

# Annual Report 2022/2023

Securities and Exchange Surveillance Commission

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# Annual Report for FY2022\* Overview

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June 2023  
Securities and Exchange Surveillance Commission

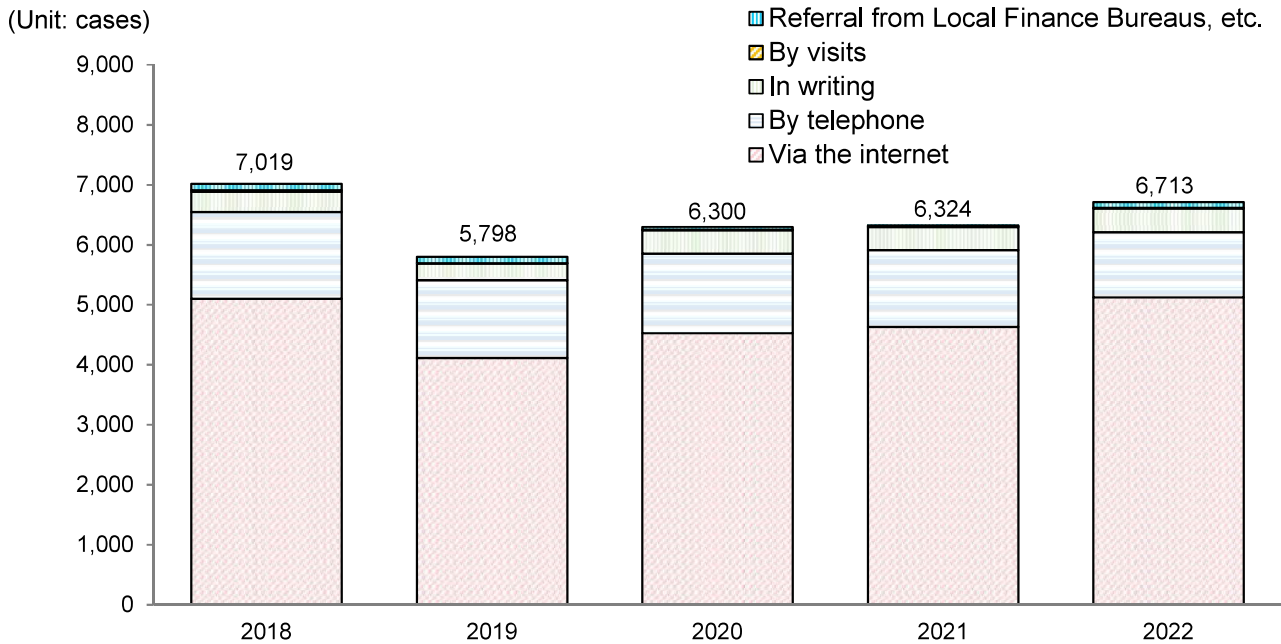


\*The period from April 1, 2022 to March 31, 2023

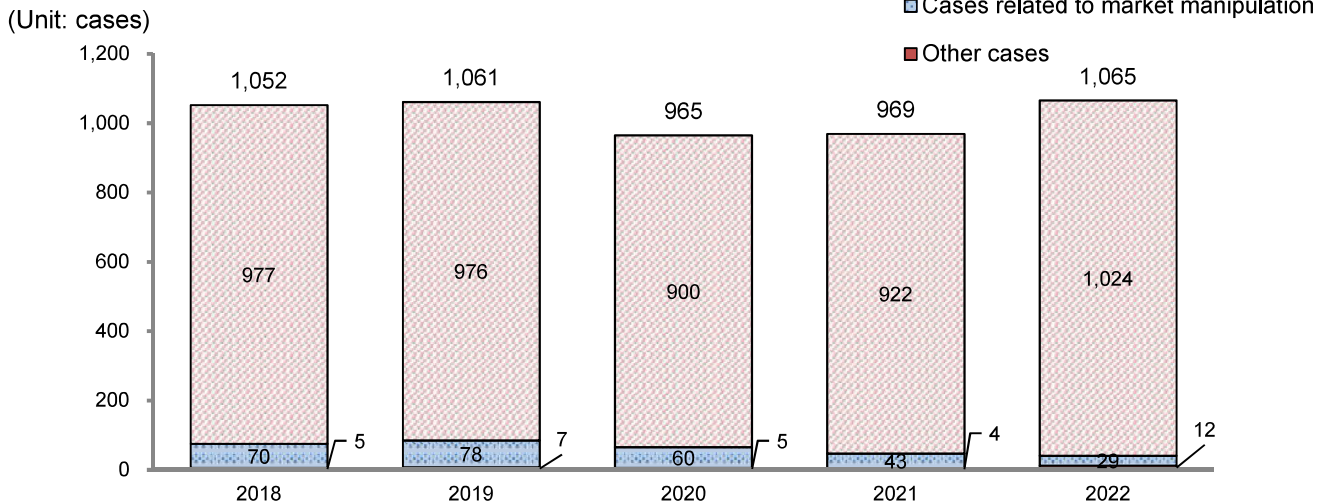
# 1 Outline of SESC's Activities in FY2022 (1)

- The SESC collected information broadly on the market as a whole, including 6,713 pieces of information received via the Contact Point for Information Reporting, etc. Based on the collected information, it conducted 1,065 examinations of transactions that were suspected as market misconduct.
- The SESC made recommendations for administrative disciplinary actions for five cases, as a result of conducting inspections of Financial Instruments Business Operators (FIBOs) based on a risk-based approach.
- The SESC conducted rigorous criminal investigations against serious and malicious violations (filing of criminal charges for eight cases), while promptly responding to market misconduct (recommendations for administrative monetary penalty payment orders for 14 cases) and violation of disclosure regulations (the same for seven cases).
- The 11th term was inaugurated in December 2022, and the Strategy & Policy 2023-2025 was formulated under the new organizational structure.

