Annual Report 2019/2020

Securities and Exchange Surveillance Commission

Annual Report 2019/2020

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[Disclaimer: This is a provisional translation for reference purpose. The Japanese version is the original.]

Introduction

The Securities and Exchange Surveillance Commission ("SESC") functions as a collegiate organization consisting of a Chairman and two Commissioners and the Secretariat attached to the Financial Services Agency ("FSA"). Our mission is to ensure the fairness and transparency of Japan's capital markets, protect investors, contribute to the sound development of the markets, and support sustainable economic growth.

The SESC, which was established in 1992, made a fresh start in December 2019 under a new organizational structure. The SESC has been authorized to investigate criminal cases with the aim of clarifying the truth behind cases of malicious market misconduct. Furthermore, over the years, the SESC expanded its authority to recommend administrative monetary penalty payment orders in 2005 and to inspect funds in 2007, while the divisions of the Executive Bureau of the SESC has been expanded from two to six divisions. Through this expansion and enhancement, the SESC has contributed to the soundness of the markets by not only filing criminal charges against cases of malicious violation but also using its inspection and investigation authorities and the administrative monetary penalty system more actively.

Key Achievements

As the environment surrounding capital markets is changing very rapidly, the SESC needs to be well informed of the circumstances of problems that might occur in the markets in order to respond to them in an appropriate manner.

In 2019, the SESC conducted market surveillance in a timely manner, gathered and analyzed information with a focus on potential risks from macro-economic perspectives. We also worked with self-regulatory organizations ("SROs") and foreign market oversight authorities, and kept a close eye on new incidents occurring in both domestic and overseas markets. We also improved our market monitoring system and techniques.

As for cooperation with foreign authorities in particular, the SESC strengthened cooperation with the Chinese authorities, whose importance is increasing, and contributed to global market surveillance by holding various international conferences in Tokyo.

With respect to the monitoring of Financial Instruments Business Operators, we implemented and strengthened integrated on-site and off-site monitoring activities based on risk assessments. The SESC also engaged in constructive dialogue, promoted customeroriented business conduct and strove to correct inappropriate sales and solicitation activities that may cause damage to investors. Furthermore, we effectively used the administrative monetary penalty system to perform prompt and efficient investigations and inspections, and responded with rigorous enforcement in very serious or malicious cases. In addition, from the viewpoint of preventing occurrence and recurrence of serious and malicious cases, the SESC strove to identify the root causes and conducted active external communications.

In light of changes surrounding capital markets, on January 24, 2020, the SESC published the Strategy & Policy of the SESC 2020-2022, which presents five measures to achieve its three goals—holistic oversight, timely oversight, and in-depth oversight—while taking into consideration the achievements made in 2017-2019.

Future Challenges

Uncertainty over future economic prospects due to increasing inflows of funds into high-risk and low-liquidity funds and geopolitical risks is growing amid the globalization of capital markets, the increasing interconnectedness between various financial markets and the global low-interest-rate environment. Capital markets are undergoing significant change, as exemplified by the remarkable progress in digitalization.

In light of these changes in the surrounding environment, the SESC intends to keep a close watch on market trends with increased vigilance amid recent signs of instability in global financial and capital markets due to the COVID-19 pandemic in order to prevent market misconduct, including attempts to cause further instability to the markets and market manipulation.

Under the Strategy & Policy of the SESC 2020-2022, the SESC will further enhance markets' self-regulation function while maintaining close collaboration with relevant authorities and SROs At the same time, it will make further efforts to develop fair, transparent, trusted and attractive capital markets and protect investors by conducting more effective and efficient market surveillance.

This annual report outlines the SESC's activities in FY2019 and explains its views pursuant to Article 22 of the Act for Establishment of the Financial Services Agency (Act No. 130 of 1998). We sincerely hope that this report will be shared with as many market participants and investors as possible, contribute to an understanding of the SESC's activities, and to establishing fair and transparent markets.

June 2020 Mitsuhiro Hasegawa Chairman Securities and Exchange Surveillance Commission

SESC's History

Year	Changes in SESC's authority and organization	Key events & activities
1991		Series of securities and financial scandals
1992	SESC established in the Ministry of Finance	
1993		Filing of criminal charges: Market manipulation related to Nihon Unisys, Ltd. shares (first criminal charge filed by SESC)
1998	Financial Supervisory Agency established: SESC comes under its jurisdiction	
2001	Financial Services Agency established; SESC comes under its jurisdiction	Major reorganization of central government agencies
2005	Administrative monetary penalty system introduced SESC mandated to exercise administrative monetary penalty investigation SESC mandated to exercise administrative monetary penalty inspection on disclosure statements Additional inspection authority for securities company etc. granted to SESC (inspection of financial soundness, inspection of investment advisors)	Filing of criminal charges: False statements in securities report related to Kanebo, Ltd.
2006	Five-division structure introduced (Planning and Management Division, Market Surveillance Division, Securities Business Monitoring Division, Administrative Monetary Penalty Investigation and Disclosure Inspection Division, and Criminal Investigation Division) Additionally mandated to exercise administrative monetary penalty investigation of market manipulation using spoofing orders; authority to conduct criminal investigation expanded	Filing of criminal charges Spreading of rumors, fraudulent means related to Livedoor Marketing Co., Ltd. shares Filing of criminal charges: Insider trading related to Nippon Broadcasting System, Inc. shares
2007	Additionally mandated to exercise authority on inspections of investment funds	Financial Instruments and Exchange Act in full effect
2008	 Additionally mandated to exercise authority to conduct disclosure statements inspection on quarterly securities reports and internal control reports; additionally mandated to exercise authority to conduct investigation for potential imposition of administrative monetary penalties on violations in quarterly securities reports (1)Additionally mandated to exercise authority to conduct disclosure statements inspection on false disclosure statements in tender offer notifications, reports of possession of large volume (2)Additionally mandated to exercise authority to conduct investigation for potential imposition of administrative monetary penalties related to market manipulation by means of fictitious or collusive sales and purchases (3)Additionally mandated to exercise authority to file petitions for court injunctions against violations by unregistered business operators 	
2010	Additionally mandated to exercise authority to inspect credit rating agencies	
2011	Additionally mandated to exercise authority to inspect group companies (consolidation regulation of large securities companies introduced) Six-division structure introduced (Planning and Management Division, Market Surveillance Division, Securities Business Monitoring Division, Market Misconduct Investigation Division, Disclosure Inspection Division, and Criminal Investigation Division) Cross-Border Investigation Office set up	

Year	Changes in SESC's authority and organization	Key events & activities
2012	Additionally mandated to exercise authority to inspect trade repositories	Filing of criminal charges, recommendation for administrative monetary penalty: False disclosure statements in securities report related to Olympus Corporation Recommendation for administrative disciplinary action, filing of criminal charges: AIJ Investment Advisors Co., Ltd. (false notifications, violation of duty of loyalty, etc.)
2013	Additionally mandated to exercise authority to conduct disclosure statements inspections on external conspirators who allegedly assisted in submission of false disclosure documents and administrative monetary penalty investigations on market misconduct, and summon alleged violators as part of administrative monetary penalty investigations	Recommendation for administrative disciplinary action: MRI International, Inc. (false notification, etc.)
2014	SESC additionally mandated to exercise authority to conduct administrative monetary penalty investigations and criminal investigations against providing of insider information and transaction encouragement which became subject to insider regulation.	
2015	Office of IT Forensics and Information set up Additionally mandated to exercise authority to conduct inspections on specified financial benchmark administrators	Filing of criminal charges: Market manipulation, spreading of rumors, use of fraudulent means, failure to submit reports of possession of large volume related to New Japan Chemical Co., Ltd. shares Recommendation for administrative monetary penalty: False statements in securities report related to Toshiba Corporation
2016	Office of Market Monitoring set up Litigation Office set up	Recommendation for administrative disciplinary action: Arts Securities Co., Ltd. (false notification, etc.)
2017		Filing of criminal charges: Use of fraudulent means by Arts Securities Co., Ltd., etc. (MARS); market manipulation in relation to shares of Stream, Co., Ltd.
2018	Additionally mandated to exercise authority to conduct inspections on high speed trading business operators	Filing of criminal charges: False statements in securities report related to Nissan Motor Co., Ltd. Recommendation for administrative monetary penalty: Manipulation of market for long-term government bond futures by Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.
2019	*	Recommendation for administrative monetary penalty: False statements in securities report related to Nissan Motor Co., Ltd.

 $\% Additionally\ mandated\ to\ conduct\ inspections\ on\ financial\ instruments\ business\ operators\ handling\ crypto-asset\ derivatives\ and$

electronic record transfer rights (the revised FIEA enacted in May 2019 and put into force in May 2020)

|------

Abbreviations				
Anti-Criminal Proceeds Act	Act on Prevention of Transfer of Criminal Proceeds (Act No.			
	22 of 2007)			
APRC	IOSCO Asia-Pacific Regional Committee			
ASIC	Australian Securities and Investments Commission			
BY	Business Year (from July 1 to June 30)			
C4	IOSCO Committee 4			
CFTC	U.S. Commodity Futures Trading Commission			
СРААОВ	Certified Public Accountants and Auditing Oversight Board			
CSRC	China Securities Regulatory Commission			
EMMoU	Enhanced Multilateral Memorandum of Understanding			
	concerning Consultation and Cooperation and the Exchange of			
	Information			
FCA	U.K. Financial Conduct Authority			
FIBOs	Financial Instruments Business Operators			
FIEA	Financial Instruments and Exchange Act (Act No. 25 of 1948)			
FIEs	Financial Instruments Exchanges			
FSA	Financial Services Agency			
FSA Establishment Act	Act for Establishment of the Financial Services Agency (Act			
	No. 130 of 1998)			
FSS	South Korean Financial Supervisory Service			
FY	Fiscal Year (from April 1 to March 31)			
GLOPAC	Global Financial Partnership Center			
Hong Kong SFC	Hong Kong Securities and Futures Commission			
HR	Human Resources			

HST	High-Speed Trading		
ICT	Information and Communication Technology		
IOSCO	International Organization of Securities Commissions		
ЛСА	Japan International Cooperation Agency		
JPX-R	Japan Exchange Regulation		
JSDA	Japan Securities Dealers Association		
MMoU	Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information		
SESC	Securities and Exchange Surveillance Commission		
Singapore MAS	Monetary Authority of Singapore		
SROs	Self-Regulatory Organizations		
ТОВ	Take-Over Bid		
TSE	Tokyo Stock Exchange		
US SEC	U.S. Securities and Exchange Commission		

Chapter 1. SESC Activity Summary

1 Overview of activities in Fiscal Year 2019

In FY2019 (April 2019–March 2020), the economic environment surrounding Japanese securities markets went through substantial changes. At the beginning of the fiscal year, the Japanese economy was recovering at a moderate pace. However, recently, the global economy is worsening rapidly in an extremely severe situation due to the COVID-19 pandemic. Therefore, it is necessary to keep a close watch on the effects of volatility in the financial and capital markets.¹

In order to deal with the significantly changing capital markets, in January 2020, the Securities and Exchange Surveillance Commission (SESC) published the Strategy & Policy of the SESC 2020-2022.² In FY2019, the SESC also engaged in market surveillance on a timely basis, such as gathering and analyzing information from macroeconomic perspectives with a focus on potential risks. In its investigation and inspection, the SESC not only made recommendations for administrative actions and filings of criminal charges of violations of regulations, but also analyzed the root causes of the violations of regulations to prevent recurrence.

- 2 Recommendations for administrative monetary penalty payment orders and filings of criminal charges of market misconduct
- (1) Recommendations for administrative monetary penalty payment orders and filings of criminal charges of market misconduct

In FY2019, the SESC made recommendations for administrative monetary penalty payment orders in 29 market misconduct cases (of which 24 were insider trading and 5 were market manipulation) and filed criminal charges in 1 case.

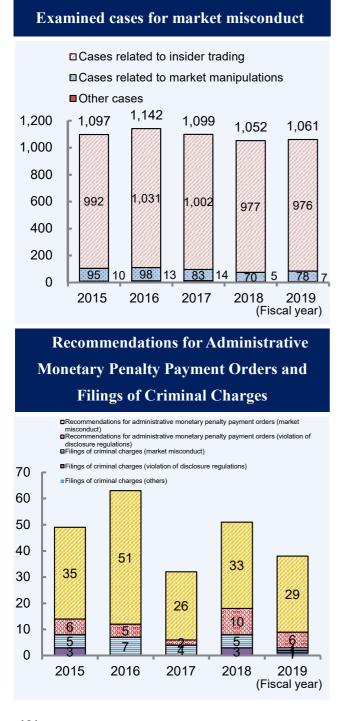
(2) Case examination for detecting market misconduct

The total number of cases examined for detecting market misconduct was 1,061 in FY2019; over 1,000 examinations have been conducted in 7 consecutive years.

¹ In light of the impacts of the COVID-19 outbreak, a statement by the Minister for Financial Services issued on March 24, 2020, stated that "the JFSA will cooperate with the SESC and the stock exchanges to conduct thorough monitoring of market manipulation and other market abuse, and to take rigorous actions against violations,

including strict enforcement of restrictions on short selling."

² The 10th Term (2020-2022) started on December 13, 2019.



(3) Trends in market misconduct

With rapid changes in the business environment as a background, the SESC made a number of recommendations in insider trading cases where business alliances and new share issuances were material facts. It also made several recommendations in insider trading cases where a petition for rehabilitation procedures was a material fact. Since April 2014, insider trading regulations have prohibited persons from providing insider information or making transaction encouragement to others. This transaction encouragement includes both for gaining profits and for avoiding losses. This year, the SESC made the first recommendation for administrative monetary penalty payment orders in a case of transaction encouragement for avoiding losses. With regard to the regulations on transaction encouragement, quite a few listed companies still lack sufficient understanding of the regulations.

The scheme of market manipulation becomes increasingly complicated and sophisticated. The SESC made recommendations for administrative monetary penalty payment orders in cases where, in order to avoid detection; (a) wrongdoers executed some spoofing orders instead of canceling them all; (b) a wrongdoer placed multiple spoofing orders across a wide range of prices covering the 10 highest bid prices; and (c) a wrongdoer raised share prices by repeatedly placing minimum unit orders.

(4) Policy going forward

Going forward, the SESC will continue to improve its surveillance systems and review the methods of examination and investigation in order to keep pace with the changing economic situations and trading methods as well as to ensure flexible and efficient examinations and investigations.

The SESC will also announce recommendations for administrative monetary penalty payment orders on its website as well as publish a casebook of administrative monetary penalty payment orders, which will provide information on trends and overviews of the cases. The casebook will also identify issues regarding internal control systems that can be improved to prevent insider trading at listed companies. This effort is aimed at preventing recurrences of market misconduct.

- 3 Identifying and addressing violations of disclosure regulations and prevention of recurrence of violations
- (1) Recommendations for administrative monetary penalty payment orders and filings of criminal charges of violations of disclosure regulations

The SESC made recommendations for administrative monetary penalty payment orders in 6 cases of violations of disclosure regulations and filed criminal charges in 1 case in FY2019.

(2) Trends and causes of the violations of disclosure regulations

Among the 6 cases of violations of disclosure regulations in which the SESC made recommendations for administrative monetary penalty payment orders, there were 2 cases of misstatements concerning non-financial information in the securities reports. Specifically, there were false statements with respect to the corporate governance system, internal control system and officers' compensation in the corporate governance section of annual securities reports.

As for the other 4 cases, there were misstatements concerning financial information in the securities reports, including premature revenue recognition and overstating of net profits through fraudulent accounting schemes, such as understating of loan loss provisions. Of the 4 cases, one was seen with the absence of "notes regarding transactions with relevant parties" in the annual securities reports.

(3) Policy going forward

Transactions are increasingly complex, corporate operations are more globalized, and the business models are being diversified and transformed. In these circumstances, early detection and preemptive actions against violations of disclosure regulations are essential. For doing this, the SESC will continue to gather information on listed companies and conduct analysis with a focus on the risk of the violations, as well as conduct timely and multifaceted inspections of disclosure statements.

In addition, the SESC will engage in dialogues and enhance mutual understanding on the background and causes of violations with the management and outside directors of listed companies that have committed violations of disclosure regulations, to assist them in building internal systems for proper information disclosure. The SESC will also proactively communicate with listed companies and their audit firms regarding the details of the actual violations of disclosure regulations detected in inspections of disclosure statements. Such efforts will collectively contribute to preventing recurrences of violation of disclosure regulations.

4 Risk-based and integrated monitoring of FIBOs³

(1) Basic monitoring policy for securities business

Since the 2016 business year,⁴ the SESC has been conducting risk assessments of all FIBOs through off-site examination involving analyses of the business environment including economic and industrial trends, as well as FIBOs' business models. Based on the respective risk assessments of FIBOs in offsite examination, the SESC has selected entities for on-site inspections in collaboration with the Local Financial Bureaus.

In carrying out on-site inspections, the SESC aims not only to point out legal problems and make recommendations for administrative actions, but also to assess the problems in a holistic manner and pursue the root causes to assist FIBOs in preventing recurrences of the problems.

In cases where the SESC identifies issues in business control environments that need to be improved but that have yet to become serious problems, the SESC has shared its views on the issues with the management of the FIBOs under inspection to encourage them to build effective internal control environments.

(2) Recommendations for administrative actions and filing of criminal charges against FIBOs

In FY2019, the SESC made 14 recommendations for administrative actions against FIBOs and filed criminal charges in 1 case.

These cases involved FIBOs that conducted seriously problematic business practices as they were lacking in awareness about compliance and investor protection. In one case, a securities company compensated customers for their losses, while in another case, an investment management firm failed to faithfully conduct investment management business for the interests of beneficiary owners. There was also a case where an investment adviser/agent provided seriously misleading advertisements to customers in relation to solicitation for the conclusion of financial instruments contracts.

(3) Policy going forward

While business operators subject to the SESC's monitoring total approximately 7,500, their size and businesses, and the products of-fered by them are diverse. Furthermore, there are business operators that are still lacking the

³ In this document, "FIBOs" refers to any business operator subject to securities monitoring, including Financial Instruments Business Operators, registered financial institutions, financial instruments intermediary service providers, Qualified Institutional Investor Business

Operators ("QII Business Operators"), and credit rating agencies.

⁴ The 2016 business year refers to the period from July1, 2016, to June 30, 2017.

fundamental awareness and controls for compliance and investor protection. The SESC will endeavor to accurately identify potential risks through its effective and efficient monitoring.

Especially in cases where the SESC identifies the necessity for early, in-depth examinations with regard to possible violations of relevant regulations or problems related to business control environments, the SESC will conduct on-site inspection to clarify the problems.

Following the enactment of the revised Financial Instruments and Exchange Act in May 2019, the SESC will monitor FIBOs handling derivatives trading related to crypto-assets⁵ and electronic records transfer rights (e.g. securities token offering).

5 Response to the advance of digitalization

(1) Use of digitalization for market surveillance

In recent years, rapid digitalization is having a significant impact on all capital markets and market participants. For example, the market landscape is being transformed as a result of the proliferation of high-speed algorithmic trading. In addition, new products and transactions, such as crypto-assets are emerging. Keeping up with such rapid changes in the environment, the SESC is promoting the use of digitalized technologies for a more effective and efficient surveillance mechanism.

(2) Policy going forward

The SESC will continue discussions with a view to keep up with possible changes in the environment and make increased use of digitalized technologies for a more effective and efficient surveillance mechanism.

