

Annual Supervisory Policy for Financial Instruments Business Operators, etc. for Program Year 2013

The Financial Services Agency (FSA) publishes its Annual Supervisory Policy for Financial Instruments Business Operators, etc. for each program year so as to clarify its supervisory priorities. This is prescribed in the “Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.,” which show basic approaches for the supervisory process aimed at Financial Instruments Business Operators, etc.

In this Program Year, in accordance with the “Basic Concepts on Future Supervision of Financial Institutions” as shown below, the FSA will place priority on the areas of 1) appropriate functioning of market intermediation, 2) risk management and the stability of the financial system, and 3) improving customer protection and convenience for users, and will supervise Financial Instruments Business Operators, etc. while striving to have straightforward and deep discussions with them.

It should be noted that this supervisory policy was drawn up in light of the circumstances that surrounded Financial Instruments Business Operators, etc. as of September 2013, and may be subject to review as necessary.

1. Environment Surrounding Financial and Capital Markets, and Basic Concepts on Future Supervision of Financial Institutions

(1) Environment surrounding financial and capital markets, and required roles of Financial Instruments Business Operators, etc.

The Japanese government is striving to create a beneficial cycle for growth/wealth generation and regain a strong economy in order to achieve an early exit from deflation, which leads to revitalize Japan’s economy and accelerate reconstruction from the Great East Japan Earthquake disaster.

The Japanese economy, supported also by the improvement of business mind, is expected to recover gradually, backed by an improving environment for exports and the favorable effects of economic measures and monetary policies. Meanwhile, attention should be paid continuously to foreign economic conditions and financial and capital markets, including the European sovereign debt problem, impacts from the U.S. policy trends, and the future prospects of the Chinese economy, etc.

Considering changes in the market environment noted above, Financial Instruments Business Operators, etc. should make efforts to manage risks in a forward-looking manner. At the same time, they are required to contribute to the development of the financial market and Japanese economy by performing market intermediary functions and leading to fair price

formation for financial instruments as market participants in order to enhance investors' confidence in Japanese financial markets.

The "Japan Revitalization Strategy," which is decided in the Cabinet in June 2013, requests an expansion of the supply of risk money. In order to facilitate the supply of risk money smoothly, Financial Instruments Business Operators, etc., under appropriate internal control systems, are expected to act as market intermediaries between fund providers and seekers (hereinafter referred to as financial intermediary functions).

In January 2014, the Japanese equivalent of Individual Savings Accounts (NISAs) will be introduced to support self-efforts' for steady asset growth of individual investors, and to promote the shift from savings to investments and expand the supply of risk money.

Under the circumstances noted above, based on the suitability rule, Financial Instruments Business Operators, etc. are expected to develop and provide products that are based on a customer-oriented view-point and will contribute to customers' medium to long-term asset growth. They are also expected to demonstrate their consulting function to support asset growth that is suitable for each customer's life and financial plans and to contribute to the expansion of risk money supply.

Considering the perspectives above mentioned, it is more important that Financial Instruments Business Operators, etc. fully recognize their required roles, and the management should make responsible and timely business judgments to respond to rapid changes of society and economy domestically and globally. In the meantime, Financial Instruments Business Operators, etc. should examine their business strategies for the medium to long-term covering the next 5–10 year period with proper considerations to the various risks.

(2) Approach Taken by the Supervisory Authority

With its awareness of the abovementioned situation, the FSA as the supervisory authority, will confirm whether Financial Instruments Business Operators, etc., under the appropriate leadership of management personnel, have enhanced their governance and risk management systems, verified the sustainability of their business models properly, and devised short and medium to long-term management strategies.

Furthermore, in this program year, the FSA will basically continue efforts to further embed and deepen "Better Regulation" (engaging in straightforward and in-depth dialogue with Financial Instruments Business Operators, etc., external communications, sharing information and collaboration on the economic and financial situations in Japan and overseas, and improving the transparency and predictability of administrative actions). To this end, the FSA will continue to take the following approaches as the supervisory authority.

The FSA will endeavor to seek the higher quality of supervision and reduce the regulatory cost on a medium to long-term basis, depending on the proposition that financial institutions improve their self-discipline and the FSA improves its own capability of supervision. This approach is based on the idea that negative impacts will be brought to the real economy by

distortions and excessive control of the regulation if financial administration is implemented through regulation only.