## Number of cases of information received



## Number of examined cases for market misconduct\*

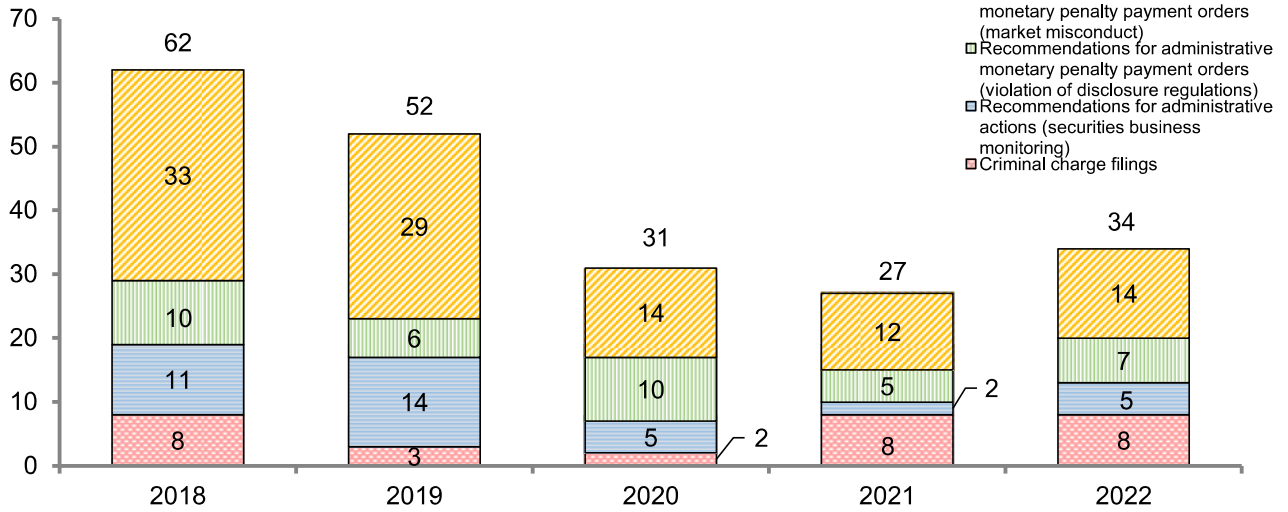


\* These numbers reflect the cases that the SESC examined as to whether the relevant transaction falls under a transaction suspected as market misconduct, with the trading data obtained from securities companies and financial instruments exchanges, etc., based on the information received via the Contact Point for Information Reporting, etc. and other various types of information

# 1 Outline of SESC's Activities in FY2022 (2)

## Number of cases for recommendations and criminal charge filings

(Unit: pieces)