6 Cooperation with relevant authorities and proactive communication with stakeholders

(1) Cooperation with relevant authorities

The SESC works with self-regulatory organizations (e.g., Financial Instruments Firms Associations, Financial Instruments Exchanges, and Japan Exchange Regulation; hereinafter "SROs") on a daily basis in examining market transactions and in monitoring the appropriateness of members' operations. The SESC further strengthened its cooperative relationship with SROs through periodic discussions to share emerging issues related to market surveillance. In FY2019, the SESC had such periodic discussions with SROs 19 times as well as discussions with FIBOs and relevant authorities to exchange views.

⁵ As a result of the revision of the Payment Services Act (put into force on May 1, 2020), the legal term representing "virtual currency" has been changed to "cryptoasset."

Regarding the cooperation with foreign authorities, the SESC participates in various multilateral discussions at IOSCO and actively engages in exchanges of views on a bilateral basis. In addition, in the cases of investigations into market misconduct using cross-border transactions, the SESC made a total of 26 requests for information to foreign authorities through the IOSCO MMoU (Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information) in FY2019.

(2) Proactive communication with stakeholders

The SESC continuously endeavors to enhance its communications with retail investors and other market participants with respect to the significance, details and root causes of the cases as well as other activities of the SESC on various occasions. The means of communication include the publication of individual cases at the time of recommendations and various casebooks, contribution of articles, and holding lectures for the purpose of enhancing self-discipline in the market. In FY2019, the SESC proactively conducted external outreach through its website, media outlets and a total of 26 seminars to market participants, certified public accountants, lawyers, and other stakeholders.

FY2019 KEY TOPICS (1)

GLOBAL MARKET SURVEILLANCE AND CLOSER COOPERATION WITH FOREIGN AUTHORITIES

Amid the ongoing globalization of markets and expansion of cross-border transactions, cooperation with foreign authorities is becoming increasingly important. In FY2019, the SESC, which is striving to contribute to global market surveillance and cooperate with relevant organizations in and outside Japan, enhanced cooperation particularly with Chinese authorities, whose importance is increasing, and hosted various international conferences in Tokyo.

In April 2019, the first Japan-China Capital Markets Forum was held in Shanghai, based on the agreement reached at the Japan-China Summit in October 2018. This forum was attended by hundreds of market participants from Japan and China. The SESC Chairman Hasegawa attended and made a speech addressing the importance of enhancing cooperation between relevant Japanese and Chinese organizations, including authorities.



Before the forum, Chairman Hasegawa and FSA Commissioner Endo held a meeting with Vice Chairman Fang Xinghai of the China Securities Regulatory Commission ("CSRC") and exchanged opinions about further enhancement of Japan-China financial cooperation and strengthening of cooperation in market surveillance. Along with this forum, a working-level meeting was held between the SESC and the CSRC to exchange opinions about enhancing the cooperative relationship between the two authorities and various issues related to securities markets.

In October 2019, the IOSCO Asia-Pacific Regional Committee ("APRC") meeting

was held in Tokyo. SESC Commissioner Indo and administrative staff attended the meeting, and the senior official of the SESC chaired the subcommittee on law enforcement. At the subcommittee, the SESC held discussions with foreign authorities, including the Australian Securities and Investments Commission ("ASIC") and the Monetary Authority of Singapore ("Singapore MAS"), on promoting information sharing and cooperation with respect to various issues related to Asia-Pacific capital markets. In November 2019, the SESC held a roundtable meeting in Tokyo, at which securities authorities and self-regulatory organizations from major countries, including the United States and European countries, exchanged information and opinions. Various issues related to market surveillance were discussed at the meeting.

Amid the ongoing globalization of capital markets and growing interconnectedness of global financial markets, the SESC will make further efforts to contribute to global market surveillance and enhance cooperation with relevant organizations in and outside Japan based on "Strategy & Policy 2020-2022," which was formulated in January 2020.

FY2019 KEY TOPICS (2)

RECOMMENDATION FOR ADMINISTRATIVE DISCIPLINARY ACTIONS AGAINST INAPPROPRIATE SALES AND SOLICITATION ACTIVITIES THAT MAY HARM INVESTORS, BY INVESTMENT ADVISORS

The role of investment advisers is to contribute to asset building by customers by providing information related to investment decisions based on analysis of the value of financial products and other matters.

Therefore, investment advisors are required to faithfully conduct business under the principle of placing customers' interests first ("fiduciary duty") and to conduct business in a sound and appropriate manner under a high level of self-discipline.

However, recently, violations of laws by investment advisors that infringed on the principle were found here and there, such as name lending, misleading advertising ("fake reviews"), and provision of unfounded advice for the purpose of using customer transactions to promote own or third-party interests ("scalping"). Some of the abovementioned violations were committed with the involvement of persons other than investment advisors.

As a result, the SESC recommended administrative disciplinary actions in the following seven cases (see Section 2-4-3 (4)).

O Name lending (2 cases)

There were cases of name lending, in which investment advisors lent their names to have investment advice provided by third-parties not registered for financial instruments business.

Engagement in financial instruments business requires registration under the FIEA. The lending of names by financial instrument business operators, including investment advisors, to other persons constitutes a malicious act that could lead to the circumvention of the registration system and is categorically forbidden under the FIEA.

A person who had provided investment advice using another investment advisor's name in an administrative disciplinary action case in the past committed a similar act again in FY2019. Therefore, the SESC published this case as a reminder.

O Misleading advertising (fake reviews) (3 cases)

Some websites evaluating and comparing investment advisors carried advertisements that included representations grossly deviating from facts.

Moreover, although those advertisements were actually articles written by outsourced advertising agencies, they were disguised as articles contributed by third-parties, providing grossly misleading representations. These are so called fake reviews.

In these cases, the SESC for the first time conducted on-site inspections of the abovementioned outsourced advertising agencies based on the authority granted by the FIEA in order to examine the situation of advertising activity by investment advisors.

O Provision of unfounded advice for the purpose of using customer transactions to promote third-party interests (scalping) (2 cases)

In these cases, investment advisors provided unfounded advice to some customers for the purpose of promoting the interests of third-parties who are substantial controllers of the investment advisors, by inducing rises in the prices of shares held by those persons.

This act, called scalping, is an extremely malicious act intended to promote the interests of thirdparties at the expense of customers' interests and is categorically forbidden under the FIEA.

In these cases, as the substantial controllers of the offending investment advisors played a leading role in committing the illegal act, their names and the fact of their involvement in the cases were disclosed. These represented the first cases in which the SESC recommended administrative disciplinary actions against scalping since the FIEA came into effect.

As described above, in FY2019, many malicious illegal acts involving persons other than investment advisors were recognized. By conducting in-depth inspections, the SESC strived to identify the situation of business conduct by investment advisors and get the full picture of illegal acts.

The SESC will continue to contribute to stable asset building by the Japanese people by strictly dealing with acts that undermine the protection of investors and by realizing markets where a broad range of investors can make investment without worries.

Meanwhile, when selecting investment advisors, investors should think carefully while giving consideration to the presence of illegal acts involving persons other than investment advisors.

2-1EXAMINATION OF TRANSACTIONS AND COLLECTION/ANALYSIS OF WIDE-RANGING INFORMATION

2-1 EXAMINATION OF TRANSACTIONS AND COLLECTION/ANALYSIS OF WIDE-RANGING INFORMATION

1. PURPOSE OF MARKET SURVEILLANCE

To realize holistic and timely market oversight adapted to the changing market environment, market surveillance is positioned as the entrance for information at the SESC. This is because the market surveillance aims at detecting any suspected market misconduct through monitoring by collecting and analyzing an extensive range of information on the overall financial and capital markets as well as the primary and secondary markets.

For the above reason, the SESC routinely receives a wide range of information from investors and others, and promptly circulates the information to the relevant divisions within the SESC (or the relevant division within FSA, if the information relates to affairs under the jurisdiction of the FSA). The SESC also cooperates with SROs to gather a variety of information related to financial and capital markets. Based on the information, the SESC analyzes the background of individual transactions and market trends, examines transactions for suspected market misconduct, and reports to the relevant divisions in the SESC if any suspicious transactions are identified.

Recently, the SESC has also closely monitored crypto-asset-related businesses operated by listed companies and their affiliated companies, in cooperation with the relevant divisions within the FSA and Financial Instruments Exchanges ("FIEs").

The SESC implements effective market surveillance with the benefit of the collected information, market trend analysis, cooperation in transaction examinations, and collaboration among the relevant divisions.

2. STATUS OF TRANSACTION EXAMINATIONS

Changes in the external environment, including macro-economic trends and advances in information technology, have affected the forms of market misconduct. As market misconduct risk grew amid increased uncertainty in the global economy, the number of cases the SESC examined to detect suspicious market misconduct reached 1,061 in FY2019, similar to the level in FY2018. Over 1,000 cases have been examined annually for 7 consecutive years.

The 1,061 cases reviewed by the SESC consist of suspected insider trading (976 cases), suspected market manipulation (78 cases) and others, including use of fraudulent means and spreading rumors (7 cases).

2-1EXAMINATION OF TRANSACTIONS AND COLLECTION/ANALYSIS OF WIDE-RANGING INFORMATION

In response to the revised FIEA, which includes the introduction of regulation on high-speed trading (e.g. registration of parties engaging in high-speed trading and the clarification of transaction strategies) and came into effect in April 2018, the SESC focused on fact finding for the purpose of effective monitoring of transactions. Specifically, the SESC analyzed transactions by, for example, examining orders placed and executed by parties engaging in high-speed trading. The SESC also examined transactions suspected of involving market misconduct in cooperation with the SROs.



3. OVERVIEW OF MARKET MONITORING

To conduct market oversight in a holistic and timely manner, the SESC enhanced its ability to collect and analyze a wide range of market information by setting up the Office of Market Monitoring in the Market Surveillance Division in June 2016.

(1) INFORMATION COLLECTION AND WHISTLEBLOWING

(i) Efforts to collect information

Information from market participants and investors represents candid opinions in the markets and can trigger the SESC's investigation and inspection. The SESC believes it is important to collect as much useful information from many stakeholders as possible.

Therefore, in FY2019, the SESC modified the contact section of its website in order to enable access via smartphone in order to improve convenience for information providers and enhance information collection. In FY2019, the SESC received 5,798 reports from the public.

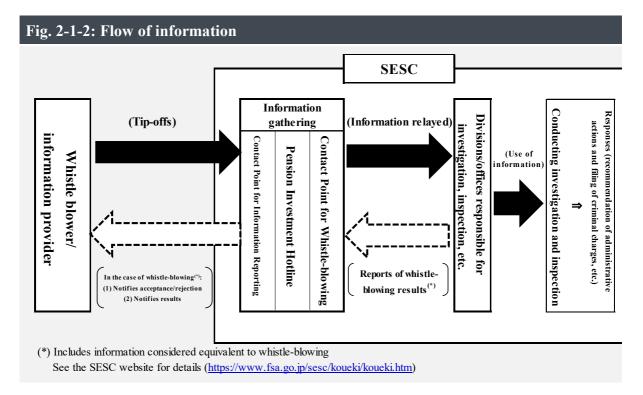
The SESC also provides preparatory consultation to whistleblowers through a dedicated Contact Point for Whistle-blowing and examines the information before formally accepting it. In FY2019, five tips from whistleblowers were accepted. The SESC utilizes information for market monitoring even if it does not fall under the definition of whistleblowing.

(ii) Use of collected information

Information/tips on suspected market misconduct are examined at the Contact Point for Information Reporting and relayed to the SESC's divisions responsible for inspection and investigation.

For example, a case of insider trading was found based on an investigation triggered by reported information about the disposal of Company A's shares conducted by a representative of Company A's subsidiary while being aware of Company A's plan to revise its financial performance downward.

As there are three contact points according to the specifics of information received, the SESC asks readers of this report to refer to the examples shown in the SESC website⁸ and provide as specific information as possible concerning market misconduct. The SESC will continue its efforts to gather a wide range of highly useful information.



(2) MARKET TREND ANALYSIS

In addressing cases of "fraudulent finance," ⁹ the SESC has utilized information gathered from market participants such as investors and securities companies. The SESC has also enhanced its

⁸ Examples of "requested information" on SESC website: https://www.fsa.go.jp/sesc/watch/example.html (Japanese version only)

⁹ "Fraudulent finance" is a series of fraudulent trading practices comprised of inappropriate acts in the primary or secondary market.

2-1EXAMINATION OF TRANSACTIONS AND COLLECTION/ANALYSIS OF WIDE-RANGING INFORMATION

market monitoring by collecting and analyzing information that covers both primary and secondary markets in close cooperation with directors of the securities and exchange surveillance departments and relevant officials at Local Financial Bureaus and FIEs. As a result, some listed companies have been forced to delist or been expelled from the capital market since they have released false information in connection with the issuance of new stocks or stock acquisition rights allocated to third parties. As there are emerging cases of attempts to hide market misconduct by using complex finance schemes or issuance of shares to overseas funds, the SESC will keep a close eye on these activities.

Given recent new developments, such as listed companies or their affiliates entering cryptoasset-related businesses, the SESC will continue, in cooperation with the FSA's relevant divisions and FIEs, to monitor market trends carefully, specifically from the perspective of monitoring listed companies' market misconduct.

Furthermore, in FY2015, the SESC established a system that enables its staff to make use of centrally-managed information that has been gathered and analyzed in the course of market monitoring. In FY2018, the SESC expanded the range of information gathered and considered how a future database should be developed in order to enable multi-faceted and multi-lineal use across all monitoring operations of the SESC.

(3) FORWARD-LOOKING ANALYSIS

Since July 2016, the SESC has monitored markets with a forward-looking perspective, focusing on risk factors and changes in the environment, by analyzing the effects of global changes related to the macro-economy and markets on the financial performance of listed companies.

For FY2019, the SESC analyzed individual companies that were selected with consideration given to economic trends, earnings trends and other factors. In doing so, the SESC collected information through interviews with private-sector experts. The SESC shared the results of the analyses within the organization and with the FSA's relevant divisions.

4. FUTURE CHALLENGES

(1) EFFECTIVE AND SOPHISTICATED MONITORING OF HIGH SPEED TRADING

In light of the widespread use of high-speed trading ("HST"), the SESC, based on information provided by FIEs, etc., will continue to identify and analyze the characteristics of orders and

2-1EXAMINATION OF TRANSACTIONS AND COLLECTION/ANALYSIS OF WIDE-RANGING INFORMATION

executions by HST operators. The SESC will also share information and exchange opinions on HST operators with the FSA's relevant divisions and FIEs, and steadily implement monitoring of HST.

(2) SOPHISTICATION OF ANALYSIS FROM A FORWARD-LOOKING PERSPECTIVE

The SESC will conduct analysis in a forward-looking manner by maintaining and deepening relationships with private-sector experts, acquiring a wide range of information on potential risks associated with uncertainties in the global economy in a timely manner, and by enhancing cooperation among the relevant divisions.

(3) USE OF DIGITALIZATION

With transactions becoming more sophisticated and complex, and new financial instruments and transactions being developed in recent years, the capability to verify and analyze large volumes of data is essential in order to conduct market misconduct examinations efficiently and effectively. Furthermore, to conduct seamless market surveillance, it is necessary to have a mechanism in place that can collect and search for data required for verification and analysis more efficiently and effectively. The SESC will address these issues through further utilization of digitalization.

(4) PROMOTION TO INCREASE RECEIPT OF INFORMATION AND WHISTLEBLOWING

To promote the reporting of useful information from the public, the SESC will continue to consider measures to enhance convenience for information providers.

2-2 INVESTIGATION INTO MARKET MISCONDUCT

1. PURPOSE OF INVESTIGATION INTO MARKET MISCONDUCT

To ensure the fairness and transparency of securities markets for the protection of investors, the SESC, pursuant to the FIEA, investigates suspected market misconduct subject to an administrative monetary penalty payment order, such as insider trading, market manipulation, spread of rumors and use of fraudulent means.

2. OVERVIEW OF CASES IN FY2019

The SESC promptly and efficiently investigates suspected market misconduct cases through active use of the Administrative Monetary Penalty System. In FY2019, there were 29 cases of market misconduct (24 cases of insider trading and 5 cases of market manipulation) in which the SESC made recommendations for administrative monetary penalty payment orders.

(1) INSIDER TRADING

In FY2019, there were 24 cases of insider trading for which the SESC made recommendations for administrative monetary penalty payment orders (See Fig. 2-2-1).

Of the 16 violators who engaged in insider trading, 7 individuals were employees of listed companies and company insiders (44 percent: largest number), followed by friends and colleagues (4 individuals, or 25 percent) who were provided insider information by company insiders (See Fig. 2-2-2).

While there were no cases of insider trading by directors of listed companies, there were 2 cases of insider information being leaked by directors of listed companies (one case was a breach of the insider trading regulation which prohibits persons from providing insider information to others). Directors of listed companies must manage information about material facts appropriately and take the initiative to prevent insider trading. However, the SESC still found such cases where directors provide information to others without a need to do so for the performance of job duties and caused insider trading.

There were 8 cases of violations of providing insider information (5 cases) and transaction encouragement (3 cases). Among transaction encouragement cases in FY2019, the SESC made recommendation against a person who encouraged his colleague to sell for the purpose of avoiding the colleague's loss. It was the first case since regulations on providing of insider information and transaction encouragements were introduced in April 2016.

Chapter 2. Activity Report for Fiscal Year 2019 2-2 INVESTIGATION INTO MARKET MISCONDUCT



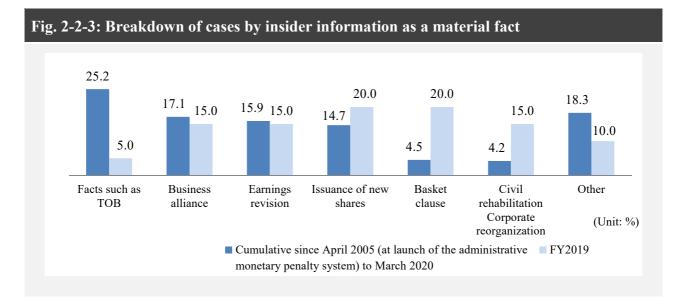
Note: The numbers include cross-border cases.

Fig. 2-2-2: Attributes of violators of insider trading in FY2019 Corporate insider Person informed by an insider Friends & colleagues Employee Other ustome 44% 6% 25% 13% **Counterparty of contracts Family members** 6% 6% (Reference) Attributes of violators Person informed by an Company insider insider Issuer or tender offeror Company insider's: Aaterial facts. Customers Officer, Employee, etc. Family Counterparty of members Material facts contracts/negotiation Friends & colleagues

In FY2019, the SESC made a total of 24 recommendations concerning 20 material facts (the number of recommendations and the number of material facts do not match because there were cases in which the same material facts were related to both the breach of insider trading regulations and the breach of providing insider information and transaction encouragement). By the type of material fact involved, there were 4 cases related to the issuance of new shares (20.0%) and 3 cases

(15.0%) respectively related to business alliance, earnings revision, and corporate reorganization. There were also 4 cases which do not fall under the scope of incidents equivalent to the material facts under Article 166(2)(i)-(iii) (determined facts, occurring facts, and earnings information) but which fall under the scope of the so-called basket clause under the FIEA (Article 166(2)(iv) and (viii)), defined as "a material fact which concerns the operations, business or assets of the Listed Company (subsidiary of the Listed Company) and has a significant influence on investors' investment decisions" (See Fig. 2-2-3).

Generally, during the process of TOBs, business alliance contracts, and negotiations with various parties outside the companies involved, there tends to be a long period of time between decisions concerning material facts and their public disclosure. Material information therefore needs to be managed very carefully.



