September 4, 2012
Financial Services Agency

Review of the Regulation and Supervision regarding Asset Management building on the Experience from the case of AIJ Investment Advisors Co., Ltd. (draft)

Following the recent case of AIJ Investment Advisors Co., Ltd., the Financial Services Agency (FSA) has elaborated, taking account of financial business practices, how to effectively revise regulation and supervision regarding asset management to address the problems that have been uncovered by this case. The FSA is hereby publishing the draft review as shown in the attachment.

While paying due consideration to their potential impact on financial business practices, we will develop draft review to relevant Cabinet Ordinances and the Supervisory Guideline. As for the matters requiring law amendment, we will consider submitting an amendment bill to the Diet.

In the future, we may consider taking additional measures depending on the results of intensive inspections, the improvement efforts made by the financial industry, etc.

（Attachment）

Review of the Regulation and Supervision regarding Asset Management building on the Experience from the case of AIJ Investment Advisors Co., Ltd. (draft)

１． Developing a mechanism for third-party oversight (e.g. by domestic trust banks) to function effectively
（e.g. a mechanism for domestic trust banks to directly obtain *net asset value* and *audit report* from the reporting source）

(1) Developing a mechanism for domestic trust banks to directly obtain *net asset value* and *audit report* from the reporting source

In order to strengthen the oversight function of third-party (e.g. by domestic trust banks) over invested assets, Discretionary investment management business operators shall take the following measures when they include investment funds in the portfolios of assets entrusted by pension funds (in cases where the assets entrusted are administered by domestic trust banks):

1) Measures to enable domestic trust banks to directly obtain the *net asset values* of investment funds from the calculators (e.g., administrators);
2) Measures to limit investment to investment funds subject to external audits and to enable domestic trust banks to obtain *authentic audit reports* regarding investment funds;
3) Measures to notify domestic trust banks of the *net asset values* indicated on Investment reports provided to customers.

Revisions to Cabinet Ordinances

(2) Requiring domestic trust banks to conduct double-checks of the *net asset value*

Domestic trust banks will be required to develop systems for double-checks of the following items and notification of the results to customers:
(i) *Net asset values* obtained through the above-described measure 1);

(ii) *Authentic audit reports* on investment funds obtained through the above-described measure 2);

(iii) *Net asset values* indicated on Investment reports and obtained through the above-described measure 3).

Revisions to Cabinet Ordinances

2. Developing a mechanism for customers (e.g. pension funds) to better detect problems
(e.g., enrichment of the contents of Investment reports)

(1) Enriching information provided in Investment reports, etc.

The matters such as the following will be added to the information provided in pre-contract documents, Investment reports and other reports(Note 1) provided by Discretionary investment management business operators (Note 2) to customers (e.g., pension funds):

- Structure of the scheme of investment funds included in the investment portfolio of assets in custody (e.g., presence or absence of affiliated companies)
- Calculation method of the *net asset value*
- Presence or absence of external audits

Law amendment and revisions to Cabinet Ordinances

(Note 1) "Other reports" include *reports on the status of trust property* compiled by trust banks and *documents concerning the status of asset investment* compiled by life insurance companies

(Note 2) "Discretionary investment management business operators" include Discretionary investment management business operators, trust banks and life insurance companies (limited to companies engaging in businesses related to insurance contracts with benefit payment linked to investment performance)

(Note 3) A legal amendment will be required regarding *the obligation for life insurance companies to provide documents concerning the status of investment*.

(2) Increasing the issuance frequency of Investment reports, etc.

The minimum issuance frequency of Investment reports to pension funds will be set at once per quarter.

Law amendment and revisions to Cabinet Ordinances

(Note) A law amendment will be required regarding *the issuance frequency of the reports on the status of assets in custody* compiled by trust banks.

(3) Stricter eligibility requirements for pension funds to be authorized as ***professional investors***

Stricter eligibility requirements will be set for pension funds to be authorized as *professional investors* (Note).

Law amendment and revisions to Cabinet Ordinances

(Note) Currently, when pension funds request to be authorized as *professional investors*, Discretionary investment management business operators may grant consent unless those funds are deemed to be unfit for the requirements in light of their knowledge, experience and asset status. Stricter eligibility requirements will be set in this respect.

(4) Introducing checking systems by Discretionary investment management business operators, etc.

The trustee which engages in managing assets of pension funds (e.g., Discretionary investment management operators) will be required to take measures including:

- Notifying customers (e.g., pension funds) when a potential violation of the obligation for diversified investment is identified;
- Developing internal systems to explain risks and other material factors in accordance with customers' knowledge, experiences, and other attributes.