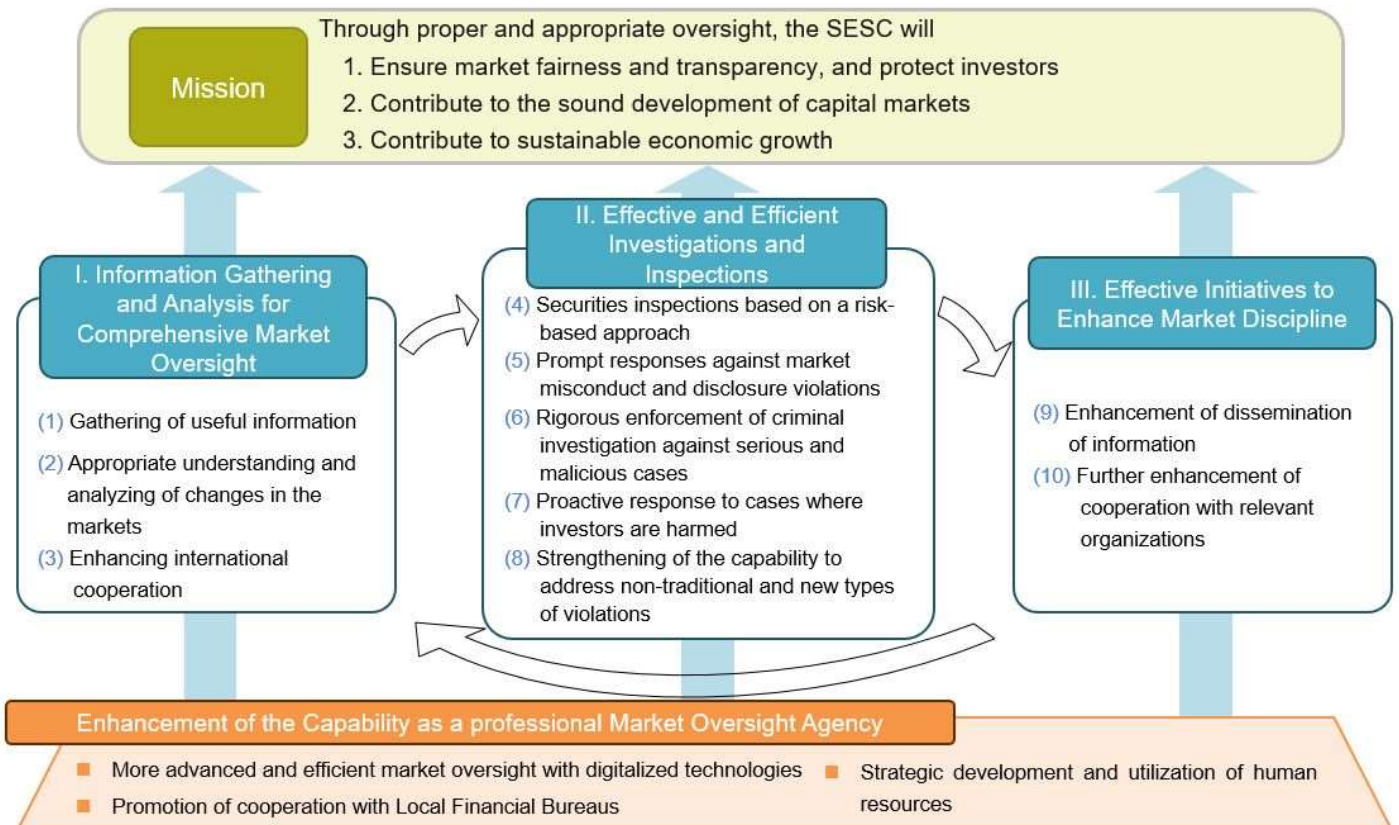


## Strategy & Policy of the SESC 2023-2025

### Strategy & Policy of the SESC 2023-2025

- For Trusted, Fair and Transparent Markets  
in Response to the Changing Times -

※Published on January 27, 2023



## Monitoring of FIBOs (Recommendations for Administrative Disciplinary Actions)

- The SESC conducted risk assessment based on the size and type of business
  - Analyzing operational risks and issues by the size and type of business
- The SESC inspected 59 FIBOs based on the risk assessment and made five recommendations for administrative disciplinary actions to the FSA Commissioner, etc.
- The SESC also took initiatives to encourage FIBOs to build effective internal control environments
  - The SESC described “Items to be noted” (issues that have yet to develop into problems but should be improved) in the notifications of completion of inspection in order to share awareness with the management of the inspected FIBOs

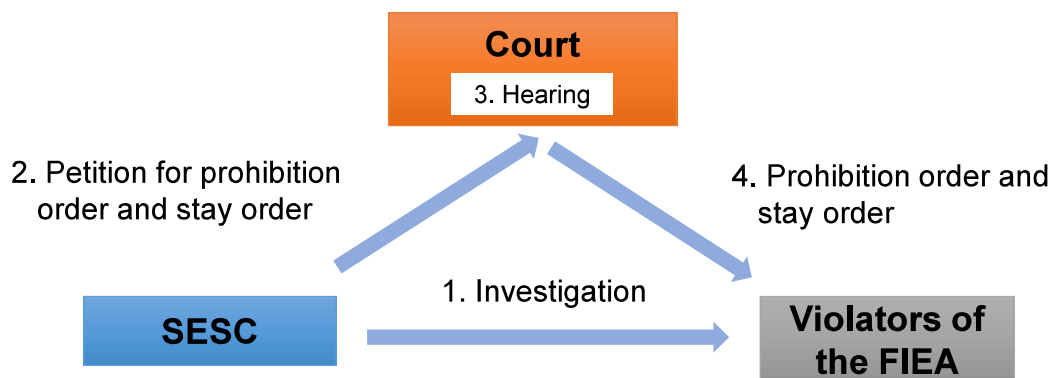
### Major cases for recommendation (securities business monitoring)

Company name	Date of recommendation	Overview
SMBC Nikko Securities Inc. (Type I financial instruments business)	Sep. 28, 2022	<p>[Conduct of making illegal purchases, etc. for the purpose of stabilizing market prices of listed shares]</p> <ul style="list-style-type: none"> <li>• In a "block offer" deal (BO), the company illegally made a series of purchases and offers to purchase for 10 issues of listed shares for the purpose of stabilizing the market prices of these shares.</li> </ul> <p>[Deficiency in the control environment for transaction screening]</p> <ul style="list-style-type: none"> <li>• The aforementioned series of transactions was not included in the coverage of transaction screening, showing that there was a deficiency in the company's control environment.</li> </ul> <p>[Deficiency in the control environment for business operations relating to BO]</p> <ul style="list-style-type: none"> <li>• The company made an inappropriate customer solicitation which could induce short selling, such as providing a buying customer with an explanation which makes the execution date of the BO inferable.</li> <li>• Additionally, since the time of introducing BO, the company had recognized concerns that buying customers' short selling of the issue subject to the BO would distort the price formation of the issue. However, the company conducted inappropriate business operations, such as commenced BO operations without appropriate discussions.</li> </ul> <p>[Inappropriate operations of the business handled in cooperation with a bank]</p> <ul style="list-style-type: none"> <li>• The company received from, or provided to the bank, which is its parent corporation, etc., undisclosed information on multiple corporate customers and shared such information within the company, despite recognizing that suspension of the information sharing was requested by those corporate customers.</li> </ul>
ES-CON Asset Management Ltd. (Investment management business)	Jun. 17, 2022	<p>[Failure to engage in investment management business faithfully on behalf of an investment corporation]</p> <ul style="list-style-type: none"> <li>• In managing assets entrusted by a real estate investment corporation, the company inappropriately urged a real estate appraisal company to raise the appraisal value of a piece of real estate owned by its parent company, etc., which is an interested party, for the purpose of having the real estate investment corporation purchase the real estate at the price recommended by the parent company.</li> <li>• Additionally, the company collected estimated appraisal values from multiple appraisal companies, and negotiated with the appraisal company that presented the highest amount so that the appraisal fee for the relevant appraisal company would become the lowest.</li> </ul>

## 2 Monitoring of FIBOs (Unregistered Business Operators, etc.)

- The SESC filed a petition for the issuance of a prohibition and stay order by the court against acts in violation of the Financial Instruments and Exchange Act (FIEA) committed by unregistered business operators in order to prevent the spread of investor damage.
- The SESC enhanced cooperation with relevant organizations, including other related divisions of the Financial Service Agency, Local Finance Bureaus, law enforcement authorities and the Consumer Affairs Agency.