While the SESC's investigation of insider trading confirmed that most of the listed companies had internal rules for preventing insider trading, the SESC also found many listed companies where the internal understanding of those rules was insufficient or whose rules did not contain any statements about prohibition of transaction encouragement. There was also a listed company which permitted its employees, who had become aware of material facts, to trade the company's stock. It was a case where, although a system for preventing insider trading was established, it was not functioning effectively in practice.

Key Case (insider trading):

Overview	Date of recommendation /amount of administrative monetary penalty ¹⁰	Points
2 amplements of a listed som	December 6	. The healtest along a way analied with a
2 employees of a listed com-	December 6,	• The basket clause was applied with re-
pany (TSE First Section) who	2019	spect to a material fact—the finding of
learned of a material fact in the	2.83 million yen	misconduct related to concealment of
course of their work sold com-	360,000 yen	discount sales and overstatement of
pany shares before the public		sales. ¹¹
announcement.		

Key case (transaction encouragement)

Overview	Date of recommendation /amount of administrative monetary penalty	Points
An employee of a (TSE First Section) learned of material facts in the course of work and encouraged sales to a colleague for the purpose of avoiding losses. ¹²	January 28, 2020 660,000 yen	 Administrative monetary penalty against a breach of the regulation on transaction encouragements was recommended for the first time in a case of encouragement for sales for the purpose of avoiding losses (in past cases of transaction encouragement, purchases were encouraged for the purpose of gaining profits). The company's internal rules did not contain a provision concerning the regulation on transaction encouragement.

¹⁰ When there are two or more persons subject to administrative monetary penalty payment orders, the amount of administrative monetary penalty for each person is indicated.

¹¹ Since the introduction of the administrative monetary penalty system, the basket clause has been applied to a cumulative total of 14 cases.

¹² This case concerns one of the persons subjected to administrative monetary payment orders in the same case who encouraged sales to a colleague for the purpose of avoiding losses.

Overview	Date of recommendation /amount of administrative monetary penalty	Points
Executives and employees of a foreign company negotiating with a listed company (TSE First Section) over the conclu- sion of a contract learned of a material fact in the course of the negotiation and conducted pur- chases before the public an- nouncement of the material fact.		 The highest-ever monetary penalty against a case of insider trading was imposed. Executives and employees of a foreign company negotiating with a Japanese listed company over a business alliance engaged in insider trading.

Key case (insider trading through cross-border transactions)

(2) MARKET MANIPULATION

In FY2019, the SESC made recommendations for administrative monetary penalty payment orders for 5 cases of market manipulation, all of which involved market manipulation by individual investors.

Trading schemes have become more complex and sophisticated. For example, there were cases in which some of the spoofing orders¹³ placed were executed instead of all of them being cancelled, in order to avoid detection, in which multiple spoofing orders were placed across a wide range of prices covering the 10 highest bid prices, or in which minimum unit orders were repeatedly placed in order to raise share prices.

The SESC also made a recommendation of monetary penalty payment order against one case of market manipulation by wrongdoers who had been subjected to an administrative monetary penalty payment order within the past five years (the amount of the penalty was increased by 1.5 times, and the cumulative number of cases to which the rule that increases the penalty amount for repeat offenders applies came to 4).

¹³ A spoofing order is a high-volume purchase (sales) order placed by an investor without the intent of executing it, for the purpose of inducing trading by other investors by creating an excess of purchase order volume over sales order volume (an excess of sales order volume over purchase order volume) so that the investor can conclude a sales (purchase) transaction at a favorable price for himself/herself.

Overview	Date of recommendation/ amount of administrative monetary penalty	Points
An individual investor used such trading patterns as placing multiple spoofing orders across a wide range of prices, revising the price for some of the spoof- ing orders instead of cancelling all of them with respect to shares of four listed companies (TSE JASDAQ and elsewhere).	September 20, 2019 1.19 million yen	 The investor created an upward price trend by placing multiple spoofing purchase orders across a wide range of prices (10 ticks from best bid price). The investor sought to avoid securities company alerts about spoofing orders by making price revisions for some of the orders instead of cancelling all of them.

Key Case (market manipulation):

3. FUTURE CHALLENGES

(1) Appropriate application of laws and regulations

Due to changes in the economic environment in Japan and abroad, share prices are affected by economic activities and judgments on corporate valuation which were not assumed at the time of establishment of the FIEA. In FY2019, there were cases of insider trading concerning data falsification and some other incidents which did not directly fall under the scope of the definition of material facts listed under the FIEA; however the cases were deemed to involve "material facts which concern the operations, business or assets of listed companies which have a significant influence on investors' investment decisions." In order to implement market surveillance seamlessly, it is important to continue to apply laws and regulations appropriately.

(2) Handling of violations of the regulations that prohibit the provision of insider information and transaction encouragement

The number of recommendations for administrative orders against violations of the regulations that prohibit the provision of insider information and transaction encouragement has been on an uptrend. In FY2019, the SESC made recommendations in five cases of violation of the regulation that prohibits the provision of insider information and three cases of violation of the regulation

that prohibits transaction encouragement. In particular, the SESC recommended an administrative monetary penalty order for the first time in a case of violation of the regulation on transaction encouragement in which a violator encouraged sales for the purpose of avoiding losses. This means that not only factors that may cause share price rises but also factors that may cause share price falls are used for the purpose of committing acts of violating those regulations. On various occasions, the SESC will inform investors and company officials that not only acts of engaging in insider trading but also acts of providing insider information and making transaction encouragement are subject to administrative monetary penalty orders.

(3) Handling of cross-border transactions

With respect to market misconduct involving cross-border transactions, the SESC will identify the circumstances in a more effective and efficient manner through collaboration with foreign authorities using MMoU¹⁴ between securities authorities and wide-ranging exchange of information and opinions with foreign regulatory authorities.

(4) Proactive communication

As a means of enhancing market discipline, the SESC appropriately distributes information¹⁵ after making recommendations (by posting it on our website, media briefing and through our "Message to the Markets¹⁶"). The SESC also gives lectures and contributes articles on a variety of topics, as well as publishing a casebook of administrative monetary penalties. Going forward, the SESC will continuously endeavor to enhance its external communications and provide easy-to-understand explanations of cases in which the SESC made an administrative monetary penalty recommendation so as to prevent occurrence of future market misconduct.

(5) Improvement of digital forensic technology

For market misconduct investigations, it is important to ensure the restoration and preservation of data contained in electronic devices possessed by investigated entities. Along with the advancement of information technology, available communication tools have become diverse (e.g., SNS) and the volume of data contained by such tools has expanded. In response, the SESC will work to further improve its digital forensic technology.

¹⁴ Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information

¹⁵ For example the FSA and the SESC revised the "FAQ Regarding Insider Trading Regulation" on July 29, 2019, so that ordinary people can make stock and other investments without worries.

¹⁶ In April 2019 the SESC email newsletter was revamped and renamed as "Message to the Markets" https://www.fsa.go.jp/sesc/message/index.htm



Case Study 1 : Do you know about regulations on transaction encouragement? - Even if you don't provide insider information, encouraging others to make

A transaction may constitute a violation -

"Do you know about regulations on transaction encouragement?" —Even if you don't provide insider information, encouraging others to make a transaction may constitute a violation—

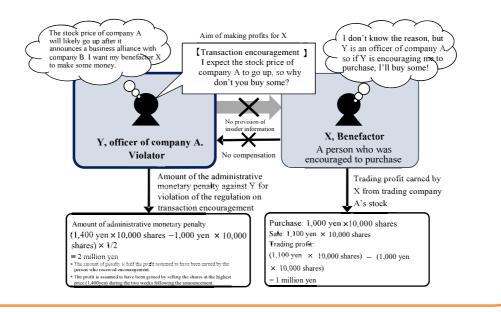
Message to company insiders and person affiliated with Tender Offer

Since regulations on the providing insider information and transaction encouragement were introduced in April 2014, there have been 24 violators (one violator of which violated both the regulation on providing insider information and the regulation on transaction encouragement). In FY2019, there were five violators of the regulation on the providing insider information and three violators of the regulation on transaction encouragement. One of the three violators of the regulation on transaction encouragement represented the first recognized case in which a person encouraged other person for sale for the purpose of avoiding losses.

If you were a company insider or person affiliated with Tender Offer, encouraging other persons to make a transaction for the purpose of gaining profits or avoiding losses may constitute a breach of the regulation on transaction encouragement even if you did not provide the persons with insider information (material facts and facts of Tender Offer).

Most listed companies have rules to prevent insider trading and prohibit unnecessary provision of insider information. However, we recognize that some companies do not have rules prescribes the regulation on transaction encouragement.

The SESC therefore encourages listed companies to prevent violations on transaction encouragement by taking steps such as stipulating relevant provisions in their internal rules and increasing company-wide awareness regarding the fact that the act of making transaction encouragement without providing insider information is also subject to the insider trading regulation.



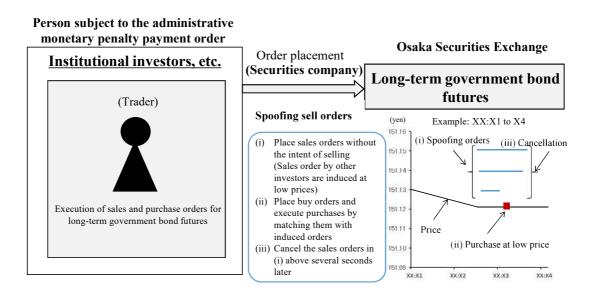


"We are keeping our eyes on market manipulation in derivatives"

Message to institutional investors

Market manipulation is conducted not only in cash trading but also in derivatives trading, such as trading in TOPIX futures and long-term government bond futures. The SESC keeps surveillance over such derivatives transactions as well, and it has recommended administrative monetary penalty payment orders with respect to transactions that constitute market manipulation.

For example, in recent years, the SESC has recommended administrative monetary penalty payment orders with respect to cases of market manipulation related to long-term government bond futures by Japanese and foreign institutional investors. Specifically, in these cases, traders employed by institutional investors conducted market manipulation by placing many sell orders without the intent of executing them, for the purpose of inducing market derivatives transactions regarding long-term government bond futures (the figure below shows an example of such a transaction).



The SESC, in cooperation with foreign market surveillance authorities and the Japan Exchange Regulation, is maintaining surveillance on a daily basis in order to deal with market misconduct.

The SESC hopes that institutional investors will recognize anew their own position as important market players and make efforts to maintain self-discipline as market users.

2-3 INSPECTION & INFORMATION GATHERING ON VIOLATIONS OF DISCLOSURE REGULATIONS

2-3 INSPECTION & INFORMATION GATHERING ON VIOLATIONS OF DISCLOSURE REGULATIONS

1. PURPOSE OF DISCLOSURE STATEMENTS INSPECTION

The FIEA's disclosure regulations are aimed at protecting investors by providing them with appropriate information to make decisions when investing in primary and secondary markets. Specifically, issuers of financial instruments are required to submit disclosure documents, such as Securities Registration Statements and Annual Securities Reports, which provide details on their business profile and financial condition, among others. These documents are available to the public and provide necessary information to investors.

Investors make investment decisions based on the disclosure documents submitted by the issuers of financial instruments. If such documents contain false information or if they lack information which should have been included, it may cause unexpected losses to investors.

To avoid such a situation, the SESC conducts inspections of disclosure statements, and if the submitted documents contain false statements, they require the issuers to make corrections, or make recommendations for administrative monetary penalty payment orders against those who violated disclosure regulations by, for example, including a serious misstatement in the documents. The SESC is also engaged in various initiatives to prevent occurrences and recurrences of violations of disclosure regulations.

2. DISCLOSURE STATEMENTS INSPECTION AND TRENDS OF VIOLATIONS IN FY2019

In FY2019, in light of the occurrence of violation of disclosure regulations by a major global company based in Japan, the SESC collected and analyzed information with a focus on the risk of listed companies violating disclosure regulations, identified the suspected companies at an early time, and conducted timely and multi-faceted disclosure statement inspection.

Through these activities, the SESC conducted 38 cases of disclosure statement inspection in FY2019, including those continued from FY2018, and 18 of those cases were completed. In six of the completed cases, material misstatements and other violations were found in the disclosure documents, such as securities reports, so the SESC recommended administrative monetary penalty payment orders. Even when the SESC did not make such recommendation, the SESC urged the issuers to voluntarily submit the correction reports of their disclosure documents when it deemed it necessary.

2-3 INSPECTION & INFORMATION GATHERING ON VIOLATIONS OF DISCLOSURE REGULATIONS

In one of the above cases, the Certified Public Accountants and Auditing Oversight Board ("CPAAOB") recommended an administrative order against the audit firm, which audited the violator company, due to extremely inappropriate and inadequate audit processes on the same day as the issuance of the SESC's recommendation for an administrative monetary penalty order. This was an example of the SESC's collaboration with the CPAAOB in preventing violations of disclosure regulations.

Furthermore, in cases where violations of disclosure regulations by a listed company were identified, the SESC discussed the background and causes of such violations with the management of the company, even if a recommendation for administrative monetary penalty payment order was not made. By sharing the authority's perceptions of the issues with the management, the SESC encouraged the issuers to establish and improve internal systems for proper information disclosure, in order to prevent recurrence of the violations. Concerning the listed companies that are not very proactive in establishing such internal systems, the SESC cooperated with relevant organizations (financial instruments exchanges, audit firms and others) in preventing recurrences of similar violations of disclosure regulations.

(1) CASES IN WHICH ADMINISTRATIVE MONETARY PENALTY WAS RECOMMENDED

	Overview	Date of recommendation/ amount of administrative monetary penalty	Background
1	Although the company's representative director at that time had a critical influ- ence on a specified corpora- tion's decision-making con- cerning financial and opera- tional matters, business transactions with the speci- fied corporation were not disclosed in the Notes on "Transactions with Related Parties."	July 19, 2019 223.85 million yen	 The company's representative director at that time was lacking in compliance awareness. The company's governance system that should supervise its representative director was weak, as indicated by the failure of the board of director's supervisory function to work effectively.

Key cases

2-3 INSPECTION & INFORMATION GATHERING ON VIOLATIONS OF DISCLOSURE REGULATIONS

			• The company's executives and employees were lacking in compliance awareness.
2	The company used multiple inappropriate accounting practices, including recog- nizing premature revenue, under instructions from its president at the time for making false financial state- ments. The company also made a disclosure that did not accurately reflect the ac- tual situation with respect to the "corporate governance" section of securities re- ports. ¹⁷	December 6, 2019 24 million yen	 The company's president at the time was totally lacking in the compliance awareness necessary for appropriate financial reporting. For example, the former president believed that falsifying financial statements was acceptable for the purpose of maintaining good relationships with creditor banks. Other directors and senior employees failed to raise objections to the former president's view, which led to the development of a corporate culture tolerating falsification of financial statements. The company's governance was not functioning at all. For example, its board of directors had become merely a formality, with its function of supervising the execution of business failing to work, and their corporate auditors seldom conducted statutory audits.
3	With respect to the "corpo- rate governance" section of securities reports, the com- pany understated the amount of compensation paid to executives as fol- lows.	December 10, 2019 2,424.895 million yen	 Power was concentrated exclusively in the hands of the company's chair- man and representative director. There was a lack of transparency over the operations of some admin- istrative divisions, as a small group

¹⁷ On the same day as issuance of the administrative monetary payment order, the CPAAOB recommended an administrative action against the company's corporate auditor for conducting extremely inappropriate and insufficient audits on the company.

- With respect to the mandatory disclosure of monetary compensation for the company's chairman and representative director at the time, the company disclosed only the already-paid portion of the amount.
- Although the total amount of consolidated compensation for the company's representative director at the time was higher than 100 million yen, the company did not disclose that fact.

of persons were tasked with the responsibility for the main divisions.

• The board of director's supervisory function was not working effectively.

In 2 of the 6 cases for which recommendations for administrative monetary penalty payment orders were made in FY2019, there were misstatements concerning non-financial information contained in securities reports. In the two cases, statements that did not accurately reflect the actual situation were contained in securities reports with respect to the development of internal control systems and compensation for the executive officers in the "corporate governance" section (see Case Study "Non-financial information is also important for investment decisions").

Among examples of the background factors and causes that led to violation of disclosure regulations, such as material misstatements in cases for which recommendations for administrative monetary penalty payment orders were made in FY2019, were:

•A lack of compliance awareness among directors (Cases 1 and 2)

• The failure of the board of directors' supervisory function to work effectively (Cases 1 to 3).

(2) CASES IN WHICH THE SESC CONDUCTED FACT FINDING ABOUT THE FUNCTIONING OF INTERNAL CONTROLS AND FOLLOWED UP ON THE IMPROVEMENTS

Key Case

Overview

In this case, multiple sales personnel conducted inappropriate accounting practices, including prematurely recognizing revenue, by counterfeiting falsified documented evidence, such as order sheets, in order to achieve unrealistic performance goals although the company had taken recurrence prevention measures in response to a past case of fraudulent accounting.

As it was found as a result of an inspection that the value of earnings affected by the inappropriate accounting practices was not necessarily large, the SESC did not recommend an administrative monetary penalty payment order.

The company submitted the correction report of their securities reports after a third-party committee conducted an investigation.

Background

- Recurrence prevention measures taken in response to a past case of fraudulent accounting did not work, and compliance awareness was lacking on a companywide basis. In this situation, the company's management placed an excessive emphasis on sales and set unrealistic performance goals.
- The board of director's supervisory function did not work effectively.

The SESC conducts disclosure statements inspections of listed companies where it is deemed that the functioning of internal controls needs to be improved. If a deficiency in internal controls is identified as a result of inspections, the SESC discuss corrective and improvement measures with the management in order to prevent occurrence of violations of disclosure regulations.

(3) DISCLOSURE STATEMENTS INSPECTION OF PERSONS WHO MAY HAVE COMMITTED SPECIFIED ACTS OF INVOLVEMENT

The SESC also proactively conducts inspections regarding the Specified Acts of Involvement.¹⁸

In FY2019, as part of disclosure statements inspection in a case of fictitious sales booked through fictitious transactions which involved material misstatements in disclosure documents and which

¹⁸ Refers to acts that facilitate or instigate the submission of disclosure documents containing material false statements.

resulted in the recommendation for administrative monetary penalty payment order in FY2018, the SESC inspected another company which may have been involved in the fictitious transactions and may have committed the Specified Act of Involvement. Although the company was not deemed to have committed the Specific Act of Involvement, the SESC will continue to watch out for similar cases closely.

3. FUTURE CHALLENGES

(1) UPGRADING ANALYSIS CAPABILITIES

The SESC will gather and analyze information on listed companies with a focus on the risk of violation of disclosure regulation occurring against the backdrop of the growing complexity of transactions, the advance of globalization of companies, and the diversification and transformation of business models. The SESC will also conduct flexible and multi-faceted disclosure statement inspections in order to detect and correct violations of disclosure regulation at an early time.

(2) ACTIONS TO PREVENT VIOLATIONS OF DISCLOSURE REGULATIONS AND RECURRENCE OF VIOLATIONS

(i) Sharing the authority's perception with management

To prevent the occurrence and recurrence of violations, the SESC will hold discussions on the backgrounds and causes of violations with the management of listed companies which violated disclosure regulations and shares the perception of existing issues, thereby urging the management to establish and develop an appropriate information disclosure system. The SESC will also work with relevant organizations to discuss effective methods to encourage listed companies that are not being proactive in establishing and developing such information disclosure systems to make improvements.

