



The SESC's Inspection Policy and Program for 2013-14

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(Note) Any views of the presentation today are not the official views of the SESC .

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1. Role of inspection



I. Role of Inspection

Mission of the SESC

- Conduct market surveillance in order to
 - ensure integrity, fairness and transparency of capital markets, and
 - protect investors

Independence and Cooperation

- The SESC conducts on-site inspections
 - on the financial instruments business operators, etc. (BOs),
 - as an independent authority from the FSA
 - in cooperation with off-site monitoring of the FSA

Objectives of Inspection

- To encourage the improvement of internal control systems in the BOs
- To ensure the appropriateness of risk management systems including financial soundness in the BOs
- To enhance the awareness of the BOs as gatekeepers

Stance in Inspection

- To build common understandings through interactive dialogue with officers and employees in the BOs
- To evaluate the awareness of senior management regarding internal control systems
- To review business operations from wider viewpoint and to focus on serious problems



2. Changes in Circumstances



2. Change in Circumstances

Changes in Circumstances

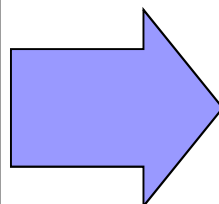
Diversification and increase in the number of BOs

- Around 8,000 operators engage in business
- Actions have to be taken against unregistered business operators
- Financial instruments and transactions have become more diverse and complex

2. Change in Circumstances

SESC's establishment

- Domestic Securities Companies
216 (Dec.1992)
- Foreign Securities Companies
49 (Jun. 1992)
- Financial Futures Dealers
216 (May. 1993)
- Registered Financial Institutions
619 (Jul. 1993)



March 2013

1. Type I Financial Instrument Businesses Operators 285
 2. Registered Financial Institutions 1,126
 3. Asset Management Firms 315
 4. Investment Corporation 53
 5. Investment Advisories/Agencies 1,051
 6. Type II Financial Instrument Businesses Operators 1,279
 7. Specially Permitted Business Notifying Firms for Qualified Institutional Investors 3,017
 8. Financial Instruments Intermediaries 743
 9. Self-Regulatory Organization 11
 10. Credit Ratings Agencies 7
- (Unregistered Business Operators)

2. Change in Circumstances

Expansion of the Scope of Verification

Traditional Focus in Inspection

- Compliance with Rules of Conduct -



Global Financial Uncertainties

Rapid Changes in Instruments and Transactions

New Areas of Verification

- The appropriateness of the internal control systems, financial soundness and risk management systems especially for securities groups engaging in large and complex business operations

Business Management			
Internal Control on Legal Compliance			
Risk Management (including Financial Soundness)			
Risks concerning Regulations on Capital Requirements	Operational Risk	IT Systems Risk	Other Risks (e.g. Investment Risk, Funding Risk)
Internal/External Audit Function			
Crisis Management (BCP)			



2. Change in Circumstances

Towards Enhanced Market Integrity

- The SESC's Policy Statement for the 7th Term -

Policy Directions

- The Japanese capital markets have been experiencing dynamic changes. Global efforts to rebuild the international regulatory frameworks are ongoing based upon lessons learned from the global financial crisis. A series of amendments have been made to the Financial Instruments and Exchange Act (FIEA). Innovations are continuing in financial products and trading methods. In response to this rapidly changing market environment, and to continue to be “feared by wrongdoers and trusted by ordinary investors”, the SESC is determined to pursue our mission through the following three policy directions.
 - (1) Market oversight with prompt and strategic actions
 - (2) Outreach activities for enhanced market integrity
 - (3) Response to the globalization of markets



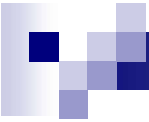
2. Change in Circumstances

Towards Enhanced Market Integrity

- SESC's Policy Statement for the 7th Term -

Primary Measures - Excerpt of securities inspection inspections -

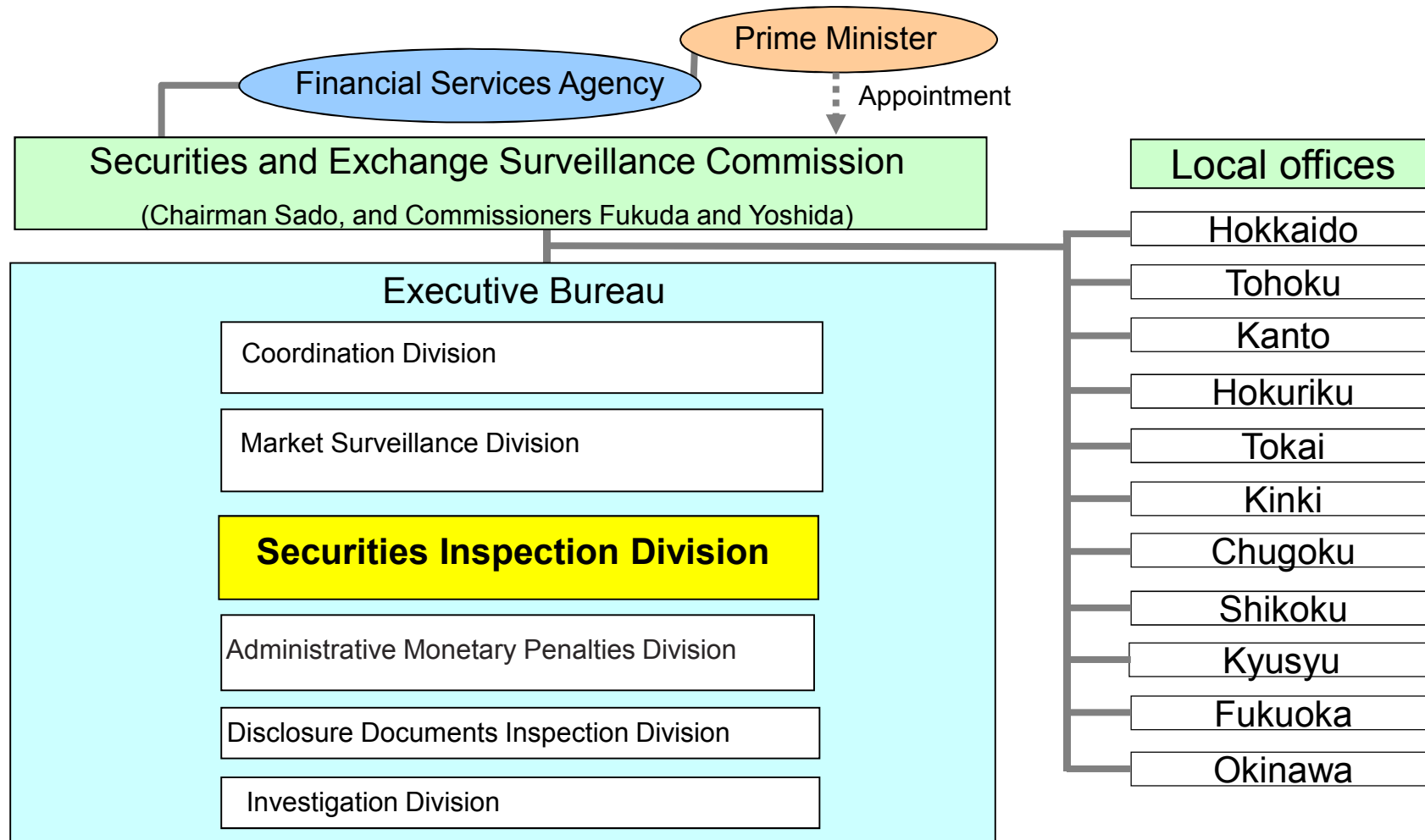
- Efficient and effective inspections corresponding to the characteristics of firms to inspect
 - **Efficient and effective inspections**
⇒ Developments of capabilities and skills corresponding to the characteristics of firms to inspect
 - **Forward-looking verifications for Globally active securities firms**
⇒ Verifying the appropriateness of their internal control and risk management systems
 - **Taking appropriate actions against fund dealers and investment advisors**
⇒ Verifying their operations and compliance from the perspective of investor protection and taking rigorous actions as necessary
 - **Taking rigorous actions against unregistered entities**
⇒ Taking rigorous actions such as petitions for court injunctions
- Enhanced cooperation with SROs
 - **Further cooperation with SROs in Oversight of member firms, rule-making, as well as outreach to market participants and investors**