### Flow of filing a petition



### Cases of petition

Respondent	Date of petition filing	Overview
Thousand Ventures Co., Ltd. and its manager	Jun. 28, 2022 (Tokyo District Court)	<ul style="list-style-type: none"> <li>Targeting the members of the money school that the respondents organized, the respondents had (i) solicited shares in collective investment schemes, etc., (ii) engaged in intermediation for over-the-counter derivative transactions, and (iii) solicited a corporate bond issued by another company on a regular basis without statutory registration (i.e., unregistered business operation), thereby collecting around 1.7 billion yen from at least 1,100 general investors in total. Furthermore, they made a public offering of its corporate bonds without filing a Securities Registration Statement.</li> </ul>
President of Mt. light (MTL)	Dec. 9, 2022 (Tokyo District Court)	<ul style="list-style-type: none"> <li>The respondent had OS-Laugh Marketing Ltd., located in Labuan Island, Malaysia, offer foreign exchange margin transactions (over-the-counter derivative transactions) to general investors in Japan under the name of Mt. light (MTL) on a regular basis without statutory registration (i.e., unregistered business operation), thereby collecting over 8.5 billion yen from at least 1,950 general investors in total.</li> </ul>

### 3 Investigations of Market Misconduct (Recommendations for Administrative Monetary Penalty Payment Orders)

- Violation of the insider trading regulations
  - Recommendations were made for eight cases.
  - The SESC made a recommendation for the case where an employee of a financial institution, misusing the information he had obtained in the course of duties, conducted and encouraged insider trading.
  - Recommendations were made for one case of violating the regulations on the provision of insider information and three cases of violating the regulations on transaction encouragement
  - In many cases subjected to recommendations for administrative monetary penalty payment orders, material facts pertained to tender offers.
- Violation of the regulations on market manipulation
  - Recommendations were made for six cases (including one cross-border case)
  - Market manipulation schemes have become increasingly complicated and sophisticated as seen in the following cases: a wrongdoer, using multiple securities accounts, including those under other persons' names, repeated cross trades intended for share price hikes while supporting lower price levels by increasing buy orders, thereby inducing transactions of third parties; and traders engaged in spoofing in Japanese Government Bond (JGB) Futures while trading Options whose underlying assets were JGB Futures.

#### Major cases where a recommendation was made (market misconduct)

Overview	Date of recommendation Amount of administrative monetary penalty	Key points
[Violation of the regulations on market manipulation] (Overview) A retail investor repeatedly pushed up prices and conducted cross trades for shares of listed companies to manipulate market prices.	Jun. 28, 2022 4,150,000 yen	<ul style="list-style-type: none"> <li>• The wrongdoer used three accounts under his name and one account under a name of his relative.</li> </ul>
[Violation of the insider trading regulations and the regulations on encouragement of transaction] (Overview) An employee of a financial institution had obtained a material fact, etc. in the course of duties and purchased relevant shares prior to the announcement of the fact and also encouraged his relative to purchase them for the purpose of letting the relative earn profits.	Sep. 2, 2022 1,630,000 yen	<ul style="list-style-type: none"> <li>• A violation by an employee of a financial institution</li> <li>• The wrongdoer used a securities account under another person's name.</li> <li>• The SESC made a recommendation for the violation of the insider trading regulations and the regulations on transaction encouragement.</li> </ul>
[Violation of the regulations on transaction encouragement] (Overview) An employee of a listed company had come to know of a planned tender offer in the course of duties and encouraged his acquaintance to purchase relevant shares for the purpose of letting the acquaintance earn profits.	Sep. 9, 2022 210,000 yen	<ul style="list-style-type: none"> <li>• Internal rules of the company did not contain the regulations on transaction encouragement, and the illegality had not been broadly disseminated in internal training or on other occasions.</li> </ul>
[Violation of the regulations on market manipulation] (Overview) An overseas corporation engaged in market manipulation known as spoofing in JGB Futures.	Jun. 21, 2022 42,850,000 yen	<ul style="list-style-type: none"> <li>• Traders, who worked for a registered High-Speed Trader, manually placed large orders without the intent to execute them.</li> </ul>

## 4 Inspections of Violations of Disclosure Regulations (Recommendations for Administrative Monetary Penalty Payment Orders)

- Recommendations were made for seven disclosure regulation violation cases.
- The SESC made recommendations for the following cases:
  - Non-disclosure of related party transactions
  - Inappropriate accounting treatment, such as overstating sales to overseas subsidiaries that should be included in the scope of consolidation
  - Non-disclosure of material events, etc.\*
- The SESC discussed the backgrounds and causes of violations of disclosure regulations with management officials of the listed companies to share awareness of the issues in order to prevent the occurrence and recurrence of the violations.

