

Annual Supervisory Policy for Financial Instruments Business Operators, etc. for Program Year 2012

“Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.,” which set out the FSA’s basic supervisory approaches for financial instruments business operators, etc. states that the Financial Services Agency (FSA) publishes its Annual Supervisory Policies for Financial Instruments Business Operators, etc. each program year so as to clarify its supervisory priorities of the year as prescribed.

In this Program Year, as shown below, the FSA will further enhance its supervision of Financial Instruments Business Operators, etc. in the areas of 1) market intermediary functions, 2) risk management, and 3) customer protection and convenience for users through open and extensive dialogues.

It should be noted that this supervisory policy has been developed by taking into account the circumstances surrounding Financial Instruments Business Operators, etc. as of August 2011, and thus may be subject to review according to the changes in the circumstances.

1. Environment Surrounding Financial and Capital Markets, and Basic Supervisory Approaches for Financial Institutions

(1) Environment Surrounding Financial and Capital Markets

Japanese economy still remains in a difficult situation, but is recovering moderately due to several factors including reconstruction demands. This recovery is expected to grow steadily. However, high uncertainties over the European sovereign debt problems still exists and more and more people consider the world economy is going to slow down. Such overseas economic conditions are downside risks to the Japanese economy through their effects on financial and capital markets. Factors such as constraints on electrical power supplies and deflation are also the risk to the Japanese economy.

Special attention should be paid to foreign economic conditions and financial and capital market trends as they are quickly changeable. Amidst globalization, it is important to enhance the resilience of the Japanese economic and financial system, to minimize its damages in event of the crisis in the global economy.

Especially, the sovereign debt problem is growing more serious in some European peripheral countries, therefore it is mentioned that the concern over creditworthiness of the sovereigns might spread to the European financial markets and financial institutions which, through damaging the economy, will deepen and widen the crisis. In the United

States, there is a down side risk in the economy where high unemployment rate continues and housing price declines. In emerging countries, attention should be paid to excessive economic expansion and inflation risk in real estates and consumer products.

In these unstable and uncertain financial and economic situations, financial instruments business operators should ensure financial soundness through more appropriate risk management than before so as to avoid amplifying the unstableness and uncertainties by themselves. At the same time, they as market intermediaries are required to contribute to the development of Japanese economic and financial systems by performing their functions appropriately and supporting fair price formation of financial instruments in order to enhance investors' confidence in Japan's financial markets.

In fact, however, the occurrence of recent serious scandals such as the AIJ problem and the insider trading cases related to public stock offering damaged both domestic and foreign investors' confidence in Japanese financial markets in the previous program year.

Financial instruments business operators should engage in their businesses by taking into account the society's critical view to the industry rather than recognizing the scandals as irrelevant to them to see they are committed by some malicious business operators, and make persistent efforts to improve their consciousness of legal compliance and professional ethics.

(2) Approaches Taken by Supervisory Authority

With its awareness of the current situation, the FSA will continue its efforts to implement "Better Regulation" as the basis for the financial administration (open and profound discussions, adequate information disclosure, appropriate cooperation in sharing information on the economic and financial situations in Japan and overseas, and improving the transparency and predictability of regulatory actions, etc.). For the discussions with financial instrument business operators, the FSA will consider the use of opportunity of Roundtable between government and private companies.

As for legal compliance, customer protection, appropriate risk management including liquidity risk and adequate performance of market intermediary functions, etc., financial instruments business operators are strongly expected to make positive managerial improvements proactively and do adequate, speedy, and responsible business judgments under the appropriate leadership of the management by considering their business targets.. Therefore, the FSA will continue the following supervisory approaches.

1) Financial Administration with a Risk Based Approach

In order to accurately respond to currently conceivable risks, the FSA will gain a deeper understanding of the trends of macro economy and financial and capital markets, and further raise awareness of how those trends affect the soundness of financial instruments business operators, etc., so as to identify the risks which are accumulating in each financial instruments business operator, etc. and in the financial system as a

whole in a forward-looking manner. The FSA will also enhance the integration of on-site and off-site monitoring to detect risks at an early stage. In light of the lessons learned from the AIJ problem, the FSA will further promote its risk-based supervision of financial instruments business operators, etc. with effective and appropriate use of its limited human resources.