1) Financial Supervision and Administration with High Risk Sensitivity

In order to accurately respond to current conceivable risks, the FSA will gain a deeper understanding of the macro economy and financial and capital markets, and deepen its understanding of how these affect the soundness of Financial Instruments Business Operators, etc., so as to identify and understand the risks which accumulate in each Financial Instruments Business Operator, etc. and in the financial system with a forward-looking perspective. The FSA will also enhance the integration of on-site and off-site monitoring to detect risks at an early stage. At the same time, the FSA will further promote its risk-based supervision of Financial Instruments Business Operators, etc. by utilizing its limited human resources accurately and effectively.

It is also important to check whether Financial Instruments Business Operators, etc. fully assume major risks in their business continuity plans (BCPs), revise these plans as necessary, and conduct relevant training with awareness of the experiences of the Great East Japan Earthquake, recent IT system glitches, etc., in order to maintain and ensure financial functions even if an unexpected event occurs. Moreover, given that any problem with IT systems at the core of financial services can greatly affect people's lives and the economy, it is important for the FSA to promote Financial Instruments Business Operators, etc.'s voluntary checkups and to implement sensitive monitoring as the regulatory authority in normal times.

2) Financial Administration from a Citizen's and User's Point of View

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 the improvement of its monitoring in view of the MRI problem, etc., thorough implementation of fraud prevention measures based on the AIJ problem and the thorough classification of customer assets for management based on the case where the investor protection fund identified repayment difficulties originating from a violation of the requirement to classify customer assets for management. The FSA will also check IT system glitch countermeasures and other matters linked to customer protection.

3) Supervisory Response 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) Supervisory Response which Contributes to Financial Instruments Business

Operators, etc.'s Improvement of their Management and Making Better Business Judgments

Through straightforward and deep discussions with Financial Instruments Business Operators, etc., and the distribution of information to them, the FSA will try to help Financial Instruments Business Operators, etc. make voluntary business improvements and decisions. Given the MRI problem, the AIJ problem and insider tradings linked to public share offerings, etc., not only actions by the supervisory authority but also Financial Instruments Business Operators, etc.'s strong acknowledgement of their public roles and their persistent efforts are required for improving confidence in Japan's financial markets.

Through such contacts as the exchange of views with each Financial Instruments Business Operators, etc. the FSA as the supervisory authority will introduce voluntary and advanced practices of other Financial Instruments Business Operator, etc. and encourage each operator to make voluntary and proactive efforts for such purposes as performing market intermediary functions, expanding risk management and improving customer protection and users' convenience to improve qualitatively the entire financial industry.

In addition to these approaches, the FSA will also bear the following points in mind when performing supervision:

- The FSA will attempt to deepen its cooperation further with relevant divisions of the Securities and Exchange Surveillance Commission (SESC) and the like, self-regulatory organizations (SROs), and the Bank of Japan (BOJ), and will strive to cooperate with overseas authorities through multilateral supervisory colleges and positively contribute to and make timely and adequate exchanges of views with organizations which set international standards. Particularly, to achieve more appropriate and effective supervision and inspection by the FSA and SESC, the FSA and SESC will aim to share information more closely and in a timely manner, and exchange views. In addition, SROs play key roles in ensuring that the financial market operates smoothly and fairly. As such, the FSA will require SROs to enhance their self-regulatory function furthermore and demonstrate it appropriately.
- The FSA will annually review requirements for reports and submitted documents, giving consideration to the reduction of burdens on Financial Instruments Business Operators, etc. Given the MRI problems, etc., however, the FSA, in the view of strengthening monitoring, will consider enhancing the requirements for reports and submitted documents if such enhancement is identified as necessary.
- 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, etc.

Financial Instruments Business Operators, etc. play roles in enabling smooth transactions by serving as market intermediaries when investors and fundraisers access the market. These roles are the core roles that Financial Instruments Business Operators, etc. must play in the market. The roles are highly public. Financial Instruments Business Operators, etc. are thus required to enhance investors' confidence in Japan's financial markets and contribute to the development of the financial market and Japanese economy by conducting highly reliable business operations with adequate user protection taken into account, by performing market intermediary functions adequately, and by making contributions to fair price formation for financial instruments.