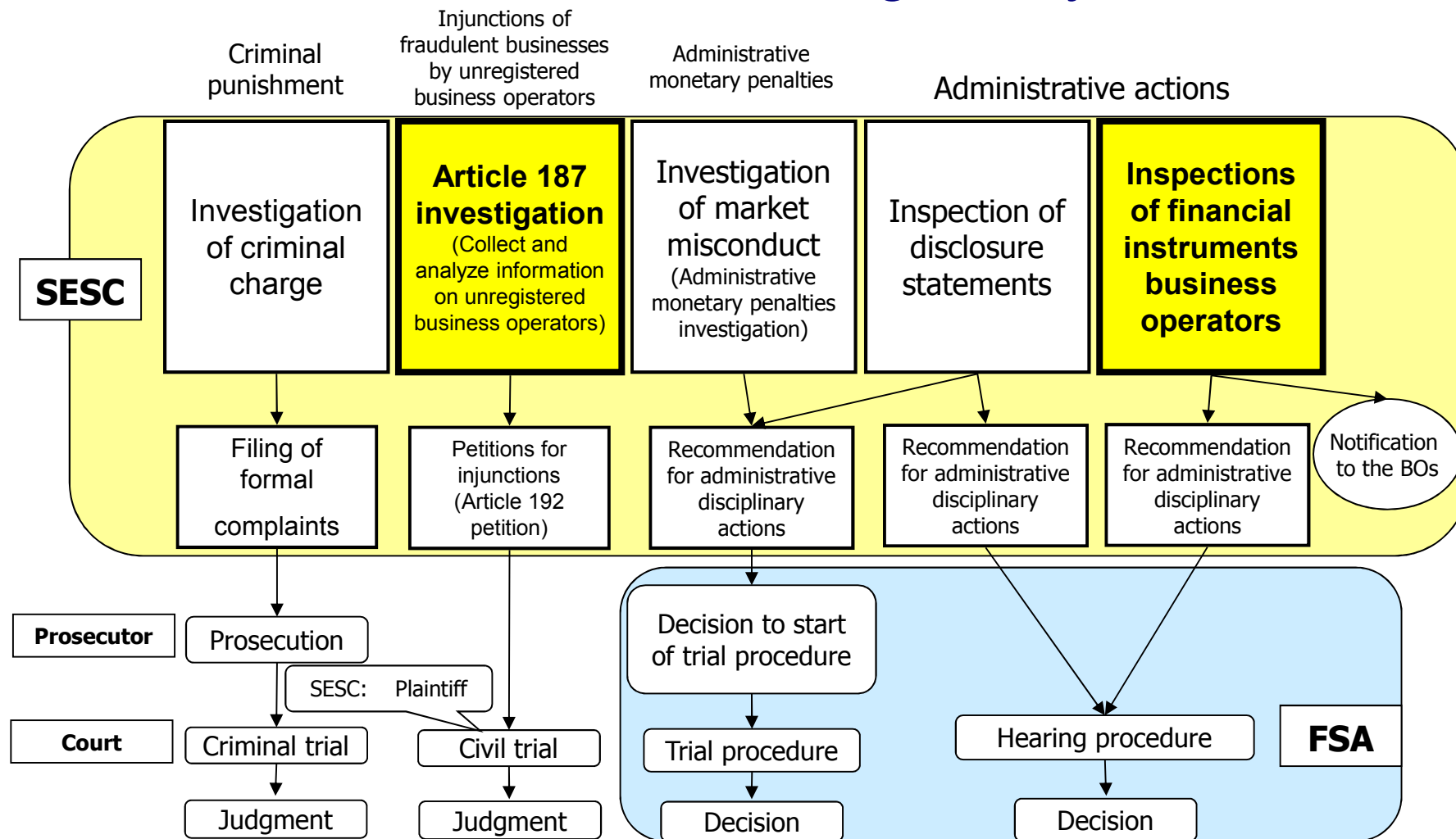
3. Process and Practice of Securities Inspection