(ii) Proactive communication with stakeholders

As part of measures to prevent violations of disclosure regulations, when providing information on cases on which recommendations for monetary penalty payment orders were made (on the SESC's website, at media briefings, etc.), the SESC has always delivered as clear explanations as possible. The SESC also promotes listed companies' internal discussions towards appropriate information disclosure and dialogue between listed companies and their certified public accountants/audit firms by annually publishing a case book presenting actual cases of violations identified through the inspections. Through proactive communication with

stakeholders, the SESC will continue its efforts to prevent the occurrence and recurrence of violations of disclosure regulations.



"Check your own role once again to prevent recurrence of

violations"

Message to Listed Companies (i)

To prevent the occurrence and recurrence of violations, the SESC holds discussions on the backgrounds and causes of violations with the management of listed companies which violated disclosure regulations and shares its perception of existing issues, thereby urging the management to establish and develop an appropriate information disclosure system.

We appreciate the cooperation of listed companies' board members by checking once again whether your company's governance has a substantial effect, rather than existing merely as a formality, and whether your company's information disclosure system is working effectively. We also appreciate that the corporate auditors and audit committee members should prevent corporate misconduct cases, including violation of disclosure regulations, by performing their primary role, which is to check on the execution of business by directors from an independent standpoint.



"Non-financial information is also important for investment decisions"

Message to listed companies (ii)

Both financial and non-financial information (written information) contained in securities reports is important for helping investors to make appropriate investment decisions. Such information is also considered to be important for companies in that it improves the quality of management through constructive dialogue with investors and leads to a sustainable increase in corporate value.

Based on this recognition, the scope of governance information has been expanded with respect to non-financial information contained in securities reports, starting in the business year that ended in March 2019. As a result, the disclosure of written information concerning management policies and strategies, business performance analysis, and business risks has been enhanced, starting in the business year that ended in March 2020.

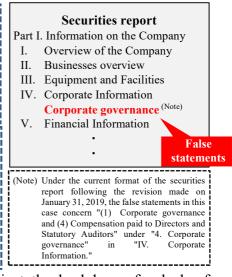
On the other hand, the SESC recommended administrative monetary penalty payment orders against two companies which were subjected to the inspection of disclosure statements in FY2019 because the "corporate governance" section of their securities reports contained false statements regarding important matters. These cases marked the first time for the SESC to recommend administrative monetary penalty payment orders in relation to false statements regarding the "corporate governance" section. The overview of the two cases is as described below.

(Case 1: Recommendation made on December 6, 2019)

The "corporate governance" section^(Note) of the securities report contained statements that did not accurately reflect the actual status of development of governance and internal control systems, or of cooperation between the corporate auditor and the audit firm.

(Case 2: Recommendation made on December 10, 2019)

The "corporate governance" section^(Note) of the securities report contained false statements concerning the amount of compensation for each of the executive officers whose consolidated compensation was higher than 100 million yen and also concerning the total amount of compensation for each category of executive officers, including those executive officers.



The abovementioned false statements were made against the backdrop of a lack of awareness among management teams about the need for appropriate information disclosure, the concentration of powers in the hands of top management, and the failure of the supervisory function of the boards of directors. The SESC requests listed companies to more proactively disclose non-financial information (written information). However, they should never make false statements that could cause investors to be misled during decision making.

2-4 MONITORING OF FINANCIAL INSTRUMENTS BUSINESS OPERATORS

1. PURPOSE OF MONITORING SECURITIES BUSINESSES

The SESC accurately recognized the operation and financial status of Financial Instruments Business Operators ("FIBOs") through seamless on-site and off-site monitoring. If any problem is found, the SESC, where necessary, recommends that the Prime Minister and the FSA Commissioner take appropriate measures or provides necessary information to the supervisory departments in the FSA. The purpose of monitoring securities businesses is to encourage FIBOs to establish proper governance and risk management systems, administer their businesses in accordance with laws, regulations, and market rules, and perform their function as market intermediaries appropriately, for example, as gatekeepers, and maintain a market environment in which investors are able to invest comfortably.

2. CHANGES IN ENVIRONMENT SURROUNDING FINANCIAL INSTRUMENTS BUSINESS OPERATORS

In FY2019, various changes took place in the domestic and international economic environment surrounding Japan's securities markets.

At the beginning of FY2019, the global economy continued to recover moderately. However, circumstances including the development of trade issues, the outlook for the Chinese economy, the UK's exit from the EU and other situations in Europe have heightened uncertainties and pushed monetary policies toward easing once again. Under these circumstances, the rise of potential risks has been pointed out. With respect to the Japanese financial capital markets, share prices have continued to fluctuate, although they still remain at high levels, and share trade volume has declined. Interest rates continue to remain at historically low levels. However, recently, international financial markets have become unstable due to the COVID-19 pandemic.

Amid the dramatically changing market environment, it has become difficult for FIBOs to secure earnings under traditional business models, which rely on commission income. Some investors' moves to pursue products with higher returns have been abused. In one case, an FIBO's sale of highrisk products to individual investors without sufficient explanations of the risks involved subsequently materialized as a problem. In another case, an unregistered business operator lured investors with the promise of high returns and caused damage.

In addition, the progress of digitalization has led to the entry of non-financial players into the financial instruments exchange business, and the use of technology such as cloud services and AI for

improved business efficiency. Cyberattacks continue to be a threat to FIBOs. The importance of cyber security is rising.

3. ACHIEVEMENTS OF MONITORING (RISK ASSESSMENT)

The number of FIBOs subject to the SESC's monitoring is approximately 7,500 in total, and their size, service details and product offerings vary widely. Some of these FIBOs have not had adequate awareness towards or systems for legal and regulatory compliance and investor protection. Therefore, given the limited human resources, it is important to monitor them efficiently and effectively in accordance with the respective characteristics of FIBOs so as to identify their risks at an early time. (See Figure 2-4-1).

Since July 2016, in its off-site monitoring of all FIBOs, the SESC has conducted risk assessment, including an analysis of the business environment covering economic and industrial trends, in collaboration with the relevant bureaus of the FSA. In assessing risks, the SESC closely examined the business operations of each FIBO, while conducting cross-sectoral reviews of major securities companies focusing on governance, IT system management, risk management, internal audits, etc.

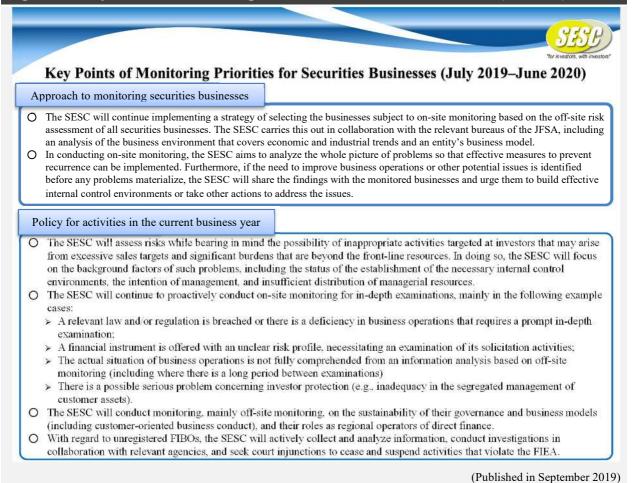
Based on the results of the risk assessment in the off-site monitoring using multi-faceted risk evaluation, the SESC, in collaboration with Local Finance Bureaus, selected the FIBOs subject to onsite monitoring. In conducting on-site monitoring, the SESC conducted in-depth analysis of the FIBOs' products and trading schemes and then examined the appropriateness of their business operations. When problems were detected, the SESC looked into their root causes, and made recommendations for administrative disciplinary actions or informed the FIBOs of issues relating to their business.

The SESC also communicated with Local Finance Bureaus on a daily basis, and shared relevant information with them in a timely fashion. The SESC also proactively provided advice and guidance to Local Finance Bureaus with respect to their on-site inspections.



Fig. 2-4-1 Number of FIBOs subject to monitoring (at the end of each fiscal year)

Fig. 2-4-2: Key Points of Monitoring Priorities for Securities Businesses (BY 2019)¹⁹



(1) SECURITIES COMPANIES

As it is becoming increasingly difficult for securities companies to secure profits based on the traditional business model, which is dependent on sales commission income, securities companies are seeking to transform to a stable earning structure by increasing assets under custody as a sales method. In BY 2019, the SESC conducted risk assessment of securities companies, focusing on their expansion of product lineups (e.g. overseas financial products and high-yield funds) and changes in their business models (e.g. expansion into new fields of business).

Furthermore, due to concerns about specific cases of legal violations and business administration environments, the SESC conducted proactive onsite monitoring of, for example, companies that needed to be subjected to in-depth investigation at an early stage and companies that needed to be investigated with respect to their marketing of products whose risks are unclear.

Of the 46 securities companies that were subjected to on-site monitoring in FY2019, the SESC notified 26 of their problems found through the monitoring and made recommendations for

¹⁹ BY 2019 refers to the period from July 1, 2019, to June 30, 2020

administrative disciplinary actions against 14 for committing serious breaches of laws and regulations, such as the presence of deficiencies in the trading management framework related to market derivatives transactions.

Company name	Date of recommendation	Description	
Citigroup Global Markets Japan Inc.	April 19, 2019	Because of deficiencies in the trading system and trade surveillance system, the company inadequately failed to cover some transactions in its trade surveil- lance. In addition, the company changed the thresh- old for extracting transactions without reasonable consideration and narrowed down the scope of trade surveillance in its trading surveillance system set- tings. Despite the fact that a number of alerts for sus- picious market fraud were concentrated on a single trader, the Company failed to investigate the inten- tion of such transactions and to scrutinize the trans- action data. Under the above trading management framework, the company accepted and executed or- ders of spoofing transactions committed by Citigroup Global Markets Ltd. and overlooked such market manipulation (Note). (Note) With respect to the transactions used for market manipula- tion, the SESC recommended an administrative monetary penalty payment order on March 26, 2019.	
Togo Securities Co., Ltd.	August 2, 2019	The company compensated some customers for some of the losses that they had incurred through listed margin FX (Note). (Note) The SESC conducted criminal investigation regarding this act and filed charges on July 9, 2019.	

Key Cases:

(2) INVESTMENT MANAGEMENT BUSINESS OPERATORS

In monitoring investment management business operators, from the viewpoint of conflict of interest management, the SESC performed on-site monitoring of investment management business

operators that are affiliated with large corporate groups, investment management business operators that do not invest in their own account, and private REIT operators. Among these, the on-site monitoring also targeted investment management business operators that had never been subject to inspections before.

Of the investment management business operators that were subjected to on-site monitoring in FY2019, one was not faithfully conducting investment management operations on behalf of beneficiary owners of investment trusts, so the SESC recommended an administrative disciplinary action.

Company name	Date of recommendation	Description
Eastspring Investments Limited	March 27, 2020	In the course of negotiation about the termination of an outsourcing contract concerning the calcula- tion of daily unit prices of investment trusts, the company received a proposal from the outsourcing company for increasing a custodian fee for a group company as a condition of the termination. By ac- cepting the proposal, the company imposed an addi- tional burden on customer assets while it avoided paying a termination fee. (The above act falls under the failure to perform investment management business faithfully on be- half of beneficiary owners of the investment trusts and therefore constitutes a violation of Article 42 (1) of the FIEA.)

Key Case:

(3) TYPE II FINANCIAL INSTRUMENTS BUSINESS OPERATORS

Regarding Type II FIBOs, which include funds investing in loan business, the SESC conducted off-site monitoring focusing on funds claiming high yields and on whether businesses in which the funds were investing actually existed. The SESC also promptly conducted on-site monitoring of business operators considered to carry high risk based on analysis of information provided by investors.

(4) INVESTMENT ADVISORS/AGENCIES

The SESC monitored investment advisors/agencies to make sure that they were not using advertisements that may mislead customers or soliciting customers based on false explanations. The SESC also conducted on-site monitoring on investment advisors/agencies considered to carry high risk. As a result, the SESC found cases in which an investment advisor/agency was lending names to third parties, or in which an investment advisor/agency created many fake articles with respect to their advisory achievements, disguised them as articles contributed by a third party, and arranged for them to be posted on multiple websites for comparing and rating investment advisors. The SESC also found cases in which an investment advisor/agency was providing unfounded advice for the purpose of using customers' transactions to promote other person's interests (See FY2019 Key Topics (2)).

Of the 11 investment advisors/agencies that were subjected to on-site monitoring in FY2019, the SESC notified 8 of their problems found in the monitoring and recommended administrative disciplinary actions on 7 of those 8 for having committed serious breaches of laws and regulations.

Company name	Date of recommendation	Description
Tokaitoshijogenservice LLC	June 21, 2019	The company registered with the Director- General of the Tokai Local Finance Bureau an employee of another company not registered as a financial instrument business operator as one of its own employees in charge of providing in- vestment advice and analysis and had the em- ployee engage in investment advisory/agency businesses. However, in reality, the company was not involved in investment advisory/agency activities conducted by the employee. The em- ployee was conducting investment advi- sory/agency activities under the command and orders of the said company not registered as a financial instrument business operator.
Smart Asset Manage- ment Co., Ltd.	September 10, 2019	The company made solicitation for conclud- ing investment advisory contracts by distrib-

Key Cases:

		uting to customers emails containing false state- ments implying that its representative was fully responsible for reviewing the analysis and se- lection of stocks although the representative was actually not at all involved in the analysis and selection. The company also made an advertisement that caused serious misconceptions concerning its advisory achievements. For example, it cre- ated many fake articles concerning its advisory achievements, disguised them as articles con- tributed by third parties, and arranged for them to be posted on multiple websites for comparing and rating investment advisors.
DTC Co., Ltd.	March 11, 2020	The company provided groundless advice to customers based on its substantial controller's instructions for the purpose of securing profits for the substantial controller and other persons by inducing rises in the prices of shares pur- chased by them. In addition, before giving advice to custom- ers, the company sold or purchased the same securities as the ones to which the yet-to-be- given advice were related in such a way that its executives, who were in a position to learn of the advice, could earn profits for themselves by taking advantage of price changes due to customers' transactions conducted on the basis of the advice.

(5) PETITIONS FOR COURT INJUNCTION AGAINST VIOLATIONS OF THE FIEA

To prevent damage to investors from fraud caused by unregistered business operators, the SESC took rigorous actions against unregistered business operators, such as asking the court to grant an injunction in cooperation with the FSA, Local Finance Bureaus and other investigating authorities. As necessary, the SESC publicly disclosed the name of the unregistered business operator, the name of the representative, and the specifics of the legal and regulatory violations.

Key Cases:

Defendant	Date of petition (name of court)	Description	Issue date
Kabushiki Kaisha D.U. corporation and one individual	June 26, 2019 (Nagoya District Court)	The company concluded an outsourcing con- tract with a foreign company and solicited retail investors for purchasing products including an automated exchange trading system provided by the foreign company. When using the trading system, customers were required to agree to let an affiliate of the foreign company manage in- vestment of funds transferred by them into in- vestment accounts. This falls under a discretion- ary investment contract. The company's sales of the trading system constituted an intermediation for the conclusion of discretionary investment contracts. The company had a total of at least 613 retail investors acquire the product in ex- change for making investments totaling around 530 million yen. The company's activities con- stituted the act of conducting investment advi- sory/agency businesses without statutory regis- tration.	July 31, 2019 (Nagoya District Court)
IFP Tokyo Co., Ltd. and one individual	July 30, 2019 (Tokyo District Court)	The company's solicitation of retail investors for purchases of multiple financial products falls under a foreign collective investment scheme and had a total of at least 203 retail in- vestors invest around 680 million yen. The company's activities constituted the act of con- ducting Type II financial instrument business without statutory registration.	October 17, 2019 (Tokyo District Court)
GPJ Venture Capi- tal LLC and two individuals	March 13, 2020 (Tokyo District Court)	The company solicited retail investors to become their members and had a total of at least 1,072 retail investors make investments totaling around 12,656 million yen. The com- pany also solicited for the acquisition of stakes in a collective investment scheme called G8C	

and had a total of at least 970 retail investors make investments totaling around 4,009 million yen. The company's activities constituted the act of conducting Type II financial instrument business without statutory registration.

(6) ISSUES REQUIRING ATTENTION

In conducting on-site monitoring, it is important that the SESC not only points out legal problems and makes recommendations for administrative actions but also analyzes the whole picture of the problems to identify their root causes, so that FIBOs can address them and design effective measures to prevent recurrences of the problems.

To that end, in cases where the SESC has recognized the need to improve business control systems although problems have yet to materialize, the SESC has shared the findings with the FIBOs under the on-site monitoring to encourage them to create effective internal control systems.

Example cases:

(i) Customer-oriented business conduct

In order to ensure customer-oriented business conduct, Company A formulated a policy for customer-oriented business conduct, which includes a shift to an employee evaluation system based on evaluation viewpoints, such as proposals made to customers, an increase in assets in custody, and compliance.

However, the company's evaluation of the performance of sales personnel ("performance evaluation") still continues to be based on an evaluation system using commission income as the only criterion and fails to take into consideration viewpoints such as an increase in assets in custody and compliance.

Going forward, the company's management needs to thoroughly implement the policy for customer-oriented business conduct from the viewpoint of the ideals of achieving business sustainability over the medium to long term and developing long-lasting relationships of trust with customers. For example, the management should hold frank and active discussions on the revision of performance evaluation and develop an environment to promote the revision.

(ii) Management of outsourcing service suppliers concerning financial instruments intermediary service

In accordance with internal regulations, Company B concluded a contract for intermediary service with its parent bank after clarifying the role that the company should perform and the

responsibilities that it should fulfill in order to ensure appropriate conduct of business by outsourcing intermediary service suppliers.

However, the company's management interpreted that the management of intermediary service should be conducted by the parent bank without considering whether or not it was necessary for the company itself to check the appropriateness of the service and conceived that it was unnecessary to be actively involved with or to provide instructions to the parent bank. As a result, the company did not receive information with respect to the monitoring situation concerning intermediary service conducted within the parent bank, complaints and administrative errors related to the service, or the issues pointed out to the parent bank following audits conducted by the Japan Securities Dealers Association ("JSDA").

In this situation, the company has recognized that in order to realize customer-oriented business conduct, it is necessary to check the appropriateness of the status of investment solicitation and sales by outsourcing suppliers of intermediary service. Therefore, the company has started activities to develop an environment for information sharing. Going forward, the company will need to make steady efforts to be actively involved with and provide instructions to the parent bank, which is an outsourcing supplier of intermediary service.

4. FUTURE CHALLENGES

(1) ENHANCING MONITORING OF SECURITIES BUSINESS

While business operators subject to the SESC's monitoring total approximately 7,500 after the enforcement of the FIEA, their size, businesses and products are diverse. Furthermore, there are business operators that still do not have adequate environments for fundamental matters, such as compliance and investor protection. To conduct monitoring of FIBOs efficiently and effectively, the SESC has integrated on-site and off-site monitoring of FIBOs since July 2016.

In conducting monitoring, the SESC has focused on verifying the appropriateness of governance and risk management. Going forward, the SESC plans to brush up securities business monitoring so that the challenges and problems FIBOs are facing are identified earlier through risk assessment based on analysis of the business environment covering economic and industrial trends.

Following the effectuation of the revised FIEA, which was enacted in May 2019, the SESC will devote efforts to the monitoring of FIBOs handling crypto asset derivatives and electronic records transfer rights.