It is also important to check whether financial instruments business operators fully prepare for the major risk scenarios in their business continuity plans, revise these plans as necessary, and conduct relevant training based on the experiences in the Great East Japan Earthquake in 2011, real cases of IT system troubles happened in the past, possible planned blackouts due to constraints on electricity supply, etc., in order to maintain and ensure financing functions even if an unexpected event occurs. Moreover, considering the fact that any malfunctioning of the major IT systems for providing financial services can significantly affect people's lives and the economy, it is important for the FSA as the regulatory authority to encourage financial instruments business operators to self-check their risk management systems for the trouble and to enhance the monitoring.

2) Financial Administration for Customer Protection

So as to further improve customer protection and convenience for users, the FSA will strive to implement administrative actions in line with a citizen's and user's point of view. Particularly, the FSA will mainly check matters related to customer protection including fraud prevention measures based on the AIJ problem, the thorough segregated management of customer assets based on the illegal case where the investor protection fund identified repayment difficulties, and IT system trouble countermeasures.

3) Financial Administration with a Forward-looking Perspective

In addition to policies from a short-term perspective, the FSA will strive to implement medium and long-term initiatives with an eye on the future. To this end, the FSA comprehends the development of international discussions and environmental changes, considering structural issues faced by Japanese financial institutions (enhancing profitability of their main business, etc.).

4) Financial Administration Contributing to Business Improvements and Decisions made by Financial Instruments Business Operators, etc.

Through open and profound dialogues with financial instruments business operators, etc. and the offering of appropriate information, the FSA will encourage financial instruments business operators, etc. to proactively improve their business and their decision making. Given the AIJ problem and insider trading problem related to public share offerings, not only the supervisory authority's countermeasures but also the

strong self-awareness of financial instruments business operators for their public roles and their persistent efforts are essential for improving confidence in Japan's financial markets.

By introducing voluntary and advanced practices of other financial instruments business operators through the exchange of views, the FSA as the supervisory authority will encourage each operator to make voluntary and proactive efforts for the market intermediary performance, risk management improvement and enhancement of customer protection and users' convenience, which lead to qualitative improvement of the entire financial industry.

In addition to these approaches above, the FSA will also take the following points into consideration for the supervision:

- The FSA will attempt to further deepen its cooperation with relevant divisions of the Securities and Exchange Surveillance Commission (SESC), self-regulatory organizations (SROs), and the Bank of Japan (BOJ), and will strive to cooperate with overseas authorities via multilateral supervisory colleges and actively contribute to and make timely and adequate exchanges of views with international standard setters..
- The FSA gives due consideration to the reduction of burdens on financial instruments business operators, etc. through annual review of report requirements and document submission, etc. However, the FSA will consider enhancing the report requirement and document submission if necessary like the AIJ problem and insider trading related to public share offerings,
- By fostering and securing staff members with expertise and expanding training sessions, the FSA will improve the quality of its staff members.

2. Appropriate Performance of Market Intermediation Functions

In the New Growth Strategy authorized by the Cabinet in June 2010 and "The Action Plan for the New Growth Strategy" which the FSA announced in December 2010, financial institutions are expected to support the real economy and business companies. The financial sector itself is also expected to lead the economy as a growing industry. Furthermore, "financial strategy" is included in eleven growth strategies for further enhancing growth potential set out in the Comprehensive Strategy for the Rebirth of Japan, which was authorized by the Cabinet in July 2012.

Financial instruments business operators, etc. play roles for smooth transactions as market intermediaries when investors and fundraisers access the market. These roles are the core functions of financial instruments business operators, etc. and must be highly public. Financial instruments business operators, etc. are thus required to enhance investors' confidence in Japan's financial markets and contribute to stabilizing Japan's economic and financial systems by conducting highly reliable business operations with adequate customer protection, by performing market intermediary functions adequately, and by making

contributions to fair price formation for financial instruments.

Based on such viewpoint, the FSA will supervise performance of market intermediary functions of financial instruments business operators, etc. from the following viewpoints:

- 1) The FSA will examine the appropriateness of internal control systems (including screening systems of public offering underwriting) so that financial instruments business operators, etc. properly perform their market intermediary functions.
- 2) Customer information forms the basis of financial instruments transactions and their intermediation thereof, and so it also needs to be managed strictly from the viewpoint of protecting personal information. Furthermore, financial instruments business operators, etc. must manage corporate-related information strictly with their recognition that the seriousness of insider trading problem which took advantage of corporate-related information of public share offerings and its damages for domestic and foreign investors' confidence in financial markets,.