Organization of the SESC



3. Process and Practice of Securities Inspection

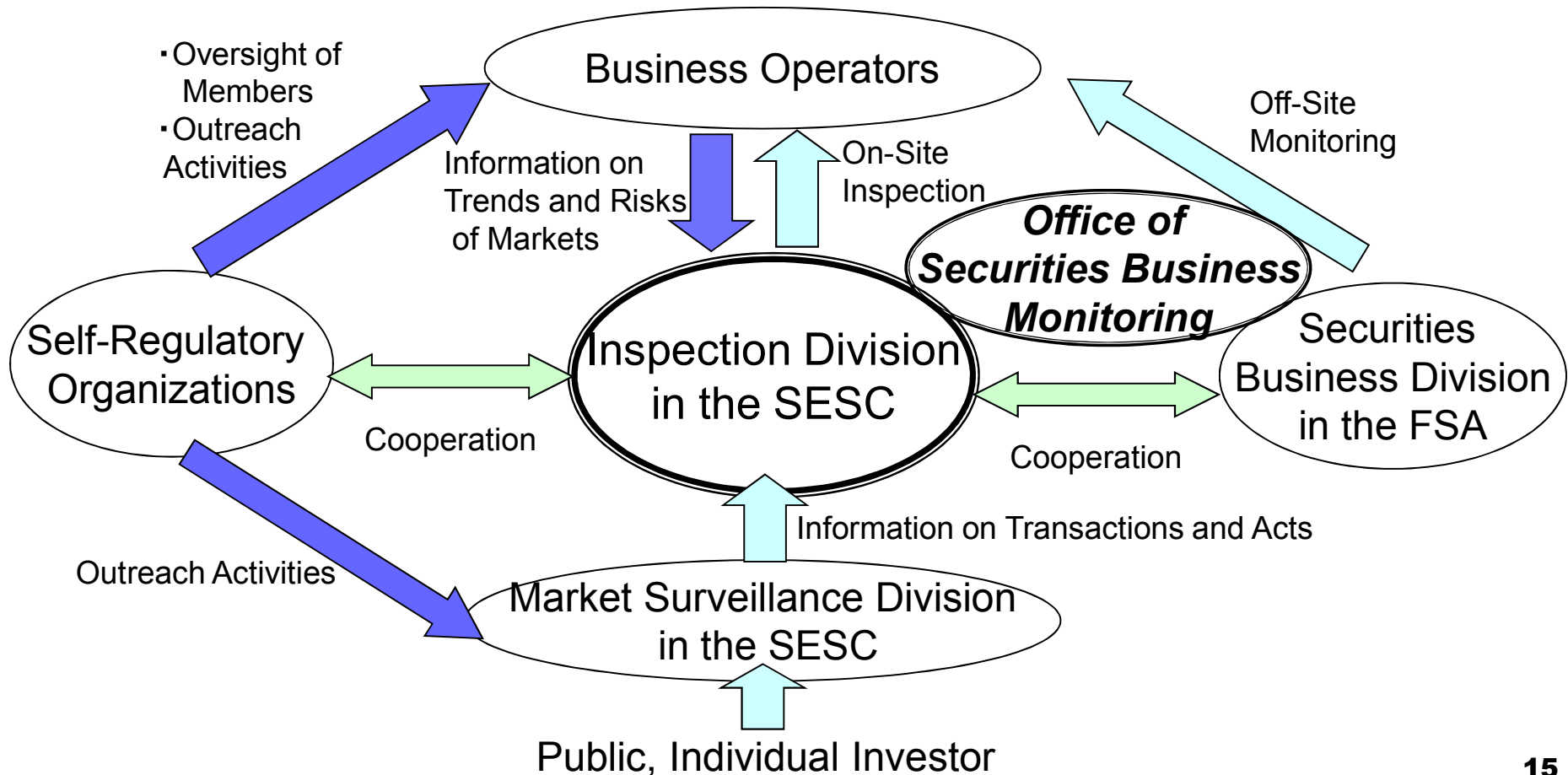
The SESC's Functions and Regulatory Tools



3. Process and Practice of Securities Inspection

Enhanced Communication and Cooperation with Other Institutions

- Importance of Information gathering
- Importance of Cooperation with SROs



3. Process and Practice of Securities Inspection

Office of Securities Business Monitoring

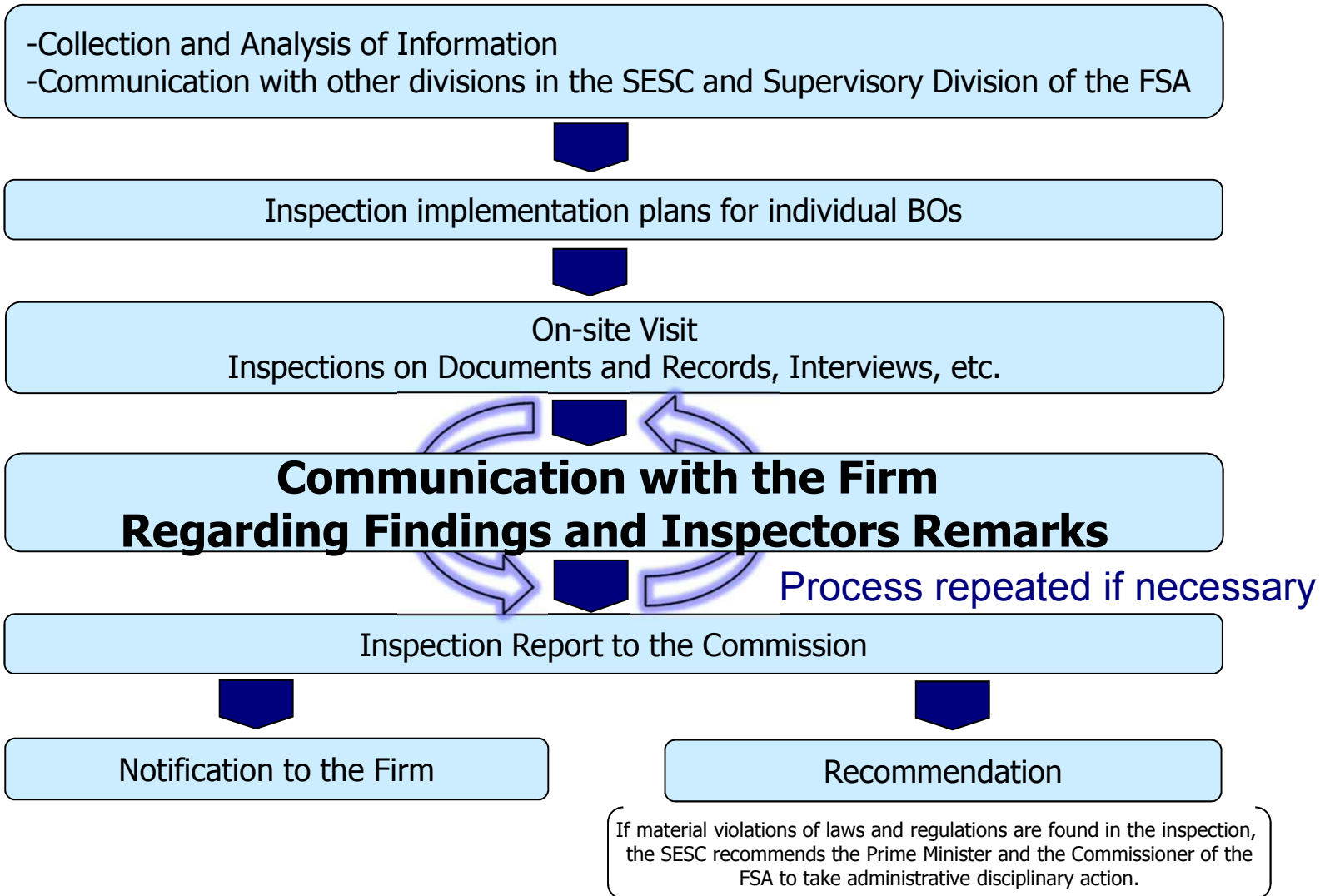
- Mission is to implement seamless supervision between on-site and off-site monitoring of systemic risks for large securities groups
 - All members have dual reporting-lines to the Supervisory Bureau of the FSA and the SESC