### Major cases where a recommendation was made (violation of disclosure regulations)

Overview	Date of recommendation Amount of administrative monetary penalty	Background and cause of inappropriate accounting practices
<p>[False statement, etc. in annual securities report, etc.] (Overview)</p> <ul style="list-style-type: none"> <li>• Advanced booking of sales and booking of fictitious sales, etc.</li> <li>• Transactions, made by a person who is substantially a major stakeholder and equivalent to a corporate officer, with the company whose majority of voting rights are held by the said person were not disclosed in the Notes on "Transactions with Related Parties."</li> </ul>	<p>Apr. 26, 2022 46,050,000 yen</p>	<ul style="list-style-type: none"> <li>• The solar power generation business was considered a sanctuary.</li> <li>• Critical operations were executed without going through resolutions of the board of directors, or board resolutions were otherwise neglected.</li> </ul>
<p>[False statement, etc. in annual securities report, etc.] (Overview)</p> <ul style="list-style-type: none"> <li>• Overstatement of sales to overseas subsidiaries that should be included in the scope of consolidation</li> <li>• Existing material events, etc.* and the details thereof were not disclosed.</li> <li>• Upon amending the aforementioned inappropriate accounting treatment and non-disclosure of the material event, the company filed the amendment report where many false statements were found, such as inconsistencies between the balance sheet and profit-and-loss statement.</li> </ul>	<p>Dec. 9, 2022 205,730,000 yen</p>	<ul style="list-style-type: none"> <li>• The company's business attitude represented by its former chairman, who insisted on drawing up unrealistic sales budgets, put pressure on officers and employees under his control to achieve those sales budgets.</li> <li>• Strongly motivated to avoid disclosing the material event, the former chairman himself booked sales by using a company where he had effective control over the decision-making body, thereby making the said company appear to have achieved profitability.</li> <li>• The company did not have personnel with the capacity to prepare amendment reports, and therefore submitted an amendment report containing many false statements, without verifying the content sufficiently.</li> </ul>

\* A material event, etc. refers to an event or a situation that gives rise to any material doubt as to the assumption that the company will continue its business activities into the future.



## 5 Criminal Investigations (Filing of Criminal Charges)

- The SESC filed eight criminal charges.
  - Seven insider trading cases and one market manipulation case
- The SESC exercises its authority for criminal investigation to take rigorous actions against serious and malicious market misconduct in order to achieve fair and transparent markets.

### Major criminal charge cases

Case	Date of filing	Overview
Market manipulation by SMBC Nikko Securities Inc.	Apr. 12, 2022	<ul style="list-style-type: none"> <li>• Suspects engaged in transactions of shares that fall under an illegal stabilization operation in an attempt to avoid a significant decline in the closing price on the day of a BO handled by the suspected company (FIBO), compared to the closing price of the previous day. The closing price forms the base value for the deal price.</li> </ul> <p>* The SESC filed a criminal charge for the related case on March 23, 2022.</p>
Insider trading of the shares of SOFTBRAIN Co., Ltd.	Jun. 3, 2022	<ul style="list-style-type: none"> <li>• Suspect A, who was a manager of the internal audit office of a listed company, had come to know a fact concerning the launch of a tender offer for the company's shares in the course of duties, and told this fact to Suspect B and Suspect D prior to the announcement of the fact for the purpose of letting them earn profits. Suspect B and Suspect D purchased the company's shares prior to the announcement. Additionally, Suspect A, in conspiracy with Suspect C and Suspect D, purchased the company's shares prior to the announcement.</li> </ul>
Insider trading of the shares of Aiming Inc.	Dec. 6, 2022	<ul style="list-style-type: none"> <li>• In the course of duties, Suspect A and Suspect C had come to know a material fact having a significant influence on investors' investment decisions, which was that the development of a new game for mobile phones, which the listed company had been working on jointly with another company, had progressed to a stage where distribution would be expected to begin. They purchased the listed company's shares prior to the announcement of that fact. Additionally, Suspect A told this material fact to Suspect B prior to the announcement thereof for the purpose of letting Suspect B earn profits, and Suspect B purchased the company's shares prior to the announcement.</li> </ul> <p>* The SESC filed criminal charges for the case of Suspect A and Suspect B, and the case of Suspect C.</p> <p>* The SESC filed a criminal charge for the related case on December 26, 2022.</p>
Insider trading of the shares of Sogo Medical Holdings Co., Ltd. and the shares of Space Value Holdings Co., Ltd.	Mar. 3, 2023	<ul style="list-style-type: none"> <li>• A suspect who used to be an employee of a private equity fund operator had come to know facts concerning the launch of tender offers for the listed companies' shares in the course of duties and purchased those companies' shares prior to the announcement of those facts.</li> </ul>

## Development of Infrastructure to Support Market Oversight (Utilization of Digital Technology and Human Resources)

The SESC is promoting initiatives

- to upgrade and enhance the efficiency of market oversight operation through the utilization of digital technology

(e.g.) Preparation for the commencement of the use of online deposit account inquiry services provided by private business operators to financial institutions (signing in April 2023)\*

- to strengthen system functions to support market oversight
- to further enhance its capability of digital forensics and upgrade the digital forensics system
- to improve SESC staff members' professional skills through on-the-job training and to hire personnel with high expertise

\* Approximately 100 financial institutions participate in the services (as of March 2023). Digitalizing operational work on inquiring and responding will reduce workloads of both financial institutions and the SESC.