From this viewpoint, the FSA will examine whether management team of financial instruments business operators, etc. take leadership in developing internal control systems for information security management, etc., in enhancing business ethics and consciousness of legal compliance for preventing the corruption of executives and employees (including information leaks and insider trading). The FSA will also examine whether financial instruments business operators, etc. subjected to sweeping checkups on corporate information take improvement and other measures, and whether other financial instruments business operators, etc. thoroughly manage corporate-related information.

Specificly,

- (i) Whether information transmission is minimized between public offering underwriting division (inward division) which receives corporate-related information from customers and sales divisions (outward division) for institutional investors?
- (ii) Whether "outward information" divisions strictly manage control corporate-related information?
- (iii) Whether information acquirers can recognize the importance of information in cases where "outward information" divisions hold corporate-related information.
- (iv) Whether information is transmitted inappropriately to institutional investors, etc.
- (v) Whether internal control divisions appropriately implement monitoring measures, including the verification of communications records.
- (vi) Whether financial instruments business operators, etc. thoroughly disseminate business ethics as corporate culture through such measures as giving priority to legal compliance in recruiting, training and evaluating human resources, and

enhancing legal compliance training.

- 3) In order to eliminate thoroughly antisocial forces like Japanese mafia from securities businesses, the FSA will lead the creation of an antisocial forces database within the Japan Securities Dealers Association in cooperation with the National Police Agency for the start of the operation within the current program year. The FSA will also encourage each financial instruments business operators, etc. to make stronger effort to exclude antisocial forces. Particularly, the FSA will closely monitor whether antisocial forces engage with those providing funds to small and medium-sized financial instruments business operators, etc. whose financial profiles and cash flow have deteriorated.

3. Risk Management and Stability of Financial System

Financial instruments business operators, etc. generally face a harsh profitability environment, with few large underwriting deals, weak market transaction volumes, instability and high uncertainty surrounding financial and capital markets, etc, while cash constantly inflows into investment trusts businesses. Under these conditions, it is increasingly important for financial instruments business operators, etc. to achieve high quality risk management.

The FSA will conduct intensive supervision, particularly large-scale securities company groups, in consideration of the current financial and economic situation.

As for small and medium-sized securities companies, etc., the FSA will pay attention to the impact of possible rapid changes in the financial and economic situation on their financial bases and cash flow.

(1) Facilitating Integrated Risk Management of the Entire Securities Company Group

- 1) In close cooperation with the Bank of Japan and foreign authorities, taking the current financial and economic situation into account, the FSA will require large-scale securities company groups, etc. (including large domestic and foreign securities companies) with a big presence in domestic and foreign financial systems to continue to fully prepare for liquidity risks including foreign currencies on a group-wide basis.

The FSA will also encourage large-scale securities company groups, etc. to voluntarily send easy-to-understand external messages so that their overall risk management, including liquidity risk management is understood appropriately by market participants, etc.

- 2) As for groups involving special financial instruments business operators, etc. and designated parent companies, which are subject to the consolidated supervision and regulation of securities company groups, the FSA will try to timely and accurately understand the situation of group-wide businesses. The FSA will verify intensively the

development of group-wide comprehensive risk management systems, the development of group-wide data collection capacity improvement systems, the appropriate implementation of stress tests covering tail risks and the utilization of stress test results for management, etc.

Particularly, the FSA will further enhance its supervision of internationally active securities company groups with large and complex operations that will be required to develop appropriate risk management systems to support their efforts to further enhance profitability in consideration of the introduction of a new international capital adequacy rule. In doing so, the FSA will encourage relevant financial institutions in Japan to enhance their risk management systems, while taking into account the systems which foreign financial institutions with large scale and variety of businesses have.

Given that potential risks affecting the financial system and the entire economy are growing, the FSA will monitor details of financial soundness and risk management from a forward-looking viewpoint. To this end, integrated on-site and off-site monitoring would be performed and strengthened in close cooperation with inspection divisions. Based on the international discussions such as at the Financial Stability Board (FSB), the FSA is working on the Recovery and Resolution Plans (RRPs) of financial institutions which are internationally active and engage in large and complex business.

For securities companies under major banking groups, the FSA will also examine their specific business models, risks and corporate cultures, which differ from deposit-taking financial institutions.