What they do are ...

- Interviewing head offices of large foreign based affiliated securities groups
- Identifying the best practices in risk management through Peer Reviews
- Continuous Monitoring on financial institutions' PDCA cycles utilizing information gathered through both on-site and off-site monitoring

3. Process and Practice of Securities Inspection

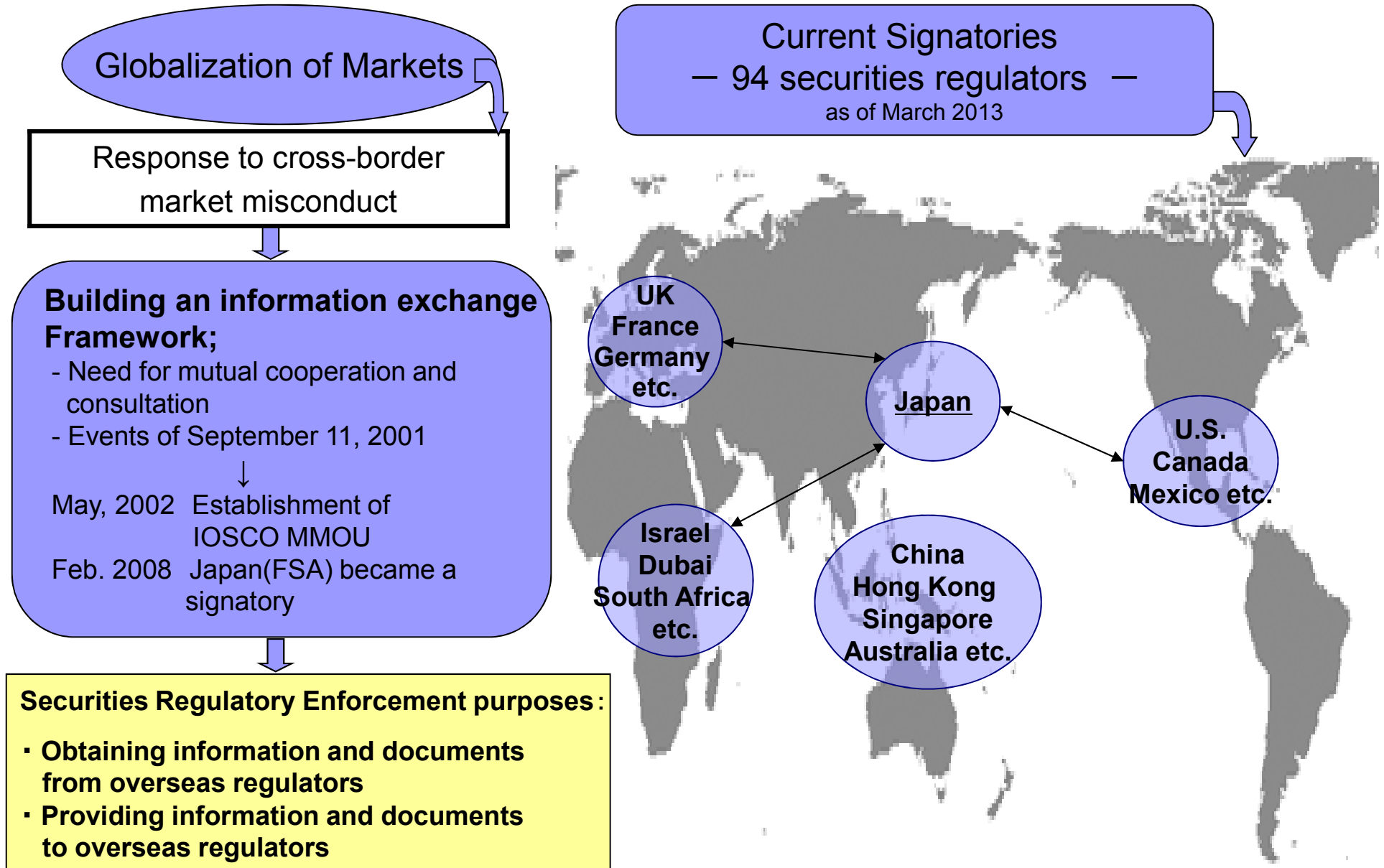
More In-depth Dialogues with BOs



Response to the globalization of markets

- Closer cooperation with overseas regulators to conduct market oversight on a global basis
 - IOSCO MMoU; Global information-sharing arrangement for securities regulators adopted by the International Organization of Securities Commissions (IOSCO)
 - Bilateral information exchange frameworks
CSRC(China), MAS(Singapore), SEC(U.S.), CFTC(U.S.), ASIC(Australia), SFC(Hong Kong) and SC(New Zealand)
- More effective inspections of globally active and large-scale securities firms, utilizing the international supervisory frameworks