Further, Financial Instruments Business Operators, etc., are required to contribute to expanding the risk money supply for economic growth, are expected to actively demonstrate financial intermediary functions which identify companies with growth potential and provide support/intermediation to persons seeking financing.

At the same time, considering such recent problems as insider-trading cases associated with public share offerings and the London Interbank Offered Rate (LIBOR) manipulation problem, Financial Instruments Business Operators, etc. should make industry-wide and persistent efforts to improve the sense of compliance and professional ethics.

Based on such viewpoint, the FSA will supervise Financial Instruments Business Operators, etc.'s performance of market intermediary functions from the following perspectives:

- 1) The FSA will verify whether Financial Instruments Business Operators, etc. appropriately develop various internal control systems to enable their performance of market intermediary functions.
- 2) The FSA will encourage Financial Instruments Business Operators, etc. to make efforts for active financial intermediary functions under appropriate internal control systems, in order to contribute to expanding the risk money supply for economic growth.
- 3) The FSA will verify whether Financial Instruments Business Operators, etc. are involved in providing financial products aligned with the purpose of NISAs and establish appropriate internal control systems for Customer Solicitation and Explanation to promote wide use and market penetration of NISAs.
- 4) Since customer information is the base for financial instruments transactions and their intermediation, the strict management of such information must be ensured thoroughly from the viewpoint of personal information protection. Recognizing that insider trading that takes advantage of corporate information toward such actions as public share offerings is a serious problem that damages domestic and foreign investors' confidence in financial markets and has resulted in the introduction of new regulations against the disclosure of inside information and trading recommendations in the revised Financial

Instruments and Exchange Act (enacted June 13, 2013), Financial Instruments Business Operators, etc. must make thorough efforts to manage corporate information more strictly.

From this viewpoint, the FSA will check whether top managers of Financial Instruments Business Operators, etc. take leadership in developing internal control systems for information security management, etc., in enhancing business ethics for preventing the corruption of executives and employees (including information leaks and insider trading, etc.), and in promoting the consciousness of legal compliance. The FSA will also verify 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 information.

Specifically, the FSA's examination will focus on the following points:

- (i) Do public offering underwriting and other "inward information" divisions receiving corporate information from customers minimize information transmission to sales divisions for institutional investors and other "outward information" divisions providing information to outside customers?
 - (ii) Do "outward information" divisions strictly control corporate information?
 - (iii) Are information acquirers led to fully identify the significance of information in question for cases where "outward information" divisions hold corporate information in question?
 - (iv) Does any inappropriate information transmission occur during contact with institutional investors, etc.?
 - (v) Do internal control divisions appropriately implement monitoring measures, including the verification of communications records?
 - (vi) Do 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?
- 5) The FSA will examine the following points to ensure that the internal control system to prevent illegal securities trading is established.
- (i) Do Financial Instruments Business Operators, etc. develop internal control systems for the verification at the time of a transaction, preparation and storage of such verification and transaction record, and reporting of suspicious transactions based on the revised Act on Prevention of Transfer of Criminal Proceeds ("PTCP Act") enforced in April 2013 for preventing money laundering and terrorism financing?

Do Financial Instruments Business Operators, etc. develop internal control systems for cross-sectional cooperation and information-sharing between relevant divisions for the prevention of money laundering and terrorism financing?

- (ii) Do Financial Instruments Business Operators, etc. make appropriate efforts, such

as developing procedures and arrangements to ban relationships with antisocial groups, with the strong will of top management and employees to eliminate antisocial groups from financial transactions? Particularly, do no 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?

Do securities companies utilize appropriately “the Antisocial Forces Reference System,” which was introduced in February 2013 by the Japan Securities Dealers Association (JSDA)?

- 6) While the manipulation of the London Interbank Offered Rate (LIBOR) has gained global attention, the credibility of important financial market benchmarks must be protected. Financial Instruments Business Operators, etc. must develop systems to prevent inappropriate activities associated with benchmark interest rates. From this point of view, the FSA will continue to check their internal control systems.

3. Risk Management and Stability of the Financial System

Earnings of Financial Instruments Business Operators, etc. have improved recently, led by increasing fees/commissions and fund flows to investment trusts in the active stock market that started in November 2012. While more attentions should be paid to the business environment and the financial market, including financial and economic trends overseas. Under these conditions, it is increasingly important for Financial Instruments Business Operators, etc. to achieve high quality risk management.