The SESC will also revise the monitoring method in light of the Strategy & Policy 2020-2022, published in January 2020, and JFSA's Initiatives for User Oriented Financial Services in a New Era - Financial Services Policy, published by the FSA in August 2019.²⁰

(2) ENHANCING FEEDBACK

In conducting on-site monitoring, the SESC has focused on finding and responding to violations of laws and regulations. Going forward, by grasping the whole picture of recognized issues and identifying their causes, the SESC will also provide the kind of feedback that helps business operators develop effective preventive measures.

Furthermore, the SESC will share feedback on the results of off-site monitoring that would contribute to encouraging FIBOs to ensure appropriate conduct of business, such as information on challenges common across sectors as well as best practices.

²⁰ To effectively and efficiently monitor securities business, the SESC published the "Basic Approach to Monitoring of Securities Companies" on May 8, 2020, so that viewpoints and points of attention regarding inspection and supervision can be better shared and clarified, and it invited public comments (the current Securities Inspection Manual is scheduled to be abolished).



"Better Preparation for cyberattacks!"

Message to financial instruments business operators

In a society undergoing digitalization, it is becoming more and more important to better ensure cybersecurity in order to increase convenience for financial service users and improve the productivity of the financial industry while securing safety for financial service users and the stability of the Japanese financial system.

In particular, at a time when cyberattacks are becoming increasingly complex and sophisticated, it is essential to increase cyber security measures and enhance the effectiveness of those measures through the examination of vulnerabilities, TLPT (Threat-Led Penetration Test) and drills in response to changes in the environment surrounding financial institutions and in preparation for international events.

Recently, an increasing number of organizations are adopting telework as a measure to deal with the COVID-19 pandemic. The SESC requests financial instruments business operators, as important infrastructure operators, to pay sufficient attention to new risks posed by attacks targeting the telework environment by taking the measures described below, for example.

Major points of attention and examples of effective measures

1. Enhancing the security inspection of the telework environment and cybersecurity

measures

In preparation for the risk of cyberattacks targeting telework, it is necessary to take appropriate cybersecurity measures, such as managing remote access to internal systems, ensuring cybersecurity of IT infrastructure (e.g., continuing to update security patches), and conducting investigation and implementing countermeasures regarding potential risks involved in the introduction of remote conferencing systems provided through external services.

2. Ensuring the availability of computer systems for continuous operation

In order to deal with system glitches and cyberattacks, please review the procedures for implementing telework and update communication arrangements.

3. Reviewing business processes in a telework environment

Please review business processes in order to avoid falling victim to BEC (business email compromise) attacks targeting a teleworking environment in which it is difficult to conduct face-to-face checks.

Reference: National Center of Incident Readiness and Strategy for Cybersecurity "Points of Attention Regarding Telework Security" April 14, 2020 <u>https://www.nisc.go.jp/active/general/pdf/telework20200414.pdf</u> (available in Japanese)

2-5 INVESTIGATION OF CRIMINAL CASES

1. PURPOSE OF CRIMINAL INVESTIGATION

The SESC responds strictly to material, malicious market misconduct in order to maintain financial and capital markets in which investors and market participants are able to participate with confidence. That has led to the establishment of fairness and transparency, and to the building of market participants' trust in markets. In order to uncover the background to malicious market misconduct that would damage the integrity of financial markets and to protect investors, the authority to investigate criminal cases involving market misconduct has been vested in the SESC under Article 210 of the FIEA since its establishment in 1992. In addition, some of the acts prescribed in the Anti-Criminal Proceeds Act, which regulates cross-border money laundering, are now subject to the SESC's criminal investigation under Article 32 of the Anti-Criminal Proceeds Act.

2. OVERVIEW OF CRIMINAL CACES IN FY2019

Given the increasingly global, complex and sophisticated trading activities in the financial markets, the SESC flexibly investigates criminal cases in both primary and secondary markets. In FY2019, the SESC filed criminal charges in 3 cases, including 1 case each of loss compensation, submission of false securities reports, and insider trading. In one of those cases, a company and 2 individuals, including the substantial controller, submitted a securities report containing false statements concerning recurring profits (losses) and so on by booking fictitious sales (the SESC filed criminal charges on August 13, 2019).

Cases	Date of filing	Filed with
Loss compensation related to Togo Securities Co., Ltd.	July 9, 2019	Public prosecutor of the Tokyo Dis- trict Public Prose- cutors Office
Submission of a false securities report related to Nice Holdings, Inc.	August 13, 2019	Public prosecutor of the Yokohama District Public Prosecutors Office
Insider trading related to Palma Corporation's shares	November 1, 2019	Public prosecutor of the Tokyo Dis- trict Public Prose- cutors Office

3. NOTABLE CRIMINAL CHARGES FILED IN FY2019

(1) CHARGES IN THE CASE OF LOSS COMPENSATION RELATED TO TOGO SECURITIES CO., LTD.

The SESC filed charges for FIEA violation (loss compensation) against one corporate suspect and three individual suspects on July 9, 2019, with the Tokyo District Public Prosecutors Office.

Case overview:

The corporate suspect, Togo Securities Co., Ltd. is a company established for the purpose of engaging in financial instruments business, while Suspect A, who was a director of the company, was overseeing the company's business operations in general as its substantial controller. At the same time, Suspect A was overseeing the business operations in general of Sakura Invest Co., Ltd. ("Sakura Invest"), which was established for the purpose of handling commodity derivatives transactions, as its substantial controller. Suspect B was overseeing business operations, such as the processing of complaints from customers, as the corporate suspect's representative director and head of the administrative division, while Suspect C was in charge of the corporate suspect's accounting as an advisor.

With respect to the corporate suspect's business operations and assets, despite the absence of legal grounds for exclusion, Suspect A and others conspired to provide profits in the form of cash and assets to eight customers who had been conducting exchange trading through trading accounts for exchange margins opened in their own names in order to compensate for some of the losses that they had incurred through the derivative transactions as described in [1] and [2] below.

[1]

1. Suspects A and B, conspiring with others, had D and E, who were customers of the corporate suspect, open accounts for over-the-counter derivatives in their names at Sakura Invest between around early August 2015 and around mid-July 2016. Subsequently, they arranged for employees of Sakura Invest to make up fictitious netting settlement transactions regarding those customers' orders purported to have been conducted in their accounts and to input trading data indicating profits attributable to the customers into personal computers installed at the company. Through this method, the suspects made it appear as if those customers conducted sales and purchase transactions through their accounts on multiple occasions between mid-August 2016 and late December 2018, thereby arranging for profits to be attributed to the accounts. As a result, the company provided profits worth 0.65 million yen

and 2.1 million yen, respectively, to Customers D and E in the form of assets, for a total of 2.75 million yen.

2. The suspects provided 0.2 million yen in cash to each of F and G, who were customers of the corporate suspect, for a total of 0.4 million yen, and had them open accounts for over-the-counter derivatives trading in the customers' names at Sakura Invest around mid-October 2016. Subsequently, through a method similar to the one described in 1. above, the suspects made it appear as if those customers had conducted sales and purchase transactions in their accounts on multiple occasions between late October 2016 and mid-December 2018, thereby arranging for profits to be attributed to the accounts. As a result, the company provided profits worth around 2.58 million yen and around 1.91 million yen, respectively, to Customers F and G in the form of assets, for a total of around 4.49 million yen.

[2]

Between around mid-October 2017 and late November 2017, suspects A, B and C conspired to conclude settlement contracts with H, I J and K, who were customers of the corporate suspect, to the effect that the corporate suspect would pay 14.58 million yen, 14.50 million yen, 20.00 million yen and 18.50 million yen, respectively, to the customers. Subsequently, based on the contracts, the suspects provided 14.58 million yen, 14.50 million yen, 16.50 million yen and 16.50 million yen, respectively, in cash to the customers in multiple installments between late November 2017 and mid-January 2019, for a total of 62.08 million yen.

The SESC filed charges in this case because it considered the case to be highly malicious given that inappropriate solicitation and sales activities conducted by the corporate suspect based on its management policy of giving priority to profit over compliance drew a succession of complaints and that the suspects tried to continue the inappropriate sales activities by compensating for losses in an attempt to stifle the complaints.

(2) CHARGES IN THE CASE OF SUBMISSION OF A FALSE SECURITIES REPORT RELATED TO NICE HOLDINGS INC.

The SESC filed charges for FIEA violation (submission of a false securities report) against one corporate suspect and two individual suspects on August 13, 2019, with the Yokohama District Public Prosecutors Office.

Case Overview:

The corporate suspect, Nice Holdings Inc. is a company established for the purpose of controlling and managing business activities of a company engaging in processing and trading of construction materials and real estate sales and purchases. The company's shares were listed on the First Section of the Tokyo Stock Exchange. Suspect A served as the corporate suspect's substantial controller until June 26, 2015, and as its representative director and chairman thereafter. Meanwhile, Suspect B served as the corporate suspect's representative director and president from June 2010 onward.

With respect to the corporate suspect's business operations, the two suspects conspired with C, who was a director of the corporate suspect, to submit to the director-general of the Kanto Local Finance Bureau a false securities report for the fiscal year from April 1, 2014, to March 31, 2015, on June 26, 2015. Although the company actually earned operating profits of around 498 million yen and net profits of around 135 million yen, and incurred recurring losses of around 18 million yen, the suspects submitted a securities report falsely indicating operating profits of 1,012 million yen, recurring profits of 496 million yen and net profits of 488 million yen by booking fictitious sales. This constitutes an act of submitting a securities report containing false statements concerning important matters.

In this case, the SESC filed charges because it considered the case to be highly malicious given that the corporate suspect, which is a well-established company listed on the First Section of the Tokyo Stock Exchange, falsely stated earnings, such as misrepresenting recurring losses as profits, and that the suspects included the corporate suspect's substantial controller and representative director at that time.

(3) CHARGES IN THE CASE OF INSIDER TRADING RELATED TO PALMA CORPORATION'S SHARES

The SESC filed charges for an FIEA violation (insider trading and providing insider information) against two individual suspects on November 1, 2019, with the Tokyo District Public Prosecutors Office.

Case overview:

Suspect A was serving as deputy head of the administrative division of Palma Corporation ("Palma"), whose shares were listed on the Mothers section of the Tokyo Stock Exchange.

Around mid-December 2017, Suspect A learned of a material fact—that Palma had decided to solicit subscribers for shares to be issued by the company—in the course of his duties. Subsequently, Suspect A made purchases as described below.

[1]

Suspect A informed an acquaintance B of the abovementioned material fact around late December 2017, before the public announcement of the material fact, for the purpose of enabling the acquaintance to gain profits by purchasing Palma shares in advance. As a result, despite the absence of legal grounds for exclusion, the acquaintance purchased a total of 3,000 Palma shares at a total of around 11 million yen at the Tokyo Stock Exchange through a securities company in own and other persons' names between early January 2018 and mid-April 2018, before the public announcement of the material fact.

[2]

Suspect B received information about the abovementioned material fact from A around late December 2017, and, despite the absence of legal grounds for exclusion, purchased a total of 3,000 Palma shares at a total of around 11 million yen at the Tokyo Stock Exchange through a securities company in own and other persons' names between early January 2018 and mid-April 2018, before the public announcement of the material fact.

In this case, the SESC filed charges because it considered the case to be malicious given that Suspect A, who was deputy head of the company's administrative division, learned of a material fact concerning the solicitation for subscription for new Palma shares (so-called third-party share allotment) in the course of his duties and informed Suspect B, an acquaintance, of the material fact and that Suspect B purchased Palma shares using accounts in own and other persons' names before the public announcement of the material fact, thereby earning a large amount of profits.

4. ISSUES REGARDING INVESTIGATION OF CRIMINAL CASES

The SESC will exercise its authority for criminal investigation and filing criminal charges in cooperation with criminal prosecutors and other relevant authorities to appropriately take rigorous actions against severe and malicious market misconduct. The SESC will continuously keep an eye not only on frequently occurring misconduct that can be easily categorized into typical types of violations, such as insider trading and market manipulation, but also on various sorts of market misconduct in order to ensure seamless market monitoring.

It is also essential for the SESC to flexibly respond to changes in the environment surrounding financial transactions. For example, the recent developments in information technology has made it easier for anyone to use advanced communication devices and has led to the arrival of SNS and other types of communication tools that were not anticipated when regulations on insider trading and other market misconduct were introduced. In addition, the increase in the number of cross-border transactions has inevitably made it necessary to seek international cooperation in monitoring markets. To adapt to various changes in the environment, the SESC will continuously contribute to enhancing fairness and transparency of the market by developing human resources with expertise in criminal investigation, while upgrading computer systems used in criminal investigations and further strengthening cooperation with relevant institutions, including foreign authorities.

2-6 ENHANCING INFRASTRUCTURE FOR SURVEILLANCE (DIGITALIZATION AND HR)

2-6 ENHANCING INFRASTRUCTURE FOR SURVEILLANCE (DIGITALIZATION AND HR)

1. ADAPTING TO PROGRESS IN DIGITALIZATION

In recent years, the remarkable progress in digitalization has had a great impact on financial markets and markets participants as a whole, as exemplified by the significant changes in the market environment caused by the diffusion of algorithm-based high-speed trading and the arrival of new types of products and transactions. In light of the changes in the market environment, Fintech trends in and outside Japan, and the use of Regtech by regulatory and law enforcement organizations, the SESC is promoting the use of digitalization for market surveillance, including for the purpose of strengthening the transaction monitoring system.

2. FUTURE CHALLENGES FOR THE USE OF DIGITALIZATION

(1) STUDY ON THE USE OF DIGITALIZATION FOR MARKET SURVEILLANCE

In FY2019, the SESC enhanced the transaction monitoring system in order to appropriately respond to changes in the market environment, such as the diffusion of high speed trading, and implement market surveillance more effectively and efficiently.

Going forward, the SESC will continue the study on further use of digitalization for market surveillance operation, including the function of accurately identifying suspicious orders and transactions from among huge volumes of order and transaction data and analyzing them, and the function of detecting signs of market misconduct based on various information available on SNS and other internet sites.

(2) PROMOTING INFORMATION SHARING WITH MARKET PARTICIPANTS

To ensure that financial markets are fair and transparent, it is essential that regulatory authorities, self-regulatory organizations and market participants, such as financial institutions, regularly have dialogues and create an information sharing system that improve efficiency in industry-wide business operations.

For example, from the viewpoint of increasing the efficiency of its investigations and inspections, the SESC, in cooperation with financial institutions and relevant administrative organizations, will promote a shift of deposit account inquiry to digital and online services based on the Digital Government Execution Plan (Cabinet decision on December 20, 2019).

2-6 ENHANCING INFRASTRUCTURE FOR SURVEILLANCE (DIGITALIZATION AND HR)

(3) IMPROVING DIGITAL FORENSIC TECHNOLOGY AND ENHANCING SYSTEM DEVELOPMENT

The IT environment surrounding the SESC has been becoming more and more complex, diverse, and sophisticated, and the data size to be processed has increasingly grown. Electronic devices (smartphones, tablet devices, etc.) have become more varied, security and other functions have become more sophisticated, and the growing use of new IT services, such as cloud services, coupled with the larger capacity of data has made the SESC's data obtaining activities more and more complex.

Responding to such changes in the environment surrounding market surveillance, the SESC aims to enhance its IT environment for protecting, recovering, analyzing and storing electronic data, and to further improve digital forensics to properly secure data in diverse and sophisticated electronic devices.

For example, in FY2019, the SESC enhanced the file server for digital forensics and the fulltext search server in order to adapt to the increasing capacity of electronic equipment subject to investigation. Going forward, the SESC will continue to enhance its IT systems as necessary.

3. STAFF TRAINING

(1) HR DEVELOPMENT

To develop human resources ("HR") with expertise and a broad perspective on market surveillance, the SESC provides various training programs for its staff to learn about the methodologies for conducting inspection and investigation.

In FY2019, with the aim of developing IT personnel who can contribute to inspection and investigation, the SESC implemented Information and Communication Technology ("ICT") training suited to the proficiency level and goals of individual staff members through the ICT Training Program to enhance the IT expertise of its staff, as it did in FY2018.

In addition, the SESC implemented staff exchanges with foreign authorities and sent staff members to seminars organized by foreign authorities or international organizations to learn monitoring, investigation, and inspection knowledge and techniques, and enhance the capability to handle international cases (improvement of skills to analyze and investigate market misconduct using cross-border transactions, etc.) (See Section 2-8-3-(2)).

(2) RECRUITMENT OF PERSONNEL WITH EXPERTISE

In order to realize professional market surveillance in response to changes in the surrounding environment, the SESC is strengthening the investigation and inspection systems by actively hiring personnel with diverse backgrounds and professional skills, including legal experts (e.g., judges, prosecutors, and lawyers), certified public accountants, and information technology experts.

The personnel with such backgrounds and skills engage in inspections and investigations of listed companies and securities companies or engage in criminal investigations targeting serious and malicious violations of laws and regulations. In addition, personnel with IT expertise plays an active role in digital forensic work in investigation.

2-7 EFFORTS TO ENHANCE MARKET DISCIPLINE

1. ENHANCING DISSEMINATION OF INFORMATION

(1) DISSEMINATION OF INFORMATION THROUGH NEWS MEDIA AND VARIOUS MEDIA, SUCH AS WEBSITES

The SESC publishes information on cases through the media when it recommends administrative actions or files criminal charges as a result of its inspection or investigation. After publication of the cases, the SESC actively responds to requests for interviews or writings from media organizations, such as newspapers, magazines and TV stations, to provide explanations on the cases. In addition, the SESC exchanges opinions and has dialogue with media personnel to encourage them to disseminate information in the form of commentaries or opinions covering the implications and analysis of the cases.

From the viewpoint of strengthening market self-discipline, in addition to making announcements concerning recommendations and criminal charges related to individual cases, the SESC annually formulates and publishes casebooks²³ that identify the implications and details of cases as well as issues related to them. The SESC actively contributes commentaries and provides lectures in relation to the casebooks to prevent the same kind of violations and misconduct.

To make market participants, including retail investors, more easily understand its activities, the SESC also posts up-to-date information on its activities on its website, including summaries of cases in which the SESC made recommendations or filed criminal charges as well as details of given lectures and published commentaries. For the complicated cases, the diagrams visualizing the relationship between related parties as well as cash flow are added in the publications.

The SESC also issues "Message to the Markets," which summarizes the SESC's activities and perceptions in a simple, easy-to-understand format on its website. With respect to cases in which the SESC made recommendations or filed criminal charges in particular, the SESC strives to enhance the contents of the information released by using diagrams visualizing the implications, characteristics and causes of the cases and alert messages for consumers so that the details of and issues related to those cases are accurately communicated. Latest information on the "Message to the Markets" can be checked with Twitter.

²³ "Casebook of administrative monetary penalties under the Financial Instruments and Exchange Act—Market Misconduct," "Casebook of Inspection of Disclosure Statements," and "Overview and Casebook of Monitoring of Securities Businesses."

The SESC will actively enhance external communications in order to reach out to the wider public going forward.

(2) MEETINGS AT LOCAL FINANCE BUREAUS

To enhance market discipline for the fairness and transparency of financial markets and investor protection, it is important to raise the awareness of market participants on the SESC's market monitoring. Additionally, in view of the fact that cases of market misconduct can take place throughout the country due to the prevalence of the internet, it is necessary for the SESC to enhance its presence across Japan.

Thus, the SESC started holding its meetings at Local Finance Bureaus in FY2015 (in FY2019, the meeting was postponed due to the COVID-19 pandemic). Through the meetings, the SESC endeavors to communicate its views, enhance its presence and strengthen cooperation with the Local Financial Bureaus.