- IOSCO Multilateral Memorandum of Understanding (MMoU) -



- Current Signatories of the IOSCO MMOU (as of March 2013) -

Europe (41)	Greece	Portugal	France	Jersey	United Kingdom	Spain	Hungary	Lithuania	Italy
	Poland	Germany	Slovak Republic	Belgium	Isle of Man	Malta	Denmark	Norway	Czech Republic
	Luxembourg	Finland	Netherlands	Romania	Guernsey	Montenegro	Albania	Croatia	Slovenia
	Cyprus	Srpska	Austria	Bulgaria	Serbia	Switzerland	Iceland	Macedonia	Estonia
	Liechtenstein	Sweden	Bosnia and Herzegovina	Ireland	Latvia				
North America Central and South America (16)	Ontario (Canada)	US SEC	Quebec (Canada)	US CFTC	Mexico	Alberta (Canada)	British Columbia (Canada)	British Virgin Islands	Bermuda
	Cayman Islands	Brazil	Uruguay	Colombia	Peru	El Salvador	Bahamas		
Asia (15)	Hong Kong	India	Sri Lanka	Singapore	Malaysia	China	FSA (Japan)	Thailand	Maldives
	Korea	Pakistan	Chinese Taipei	METI (Japan)	MAFF (Japan)	Labuan			
Oceania (2)	Australia	New Zealand							
Middle East (10)	Turkey	Israel	Dubai	Bahrain	Jordan	Saudi Arabia	Syria	Oman	United Arab Emirates
	Qatar								
Africa (10)	South Africa	Nigeria	Morocco	Kenya	WAEMU *	Tunisia	Tanzania	Egypt	Mauritius
	Malawi								

* WAEMU: West African Economic and Monetary Union

4. Recent Developments





4. Recent Developments

Revelation of Serious Cases and the Focus of Verification

- Importance on Protection of Personal Investors
 - Detailed Stipulations of Mandate and Prohibition in relation to transactions of stocks and investment trusts



Revelation of Recent Serious Cases among BOs and Institutional Investors

- The case of AIJ Investment Advisors Co., Ltd.
- Insider Trading related to Public Offerings of Shares
- Misconduct related to LIBOR/TIBOR Rate Offers

- Urgent task of restoring investors' confidence in the Transactions among BOs and Institutional Investors
 - Verifying the compliance
 - Urging all BOs and the society to improve their posture toward legal compliance and professional ethics
- More Weight on Duties of BOs as Gatekeepers
 - Fairness in Issuance, Transactions, and Price Formation in the Market
 - Suitability
 - Duty of Due Care of a Prudent Manager
 - Measures to Ensure the State of Appropriate Business Operation

4. Recent Developments

Rules of Conduct

- Common Rules for All Kinds of BOs
 - ☑ Duty of Good Faith to Customers (Article 36)
 - ☐ Regulation on Advertising, etc. (Article 37)
 - ☐ Delivery of Document Prior to/upon Conclusion of Contract (Article 37-3,4)
 - ☐ Prohibited Acts (Article 38):
 - Provision of false information,
 - Provision of conclusive evaluation,
 - Unrequested solicitation, etc.
 - ☐ Prohibition of Compensation of Loss, etc. (Article 39)
 - ☑ Suitability (Article 40)

Note: Article Numbers are as of the FIEA

Rules of Conduct (continued)

- Rules for Investment management business
 - ☑ Fiduciary Duty of Loyalty, Duty of Due Care of Prudent Manager (Article 42)
 - ☐ Prohibited Acts (Article 42-2): transactions made between investment asset accounts, transaction under terms and conditions different from ordinary terms and conditions and detrimental to the right holder's interest, etc.
 - ☐ Prohibition of Compensation of Loss, etc. (Article 39)
 - ☐ Duty of Delivery of Investment Report (Article 42-7)

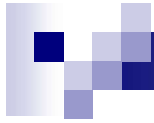
Note: Article Numbers are as of the FIEA

4. Recent Developments

The Financial Instruments and Exchange Act

Article 1: Purpose

The purpose of this Act is, inter alia, by developing systems for disclosure of corporate affairs and other related matters, providing for necessary matters relating to persons who engage in Financial Instruments Business and securing appropriate operation of Financial Instruments Exchange, 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.



5. Inspection Policy And Program for 2013-14

Main points of Inspection Policy for 2013-14



《Basic Direction》

Role of inspections

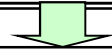
- To take rigorous actions against illegal activities and play a role in sending alerts to the market
- To ensure investor confidence in the markets by enhancing self-discipline of BOs

Change in Circumstances

- Diversification and increase in the number of BOs (Around 8,000 operators engage in business)
- Financial instruments and transactions have become more diverse and complex

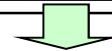
Current Challenges

- Revelation of Serious Cases
- To restore investors' confidence by not only verifying the compliance but also urging BOs to improve compliance posture and professional ethics



< Efforts toward efficient, effective and viable securities inspection corresponding to the diverse characteristics of the BOs >

- Strengthening the capabilities to collect and analyze information by enhancing the capacity of the SESC to identify potential problems with consideration of the characteristics of business types, customers types, and types of financial instruments and transactions.
- Utilizing a risk-based approach to decide BOs to inspect by considering their business types, sizes, other characteristics and other information in a comprehensive manner.
- Measures for increasing the coverage of the inspections to decrease risks caused by uninspected small BOs.



《Implementation Plan and Focus in Verification》

- Management of non-public material information
- Conducting intensive inspection on Discretionary investment business operators
- Measures against fund BOs engaging in illegal activities and unregistered BOs

- Monitoring the whole operational systems of large securities groups that engage in complex business operations as a group
- Verification of financial soundness of BOs
- Checking the setup status of the operational systems of small business operators as early as possible after their registrations

Inspection Policy for 2013-14

Measures to tackle with Challenges

Efforts toward efficient, effective and viable inspections

- Strengthening the capabilities to collect and analyze information

⇒ Three types of diversification and complexity for BOs

- ◆ characteristics of (i) business types, (ii) customers types, and (iii) financial instruments and transactions

⇒ Select business operators to inspect by using risk-based approach

- ◆ (i) each BO's business types, (ii) each BO's scale and other
- ◆ business characteristics, (iii) market environment, and (iv) other individual issues

Inspection Policy for 2013-14

Implementation Plan

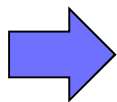
1. Focus in verification

1) Types of business operations or other characteristics

A. Market intermediary functions

□ Gatekeeper functions

- Proper identification of individuals at the time of transactions and the appropriate reporting of suspicious transactions
- Systems for preventing transactions with anti-social forces
- Examination systems for underwriting business in connection with IPOs
- Risk management systems