### Development of infrastructure to support market oversight



### Active participation by outside experts

(Unit: Persons)

	As of April 2022	As of April 2023
Attorneys	9	10
Certified public accountant	19	18
Real estate appraisers	1	2
Information processing engineers	6	7
Personnel with practical financial experience	13	14
<b>Total</b>	<b>48</b>	<b>51</b>

## 7 SESC's Initiatives to Enhance Market Discipline

The SESC is promoting the following initiatives:

- disseminating information through various channels
    - communicate the implications and key takeaways of the cases on which the SESC made recommendations via its website, public speeches and articles, etc.
    - call attention through the casebooks and columns (in the annual report) for preventing recurrence and occurrence of misconduct
  - making a positive contribution to the development of the market environment
    - In FY 2022, the SESC issued one policy proposal as shown below
  - close cooperation with self-regulatory organizations
    - work regularly with self-regulatory organizations in market surveillance activities, etc. and exchange opinions periodically to share awareness of issues on a timely basis
  - making a request to securities companies regarding their transaction monitoring systems
    - request securities companies to conduct self-check for their transaction monitoring systems to enhance the effectiveness of their transaction monitoring
  - close cooperation with foreign authorities
    - proactively participate in discussions on issues concerning securities regulations at the International Organization of Securities Commissions (IOSCO), and engage in swift enforcement against misconduct in cross-border transactions through information exchange under the IOSCO MMoU\*
    - enhance networks and share awareness with foreign authorities through training programs for staff of foreign authorities
- \* IOSCO MMoU: Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information formulated by the IOSCO

### Policy proposal

Case title	Overview
Solicitation of offers to acquire the membership rights of a limited liability (Jun. 21, 2022)	Recently, numerous inquiries and complaints have been received from outside sources that limited liability companies with unknown business conditions solicit investments from a large number of investors in an inappropriate manner, by asking them to invest in the membership rights of those companies, through a large number of employees/hired persons who do not always understand their business. Considering the situation, the SESC submitted a policy proposal to take appropriate measures, such as expanding the requirements for registration as a financial instruments business operator, to cover solicitation to acquire a limited liability company's membership rights by persons other than its executives, such as employees and hired persons.

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### Changes in the numbers of information exchange cases under MMoU

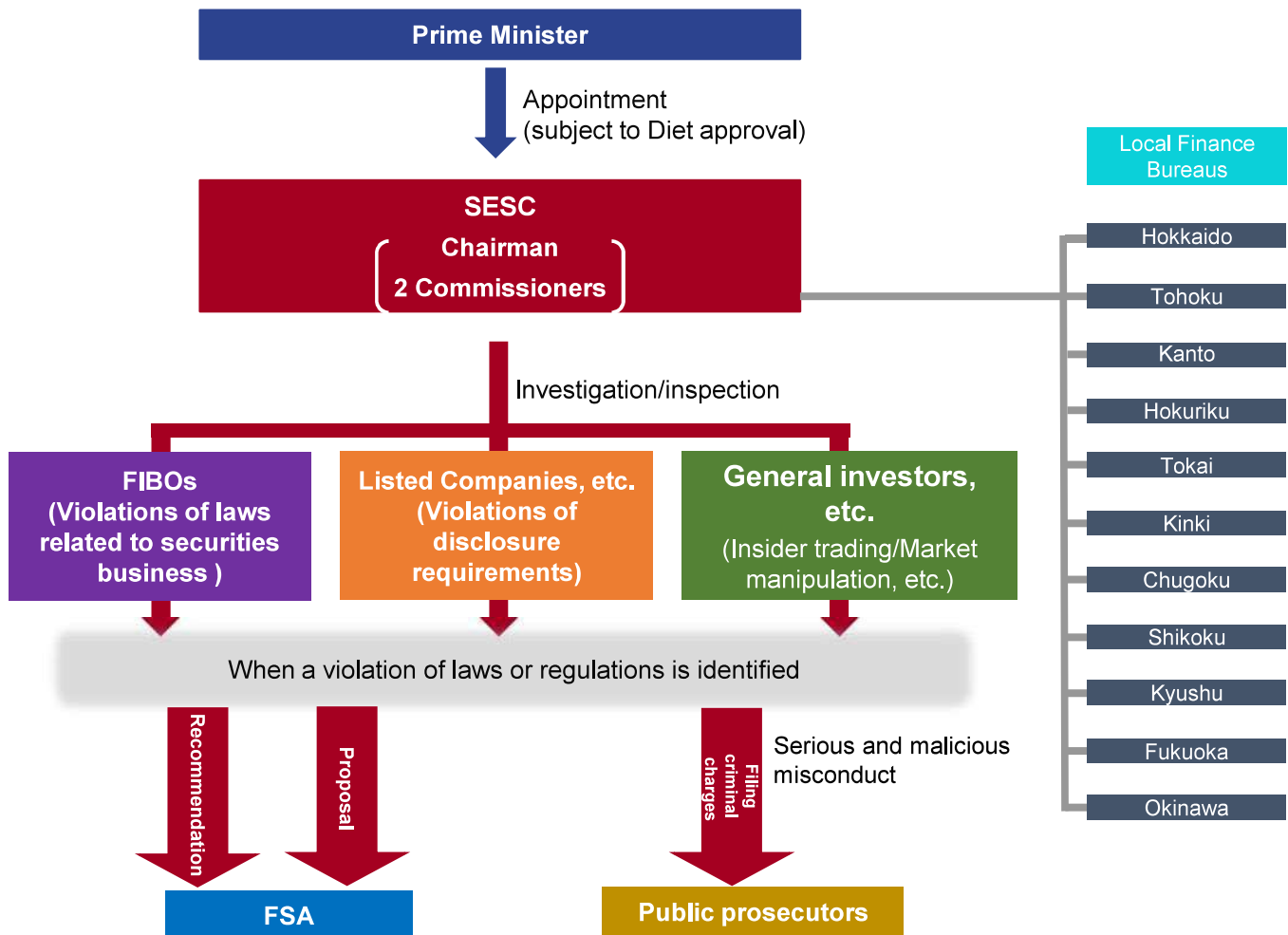
	FY2020	FY2021	FY2022
<b>Cases of receiving information from foreign authorities</b>	<b>64</b>	<b>64</b>	<b>76</b>
Requests to foreign authorities for the provision of information	32	22	20
Voluntary provision of information from foreign authorities	32	42	56
<b>Cases of providing information to foreign authorities</b>	<b>9</b>	<b>8</b>	<b>4</b>
Requests from foreign authorities for the provision of information	7	6	1
Voluntary provision of information to foreign authorities	2	2	3