In conjunction with the meeting, the SESC exchanged opinions with market participants in each region to deepen their understanding of the SESC's activities and perceptions, while working to make the SESC's presence more visible in each region by providing explanations on the purpose of the meeting and an overview of the SESC's operations to local news media.

Through such efforts, the SESC aims at implementing rigorous and appropriate market monitoring for the fairness and transparency of markets and investor protection, while strengthening cooperation with the Local Finance Bureaus and market participants in each region.

2. COOPERATION WITH RELEVANT ORGANIZATIONS

(1) COOPERATION WITH SELF-REGULATORY ORGANIZATIONS

SROs, such as Financial Instruments Firms Associations, Financial Instruments Exchanges, and Japan Exchange Regulation ("JPX-R"), are engaged in their own market monitoring activities. Their tasks include market surveillance, listing examination/monitoring the listed company, and compliance examination and inspection of its members. The SESC works closely with SROs from the perspective of efficient and effective market monitoring.

For further collaboration towards enhancing market discipline and market monitoring capability, the SESC regularly holds meetings with JPX-R and the JSDA to exchange views on emerging issues facing securities markets and to share issues of mutual interest. In FY2019, the SESC continued to strengthen the collaboration and shared information and perceptions in a timely manner through active discussions on challenges and issues regarding market monitoring.

The SESC believes these efforts will further promote the sharing of views between the SESC and SROs and enhance the self-discipline function of markets. The SESC will continue its active exchange of information and communicate its perceptions to achieve closer collaboration.

(2) COOPERATION WITH RELEVANT AUTHORITIES (PROSECUTORS, POLICE, ETC.)

In cases where the SESC, in the course of market misconduct inspection and investigation, identifies unregistered financial instruments business operators selling fraudulent financial instruments or activities that may be associated with anti-social forces, the SESC cooperates with police authorities by sharing information to deal with these cases. In criminal investigations, the SESC works in cooperation on a daily basis with prosecutors who the SESC files criminal charges with, which is an example of how the SESC endeavors to strengthen relationships with relevant authorities.

The SESC expands and deepens cooperation with these authorities through daily exchange of information and meetings, sharing know-how related to investigations, emerging issues, and information from wider perspectives.

In addition, the SESC exchanges views and information with regional public prosecutors' offices, prefectural police, and regional taxation bureaus on various occasions.

To reinforce the market discipline function in financial markets through voluntary efforts by market participants, the SESC offers lectures and meetings to exchange views at Bar Associations and the Japanese Institute of Certified Public Accountants.

3. ACTIVE CONTRIBUTION TO THE ENHANCEMENT OF MARKET ENVIRONMENT

To establish fair and highly transparent financial markets and maintain investors' trust in the markets, market rules should be aligned with changes in the environment surrounding the markets. To ensure fairness in transactions, investor protection, and the public interest, under Article 21 of the FSA Establishment Act, the SESC is empowered to make a policy proposal to the Prime Minister, the FSA Commissioner or the Minister of Finance in order to facilitate appropriate development of rules that reflect the status of markets, if it is considered necessary as a result of its inspections or investigations.

The above provision is intended to incorporate the SESC's views regarding laws, regulations and SRO's rules formed through comprehensive analyses of the outcomes of its inspections and investigations, into various measures taken by the government and SROs. Thus, the SESC's proposals are treated as key information when regulatory authorities and SROs formulate their policy measures.

Specifically, when the SESC recognizes room for improvement in relevant laws, regulations or SRO's rules to reflect the actual practice of trading activities, the SESC points out its findings and, from the perspective of ensuring fair trading, investor protection or the public interest, it presents issues to be discussed with respect to how and what laws, regulations and SROs' rules should be enforced and requests the revision of existing laws, regulations or SROs' rules.

In recent years, the SESC made two such proposals, one concerning the provision of information to investors in loan-type funds (December 7, 2018) and the other concerning the establishment of procedures for gathering and analyzing digital evidence for criminal investigations (February 26, 2019). The SESC has made a total of 26 such proposals since its establishment in 1992.

The SESC will actively make proposals going forward, regarding measures that are deemed necessary as a result of inspections and investigations based on the FIEA.

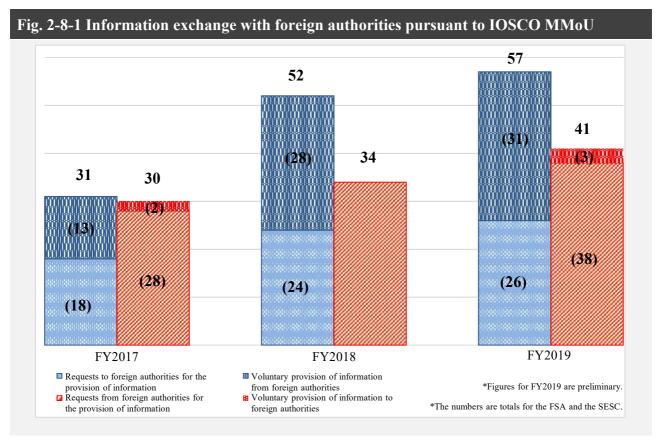
2-8 CONTRIBUTING TO GLOBAL MARKET SURVEILLANCE

1. OVERVIEW OF GLOBAL MARKET MONITORING

The changes in the environment surrounding global markets are making the future of global markets more uncertain. Furthermore, financial markets in Japan are now under the great influence of global macroeconomic trends and specific events, against the background of Japanese companies' active international business expansion and many Japanese institutional investors' investment in foreign markets. As a result, cross-border transactions and the globalization of markets have been progressing, as indicated by an increase in overseas investor participation in the market.

In such a market environment, it is important for the SESC to work more closely with foreign authorities. To this end, the SESC has included "enhanced cooperation with foreign authorities" and "contribution to international cooperation for market oversight" as part of its medium-term activity policy called "Strategy & Policy of the SESC 2017-2019," which was published in January 2017. As it has also included "intelligence gathering through closer cooperation with foreign authorities" and "enhanced contribution to global market oversight" as part of the "Strategy & Policy of the SESC 2020-2022," which was formulated in January 2020, the SESC will promote further cooperation with foreign authorities.

The SESC has been enforcing securities laws and regulations against violations involving crossborder transactions, exchanging various information with foreign authorities based on the IOSCO MMoU.



The SESC aims to maintain smooth cooperation with foreign authorities by developing mutual trust and reinforcing exchanges of information and collaboration in exercising investigation, inspection and law enforcement. The SESC will utilize relevant information on law enforcement cases and legal systems of foreign authorities obtained through the cooperation for its market surveillance.

Furthermore, the SESC proactively raises the issues related to international cooperation that are identified through its surveillance activities, and shares information at bilateral meetings as well as multilateral meetings, such as those of the IOSCO. In this way, the SESC endeavors to contribute to market surveillance on a global level.

2. ACTIVITIES AT IOSCO

IOSCO is an international organization that aims to fill the gap between securities regulations across jurisdictions and promote cooperation between securities regulators. It is comprised of 227 member organizations of various countries and regions, including 129 ordinary, 31 associate, and 67 affiliate members (all figures as of the end of March 2020). The SESC joined IOSCO as an associate member in October 1993 (the FSA is an ordinary member).

IOSCO holds its Annual Conference under the leadership of the Presidents Committee, the organization's highest decision-making body. In the conference, top officials of the member

organizations and other participants discuss and exchange views on the current status and issues of securities regulations. To conduct appropriate market surveillance in Japan amid increasing crossborder transactions in financial/capital markets, it is extremely important for the SESC to deepen its cooperative relationships with foreign authorities by exchanging information and views. SESC Commissioners and senior administrative staff members regularly participate in the conference for this reason. In FY2019, SESC Commissioner Indo participated in the IOSCO Annual Conference held in Sydney (Australia) in May. Taking advantage of this valuable opportunity where various regulators gathered from all over the world, Commissioner Indo exchanged views at several bilateral meetings during the conference.

SESC Commissioners and senior administrative staff members also regularly participate in the APRC, where specific regional issues are discussed. In FY2019, a meeting of the APRC was held on the occasion of the Annual Conference in May and also in October in Tokyo. At the Tokyo meeting, a senior administrative official of the SESC chaired the subcommittee on law enforcement and worked to enhance the SESC's cooperation with securities authorities in the Asia-Pacific region, including ASIC and Singapore MAS.

IOSCO also has the IOSCO Board, consisting of regulators from various countries and regions, who discusses key regulatory issues in the international markets and propose practical solutions to the issues. Under the board, there are several policy committees discussing specific policy issues. In FY2019, the SESC's representatives participated in Committee 4 ("C4") among other committees. C4 members discussed ideal forms of information exchange and cooperation in the area of law enforcement among regulators in order to tackle securities-related crime and market misconduct associated with cross-border transactions.

The SESC's representatives also participate in the Screening Group, which reviews applications submitted by regulators to become signatories to the MMoU or the enhanced MMoU ("EMMoU"). In FY2019, the Kazakh Astana Financial Services Authority and two other regulators signed the MMoU, while the U.S. Securities and Exchange Commission ("US SEC") and three other regulators signed the EMMoU.

3. COOPERATION WITH FOREIGN AUTHORITIES

(1) EXCHANGING VIEWS WITH FOREIGN AUTHORITIES.

The SESC actively exchanges views with foreign authorities and with financial institutions that have global operations to recognize international financial/capital market trends and overseas

securities regulators' initiatives to ensure market integrity, and to promote their understanding of the SESC's activities.

In FY2019, Chairman Hasegawa attended the first Japan-China Capital Markets Forum, which was held in Shanghai, China, in April. In a meeting with the CSRC, the SESC exchanged opinions about further strengthening Japan-China financial cooperation and enhancing cooperation in market surveillance. A working-level meeting was also held to coincide with the forum in order to exchange opinions about enhancing the cooperative relationship between the SESC and the CSRC and various issues related to securities markets. The working level meeting on market surveillance was held in Seoul (South Korea) in September 2019. The SESC's representatives discussed various practical issues with Asian market regulators, including South Korean Financial Supervisory Service ("FSS"), Singapore MAS, Hong Kong Securities and Futures Commission ("Hong Kong SFC") and ASIC. In Tokyo in November, the SESC hosted a roundtable for securities authorities and self-regulatory organizations from major countries, including the United States and European countries, to exchange information and opinions, and discuss various issues related to market surveillance.

Furthermore, the SESC exchanged views on various occasions, such as at IOSCO meetings, with overseas securities regulators from the US, Europe and Asia, as well as with globally active financial institutions and international securities associations, at both executive and working levels. In this way, the SESC remained active in contributing to global market surveillance through the sharing of issues and challenges regarding international cooperation.

(2) SENDING STAFF MEMBERS TO FOREIGN AUTHORITIES AND PARTICIPATING IN SHORT-TERM TRAINING PROGRAMS

The SESC has sent staff members as secondees to the US SEC, U.S. Commodity Futures Trading Commission ("CFTC"), U.K. Financial Conduct Authority ("FCA"), Hong Kong SFC, Thailand Securities and Exchange Commission, Malaysia Securities Commission, and Singapore MAS. The aim of the secondment is to have them learn about and analyze the foreign authorities' methodologies in surveillance, investigation and inspection of, as well as to share Japanese methods and knowledge. The SESC has also sent staff members to short training programs hosted by IOSCO or foreign authorities.

Conversely, the SESC regularly offers training programs on Japan's market surveillance and investigation of market misconduct for selected trainees from financial regulators of emerging economies, who are invited to the Global Financial Partnership Center ("GLOPAC") set up within

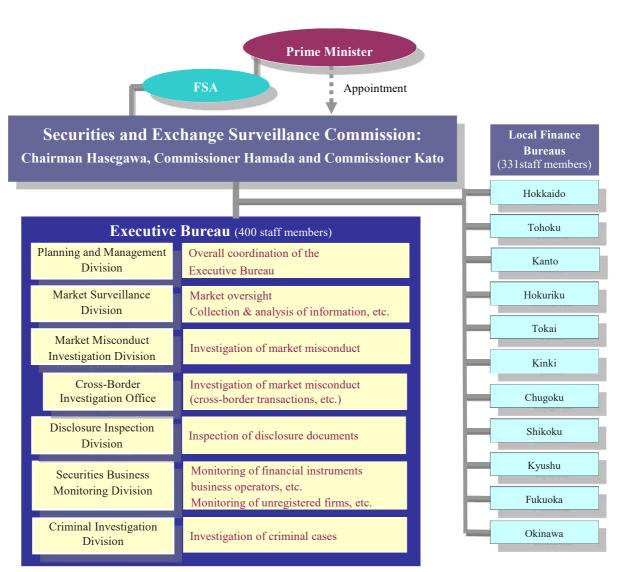
the FSA or training programs run by the Japan International Cooperation Agency ("JICA"). The SESC also provides training to specific securities regulators upon their request.

To reinforce the global market surveillance regime, the SESC will strengthen the network with foreign authorities to share the concerns each other through the secondment of the SESC's staff to these foreign authorities, exchanges of views with staff of foreign authorities and courtesy call to foreign authorities by senior officials of the SESC.

Appendices

Chart 1

Organization Chart

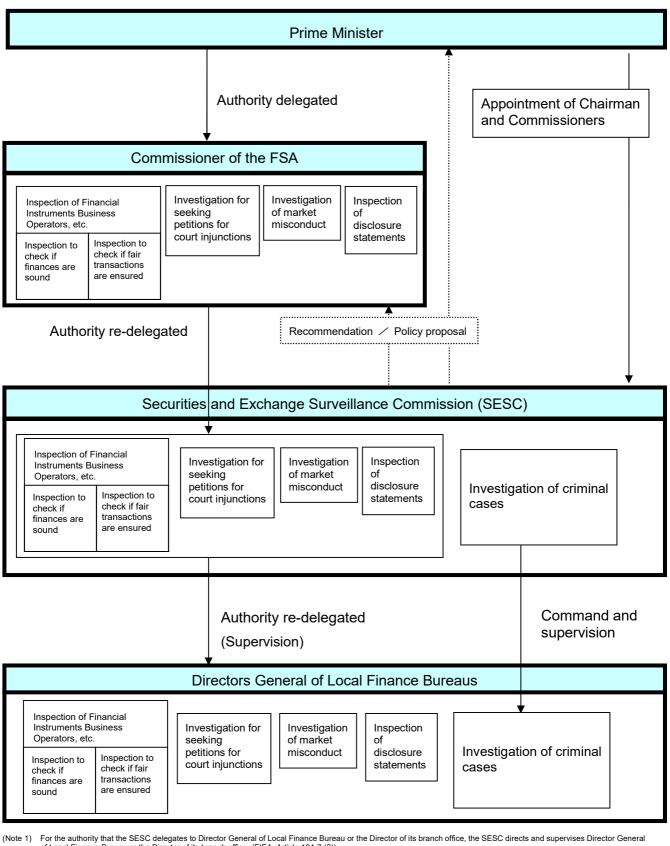


Note1: Staff members of Executive Bureau are quota as at the end of FY2020.

Note2: In July 2006, the SESC was transformed from two divisions (the Coordination and Inspection Division and the Criminal Investigation Division) and three offices (the Compliance Inspection Office, the Market Surveillance Office, and the Office of Penalties Investigation and Disclosure Documents Examination under the Coordination and Inspection Division) into five divisions (the Planning and Management Division, the Market Surveillance Division, the Securities Business Monitoring Division, the Civil Penalties Investigation and Disclosure Documents Inspection Division, and the Criminal Investigation Division). Furthermore, in July 2011, the Civil Penalties Investigation and Disclosure Documents Inspection Division was divided into two divisions (the Market Misconduct Investigation Division, and the Disclosure Inspection Division), meaning that the SESC was transformed into six divisions. In August 2011, Cross-Border Investigation Office was established within the Market Misconduct Investigation Division, to investigate transactions, etc. conducted by persons in foreign countries.

Chart 2

Relationship among the Prime Minister, the Commissioner of the FSA, the SESC, and Directors General of Local Finance Bureaus

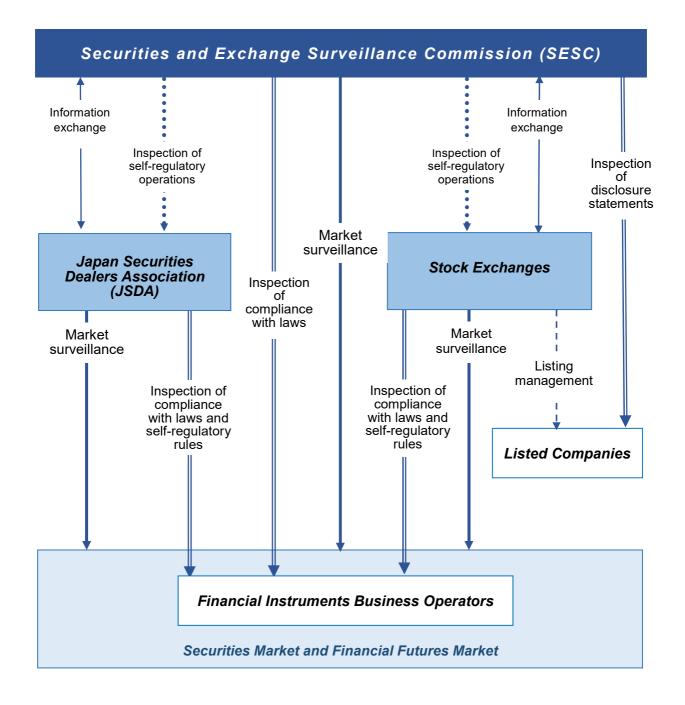


of Local Finance Bureau or the Director of its branch office. (FIEA: Article 194-7 (8)) (Note 2) For an investigation of a criminal offence, the SESC directs and supervises the Director General of a Local Finance Bureau or the Director of its branch office. The SESC may, deeming it necessary for investigating a criminal offence, direct and supervises firsthand an official of a Local Finance Bureaus or the Director of its branch office. (FIEA:

- (Note 3) The SESC does not delegate authority to the Director-General of local finance bureaus, etc. related to financial instruments business operators etc designated in the file of the Director of the Direct
 - tollowing public notices The public notice to designate a financial instruments business operator, etc. under paragraph 5, Article 44 of the Order for Enforcement of the FIEA and paragraph 2, Article 136 of the Order for Enforcement of Act on Investment Trust and Investment Corporation
 - The public notice to designate a financial instruments business operators, etc. under paragraph 6, Article 28 of the Order for Enforcement of Act on the Prevention of Transfer of Crime Proceeds

Chart 3

Relationship with Self-Regulatory Organizations



Activities in Figures Table of Summary

					-	U	Jnit: Numb	er of cases
Cate	Fiscal year gory	1992 to 2014	2015	2016	2017	2018	2019	Total
C	riminal charges	173	8	7	4	8	3	203
R	ecommendations	840	59	91	38	54	49	1,131
	Recommendations based on securities inspections	496	18	35	10	11	14	584
	Recommendations for administrative monetary penalty payment orders (market misconduct)	252	35	51	26	33	29	426
	Recommendations for administrative monetary penalty payment orders (false statements in disclosure statements, etc.)	88	6	5	2	10	6	117
	Recommendations for order to submit correction report, etc.	4	0	0	0	0	0	4
pe sp	nouncement of results of inspection of rsons making notification for business ecially permitted for qualified institutional vestors	42	17	23	4	0	2	88
un wi	tition for a court injunction, etc., against registered business operator or solicitation thout the filing of securities registration ttements	14	3	1	2	2	3	25
Pı	roposals	24	0	0	0	2	0	26
	Financial instrument businesses operators	2,888	128	37	25	55	64	3,197
	Type I financial instrument businesses operators	2,134	61	16	19	35	44	2,309
	Type II financial instrument businesses operators	244	32	9	2	7	4	298
	Investment management firms Investment advisories/agencies	510	35	12	4	13	16	590
ions	Registered financial institutions	345	1	0	0	3	2	351
inspect	Persons making notification for business specially permitted for qualified institutional investors	84	30	20	0	4	0	138
Securities inspections	Financial instruments intermediaries	49	19	2	0	4	2	76
Se	Credit rating agencies	9	0	0	0	0	1	10
	Self-regulatory organizations	29	3	0	0	0	2	34
	Investment corporations	47	1	1	0	1	1	51
	Other	10	3	1	0	1	1	16
	Total	3,461	185	61	25	68	73	,
М	larket oversight	13,719	1,097	1,142	1,099	1,052	1,061	19,170

Notes

1. Total number of securities inspections refers to the number of cases that have been started.

2. In addition to the inspections of Type I financial instrument businesses operators (former domestic securities companies) above, Local Finance Bureaus and other organizations conduct inspections of individual branches of those Type I financial instrument businesses operators (former domestic securities companies) that are assigned to the SESC.
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September 6, 2019 Securities and Exchange Surveillance Commission

Monitoring Priorities for Securities Businesses (July 2019–June 2020)

Introduction

The missions of the Securities and Exchange Surveillance Commission (SESC) are: (1) ensuring market integrity and transparency/protection of investors, (2) contributing to the sound development of markets, and (3) contributing to sustainable economic growth.