It is also important to note that the management of Financial Instruments Business Operators, etc. should become aware of key management issues and get involved in building a business model with medium to long-term sustainability, especially under the current favorable environments.

Given current financial and economic conditions, the FSA will conduct supervision more carefully on large-scale securities company groups. Further, the FSA will encourage further efforts towards enhancement of earnings and devising medium to long-term management strategies, including overseas strategies, through discussions with management, if necessary.

As for small and medium-sized securities companies, etc., the FSA will closely monitor their financial bases and liquidity positions considering the possible effects of sudden changes in financial and economic environment, and discuss business strategies with management, if necessary.

(1) Facilitating Integrated Risk Management for Entire Securities Company Groups

- 1) In close cooperation with the Bank of Japan and foreign authorities, taking into account the current financial and economic situation and the progress in international discussions regarding financial regulations which could affect liquidity positions of securities companies, the FSA will require large-scale securities company groups, etc.

(including large domestic and foreign securities companies) with a major presence in domestic and foreign financial systems to continue to ensure the management of liquidity risks, including foreign currencies, on a group-wide basis.

The FSA will also encourage large-scale securities company groups, etc. to implement external communications by voluntarily submitting easy-to-understand information so that their overall risk managements, including liquidity risk management, are clearly understood by market participants, etc.

- 2) As for groups involving special Financial Instruments Business Operators, etc. and designated parent companies, which are subject to consolidated supervision and the regulation of securities company groups, the FSA will continue to try to timely and accurately grasp the condition of group-wide businesses. The FSA will intensively verify the development status concerning group-wide comprehensive risk management systems, initiatives to improve group-wide data processing capabilities, the appropriateness of stress testing to accurately capture tail risks, and the utilization of stress test results for management, etc.

Particularly, the FSA will further enhance its supervision, particularly concerning internationally active securities company groups with large and complex operations, because these groups need to develop group-wide governance structures and manage a variety of risks appropriately and accurately on a group-wide basis in view of the effect that the financial and economic trends in Japan and overseas as well as progress in international financial regulations may have on the group and the overall financial system. In this regard, the FSA will also urge such groups to refer to the risk management systems of foreign financial institutions with large-scale and various business operations.

Further, in order to monitor the financial soundness and risk management of these groups with large and complex operations in detail from a forward-looking perspective, the FSA will implement and enhance integrated on-site and off-site monitoring in close cooperation with the Inspection Bureau. Additionally, based on the ongoing international discussions by the Financial Stability Board (FSB) and other forums, the FSA will encourage internationally active securities company groups with large and complex operations to implement the following initiatives:

- (i) Reinforcement of internal control and group governance backed by properly functioning business, risk management, finance, and internal audit divisions
- (ii) Improvement of utilizing results from stress testing in making management decisions
- (iii) Development of internal systems for setting capital policy
- (iv) Strengthening of Management Information Systems (MIS) to maintain appropriate data gathering capabilities

- (v) Improvement of the skills and expertise of personnel in charge of risk management and internal auditing
- (vi) Development of recovery plans, etc.

At the same time, the FSA will continue working to develop the Resolution Plan in view of the revised Deposit Insurance Act approved by the Diet in June 2013.

Other than the above, in line with active international discussions for the advancement of supervisory methodologies applied to large-scale financial institutions, the FSA will continue working on strengthening its supervisory methodologies, and if necessary, consider further clarification of key requirement issues for financial groups with large-scale and complex operations.

The FSA will also continue its careful monitoring of economic trends in Japan and the development in financial markets/real economies overseas and their potential effects on the financial system. At the same time, closely coordinating with the BOJ, the FSA will continue its analyses and supervision from the macro-prudential perspective, striving to monitor whether the entire financial system would develop in a sustainable and stable trend.

(2) Preparations for Business 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 industry-wide and time-series analyses.
- 2) If signs of financial deterioration or liquidity concerns are noted 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.

In addition, the FSA will examine intensively whether these companies maintain the customer's assets extremely carefully and manage them appropriately through segregation management. The FSA will also watch out for the possibility that antisocial forces or people who lack either the intention or ability to conduct sound business operations could engage in business management of Financial Instruments Business Operators, etc. as fund providers, etc.