(\*1) Excluding the number of cases of information provision pertaining to inquiries for eligibility screening by the authorities (regarding persons who assume important positions in financial institutions or local corporations that file applications for approval, etc.)

(\*2) The numbers of cases may change in the future as a result of alteration of tabulation methods or screening of the details of exchanged information.

# Reference Overview of the SESC

## Organization



## Chairman and Commissioners



**Commissioner  
KATO Sayuri**

**Chairman  
NAKAHARA Ryoichi**

**Commissioner  
HASHIMOTO Takashi**

KATO Sayuri was appointed as SESC Commissioner in December 2019 (reappointed in 2022). Previously, she served as Director of the Consumer Affairs Agency, Vice-Governor of Nagano Prefecture, and Executive Vice President of the National Consumer Affairs Center of Japan.

NAKAHARA Ryoichi was appointed as SESC Chairman in December 2022. Previously, he served as the Chief Public Prosecutor of the Hiroshima and Fukuoka High Public Prosecutors Offices.

HASHIMOTO Takashi was appointed as SESC Commissioner in December 2022. Previously, he served as a professor at Nihon University College of Commerce and at Aoyama Gakuin University Graduate School of Professional Accountancy.

# Annual Report 2022/2023

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

# Introduction

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The Securities and Exchange Surveillance Commission (SESC) is a collegiate organization within the Financial Services Agency (FSA) consisting of a Chairman and two Commissioners. Our mission is to ensure market fairness and transparency, and protect investors through proper and appropriate market oversight, and to contribute to the sound development of capital markets and to sustainable economic growth. The SESC's 11th term (December 2022 to December 2025) was inaugurated in December 2022.

Since its foundation, the SESC's authority to monitor markets has been enhanced and strengthened, including by the introduction of the administrative monetary penalty payment system in 2005 and the expansion of its authority to conduct securities inspections in 2007. Its organization has also been expanded, with the number of divisions increased from two at the time of foundation to six. While going through these changes, the SESC has proactively utilized its market oversight authority and has endeavored to ensure the fairness and transparency of the markets and protect investors.

## Key Achievements

In FY2022, in cooperation with self-regulatory organizations and foreign authorities, the SESC conducted multi-faceted analyses of new trends and problems in the markets by broadly collecting information concerning various markets inside and outside Japan and surveying and analyzing risks of market misconduct and problems regarding information disclosure.

Additionally, by selecting securities business monitoring targets through a risk-based approach, the SESC verified the degree to which customer-oriented business conduct had been entrenched in securities companies' business operations, and ascertained the reality of market misconduct and disclosure regulations violations through prompt implementation of investigations and inspections. For serious and malicious violations, the SESC exercised its authority to conduct criminal investigations and took strict actions. Through these efforts, the SESC made recommendations for administrative disciplinary actions to securities companies that made illegal purchases, etc. for the purpose of stabilizing market prices of listed shares, and also filed criminal charges against insider trading by a related party of a private equity fund operator in FY2022. Additionally, from the perspective of preventing the recurrence and occurrence of misconduct, the SESC actively promoted external communications by such means as publishing annual casebooks compiling cases subjected to administrative monetary penalties.

## Future Challenges

In recent years, capital markets have been rapidly and dramatically changing due to the increasing digitalization and internationalization, and market mechanisms and legal systems are also changing. In addition, there is the possibility that new environmental changes may further emerge in the future. Accordingly, in order to continue working for trusted, fair and transparent markets, the SESC considers it important to develop an ability to properly respond to those changes and

unprecedented incidents, in other words, to develop an ability worthy of being called a "professional market oversight agency," and to exercise such ability.

With this view in mind, the SESC will continue utilizing its functions in a timely and appropriate manner, which include broad market monitoring, prompt exercise of administrative functions to conduct investigations and inspections for administrative monetary penalties as well as securities inspections, and strict enforcement against serious and malicious cases. The SESC's Strategy & Policy 2023-2025 for its 11th term, which was formulated in January 2023, shows its commitment to making efforts for achieving a virtuous cycle of market oversight of "I. Information Gathering and Analysis for Comprehensive Market Oversight," "II. Effective and Efficient Investigations and Inspections," and "III. Effective Initiatives to Enhance Market Discipline," thereby contributing to curbing illegal and inappropriate market conduct. As the basis for achieving this, it is also stated that the SESC will endeavor to "further enhance its ability as a professional market oversight agency" through promoting digitalization and fostering human resources.

Based on skills and experience regarding market oversight accumulated so far and its past efforts for cooperating with related organizations inside and outside Japan and further adding originality and ingenuity, the SESC will further develop its ability to discover the nature of incidents, and will perform its duties in market oversight with open minds and from a broad perspective to earn people's trust.