Under these missions, the purpose of the SESC's monitoring of financial instruments business operators (FIBOs, or securities businesses¹) is to ensure investors' confidence in the markets. For this purpose, the SESC encourages FIBOs ² to enhance self-discipline in performing their function as market intermediaries and to operate properly in compliance with relevant laws, regulations, and market rules. It also seeks to examine the actual situations of securities businesses swiftly and in depth.

In "*Strategy & Policy of the SESC 2017-2019*," released in January 2017, the SESC cited "effective risk-based monitoring of regulated entities" as one of the concrete measures to fulfill its mission for the period. For this measure, the SESC has been collaborating with relevant departments of the Financial Services Agency (JFSA), based on "*Assessments and Strategic Priorities*,"³ etc.

This document outlines the basic monitoring policy for FIBOs and sets forth the areas of focus in the monitoring activities in the 2019–2020 business year.

1. Monitoring Priorities for Securities Businesses

(1) General environment surrounding securities businesses

The global economy continues to recover gradually. However, circumstances including the development of trade issues, the outlook for the Chinese economy,

¹ "Monitoring of securities businesses" in this document includes both on-site and off-site monitoring. On-site monitoring means inspections conducted at the site, while off-site monitoring means a wide range of monitoring activities carried out by the SESC, Local Finance Bureaus and others, other than on-site inspections, which may include interviews with and reports from FIBOs and information collection through exchanges of opinions with relevant parties.

² FIBOs or securities businesses are any businesses that are subject to securities monitoring pursuant to the Financial Instruments and Exchange Act, including financial instruments business operators, registered financial institutions, financial instruments intermediaries, persons who have notified that they are engaging in business specially permitted for qualified institutional investors, credit rating agencies, and other entities.

³ Combines "Strategic Directions and Priorities" and "Progress and Assessment of the Strategic Directions and Priorities," and has been published since business year 2018.

the UK's exit from the EU and other situations in Europe have heightened uncertainties and pushed monetary policies toward easing once again. Under these circumstances, the rise of potential risks has been pointed out.

With respect to the Japanese financial capital markets, share prices have continued to fluctuate, although they still remain at high levels, and share trade volume has declined. Interest rates continue to remain at historically low levels.

Circumstances such as the above make it difficult for FIBOs to secure earnings under traditional business models, which rely on commission income.

Some investors' moves to pursue products with higher returns have been abused. In one case, an FIBO's sale of high-risk products to individual investors without sufficient explanations of the risks involved subsequently materialized as a problem. In another case, an unregistered business operator lured investors with the promise of high returns and caused damage.

In addition, the progress of digitalization has led to the entry of non-financial players into the financial instruments exchange business, and the use of technology such as cloud services and AI for improved business efficiency. Cyberattacks continue to be a threat to FIBOs. The importance of cyber security is rising ahead of the 2020 Olympics and Paralympics Games in Tokyo.

Furthermore, due in part to FATF's fourth mutual evaluation of Japan that will take place in autumn of 2019, Japan's financial institutions are internationally required to be achieve further sophistication in addressing Anti-Money Laundering/Counter Financing of Terrorism (AML/CFT).

(2) Approach to monitoring securities businesses

Securities businesses subject to monitoring by the SESC currently total approximately 7,200. These firms offer an increasingly diverse, complex set of services and products, and include businesses that have yet to introduce adequate basic control environments for compliance and investor protection.

Regulatory authorities must therefore make their best efforts to conduct effective, efficient monitoring of securities businesses as well as to promptly identify risks that could undermine investors' confidence based on the risk characteristics of FIBOs, and to do so with limited human and other resources.

The SESC will continue implementing a strategy of selecting the businesses subject to on-site monitoring based on the off-site risk assessment of all securities businesses. The SESC carries this out in collaboration with the relevant bureaus of the JFSA, including an analysis of the business environment that covers economic and industrial trends and an entity's business model.

In conducting on-site monitoring, the SESC aims not only to point out problems and to take actions such as making recommendations for administrative disciplinary actions, but also to analyze the whole picture of the problems to identify their root causes, so that businesses can address them and prevent recurrence.

Furthermore, if the need to improve business operations or other potential issues is identified before any problems materialize, the SESC will share the findings with the monitored businesses and urge them to build effective internal control environments or take other actions to address the issues.

(3) Activities in the last business year

In the last business year, the SESC thoroughly conducted on-site monitoring of securities firms after gathering information on business model trends and the circumstances surrounding overseas outsourcing of back office operations, and understanding each company's risks. As a result, the SESC found cases where some small- and medium-sized securities firms had made false or misleading representations on important matters upon soliciting foreign shares, as well as a case where the trade surveillance system did not fully function at a foreign securities firm mainly due to overseas outsourcing of systems functions. Furthermore, the SESC embarked on full-scale inspections in view of the rise of interest in AML/CFT following the implementation of Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism.

With respect to investment management business operators, some business operators have not been inspected for long periods. In light of such a situation, the SESC conducted on-site monitoring on business operators of major corporate groups, business operators that outsource investment management, and private placement businesses of real estate investment trust (REIT) from the perspective of control measures, including those to prevent conflicts of interest. In addition, while conducting monitoring, the SESC took into consideration developments to sophisticate asset management, with a focus on major investment management business operators.

With respect to Type II FIBOs, investment advisors/agencies, and persons who have notified that they are engaging in business specially permitted for qualified institutional investors (QII business operators), the SESC identified high risk businesses from among the large number of businesses falling under these categories and carried out on-site monitoring as needed based on the analyses of risks associated with their products and information provided by outside sources. As a result of the on-site monitoring, the SESC found multiple cases of violations of the Financial Instruments and Exchange Act (FIEA) and problematic cases in terms of investor protection. By way of example, for sellers of loan-type funds, the SESC identified cases where sellers had made false or misleading representations about their usage of funds, and had failed to establish the control environment to comprehend the actual situation of borrowers and the usage of funds.

Furthermore, the SESC sought court injunctions to force the cessation and suspension of activities at, among others, unregistered Type II FIBOs that caused a large amount of damage to general investors.

(4) Policy for activities in the current business year

As it is becoming increasingly difficult for the traditional business model dependent on sales commission income to secure earnings, many FIBOs are seeking to transform to a stable-earning structure by increasing assets under management as a sales method in recent years. They have also begun expanding their product lineups to include overseas financial products and higher-return funds.

In the current business year, the SESC will assess risks, while bearing in mind the possibility of inappropriate sales to investors that may arise from excessive sales targets and significant burdens beyond the front-line resources for sales, which are likely to arise amid the aforementioned trends and changes in business models. In doing so, the SESC will focus on factors which are in the background of such problems, including the status of the establishment of the necessary internal control environments, the intention of management, and insufficient distribution of managerial resources.

In particular, the SESC will continue to proactively conduct on-site monitoring for in-depth examinations where it is necessary to comprehend further details in the event that:

- a relevant law and/or regulation is breached or there is a deficiency in business operations that requires a prompt in-depth examination;
- a financial instrument is offered with an unclear risk profile, necessitating an examination of its solicitation activities;
- ③ the actual situation of business operations is not fully comprehended from an

information analysis based on off-site monitoring (including where there is a long period between examinations); or

 there is a possible serious problem concerning investor protection (e.g., inadequacy in the segregated management of customer assets).

At the same time, particularly for regional securities firms, the SESC will conduct monitoring on the sustainability of their governance and business models (including customer-oriented business conduct), and their roles as regional operators of direct finance. The monitoring on this point will be conducted mainly off-site and from the viewpoint of contributing to the sound development of capital markets by ensuring market fairness and transparency as well as seeking investor protection.

With regard to unregistered FIBOs, the SESC will actively collect and analyze information, conduct investigations in collaboration with relevant agencies, and seek court injunctions to cease and suspend activities that violate the FIEA so as to contain the spread of damage to investors.

2. Industry-wide and thematic monitoring priorities

In monitoring securities businesses, the SESC will aim to work closely with the relevant departments of the JFSA to look into and monitor the following as thematic monitoring priorities applied across the industry through appropriate methods required for each theme in accordance with the "Assessments and Strategic Priorities."

- ① Efforts to enhance AML/CFT measures
- ② Sufficiency of cyber security measures, implementation of system risk management that suits business model
- ③ Measures to implement customer-oriented business conduct
- ④ Implementation of measures to improve or prevent the recurrence of matters pointed out in results of internal audits or examinations by self-regulatory organizations (SROs)

In addition to the above, the SESC will flexibly examine FIBOs on other themes in response to changes in the environment surrounding them.

Monitoring strategies for various FIBO business models

Based on the results of monitoring in the previous business year, taking into consideration the scale of FIBOs' businesses and type of service and in accordance with the "Assessments and Strategic Priorities," the SESC will examine a FIBO if the SESC has concerns regarding its violation of relevant laws and regulations or control environments surrounding business operations, or if the actual situation of a FIBO's business operations are not fully comprehended from an information analysis conducted through off-site monitoring. The examination will be conducted with a focus on the following points.

Upon doing so, the SESC will monitor Type I FIBOs and investment management business operators that belong to major groups in view of their relationships with the overall group's strategies and operation policies.

With regard to operations related to High Frequency Trading conducted by Type I FIBOs, the SESC will look into the development of internal control environments for entrusted operations.

(1) Major securities business groups⁴

The SESC will continue to monitor major securities business groups on a continuous basis with regard to such matters as the development of governance and risk control environments that support domestic and overseas business operations, efforts to establish a sustainable business model, efforts to establish an effective and principle-based compliance environment that is beyond mere compliance with formal rules, efforts to instill and establish customer-oriented business conduct, and efforts to enhance AML/CFT measures. In doing so, the SESC will take into consideration the management environment surrounding each company.

For securities businesses under the three mega banking groups, given their intentions to expand their customer bases through banking and securities collaborations, the SESC will monitor their control environments to manage conflict of interests and other control measures, in addition to the points listed above.

Also, the SESC will swiftly conduct on-site monitoring where it is necessary to confirm the actual sales practices at sales offices.

⁴ Major securities business groups: Japanese securities companies with global operations

(2) Foreign securities firms

The SESC will monitor the development of internal control environments that respond to the progress of overseas outsourcing of back office operations as part of the group strategy and structural changes in business models.

In light of the prolonged low interest rate environment, the SESC will also examine the trends in products sold to Japanese financial institutions and other investors and the risks of these products.

At the same time, the SESC will monitor the status of investment banking operations, such as underwriting operations, amid the increase in the size of M&As and bond issuance, which are on the rise in recent years.

(3) Online securities firms

For online securities firms, the SESC will examine their implementation of system risk management that covers cyber security and the status of internal control environments that reflect the increase in products they offer, and their launch and expansion of face-to-face sales activities in collaboration with independent financial advisors (IFAs) and regional financial institutions. In doing so, the SESC will take into consideration the group-wide strategies and operation policies of the entire corporate group, including non-financial entities that are rapidly entering the market and their earnings.

(4) Semi-major securities firms and regional securities firms

Amid severe management environments arising from the outflow of customer funds through the aging of customers and inheritance, the SESC will examine whether they have inappropriately solicited customers, particularly in connection with foreign shares and high return products, or engaged in other conducts that are problematic from the viewpoint of investor protection. In addition, the SESC will examine the business operation environments of securities firms whose major shareholders or management structure changed, for example, due to participation of foreign capital or other investors and securities firms that participate in funding by companies with financial troubles.

At the same time, for regional securities firms, the SESC will conduct monitoring of governance and sustainability of their business models (including customeroriented business conduct), and their roles as regional operators of direct finance, in close collaboration with Local Finance Bureaus (LFBs). The monitoring on this point will be mainly conducted off-site. (5) Foreign currency margin transactions (FX transactions) business operators

For FX transactions business operators, the SESC will examine their response to the revision of the Cabinet Office Ordinance to strengthen settlement risk management, which includes disclosure of risk information, appropriateness of stress tests, and an appropriate reflection of the results of the implemented stress tests to capital.

(6) Investment management business operators

The SESC will examine control environments for the management of conflicts of interests and outsourced investment management. Furthermore, the SESC will assess the actual situation of business operators managing real estate-related funds such as private REITs, which are in high demand from regional financial institutions and pension funds, as well as the current situation of investments in alternative assets.

(7) Investment advisors/agencies

The SESC will examine whether or not any misleading advertisements are used, or if any solicitation activity is conducted using false explanations.

(8) Type II FIBOs and QII business operators

For Type II FIBOs (including sellers of loan-type funds) and QII business operators, the SESC will conduct monitoring with a focus on funds advertising high returns and the actual existence of the business project in which investment is to be made. In addition, the SESC will conduct examinations based on the analyses of information provided by investors and other sources.

(9) Other securities businesses subject to monitoring pursuant to the FIEA

For other securities businesses, including securities finance firms, credit rating agencies, registered financial institutions, and SROs, the SESC will conduct risk-based monitoring in light of the firm's particular business type.

(10) Unregistered business operators

To prevent damage to investors caused by unregistered business operators, the SESC will strengthen cooperation with the JFSA's Supervisory Bureau, LFBs, and other investigative authorities. Where appropriate, the SESC will exercise its investigative authority to seek court injunctions that will force these firms to cease and suspend their activities that violate the FIEA.

The SESC will also continue to take strict actions, including public disclosure of the firms' names, the names of their representatives, and the nature of their illegal conduct.

Cooperation with relevant organizations

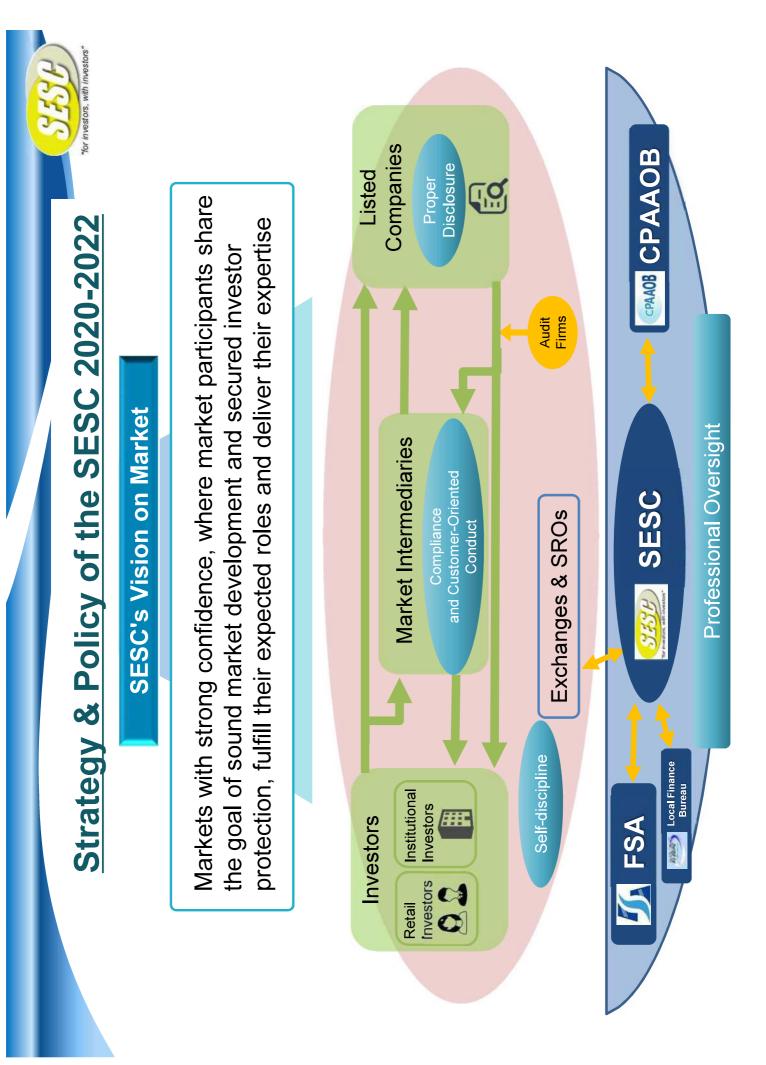
The SESC will work closely with LFBs through direct communication from the planning stage of both off-site and on-site monitoring, including information sharing, and also conduct joint examinations as needed. If a case that involves multiple LFBs occurs, the SESC will exercise its guidance and coordination functions by, for instance, determining ways to collect and share information and considering appropriate monitoring methods. It will also focus on the necessary training to support such activities of LFBs and others.

The SESC will also continue collaborating closely with relevant organizations, including SROs, by exchanging information in a timely manner, for instance. Sharing information and perspectives on issues as needed will contribute to the efficient monitoring of securities businesses, while also effectively improving matters detected and preventing recurrences in order to ensure market fairness and transparency as well as protect investors.