Furthermore, the FSA will continue its analysis and responses from a macro prudence perspective to see whether the entire financial system is expected to grow in a sustainable and stable manner, in close cooperation with the Bank of Japan by considering the impacts of trends of domestic economy affected by the recent earthquake etc., overseas economies, and financial markets on the financial system.

(2) Preparations for Business Management Risks at Small and Medium-sized Securities Companies (domestic and foreign), Investment Management Companies, etc.

- 1) The FSA will require small and medium-sized securities companies (domestic and foreign), investment management companies, etc. to secure thorough, higher-quality risk management in view of possible rapid changes in the financial and economic situation. In order to ensure the soundness of their business management, the FSA will also properly operate the early warning system, ascertain the overview of business models and recent business conditions, and perform cross-industry and time series analyses.
- 2) If signs of financial deterioration or liquidity concern are seen at small and medium-sized securities companies (domestic and foreign), investment management

companies, etc., the FSA will promptly verify their responses, including the development of sound and feasible business management and earnings reforms, and liquidity improvement measures.

Taking into account the case in the previous program year where the investor protection fund identified repayment difficulties at a small and medium-sized securities company that used customers' deposits for its business operations in the face of financial deterioration, the FSA will carefully watch relevant business trends by paying full attention to the maintenance of customer assets (customer assets segregation management) and by taking note of the possibility that antisocial forces or people who lack intention or ability to perform sound business operations as financial instruments business operators, etc. could engage in business management as fund providers, etc.

Given the current overseas financial and economic situation, the FSA will also closely watch business management conditions at overseas parents of foreign small and medium-sized securities companies operating in Japan.

(3) Initiative for Monitoring Various Funds

In order to take necessary actions in a forward looking manner in anticipation of the future emergence of risks, the FSA, through continuing to conduct fund monitoring surveys, will comprehend the situation of solicitation and operation of various funds including hedge funds.

4. Improvement of Customer Protection and Convenience for Users

In the previous program year, serious cases which hurt customer protection occurred one after another, including the AIJ scandal and insider trading cases related to public share offerings. While not all these problems have been verified, findings indicate that these cases were caused not by non-professional people motivated by sudden whim of the amateur but by professionals with advanced expertise in finance working for financial institutions in the process of doing their work, which lead to damages to the confidence of the market and society in financial institutions.

To this end, financial instrument business operators must first appropriately understand and decide whether each financial instrument, etc. is suitable for sale and solicitation to each customer, considering his/her profile (knowledge, experience, asset situation, objective, etc.), then develop financial instruments, etc. Furthermore, when selling and soliciting financial instruments etc., their appropriate explanation which suits the customer's profile is essential. Financial instruments business operators have to also be aware that customer consultations and complaints after sale will be the opportunities to discover potential customer's needs, and should respond to them appropriately and positively.

Particularly, compliance regarding customer protection is not enough to be met just by formal observance of laws and regulations. Financial instruments business operators should fully understand the objectives of laws and regulations, and understand customers' request and meet their expectations in a reliable manner as their functions have a highly public nature.

To this end, financial instrument business operators must first appropriately understand and decide whether each financial instrument, etc. is suitable for sale and solicitation to each customer, considering his/her profile (knowledge, experience, asset situation, objective, etc.), then develop financial instruments, etc. Furthermore, when selling and soliciting financial instruments etc., their appropriate explanation which suits the customer's profile is essential. Financial instruments business operators have to also be aware that customer consultations and complaints after sale will be the opportunities to discover potential customer's needs, and should respond to them appropriately and positively.

Considering the above, in this program year the FSA supervise financial instrument business operators particularly under the following initiatives aiming to have improved customer protection and better convenience for users of financial instruments business operators.

In doing so, the FSA will respect the self-motivated efforts of each financial instruments business operator, etc. and proceed with supervision that places importance on incentives. In its supervision of financial instruments business operators, etc., the FSA will also pay attention to (1) under what kinds of management policies, what kinds of financial products and services financial instruments business operators, etc. are providing to customers with what kinds of profile, (2) whether there are warped incentives that may arise because financial instruments business operators, etc. are pursuing short-term profits or because they have conflicts of interest, (3) whether a system is developed to internally check (including by management) whether management policies are thoroughly implemented in a front office.

The FSA will also focus on whether each financial instruments business operator takes appropriate actions in line with measures to be stipulated at government, industry, company, and other levels to prevent scandals that emerged in the previous program year.

Given the increase in unregistered business operators' financial crimes, the FSA will cooperate with police authorities and the Consumer Affairs Agency as necessary.

