic and overseas. The SESC will continue to make further efforts by effective and efficient use of its expertise and resources of market oversight towards ensuring trust from all the market participants and stakeholders.

## Strategic Objectives

### 1. Holistic market oversight

- **All new products/transactions:**  
Adequate understanding and analysis of risks of all new products/transactions
- **All financial markets:**  
Market-wide monitoring, including Proprietary Trading System (PTS), dark pools<sup>2</sup>, derivatives and primary equity/bond markets, not limited to cash equity markets in the stock exchanges
- **Bigger picture in addition to details:**  
Analysis of entire picture of individual cases, including root causes

### 2. Timely market oversight

- **Early detection of potential market misconduct:**  
Timely detection of signs of market misconduct and response to address them through examination/investigation

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<sup>2</sup> A dark pool commonly means a private electronic stock trading platform, usually created and run by some of securities firms, matching sell orders/buy orders and passing the orders on to off-floor trading markets.

- **Preemptive actions against market abuse:**  
Prevention of misconduct and its expansion through preemptive actions against market abuse
- **Effective investigation and early corrective action:**  
Timely analysis of individual cases and effective remedial measures to fix the problems

### 3. In-depth market oversight

- **Root-cause analysis:**  
Deep-dive identification and analysis of root causes behind market misconducts towards encouraging effective corrective actions to fix and prevent recurrence of the problems
- **Horizontal analysis for system-wide issues:**  
Identification of market-wide structural issues based on horizontal analysis of market misconducts and contribution to policy development for enhanced market integrity

## Concrete Measures

### 1. Intelligence Gathering

- **Forward-looking analysis of potential market misconduct from macro-economic perspective:**
  - In order to prevent market misconduct and to facilitate the early detection of such misconduct in the rapidly changing market environment, the SESC will conduct forward-looking analysis and identification of potential market misconduct from a macro-economic perspective, in addition to conventional ex-post oversight.
  - In particular, the SESC will conduct analysis on emerging impact of macro-economic developments to specific industries and companies in relation to their stock prices and potential market misconducts. The results will be shared within the SESC for the use of examination/investigation.

- **Enhanced cooperation with foreign authorities:**
  - The SESC will enhance working relationships with foreign authorities through mutual trusts, including information-sharing as well as cooperation in examination/investigation and enforcement actions. The SESC will also make effective use of information on enforcement actions and new regulations overseas for its market oversight in Japan.
- **Oversight of all new products/transactions:**
  - The SESC will, through continuous monitoring, cover all products /transactions in the markets including those newly developed as well as those hard to be identified for oversight.

## 2. Prompt/Effective Examination/Investigation

- **Effective use of monetary penalty investigation:**
  - The SESC will conduct prompt and efficient examination/investigation of market misconduct through effective use of monetary penalty investigation in response to the larger and more complex market misconduct.
- **Proactive response to cross-border matters:**
  - The SESC will take proactive enforcement action against cross-border market misconduct by using the information-sharing framework among foreign authorities.
- **Response to material market abuse with criminal investigation:**
  - The SESC will take robust enforcement action against material market abuse by conducting criminal investigation. In addition, the SESC will cooperate with relevant organizations including other law enforcement authorities both in Japan and overseas in order to effectively address the misconduct by deep-dive investigation as well as imposing adequate penalty.
- **Effective risk-based monitoring of regulated entities:**
  - The SESC will conduct seamless on-site/off-site monitoring and effective risk assessment of all financial instruments business operators based on their business models and effectiveness of their governance and risk management.
  - The SESC will conduct on-site monitoring based on risks identified

through off-site monitoring. The on-site monitoring will conduct in-depth review of products and transaction schemes to assess the appropriateness of business operation, and will identify root cause of problems.

### 3. In-depth Analysis of Investigation Results

- **Root-cause analysis:**
  - The SESC will make a recommendation for administrative disciplinary actions against non-compliance with laws and regulations which are identified by inspections and investigations. In addition, the SESC will conduct holistic analysis of the entire picture of the problems and identify their root causes to prevent recurrence of similar issues.
- **Leveraged use of outputs of oversight activities:**
  - The intelligence<sup>3</sup> obtained through individual SESC's inspections and investigations will be shared within the SESC to be accumulated and used for future market oversight activities across the SESC.
- **Enhanced public outreach:**
  - The SESC will enhance its public outreach through providing more information on individual cases including their backgrounds as well as their implications for market discipline.
- **Contribution to policy development for better market environment:**
  - The SESC will identify structural or system-wide issues through horizontal or thematic approach of inspection and investigation and contribute to policy development for better market environment.
- **Contribution to international cooperation for market oversight:**
  - Based on its oversight activities, the SESC will contribute to international cooperation for market oversight by active participation in the policy discussion as well as by collaboration with overseas authorities through bilateral/multilateral information-sharing frameworks, including the IOSCO MMoU.

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<sup>3</sup> "Intelligence" means the information useful not only for specific individual cases but also for other cases.

#### 4. IT and HR Development

- **Development of RegTech:**
  - In response to structural changes including development of IT and AI (Artificial Intelligence) technology in the securities market, the SESC will enhance its IT platform (RegTech<sup>4</sup>) for its market oversight, including the transaction surveillance system.
- **Response to FinTech development:**
  - The SESC will timely respond to new types of transactions and products arising from IT innovation, including FinTech, in order to conduct holistic market oversight.
  - In response to recent advancement of IT and increase of data capacity, the SESC will upgrade its competence on Digital Forensics<sup>5</sup> technology for examination/investigation.
- **Enhanced expertise of SESC staff with a broader perspective:**
  - The SESC will continue to develop further human resources with highly skilled expertise and a broader perspective for market oversight in order to properly achieve its mission.

#### 5. Cooperation with SROs and other stakeholders

- **Closer cooperation with SROs for effective/efficient market oversight:**
  - The SESC expects enhanced role of SROs for market oversight under significant changes in the domestic and overseas market environments through their timely and flexible approach. The SESC will share more information with SROs to support their market oversight function.
  - In response to the increased volume of high-speed algorithmic transactions from overseas, the SESC will enhance its transaction surveillance mechanism in cooperation with SROs. In addition, the SESC will expect enhanced trade surveillance function among broker dealers as market gatekeepers.

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<sup>4</sup> “RegTech” used here means the use of IT innovation in connection with regulatory and enforcement authority.

<sup>5</sup> “Digital Forensics” is a process of analyzing electronic data and preserving evidence.

- In response to a shift to seamless on-site/off-site monitoring of financial instruments business operators, the SESC will also discuss with SROs for better oversight function of their member firms in coordination with the SESC's monitoring.
- **Enhanced cooperation with various stakeholders for market integrity:**
  - In addition to the existing cooperation with SROs and foreign authorities, the SESC will enhance cooperation with various stakeholders for market integrity including investors and other market participants towards market-wide discipline.

## Conclusion

The SESC, celebrating its 25<sup>th</sup> anniversary this year, will move forward to ensure securities market with compliance and trust from all market participants through achieving three objectives set out in this Strategy & Policy: (1) Holistic, (2) Timely, and (3) In-depth market oversight.

This Strategy & Policy was prepared in light of the current economic and financial situation. As the environment surrounding the markets rapidly changes, it is important for the SESC to take proactive responses to new issues and challenges based on PDCA cycle<sup>6</sup>. In order for that, the SESC will conduct continuous review of its market oversight approach by listening to views among external experts.

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<sup>6</sup> "PDCA cycle" is a method for continuous improvement by repeating "Plan, Do, Check, Action" cycle.