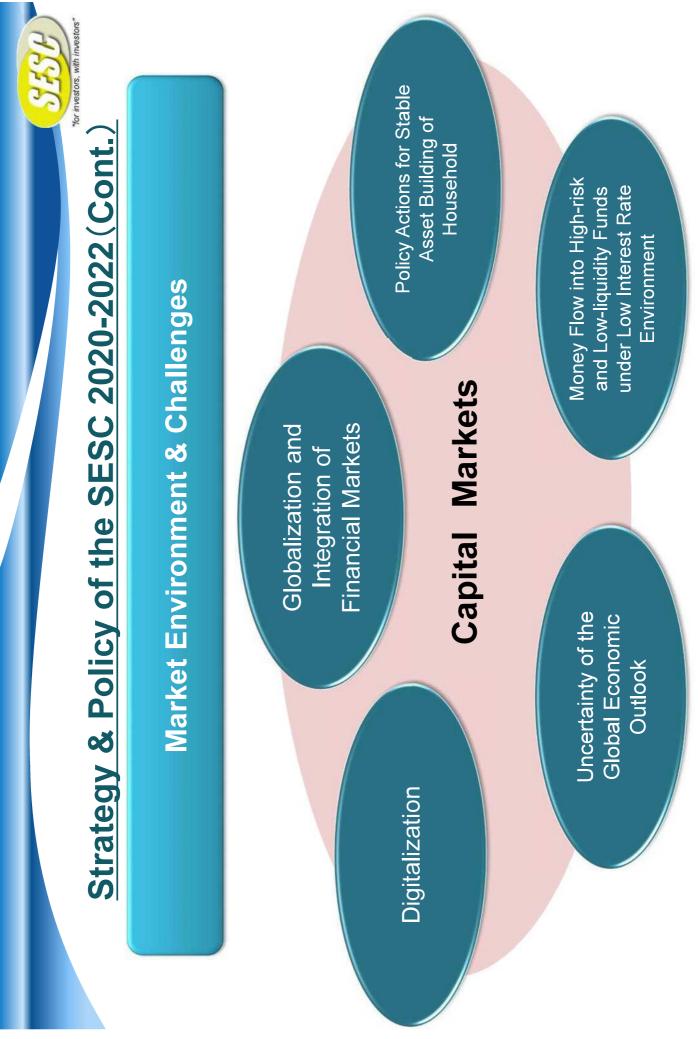
Dissemination of monitoring results and other initiatives

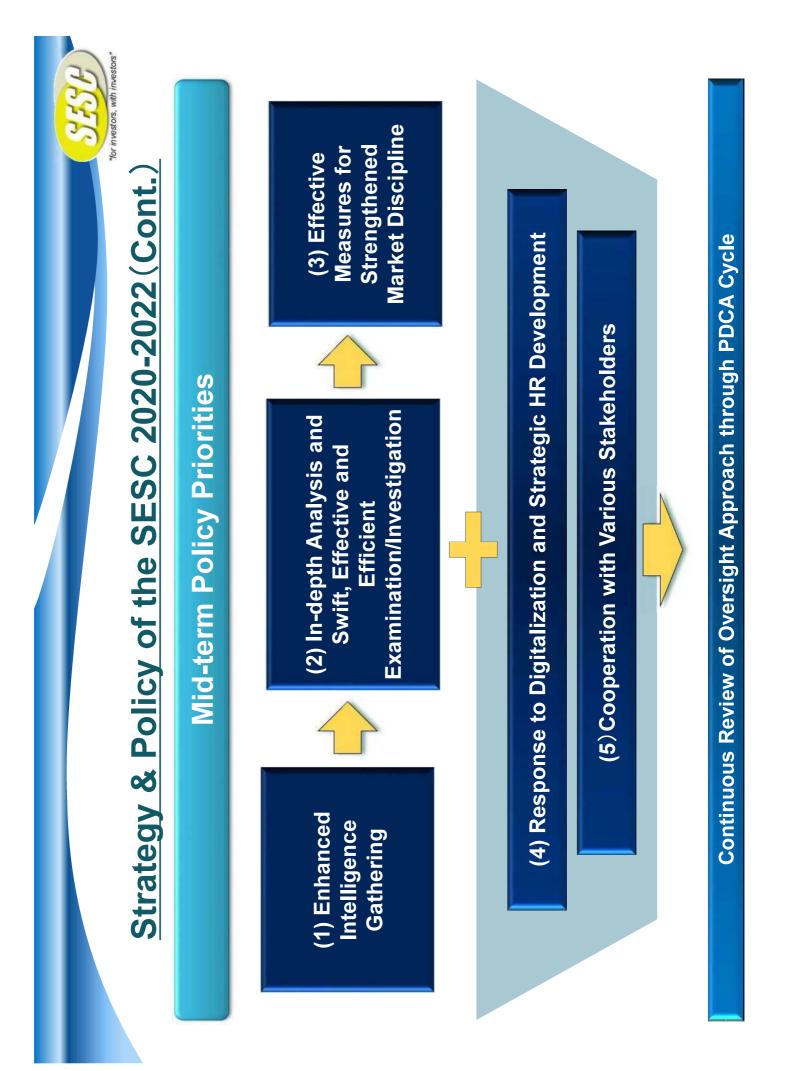
The SESC will encourage voluntary improvement efforts by providing FIBOs with feedback on problems and best practices found in the monitoring of securities businesses, and sharing the monitoring results with parties related to such audits at the time of review as needed, in cooperation with the relevant departments of the JFSA if necessary.

The SESC will also endeavor to provide the public with more information about the results of its monitoring of securities businesses in a specific and straightforward manner as a way to help market participants correctly understand the SESC's perspectives on issues requiring attention, including the publication of the "Overview of Monitoring of Securities Businesses and Case Studies."



f the SESC 2020-2022 (Cont.) In Investor.		Cooperation Excellence	In-depth oversight	 Identifying root causes of the problems Recognition of structural issues of the markets through in-depth and cross-sectoral analysis
cy of the SESC 202	Values and Goals	Forward- looking Efficiency	Timely oversight	 Early detection of potential market misconduct Preemptive actions against market abuse Effective investigation and early corrective action
Strategy & Policy of		Fairness Accountability	Holistic oversight	 Vigilance against emerging products and transactions Surveillance of multiple markets and cross-markets activities Protection of investors in consideration of their diverse characteristics (e.g. age, life stage) Comprehensive analysis of cases and cross-sectoral application of findings Enhanced outreach to stakeholders







"for investors, with investors"

(1) Enhanced Intelligence Gathering

- Forward-looking surveillance from macroeconomic perspectives
- Cross-sectoral surveillance across financial markets
- Intelligence gathering through closer cooperation with foreign authorities

Information gathering with due attention to the risk of potential misconduct, such as money flow into high-risk, low-liquidity investment funds

Equity / fixed income, cash / derivative, primary/secondary markets, etc.



	(HKKK)
Mid-term Policy Priorities	
(2) In-depth Analysis and Swift, Effective and Efficient Examination/Investigation	s and Swift, nation/Investigation
 Multi-directional/dimensional analysis and review Swift recommendation of administrative penalty Effective and efficient examination and investigation of cross- 	and review ve penalty id investigation of cross-
 border cases Active information exchance Rigorous enforcement of criminal invest misconduct 	Active information exchange through IOSCO MMoU nt of criminal investigation against market
Risk-based monitoring of securities business	usiness
 Monitoring of compliance with rules and customer oriented business Analysis of group-wide strategies, business type and size. 	s and customer oriented business business type and size.
Proactive response to cases where investors are harmed	ivestors are harmed
 Petitions for court injunction against unregistered firms to suspend the violation Monitoring of inappropriate sales and solicitations of financial products 	ed firms to suspend the violation ns of financial products





(4) Response to Digitalization and Strategic HR Development

- Advanced and efficient surveillance with digitalized technologies
 - Swift response to rapid digitalization in the capital market

 Strategic HR development (market abuse, corporate disclosure and securities business monitoring)

(5) Cooperation with Various Stakeholders

- Closer cooperation with SROs
- Enhanced cooperation with stakeholders

Foreign authorities and other organizations including those relevant to investor protection Enhanced contribution to global market oversight

Proactive participation in international discussions, e.g. IOSCO

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Strategy & Policy 2020-2022

- For Trusted and Attractive Capital Markets -

January 24, 2020 Securities and Exchange Surveillance Commission

Mission

Through proper and appropriate oversight, the SESC

- 1. Ensures market fairness and transparency, and protects investors
- 2. Contributes to the sound development of capital markets
- 3. Contributes to sustainable economic growth

SESC's Market Vision

Markets with strong confidence, where market participants share their commitment towards the sound development of capital markets and solid investor protection, fulfill their expected roles and exercise their professionalism

Philosophy

Fairness Accountability Forward-looking Effectiveness and Efficiency Close Cooperation Commitment to Excellence



Market Environment and Challenges

In December 2019, the SESC, whose mission is to protect investors and market integrity, inaugurated its 10th term under new leadership.

Since its inception, the SESC has pursued criminal prosecutions against flawed and material market misconduct and has made recommendations for administrative monetary penalty payment orders and administrative actions for violations of securities laws. The SESC has also conducted oversight through exercising its authority over investigations and inspections in an effort to ensure the fairness and transparency of the markets and protection of investors.

At present, capital markets are undergoing substantial changes:

- Regarding structural changes, an increase in the number of offshore investments and the globalization of companies (diversifying corporate operations towards overseas subsidiaries, outsourcing, etc.) are further accelerating the globalization of capital markets and closer integration of various financial markets.
- Regarding fund flows, the global ultra-low interest rate environment is driving the flow of funds into higher-risk and lower-liquidity funds, which exacerbates the uncertainty of the global economic outlook in the face of geopolitical risks.
- Furthermore, rapid digitalization is having a significant impact on all capital markets and market participants. Financial institutions are being pressed to overhaul their business models due to progress in technology, such as AI and in the utilization of data, and the market landscape is being transformed as a result of the proliferation of high-speed algorithmic trading. In addition, new products and transactions, such as crypto-assets are emerging.

In addition, the policy priorities of the Financial Services Agency (FSA) are encouraging financial institutions to accommodate the diverse needs of users. For its part, the SESC will make a greater contribution to enabling households' stable asset building and realizing a virtuous circle of fund flow through the solid protection of investors' interests and market integrity.

Keeping up with such substantial changes in the environment, in the 10th term, the SESC will focus on achieving three goals based on its values: holistic, timely,



and in-depth oversight. In order to attain these goals, the SESC will pursue five policy priorities.

Goals

1. Holistic oversight

- (1) Vigilance against new financial products and transactions Extensive monitoring and analysis of risks relating to new products and transactions
- (2) Surveillance of multiple markets and cross-market activities Comprehensive surveillance of a wide range of market transactions, in equity/fixed-income markets, cash/derivative markets, and primary/secondary markets

(3) Protecting investors of diverse characteristics

Promoting investor protection that reflects diverse investors in terms of knowledge, experience and competence, including elderliness

(4) Holistic and comprehensive investigation of cases and crosssectoral application of findings

Exercising holistic and comprehensive investigation referring to crosssectorial relevant precedents and to reveal the root cause of misconduct

(5) Enhanced outreach to stakeholders

Enhancing outreach to stakeholders with the aim of preventing misconduct

2. Timely oversight

(1) Early detection of market misconduct

Early detection and timely investigation and inspection of potential misconduct in the markets

(2) Preemptive actions against market misconduct

Before identified problems are materialized, if necessary, urging entities under investigation or inspection to take necessary measures for prevention of violations

(3) Effective investigation and inspection, and swift corrective action Early and effective identification of issues and swift responses to them



in investigation and inspection

3. In-depth oversight

(1) Identifying root causes of problems

When a violation of a securities law is identified, focusing on the substance of the problems, unravelling their root causes and engaging in an in-depth discussion with the entities involved, so that they can take actions proactively for improvements and prevent recurrences of similar violations

(2) Recognizing structural issues of the markets through in-depth and cross-sectoral analysis

Identifying structural issues in the markets and contributing to the improvement of relevant regulations through root causes analysis of the misconduct and cross-sectoral application of the findings

Five policy priorities to achieve the goals

1. Enhanced intelligence gathering

(1) Forward-looking surveillance with macro-economic perspectives

- The SESC will conduct forward-looking market oversight through constant market monitoring and industry sector analysis with macroeconomic perspectives.
- Specifically, to detect clues for investigation and inspection, the SESC will analyze the sectors and companies that might have potential risks of misconduct based on its insight of macro-economic trends. The findings will be shared with relevant divisions within the SESC for their investigations and inspections.

(2) Cross-sectoral surveillance across financial markets

- The SESC will exercise multi-dimensional monitoring and conduct cross-sectoral surveillance of equity/fixed-income markets, cash/derivative markets, and primary/secondary markets.
- (3) Intelligence gathering through closer cooperation with foreign authorities
 - > The SESC will further strengthen fostered relationships with foreign



authorities, especially among enforcement divisions, and bolster cooperation in the surveillance, investigations and inspections, and enforcement. The SESC will leverage information obtained from foreign authorities, such as insights on enforcement and regulatory frameworks, in its own oversight activities.

2. In-depth analysis and swift and effective investigations and

inspections

- (1) Multi-directional/dimensional analysis and review
 - Transactions are increasingly complex, corporate operations are more globalized, and the business models of financial firms are undergoing structural transformation. In these circumstances, untraditional and new types of violations of securities laws are emerging. The SESC will be attentive to potential risks to investors and respond to them without being fixed to the past precedents¹.
- (2) Swift recommendation for administrative monetary penalty payment orders
 - As the nature of violations becomes more varied and complex, the SESC will proactively and flexibly conduct investigations and inspections, so that it can swiftly bring recommendations for an administrative monetary penalty payment order. By doing so, the SESC will also reveal the facts of market misconduct and disclosure violations and contribute to their prevention.
- (3) Effective and efficient investigations and inspections of cross-border cases
 - The SESC will actively pursue cases involving cross-border transactions as well as misstatements of multi-national corporations through working with foreign authorities. Through those operations, the SESC will perform effective and efficient investigations and inspections corresponding to the nature of respective cases.

¹ Notably, in the term 2017-2019, the SESC pursued a case of unique method of spoofing (as "the use of fraudulent means" specified in Article 158 of the Financial Instruments and Exchange Act), cases of manipulation in listed derivative markets, cases of false statements in non-financial information, and cases of exaggerated or false claims in website advertisements.



- (4) Rigorous enforcement of criminal investigation against market misconduct
 - Serious cases of insider trading, market manipulation, spreading rumors, fraudulent means and false statements in financial reporting can be subject to the criminal penalties. The SESC will take rigorous enforcement actions against material and egregious violations by exercising its powers of criminal investigation. In such instances, the SESC will cooperate with criminal investigators and prosecutors as well as foreign authorities in order to effectively reveal the facts, including who is to blame.

(5) Risk-based examination of financial instruments business operators

- The SESC will conduct risk-based and integrated examination of financial instruments business operators (FIBOs).
- Regarding off-site examination, the SESC will work with supervisory divisions of the FSA and the Local Finance Bureaus to assess risks of violations of securities laws by FIBOs, taking into account not only business types and scales of the FIBOs, but also their business models, group-wide strategies and management policies. Based on the risk assessments, the SESC will select entities for on-site inspection.
- Regarding on-site inspection, the SESC will perform in-depth analysis of the products and transaction schemes offered by the FIBOs. To ensure such products are provided to investors appropriately, the SESC will review the appropriateness of the FIBO's business operation from the viewpoint of investor protection, including compliance with rules and customer-oriented business conduct.

(6) Proactive response to cases where investors are harmed

The SESC will identify and respond to the FIBOs' inappropriate selling and promotion of financial products as well as insufficient internal management systems that could harm investors. Also, in the case of unregistered business operators, the SESC will actively file petitions with the courts to issue prohibition orders. In this way, the SESC will proactively fulfill its mission of investor protection.

3. Effective measures for strengthened market discipline

(1) Multi-dimensional/directional use of insights from investigations and inspections



- In its investigations and inspections, the SESC will not limit itself to narrowly defined "exits," such as recommendations for administrative actions or criminal prosecutions. Rather, the SESC will make full use of all intelligence² gathered from each case in its oversight activities and engagement with stakeholders.
- The SESC will conduct investigations and inspections based on extensive perspectives. If the findings of investigations and inspections suggest structural problems in the markets, the SESC will take actions to realize better market environments through providing inputs to relevant policymaking.
- (2) Root-cause analysis and engagement with stakeholders to prevent recurrence of market abuse
 - When the SESC identifies a violation of a securities law during its investigation or inspection, it will not only pursue administrative actions or monetary penalty payment orders, but will also assess the problem in a holistic manner and pursue the root causes. Thus, the SESC will engage in in-depth discussions with the management of the entities under investigation or inspection and prevent recurrence of violations.
 - When the SESC identifies potential market abuse during its investigation or inspection before it is materialized, the SESC will share its view on the issue with the management of entities under investigation or inspection to prevent violations from occurring.
- (3) Enhanced outreach domestically and globally as pre-emptive measures against market misconduct
 - The SESC will highlight the significance, focus and details of the case in the press release of specific cases at the time of the recommendations as well as in the casebooks it publishes³. The aim is to strengthen market integrity through providing information that is both concrete and comprehensive.
 - To prevent investors from being harmed by market misconduct, the SESC will enhance issuance of warnings, such as investor alerts.
- (4) Extensive measures for seamless surveillance
 - > The SESC will always keep a close eye on developments in the markets,

² Information which could have add-value for other cases

³ "Casebook of Administrative Monetary Penalties Imposed under the Financial Instruments and Exchange Act – Market Misconduct Section," "Casebook of Inspection of Disclosure Documents," and "Securities Monitoring Overview and Casebook"



including emerging products and transactions as well as those that might be outside its surveillance. Through outreach and policy proposals, the SESC will take necessary actions in order to conduct seamless surveillance.

4. Response to digitalization and strategic HR development

(1) Advanced and efficient surveillance with digitalized technologies

The SESC will develop a more effective and efficient surveillance mechanism in light of technological advancements in markets and the use of digitalized technologies for the surveillance activities by other regulatory authorities and enforcement organizations. To this end, the SESC will work with its peer organizations to leverage digitalization in its market surveillance systems.

(2) In-time response to rapid digitalization in the capital market

- To achieve comprehensive market surveillance, the SESC will analyze and respond in a timely manner to new products and transactions that emerge as a result of rapid progress in digitalization.
- To adapt to the rapid progress of digitalization and increases in the volume of handled data, the SESC will further utilize digital forensics technology⁴ in its overall technological environment.

(3) Strategic HR development

As digitalization is advancing, transactions are more complex, and companies are significantly globalizing, the SESC will work to equip its human resources with specialized skills and broad perspectives in market surveillance so that the SESC can duly fulfill its mission.

5. Cooperation with various stakeholders

(1) Closer collaboration with SROs

- To support proactive oversight by self-regulatory organizations (SROs), the SESC will share its intelligence with them in a timely manner and reinforce the self-disciplinary mechanism of the market.
- In order to realize more effective and efficient market surveillance, the SESC will also continue to review the way it cooperates with the SROs.

⁴ Technology for analyzing electronic data and preserving it as evidence



To keep up cross-sectoral surveillance that covers multiple financial markets, the SESC will work with the width and quality of its market monitoring.

(2) Enhanced cooperation with stakeholders

To reinforce its existing cooperative relationship with SROs, foreign authorities and peer organizations, the SESC will expand its coordination with other stakeholders, including those involved in market fairness/transparency and investor protection, and thereby strengthen overall surveillance functions.

(3) Enhanced contribution to global market oversight

- As for oversight issues relating to cross-border transactions, the SESC will raise and share emerging issues both at the bilateral and multilateral venues with foreign authorities by proactively participating in the discussions at, for example, the International Organization of Securities Commissions. By doing so, the SESC aims to contribute to global market surveillance and international cooperation.
- By being closely involved in global market surveillance activities among regulators, the SESC will be attentive to emerging issues and major market developments, including key enforcement cases by other regulators. The SESC will apply those insights to its market oversights.

Moving forward

The SESC keeps its initiative towards "holistic, timely and in-depth" oversight.

This paper is based on our current observation on the capital market conditions and, in view of the rapidly evolving market environment, the SESC will review its Strategy & Policy through the PDCA cycle⁵, for accurately identifying challenges and proactively taking necessary actions. The SESC will continue to closely engage with outside advisors and other stakeholders to fulfill its mission.

⁵ A method for continuous improvement by repeating the "Plan, Do, Check, Act" cycle



"for investors, with investors"

The two ellipses crossing each other symbolize the securities markets and financial futures markets, which are both subject to our surveillance, the cooperation between the SESC and other domestic authorities concerned, and moreover our relationship with investors.

The slogan "for investors, with investors" represents the principle position of the SESC, which was established to protect investors and respect its relationship with them.