(1) Selling Systems, etc.

In the sale and solicitation of financial instruments, it is not sufficient that financial instruments business operators, etc. simply comply with the laws and self-regulations. It is also important that they strive to provide easily understood explanations from the customer viewpoint, so customers can understand product qualities and risks characteristics.

Regarding methods of sale and solicitation by financial instruments business operators, etc., while taking into account information which the FSA receives from investors, the FSA will conduct detailed interviews with operators periodically and as needed, in order to understand the situation of sale, solicitation and the customer follow-up system of each operator, and urges them to make improvements.

Based on this viewpoint, the FSA will urge financial instruments business operators, etc. to thoroughly conduct sales activity in line with the customer's viewpoint in order to build long term relationships with customer.

- 1) With regards to sales of products that carry risks, such as investment trusts, structured bonds and derivatives (including currency derivative products), the FSA examines whether the system of solicitation and explanation considers each customer's standpoint, including compliance with the regulation of unsolicited offers. In particular, the FSA will have a particular focus on the following points:
 - i) Whether financial instruments business operators, etc. make appropriate sales preparations, including the classification of suitable customers according to locations of risks, complexity and characteristics, for products subject to development, promotion and sales, and whether they timely and appropriately implement sales strategy revisions, including changes to the classification of customers as sales targets, in consideration of customer claims, risk fluctuations, etc. even after sales
 - ii) Whether financial instruments business operators, etc. fully confirm customers' investment purposes and intentions for identifying customer attributes, etc., including customers' investment intentions and experiences, make customer cards, etc., and share them with customers
 - iii) Whether financial instruments business operators, etc. give appropriate and flexible explanations about risks and inherencies of products to customers in light of their knowledge, experience, wealth level, and the purpose of investment, so as to aid them to make a right decision for each investment (particularly, whether financial instruments business operators, etc. give appropriate explanations on profit or loss, sales and promotion fees, and other matters that influence customers' investment decisions)
 - iv) Whether financial instruments business operators, etc. make check-sheets as needed and collect them from customers to confirm their understanding about the contents of explanations
 - v) Whether financial instruments business operators, etc. provide customers with warning documents
 - vi) Whether the salary and bonus systems of the sales staff and managers are not biased with excessive linkage to gaining short-term profits
 - vii) Whether the sales system and product composition place too much emphasis on gaining fee earnings

2) The FSA will focus on the following points:

- i) Whether adequate explanations are provided to customers in sales, in light of characteristics of mutual funds and their risk, including those investing in foreign stocks and bonds, currency selection type funds, and monthly distribution funds
- ii) Whether financial instruments business operators, etc. conduct prudent sales management, including the requirement for managerial officials' approval on sales of currency selection type funds and other highly risky products, particularly for customers who prioritize the safety of principals
- iii) Whether financial instruments business operators, etc., when selling or cancelling investment trusts, provide adequate explanations on losses or profits, sales and cancellation fees, trust fund fees and other costs, the possibility of including part or all of dividends in principal repayments, and other key matters that could influence customers' investment decisions (particularly, whether financial instruments business operators, etc. provide adequate explanations on these points to customers planning to switch from some investment trusts to others, while taking care to prevent any unnecessary switching for customers)
- iv) Whether financial instruments business operators, etc. are acting from the customer's viewpoint, for instance, creating and providing documents to customers (e.g. prospectus) with easily understood descriptions of information on risk characteristics, fees and dividends
- v) Whether financial instruments business operators, etc., when concluding currency selection type fund investment contracts with customers with no experience in investment in such funds, receive customers' statements specifying their understanding of characteristics of the product and its risk, and keep these statements
- vi) Whether financial instruments business operators, etc. provide customers with fine-tuned investment support, including conveying information timely and adequately when rapid market trend changes and developments exerting a great impact on markets are likely to gravely affect standard sales prices of investment trusts
- vii) Whether investment trust management companies have provided specific explanations on risk characteristics to investment trust sellers
- viii) Whether in-house systems have been made for decisions on dividends

3) It has been found that AIJ provided false explanations in soliciting customers. Regarding the AIJ problem, it has also been suspected that pension funds with insufficient investment management capabilities or experiences were treated as professional investors. Given these points, the FSA will verify solicitation and explanation systems at discretionary investment business operators and pay attention to

whether the professional investor system is operated in accordance with the suitability rule.