Close cooperation with
the Office of Securities Business Monitoring

- Sales management systems for high-risk products

Inspection Policy for 2013-14

Implementation Plan (continued)

B. Management of material non-public information

- Management systems as preventive measures against insider trading
 - Registration of material non-public information and information barriers,
 - Surveillance of transactions by insiders, officers and employees, and
 - Prevention of any improper distribution and use of information

C. Conduct that may hinder fair pricing

- Practices that could hinder the formation of fair pricing
- Transaction surveillance systems for preventing unfair trading
- Management systems for short selling regulations

Inspection Policy for 2013-14

Implementation Plan (continued)

D. Solicitation for investment

- Investment trust, OTC derivative products and complex structured bonds
 - Suitability principle
 - Appropriateness of explanations regarding important risks and other factors that affects customer's decisions such as the probable maximum losses and the settlement money on cancellation

E. Legal compliance of investment management business operators

- Intensive inspections on discretionary investment management operators
 - Fiduciary duty and due care of a prudent manager
 - Systems for managing conflicts of interest
 - Due diligence

Inspection Policy for 2013-14

Implementation Plan (continued)

2) Internal control systems and financial soundness

A. Internal control systems

- Focus on large securities groups engaging in complex business operations
 - constantly monitoring the status of group-wide business operations
 - verification from a forward looking viewpoint
- Internal control systems and risk management systems in case where problems are found related to business operations

B. IT systems risk management

- Management systems for the IT systems risk preventive measures
- Business continuity plans including erroneous order placement prevention, IT systems troubleshooting, information security management, etc.

C. Financial soundness

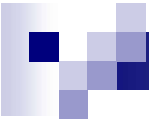
- Segregated management of customer assets
- Status of net assets and capital adequacy ratios

Inspection Policy for 2013-14

Implementation Plan (continued)

2. Efficient, effective and viable inspections

- 1) Risk-based prioritization of the inspection reflecting business type and other characteristics
 - Taking risk-based approach selecting which BOs to inspect
 - Continuing the Intensive Inspections on DIM business operators
 - New measures to check setup status of the operational systems after registration for Type II FIBOs and Investment advisors/agencies
- 2) Viable Inspection
 - Enhancement of interactive dialogue
 - Rigorous actions against conduct hindering the efficacy of inspections
- 3) Enhancement of cooperation with overseas securities regulators and self-regulatory organizations



Inspection Program for 2013-14

Type I FIBOs (including Registered Financial Institutions), IMBOs, and CRAs	150 companies (110 out of 150 to be inspected by the SEDs) (including the Intensive Inspections of DIM Business Operators)
Type II FIBOs, Investment Advisories/Agencies, QII Business Operators, and Financial Instruments Intermediaries, etc.	To be inspected based on individual information and condition
SROs etc.	To be inspected as necessary
Unregistered Business Operators	To be inspected as necessary

Note: The above numbers of inspections are subject to change due to revisions of the Inspection Program within the year and/or implementations of special inspections.



Activities in figures and Activities other than Inspection

Number of Inspected Entities

Business categories	Jul-08	Apr-09	Apr-10	Apr-11	Apr-12
	Jun-09	Mar-10	Mar-11	Mar-12	Mar-13
Financial Instruments Firms	191	176	148	148	153
Type I Financial Instruments Business	117	91	91	85	57
Type II Financial Instruments Business	1	22	6	14	20
Asset Management Firms	15	18	15	9	36
Investment Advisories/Agencies	58	45	36	40	40
Registered Financial Institution	25	24	28	32	28
Financial Instrument Intermediary Service Providers	0	1	1	9	9
Investment Companies	7	9	6	2	0
Self Regulatory Organizaitions	5	5	1	0	0
Others	0	1	2	11	24

(Note 1) The number above is that of inspections undertaken.

(Note 2) "Investment management business" and "Investment advisory and agency business" are "Former management business of investment trust" and "Former investment advisor," respectively, in and before business year 2006.

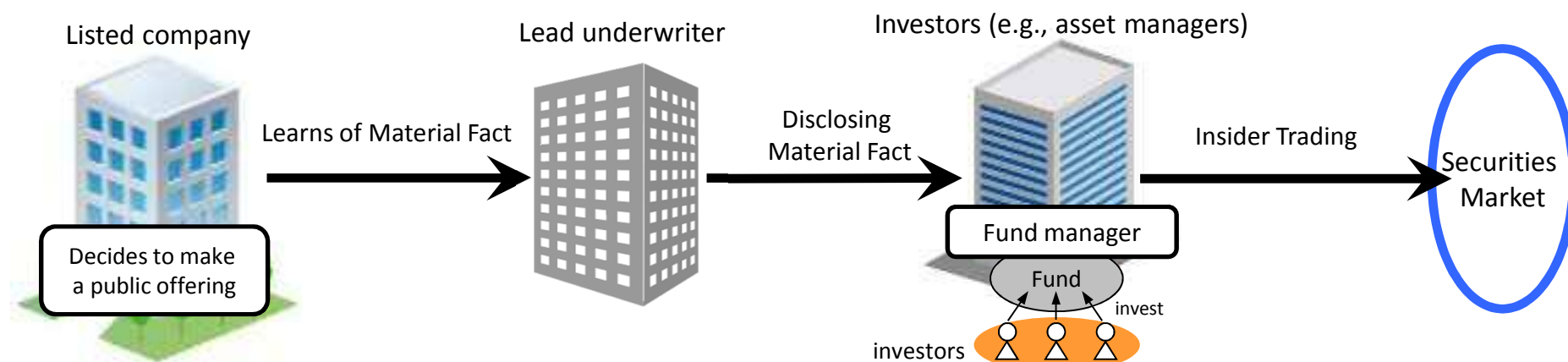
Findings from Inspections

Category	Apr-10	Apr-11	Apr-12
	Mar-11	Mar-12	Mar-13
Recommendation	19	16	18
Firms with problems found	105	87	102
Unfair transactions	9	7	6
Lack of investor protection	45	46	52
Improper financial soundness	18	31	11
Others	71	58	71

Note) “firms with problems found” shows the number of the firms for which we pointed out some problems in the inspection.