In this regard, if any securities firm, etc. shows signs of financial deterioration or tightening liquidity, the FSA will strengthen coordination with the JSDA and Investor Protection Fund to find these issues at an early stage.

Further, 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) Initiatives 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

Improvement of customer protection and convenience for users of financial institutions not only contributes to the development of a sound national economy, but also stabilizes the Japanese financial system by enhancing citizens' trust in financial institutions. Financial Instruments Business Operators, etc. must establish robust business operation systems under the management leadership, and ensure the protection of customers' interest and a sense of security and trust. Based on this, Financial Instruments Business Operators, etc. should accurately reflect customers' needs, endeavor to provide innovative financial products/services to enhance their competitiveness, and contribute to the sound growth of Japan's financial market.

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

To this end, Financial Instrument Business Operators, etc. 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 suiting the customer's profile is essential. Financial Instruments Business Operators, etc. 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 supervises Financial Instrument Business Operators, etc. particularly under the following initiatives aiming to have improved customer protection and better convenience for users of Financial Instruments Business Operators, etc.

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 profiles, (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.

Further, in view of recent compliance issues such as the MRI problem, etc., the FSA will enhance its risk-based supervisory approach by strengthening its monitoring system and improvement of information analysis by proper and effective uses of limited human resources.

(1) Sales Systems, etc.

In the sales 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 the sales, solicitation, and the customer follow-up systems of each operator, and urge them to make improvements based on the results of the interviews.

Based on this view point, the FSA will urge Financial Instruments Business Operators, etc. to thoroughly conduct sales activities in line with the customer's viewpoint in order to build trust and a long-term relationships with the customer.

- 1) With regard 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, taking into account the supervisory guidance related to solicitation and explanation, the FSA will focus especially 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. give appropriate and flexible explanations about risks and inherencies of products to customers providing documents with easy-to-understand descriptions prepared in light of the customer's

knowledge, experience, wealth level, and the purpose of investment, so as to aid them to make the right decision for each investment. Particularly, whether Financial Instruments Business Operators, etc. give appropriate explanations on matters that influence the customer's investment decisions, including risks and inherencies related to product characteristics and price volatilities, etc., fees such as sales commissions and cancellation fees, trust fees, and other expenses, and the possibility that dividends may be paid using the principal amount in part or full, as well as and appropriate explanations and suggestions for unnecessary switching of funds in the case of fund switching;

- (iii) Whether Financial Instruments Business Operators, etc. develop internal control systems appropriately for receiving consultations from elderly customers, taking into consideration the possibility that they may not fully understand the contents of contracts due to deteriorations of their eyesight and hearing, even if they have enough investment experience. Furthermore, whether Financial Instruments Business Operators, etc. develop internal control systems properly to ensure that elderly customers understand the characteristics and risks of financial products, to prevent and detect potential problems at each phase of the transactions (solicitation, order, confirmation, and post execution) through each sales channel (face-to-face, telephone, and over-the-counter);
 - (iv) Whether Financial Instruments Business Operators, etc. make check-sheets as needed and collect them from customers to confirm the customers' understanding about the contents of explanations;
 - (v) Whether Financial Instruments Business Operators, etc. provide customers with documents of warning points;
 - (vi) Whether the compensation systems of sales staff and managers are not biased and are not linked excessively to short-term profits;
 - (vii) Whether the sales system and product composition do not place too much emphasis on gaining fee earnings;
 - (viii) Whether necessary actions, such as IT system developments, are taken properly to prepare for upcoming revisions to the self-regulatory regulations by the JSDA in relation to the notification system for the total return of investment trusts and other financial products.
- 2) The NISA system is scheduled to be introduced in January 2014, and the customers who have little investment experience or knowledge are expected to use the NISAs. The FSA will check for the existence of initiatives to improve the financial literacy of such customers, procedures for giving customers explanations on NISAs, and whether financial products are being provided reflecting the purpose of the NISA system, in accordance with the Supervisory Guidelines revised in August 2013.
- 3) 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 customers' viewpoint.