- 4) The relationship between a financial institution and an investor does not end at the time when the product is sold. Intimate care after the product sale is also essential for building trusting relationships with investors.

It is especially important to provide timely, accurate and easily understood information to customers on market trends and changes in issuers' credit strength which affect price changes in investment products (including information from investment trust management companies to sellers in regard to investment trusts), in order to deepen investors' understanding, and to provide detailed support for investment decisions. As part of this, the investment decision-making ability of elderly customers can change in a short time, and it is essential to provide them with especially careful follow-up, such as diligently providing advice from the customer's standpoint.

From this viewpoint, the FSA will encourage appropriate after care from the customer's viewpoint.

(2) Complaint and Consultation Handling System

For cases in which trouble arises between the financial instruments business operator, etc. and an investor concerning a financial instrument transaction, it is important that each operator handles it sincerely, and strives to enhance the investor's feeling of consent.

Also, in connection with the financial Alternative Dispute Resolution (ADR) system, the FSA will watch carefully whether financial instruments business operators, etc. are:

- i) making sincere efforts for quick dispute resolution, such as proactive disclosure of required information;
- ii) preparing arrangements for facilitating easy use of the system nationwide;
- iii) introducing the ADR system to customers as needed when they make consultations; and
- iv) providing explanations anew on the ADR system when customers' consent is difficult to obtain at talks between parties to disputes or when damages are difficult to determine.

From this viewpoint, the FSA examines the complaint and consultation handling system in each operator, and encourages their handling from the investor's viewpoint.

(3) Business Continuity

- 1) Computer systems of financial institutions are the core of their settlement systems supporting the market. They have a strong public aspect as social infrastructure. If a failure occurs, it may greatly affect user convenience and society, leading to loss of credibility of financial instrument business operators, etc. The FSA encourages each

operator to conduct voluntary check under proactive leadership by management, regarding awareness of IT system risks, ensuring IT system sufficiency in response to changes in the external environment, business strategy on IT system investments (including human resource allocation and human resource training), risk management when failure occurs, and ensuring an appropriate audit system, etc. The FSA also focuses on examining these matters.

In particular, the FSA will verify the following points:

- i) Whether top managers of financial instruments business operators, etc. fully recognize the prevention of computer system troubles and the prompt recovery from such troubles as great business management challenges and have built sufficient relevant systems (for example, whether financial instruments business operators, etc. outsourcing computer system management have taken such measures as the appropriate internal distribution of system experts without leaving outsourcees to undertake system management)
 - ii) Whether financial instruments business operators, etc. have made data-processing capacity identification and assessment efforts, including the identification of capacity limits, and have considered systemic and administrative responses to cases where demand exceeds capacity limits
 - iii) Whether financial instruments business operators, etc. continuously sort out present underlying system risks and implement methodical investment in system maintenance and improvement
 - iv) Whether financial instruments business operators, etc. work out and implement specific plans for the devolution of present system designs and developed technologies and the development of relevant experts
 - v) Whether financial instruments business operators, etc. have fully understood the details of systems subject to outsourcing, specified how to share roles, responsibilities, etc. with outsourcees in advance and made monitoring arrangements including outsourcees
 - vi) Whether top managers identify risks accompanying the replacement and integration of systems and conduct project management appropriately
 - vii) Whether financial instrument business operators, etc. try to not only take measures for forestalling system troubles but also develop systems (including the development of call centers for the case of suspended online transactions and accident checkup procedures as stipulated in Article 39-3 of the Financial Instruments and Exchange Act) for protecting customers on the occasion of a system glitch.
- 2) Being mindful of the experience of the recent Great East Japan Earthquake, the FSA will verify that financial instruments business operators, etc. conduct self-assessments as to whether their existing BCPs have effectively functioned, whether they

sufficiently assumed major risks such as earthquakes and other natural disasters, pandemic influenza and large electricity blackouts, and whether they built up sufficient countermeasures, etc.

As necessary in consideration of the sizes of financial instruments business operators, etc., the FSA will also ascertain whether they check the effectiveness of their relevant BCPs (including the securing of fuel and personnel for business continuity, backing up of systems, and dealing with customers) through on-the-job training and whether they revise these plans as necessary through training.