Revisions to Insider Trading Regulations

(Overview of Cases of Insider Trading relating to Public Offerings)



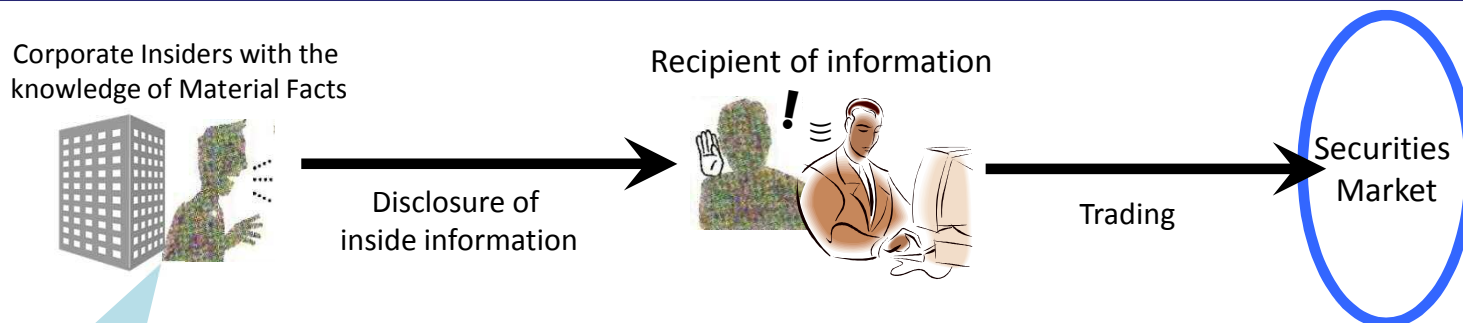
Issuer	Date of announcement of public offering	Lead underwriter	Asset managers	Date of SESC recommendation (Date of order)	Amount of monetary penalty
INPEX COPPORATION	Jul 8, 2010	Nomura Securities Co., Ltd.	Chuo Mitsui Asset Trust Bank, Ltd.	Mar 21, 2012 (Jun 27, 2012)	50,000 yen
Nippon Sheet Glass Co. Ltd.	Aug 24, 2010	JP Morgan Securities Japan Co., Ltd.	Asuka Asset Management Co., Ltd.	May 29, 2012 (Jun 26, 2012)	130,000 yen
Mizuho Financial Group, Inc.	Jun 25, 2010	Nomura Securities Co., Ltd.	Chuo Mitsui Asset Trust Bank, Ltd.	May 29, 2012 (Jun 27, 2012)	80,000 yen
Tokyo Electric Power Co., Inc	Sep 29, 2010	Nomura Securities Co., Ltd.	First New York Securities LLC. and an individual	Jun 8, 2012 (Hearing Procedure concluded)	14.68 million yen 60,000 yen
Nippon Sheet Glass Co. Ltd.	Aug 24, 2010	Daiwa Securities Co., Ltd.	Japan Advisory Inc.	Jun 29, 2012 (Jan 8, 2013)	370,000 yen
Elpida Memory, Inc.	Jul 11, 2011	Nomura Securities Co., Ltd.	Japan Advisory Inc.	Nov 2, 2012 (Apr 16, 2013)	120,000 yen

Footnotes 1: FSA issued a business improvement order against Nomura on August 3, 2012.

2: Kanto Local Finance Bureau rescinded registration of Japan Advisory as Investment Advisory and Agency Business operator on June 29, 2012.

Revisions to Insider Trading Regulations

(A new regulation against the disclosure of inside information and trading recommendations)



Concept

- Newly regulate improper disclosure of inside information which leads to trading while taking into account not to disrupt normal business activities of companies

Regulation

Corporate Insiders with unpublished Material Facts (e. g., officers or employees of listed companies or lead underwriters) shall not disclose inside information or recommend trading to another person, with the intention to encourage the person to make a profit by trading prior to publication

- ⇒ Criminal sanctions and monetary penalty shall be imposed on offenders in cases where trading has taken place prior to publication with these acts being a factor in the investment decision

Enforcement

	Criminal sanctions	Monetary penalty	Publication of the offender's name as a warning
In cases of violation by securities companies, etc.	<ul style="list-style-type: none"> • 5 years or less imprisonment • Fine of 5 million yen or less 	On securities companies: <ul style="list-style-type: none"> • trading commissions received from the person who conducted the trading (for 3 months) • [In the case of violation relating to public offerings] above trading commissions (for 3 months) plus half of the underwriting commission 	The officer or the employee involved in the violation (excluding those who played a supplementary role)
In cases of violations by persons other than securities companies	<ul style="list-style-type: none"> • Additional fine of 500 million yen for legal entities 	<ul style="list-style-type: none"> • Half of the profit obtained by the person who conducted the trading 	—

Comparison of the Regulations on Insider Trading (Before the Amendment of the Law)

		Japan	U.S.	U.K.	France	Germany
Scope of the regulation						
	Insider trading	○	○	○	○	○
	Disclosure of inside information	×	○ ^{*1} Only when the recipient has conducted insider trading	○ ^{*2}	○ ^{*2} Enforced only when the recipient has conducted insider trading	○ ^{*3} Enforced only when the recipient has conducted insider trading
	Trading recommendations	×	△ ^{*4}	○	○ Enforced only when the recipient has conducted insider trading	○ Enforced only when the recipient has conducted insider trading
Monetary penalty		○	○	○	○	△ ^{*5}
	Amount of monetary penalty when trading is conducted on client accounts	Amount of fees	Up to 3 times the profit from insider trading	Amount of fees plus penalty	€100 million or 10 times the amount of fees or less	(Not subject to monetary penalty)
Criminal sanctions		○ (5 years or less imprisonment with work)	○ (20 years or less imprisonment)	○ (7 years or less imprisonment)	○ (2 years or less imprisonment)	○ (5 years or less imprisonment)

*1 Only when the inside information was disclosed in violation of fiduciary duty to issuer/shareholder or duty of trust and confidence to the source of inside information, etc.

*2 Except when conducted in the proper performance of the functions of his employment, office or profession, etc.