Amendments to Cabinet Ordinances and Supervisory Guideline

3. Strengthening disincentives to fraud
(Introducing stricter punishment against *false* reports and *fraudulent* solicitation by Discretionary investment management business operators)

○ **Introducing stricter criminal penalties toward Discretionary investment managements business operators for (i) making false statements in Investment reports delivered to customers, (ii) making false statements in the course of solicitation, and (iii) concluding Discretionary investment contracts using fraudulent means.**

Law amendment

1) **Making false statements in Investment reports**

Current law: Imprisonment with work for not more than six months or a fine of not more than 500,000 yen (no additional corporate fines)

Draft amendment: Imprisonment with work for not more than three years or a fine of not more than 3 million yen (additional corporate fines of not more than 300 million yen) (Note 1).

2) **Making false statements in the course of solicitation**

Current law: Imprisonment with work for not more than one year, or a fine of not more than one million yen or not more than 3 million yen (no additional corporate fines or additional corporate fines of not more than 200 million yen)

Draft amendment: Imprisonment with work for not more than three years, or a fine of not more than 3 million yen (additional corporate fines of not more than 300 million yen) (Note 2)

3) **Concluding Discretionary investment contracts using fraudulent means**

Current law: Imprisonment with work for not more than three years, or a fine of not more than 3 million yen (additional corporate fines of not more than 300 million yen)

Draft amendment: Imprisonment with work for not more than five years, or a fine of not more than 5 million yen (additional corporate fines of not more than 500 million yen)

(Note 1) Regarding the administration type of trusts, the punishment will be strengthened to imprisonment with work for not more than one year, or a fine of not more than 3 million yen (additional corporate fines of not more than 200 million yen).

(Note 2) Regarding the administration type of trusts, the punishment will be left unchanged at imprisonment with work for not more than one year, or a fine of not more than 3 million yen (additional corporate fines of not more than 200 million yen).

4. Reviewing the regulation, supervision, and inspection systems regarding investment management businesses

(1) Enriching information provided in Business reports submitted to the FSA

In order to better grasp the actual status of Discretionary investment management business operators, the matters such as the following will be added to information provided in the Business reports they submit to the FSA:

- Structure of the scheme of investment funds included in the portfolio of invested assets (e.g., presence or absence of affiliated companies)
- Presence or absence of external audits
- Major business performance indicators for the most recent three years

(e.g., the number of contracts, investment returns, the total amount of invested assets, fees for managing entrusted assets and the ratio of entrusted pension assets to the total entrusted assets)

Revisions to Cabinet Ordinances

(2) Strengthening the supervision of Discretionary investment management business operators

Following the first-round survey conducted for Discretionary investment management business operators, the FSA has been conducting further in-depth second-round survey for the selected ones. In addition, the FSA has been conducting hearings from those which were not selected for the second-round survey.

Based on the results of the series of above-mentioned measures, the FSA will add any needed provisions in the Supervisory Guideline and continue prioritized off-site monitoring in accordance with the identified risks so that the FSA can effectively supervise investment management business operators, reflecting the degree of their risks.

Revisions to the Supervisory Guideline

(3) Strengthening inspection of Discretionary investment management business operators

1) Based in part on the results of comprehensive surveys conducted by the FSA

on Discretionary investment management business operators, and in order to examine the actual circumstances of their business operations and the status of their compliance with laws and regulations in light of the characteristics of their business types and customers, the Securities and Exchange Surveillance Commission (SESC) will conduct intensive inspections of the Discretionary investment management business operators' businesses in cooperation with supervisory departments.

2) The SESC will also strengthen its capacity for collecting and analyzing information on pension funds' asset management. Specifically, it will set up a dedicated channel for collecting information of high importance and usefulness from external sources (Pension Investment Hotline), and will assign specialists in pension funds' asset management. The SESC will conduct active, high-quality analysis of collected information as an input for determining the inspection priorities and the focus of inspections.

Basic Securities Inspection Policy and Program for 2012

(4) Reinforcing the authorities' capacity for strengthening inspection and supervision

Based on the measures specified above in (2) and (3), the following measures will be implemented in order to strengthen inspection and supervision that make maximum use of existing human resources:

- Strengthening capacity to collect and analyze information;

  (e.g., establishing a contact point office dedicated to collecting information regarding pension funds' asset management [Pension Investment Hotline])

- Improving monitoring techniques and other administrative methodologies.

  (e.g., supervision that takes account of risks regarding Discretionary investment management business operators based on supervisory key points)

In addition, efforts will be made to recruit experienced personnel with good knowledge of the Discretionary investment business practices and to secure necessary staffing.

(End)