Among measures for the immediate future, financial instruments business operators, etc. are implementing electricity-saving measures throughout Japan, including regions covered by Hokkaido Electric Power Co., Kansai Electric Power Co., Shikoku Electric Power Co. and Kyushu Electric Power Co., as electricity supply decreases with nuclear power plants halted. In some regions (including those covered by Kansai Electric), financial instruments business operators, etc. are preparing for rolling blackouts as a precaution. The FSA will continue to identify each financial institution's electricity-saving measures this summer and whether business continuity could remain unaffected at system centers and other key business bases. Given that system troubles and other troubles have occurred even in regions other than those subject to rolling blackouts, the FSA will confirm whether financial instruments business operators, etc. and their outsources check the preparation of BCPs, the establishment of private power generators and back-up centers, and training for securing the effectiveness of BCPs as necessary.

(4) Responses to Problem Prevention Measures regarding discretionary investment business operators

The FSA will continue a sweeping survey of discretionary investment business operators (the second survey) and share information in the survey with the Securities and Exchange Surveillance Commission (SESC). The FSA will thus closely cooperate with the SESC's intensive inspection of discretionary investment business operators and supervise these investment managers on a risk basis.

The FSA will also focus on whether discretionary investment business operators appropriately implement problem prevention measures based on the AIJ problem.

(5) Compliance with Regulations on Foreign Currency Margin Transactions

The FSA will continue to verify the adequateness of FX businesses' customer solicitation and explanation systems, based on such guidelines as those provided by the Financial Futures Association of Japan on affiliate advertisements. Given the case where SESC recommendations were given in regard to slippage in foreign currency margin transactions, the FSA will pay attention to whether other FX businesses have similar problems.

(6) Self-regulation in Type II Financial Instruments Business

Since the Type II Financial Instruments Firms Association was approved as an authorized financial instruments firms association in June 2011, it has been making efforts to create self-regulatory rules. Given that it will become more important for the self-regulatory organization to perform its functions appropriately in the present situation where Type II financial instruments firms are abundant, the FSA will encourage further investor protection efforts to Type II financial instruments firms in order to lead the association to expand its membership and promptly perform self-regulatory functions, including the creation of self-regulatory rules, to fully secure investor protection.

(7) Responses to the Regulations for Credit Rating Companies

- 1) Regarding credit rating agencies, the FSA puts priority on examining whether internal control systems are developed to prevent conflicts of interest and ensure fairness of rating processes, whether the information concerning rating policy is appropriately disclosed, and etc. The FSA will base its supervision on international discussions regarding the supervision of credit rating agencies.
- 2) The FSA will also check whether securities companies provide appropriate explanations regarding ratings issued by unregistered ratings companies. Moreover, the FSA will facilitate each securities company to recognize the limitations of ratings and conduct its own credit risk evaluation without reliance on ratings by conducting own supplemental analyses given the ratings, and providing them to investors.

(8) Addressing Financial Crimes

- 1) There are still cases of maliciously fraudulent solicitation of investment in unlisted shares, corporate bonds, collective investment schemes (funds), etc. Given that legal revisions were put into force in June 2011 to toughen penalties on unregistered financial instruments business operators, etc. and in November 2011 to make their activities such as the sale of unlisted shares invalid in principle and prohibit their advertisement and investment solicitation, the FSA will enhance its response to these unregistered business operators, etc. while promoting cooperation with police authorities, the Consumer Affairs Agency, and etc., including the sharing of information on malicious business operators, etc. The FSA will also appropriately deal with unregistered overseas business operators, etc. who solicit domestic investors for financial instruments.
- 2) In April 2012, after a malicious business operator was identified as taking advantage of the notification system for specially permitted businesses for qualified institutional investors to manage funds without meeting the requirements for specially permitted

businesses, the range of matters for notification was expanded to include the names of qualified institutional investors, and the points to be checked upon notification were increased. Based on the institutional revision, the FSA will try to confirm the requirements for businesses subject to notification and grasp the situation of businesses (including whether a qualified institutional investor has actually invested, and whether an institutional investor, even though with some investment, engages in such actions as the receipt of compensations for superficial operations to make the investment a nominal investment or an investment for circumventing laws). If any malicious operators, etc. of specially permitted businesses are found, the FSA will take strict actions in cooperation with police authorities.

- 3) In order to prevent crimes related to financial transactions, including fraudulent solicitation involving transactions in unlisted shares and collective investment schemes (funds), the FSA will promote the provision of information to investors, including the announcement of cases subject to warning, and encourage relevant industry organizations (self-regulatory organizations) and financial instruments business operators, etc. to take the appropriate responses.