(2) Complaint and Consultation Handling System

It is extremely important for Financial Instruments Business Operators, etc. to handle complaints and consultations proactively, timely, and appropriately, in order to ensure customer's trust in financial products and services, and to positively utilize customers' needs for better business management. From this viewpoint, the FSA will check whether Financial Instruments Business Operators, etc. develop internal control systems, under the involvement of the top management, for maintenance of consultation counters, analyses of the causes of consultations and complaints, sharing information within the institution, developments and notifications of measures to prevent the recurrence of complaints, and following up the implementation of these measures, in an appropriate manner.

Also, in connection with the financial Alternative Dispute Resolution (ADR) system, the FSA will examine carefully whether Financial Instruments Business Operators, etc. are;

- (i) making sincere efforts for quick dispute resolution, such as active 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 undertake consultations; and
- (iv) providing explanations anew on the ADR system when customers' consent is difficult to obtain between parties or when financial damages are difficult to determine.

From this viewpoint, the FSA will examine each operator's internal control system for handling customers' complaints and consultation, and encourage them to respond from the customers' viewpoints. At the same time, the FSA will encourage the development of internal control systems to utilize customer complaints and consultation for the improvement of business operations.

(3) Business Continuity

- 1) The computer systems of financial institutions are the core of the settlement systems supporting the market. They have a strong public aspect as social infrastructure. If a failure occurs, it impairs user convenience and has a great impact on society, and inevitably leads to a loss of credibility of Financial Instrument Business Operators, etc. Recently, some securities companies which offer Internet transaction services have faced IT glitches of unstable systems due to a sudden increase of transaction volumes. The FSA encourages Financial Instruments Business Operators, etc. to conduct voluntary checks 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 training), risk management and ensuring business continuity procedures at system failure, and ensuring an appropriate audit system, etc. The FSA also focuses on examining these matters.

In particular, FSA will verify the following:

- (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 important business management challenges and have built sufficient relevant systems
- (ii) Whether Financial Instruments Business Operators, etc. have accurately identified their data-processing capacities including capacity limits and have examined 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. make and implement specific plans for the succession of their present systems and technologies and for the training of relevant experts
- (v) Whether Financial Instruments Business Operators, etc. have fully understood the details of outsourced systems, specified how to share roles, responsibilities, etc. with outsourcing in advance and made monitoring arrangements to the system including contractors. Moreover, whether Financial Instruments Business Operators, etc. are adequately involved in outsourced tasks to avoid over-reliance on the outsourcing contractor, for instance, by placing its own personnel equipped with a thorough knowledge of IT systems.
- (vi) Whether top managers identify risks accompanying the replacement and integration of systems, and whether they conduct project management appropriately
- (vii) Whether Financial Instrument Business Operators, etc. try to not only take measures for preventing system glitches but also develop systems (including the development of call centers and alternative means in the event 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 failure.

Further, if system glitches occur, the FSA will also confirm the causes and measures to prevent a recurrence of such glitches by conducting interviews with the outsourcing contractors as needed.

- 2) The FSA will verify whether Financial Instruments Business Operators, etc. are adequately prepared to continue the critical operations in the event of a crisis, including the following preparations:
 - (i) Whether financial institutions set up solid business continuity systems under sufficient considerations of major risks, such as earthquakes and other natural disasters, pandemic influenza, and large-scale electricity blackouts
 - (ii) Whether Financial Instruments Business Operators, etc. review their Business Continuity Plans in light of experiences of large natural disaster, and system glitches and reports at Central Disaster Management Council, etc.
 - The FSA will confirm whether key business bases like system centers can continue business. Specifically, the FSA will confirm whether Financial Instruments Business Operators, etc. and their outsourcing contractors check the preparation of BCPs, the installment of private power generators and back-up centers, and training for securing the effectiveness of BCPs, as necessary.
 - Additionally, the FSA will confirm whether Financial Instruments Business Operators, etc. which offer Internet trading services have an adequate business continuity system in case of an emergency event.
 - Further, the FSA will check whether Financial Instruments Business Operators, etc. take security measures for cyber-attacks, prepare Crisis Management systems to minimize damages upon attack, and establish a monitoring and reporting system, etc.

(4) Discretionary Investment Business Operators

The FSA will continue its efforts to grasp the status of Discretionary Investment Business Operators and supervise them through a risk-based approach, closely cooperating with the SESC's intensive inspection of discretionary investment business operators and enhancing information sharing with SESC.