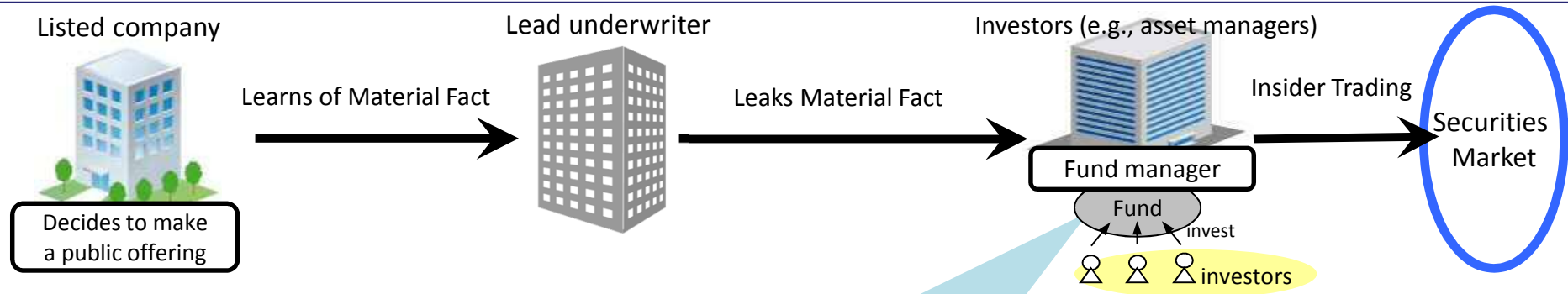
*3 Only when conducted without the authority to do so.

*4 Although these acts are not explicitly prohibited by laws, they may constitute a violation if trading has been conducted by a person who was recommended to do so.

*5 Only those who disclosed inside information or recommended trading may be subject to administrative measure (fine(€200,000 or less)).

Revisions to Insider Trading Regulations

(Raising the monetary penalty for violations committed by asset managers on client accounts)



Point

- [Current]** The amount of monetary penalty is “management fees (for 1 month)” multiplied by “the ratio of the value of the relevant stocks to the total Assets Under Management”
- [Proposal]** Calculate monetary penalty based on “the overall management fees for 3 months ”
 ⇒ Asset managers are able to continue receiving the overall management fees from improved investment performance

Proposal for revision of Monetary Penalty Regime for Violations Committed “on Client Accounts”

	Current	Proposal for revision
	Monetary penalty	Monetary penalty Publication of the offender’s name as a warning *1
Asset managers	On asset managers, $\text{Management fees (for 1 month)} \times \frac{\text{Maximum value of the relevant stocks}}{\text{Total Assets Under Management}}$	On asset managers, Management fees (for 3 months) • Persons who committed violations repeatedly *2 • Persons who conducted insider trading by taking advantage of their business relationships to demand Material Facts
Others	The proceeds from the violation	The proceeds from the violation

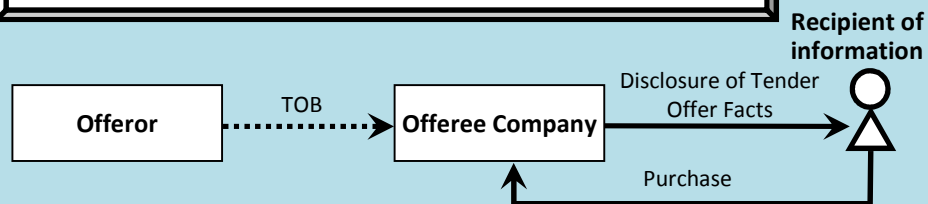
*1 Including violations committed “on propriety trade account”
 *2 Including other violations such as Market Manipulation

【Developing measures for effective investigation of monetary penalty cases, etc.】

- Enable the authority to order submission of articles in the investigation of monetary penalty cases (⇒ to secure trading records and evidence of disclosures)
- Enable the authority to inquire public agencies in relation to the investigation of monetary penalty cases (⇒ to identify the whereabouts of offenders)

Measures following Insider Trading relating to Public Offerings, etc. (Reform of Regulation in the Light of Recent Financial and Corporate Practices)

Expansion of the scope of the term TOB Insiders



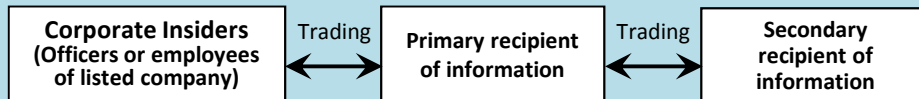
[Current] Offeree company is not determined as a TOB Insider in cases where the offeree company has made no agreement with the offeror

⇒ The recipient from the offeree company is a secondary recipient of information and omitted from the scope of regulation

[Proposal] The offeree company will be determined as a TOB Insider regardless of the existence of an agreement with the offeror

* Offeree company is generally notified of Tender Offer Facts by the offeror prior to the public announcement

Exemption related to trades conducted between persons in possession of Material Facts



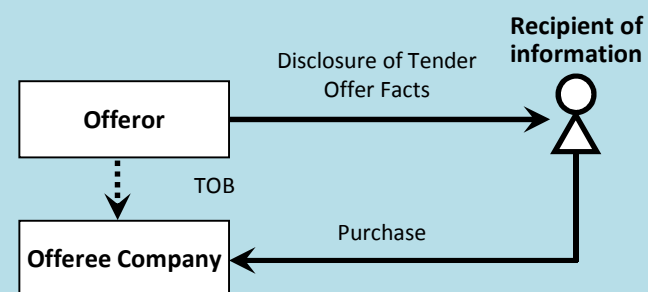
[Current] Within over-the-counter or negotiated transaction conducted between specific persons who possess Material Facts :

- trading conducted between a Corporate Insider and a primary recipient of information is included in the regulatory exemption, while
- trading between a primary recipient and a secondary recipient of information is not included

⇒ Difficult for a primary recipient of information to sell his/her shares

[Proposal] Newly include over-the-counter or negotiated transaction conducted between a primary recipient and a secondary recipient of information in the regulatory exemption

Exemption of trades conducted by the recipients of Tender Offer Facts



[Current] A recipient of Tender Offer Facts cannot purchase shares of the offeree company

⇒ Prevents fair competition and smooth trading in some cases, such as when the offeror discloses unpublished Tender Offer Facts to other potential acquirers to prevent them from purchasing shares of the offeree company

[Proposal] The purchase by a recipient of information will be permitted under the following cases:

- (1) **[information made public]** where the recipient discloses the received information in a Tender Offer Notification, etc. when the recipient makes his/her own offer
- (2) **[information has lost its usefulness]** where six months have passed since the recipient of information last received the information

Thank you



"for investors, with investors"