The FSA will also focus on whether Discretionary Investment Business Operators have appropriately implemented measures to prevent the recurrence of events such as the AIJ problem.

(5) Foreign Currency Margin Transactions

The FSA will continue to verify the adequacy of FX businesses' customer solicitation and

explanation systems, based on guidelines such as those provided by the Financial Futures Association of Japan (FFAJ) on affiliate advertisements. The FSA will verify whether binary options for retail customers are traded in compliance with the cabinet office ordinances, supervisory guidelines and self-regulatory rules set out by the FFAJ, which are enacted in August 2013. The FSA will also verify whether the slippage associated with FX transactions are treated in compliance with the revised supervisory guidelines and the FFAJ's self-regulatory rules, which are enacted in August 2013.

(6) Type II Financial Instruments Business

In view of the MRI problem, the FSA will enhance its monitoring of the status of Type II Financial Instruments Firms by collecting more information on the investment targets of funds and investor characters, share information with the SESC, and call for prompt inspections, to Type II Financial Instruments Firms as necessary.

In addition, the FSA will improve its capabilities to analyze information, including system enhancement, and develop a supervisory system and cooperation between the FSA and the Local Finance Bureaus for more flexible, speedy, and risk-based supervision.

Obviously, Type II Financial Instruments Firms should establish legal compliance systems, etc. on their own. At the same time, given the large number of existing Type II Financial Instruments Firms, it is essential that the self-regulatory organization perform its function appropriately. However, there are only a small number of operators registered as members of the Type II Financial Instruments Firms Association (Type II FIFIA). Therefore, in order to ensure that investors are protected appropriately, the FSA will continue to encourage Type II Financial Instruments Firms, to take further investor protection efforts in order to lead the association to expand its membership and promptly perform self-regulatory functions, including the creation of self-regulatory rules.

(7) Credit Rating Agencies

- (i) Regarding credit rating agencies, the FSA places priority on examining whether internal control systems are developed to prevent conflicts of interest and ensure the fairness of rating processes, whether the information concerning the rating policy is appropriately disclosed, whether adequate operational management systems are developed to prevent errors in press releases on rating actions, etc. The FSA will base its supervision on international discussions regarding the supervision of credit rating agencies.
- (ii) The FSA will also check whether securities companies provide appropriate explanations regarding ratings issued by unregistered ratings companies. Moreover, the FSA will help each securities company to recognize the limitations of ratings and conduct its own credit risk evaluation without reliance on ratings by conducting its own supplemental analyses given the ratings, and provide them to investors.

(8) Addressing Financial Crimes, etc.

- (i) There are still cases of maliciously fraudulent solicitation of investments in unlisted shares, corporate bonds, collective investment schemes (funds), etc. To cope with such fraudulent activities and unregistered Financial Instruments Business Operators, etc. the FSA will promote coordination with police authorities, the Consumer Affairs Agency, etc., including the sharing of information, etc. Additionally, the FSA will endeavor to deal with such unregistered Financial Instruments Business Operators, etc. (including unregistered overseas business operators soliciting investors in Japan) appropriately, by promptly issuing warning notices and providing investors with the disclosed information of such warning notices, etc. Further, the FSA will urge the related industry bodies (self-regulatory organizations) and Finance Instruments Business Operators, etc. to take appropriate actions to prevent the fraudulent cases and other crimes related to financial transactions.
- (ii) In April 2012, after a malicious business operator was found to have abused the notification system for Specially Permitted Businesses for Qualified Institutional Investors and managed funds without meeting the requirements for such businesses, the range of notification items was expanded to include the names of qualified institutional investors, and the check points upon receiving notifications were increased. Based on the revision of the system, the FSA will try to confirm whether business operators meet the requirements of notification businesses and grasp the actual status of businesses. For example, the FSA will check whether Qualified Institutional Investors have actually made investments, whether such investments are done for nominal purposes and evasions of the law under the situation that the Qualified Institutional Investors receive compensations in return for engaging in businesses without operational substance. The FSA will also share information with the SESC. Further, if malicious operators are identified, the FSA, in cooperation with police authorities, will take strict actions, such as prompt issuances of warning notifications, publications of such issuances, and quick updates on the “List of Registered Business Operators with Potential Problems.”