This annual report outlines the SESC's activities in FY2022 pursuant to Article 22 of the Act for Establishment of the Financial Services Agency. We sincerely hope that this report will be shared by as many people as possible and contribute to deepening their understanding of the SESC's activities and awareness of issues and to establishing trusted, fair and transparent markets.

June 2023

NAKAHARA Ryoichi

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	<b>SESC established in the Ministry of Finance</b>	
1993		<b>Filing of criminal charges:</b> 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 Supervisory Agency reorganized into Financial Services Agency	Major reorganization of central government agencies
2005	<b>Administrative monetary penalty system introduced</b> SESC mandated to exercise administrative monetary penalty investigation SESC mandated to exercise administrative monetary penalty inspection on disclosure statements Additional inspection authority for securities companies, etc. granted to SESC (inspection of financial soundness, inspection of investment advisors)	<b>Filing of criminal charges:</b> False statements in securities report related to Kanebo, Ltd.
2006	<b>Five-division structure</b> 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	<b>Filing of criminal charges:</b> Spreading of rumors, fraudulent means related to Livedoor Marketing Co., Ltd. shares <b>Filing of criminal charges:</b> 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 to the court for a prohibition order and stay order against acts in violation by unregistered business operators	
2010	Additionally mandated to exercise authority to inspect credit rating agencies	

Year	Changes in SESC's authority and organization	Key events & activities
2011	<p>Additionally mandated to exercise authority to inspect group companies (consolidation regulation of large securities companies introduced)</p> <p><b>Six-division structure</b> introduced (Planning and Management Division, Market Surveillance Division, Securities Business Monitoring Division, Market Misconduct Investigation Division, Disclosure Inspection Division, and Criminal Investigation Division)</p> <p>Cross-Border Investigation Office set up</p>	
2012	<p>Additionally mandated to exercise authority to inspect trade repositories</p>	<p><b>Filing of criminal charges, recommendation for administrative monetary penalty:</b> False statements in securities report related to Olympus Corporation</p> <p><b>Recommendation for administrative disciplinary action, filing of criminal charges:</b> AIJ Investment Advisors Co., Ltd. (Use of fraudulent means on discretionary investment contract . related to Pension Fund)</p>
2013	<p>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 committed by asset managers on client accounts, and summon alleged violators as part of administrative monetary penalty investigations</p>	<p><b>Recommendation for administrative disciplinary action:</b> MRI International, Inc. (false notification, etc. related to MARS)</p>
2014	<p>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 trading regulation.</p> <p>Additionally mandated to conduct inspections on financial instruments business operators handling commodity derivatives</p>	
2015	<p>Digital Forensic Solutions Office set up</p> <p>Additionally mandated to exercise authority to conduct inspections on specified financial benchmark administrators</p>	<p><b>Filing of criminal charges:</b> 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</p> <p><b>Recommendation for administrative monetary penalty:</b> False statements in securities report related to Toshiba Corporation</p>
2016	<p>Office of Market Monitoring set up</p> <p>Litigation Office set up</p>	<p><b>Recommendation for administrative disciplinary action:</b> Arts Securities Co., Ltd. (false notification, etc. related to medical fee receipt bonds)</p>
2017		<p><b>Filing of criminal charges:</b> Use of fraudulent means by Arts Securities Co., Ltd., etc. (related to medical fee receipt bonds); market manipulation related to Stream Co., Ltd. shares</p>

Year	Changes in SESC's authority and organization	Key events & activities
2018	Additionally mandated to exercise authority to conduct inspections on high speed trading business operators	<p><b>Filing of criminal charges:</b> False statements in securities report related to Nissan Motor Co., Ltd.</p> <p><b>Recommendation for administrative monetary penalty:</b> Manipulation of market for long-term government bond futures by Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.</p>
2019		<p><b>Recommendation for administrative monetary penalty:</b> False statements in securities report related to Nissan Motor Co., Ltd.</p>
2020	<p>IT Strategy Office set up</p> <p>Additionally mandated to exercise authority to conduct inspections on financial instruments business operators handling crypto-assets derivatives and electronically recorded transferable rights</p>	<p><b>Filing of criminal charges:</b> Transaction encouragement related to Don Quijote Holdings Co. shares</p>
2021	Additionally mandated to exercise authority to conduct inspections on financial service intermediaries that provide securities intermediary services.	<p><b>Filing of criminal charges:</b> Market manipulation by SMBC Nikko Securities Inc.</p>
2022	Foreign Securities Business Monitoring Office set up	<p><b>Recommendation for administrative disciplinary action:</b> SMBC Nikko Securities Inc. (market manipulation, etc.)</p> <p><b>Filing of criminal charges:</b> Insider trading of the shares of SOGO MEDICAL HOLDINGS CO., LTD. and the shares of SPACE VALUE HOLDINGS Co., Ltd.</p>

## Abbreviations

Anti-Criminal Proceeds Act	Act on Prevention of Transfer of Criminal Proceeds (Act No. 22 of 2007)
APRC	IOSCO Asia Pacific Regional Committee
BY	Business Year (from July 1 to June 30)
EMMoU	Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information
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)
FY	Fiscal Year (from April 1 to March 31)
HST	High-Speed Trading
IOSCO	International Organization of Securities Commissions
JPX-R	Japan Exchange Regulation
JSDA	Japan Securities Dealers Association
MMoU	Multilateral Memorandum of Understanding of Concerning Consultation and Cooperation and Exchange of Information
SESC	Securities and Exchange Surveillance Commission
SROs	Self-Regulatory Organizations

# 1 EXAMINATION OF TRANSACTIONS AND GATHERING / ANALYSIS OF WIDE-RANGING INFORMATION

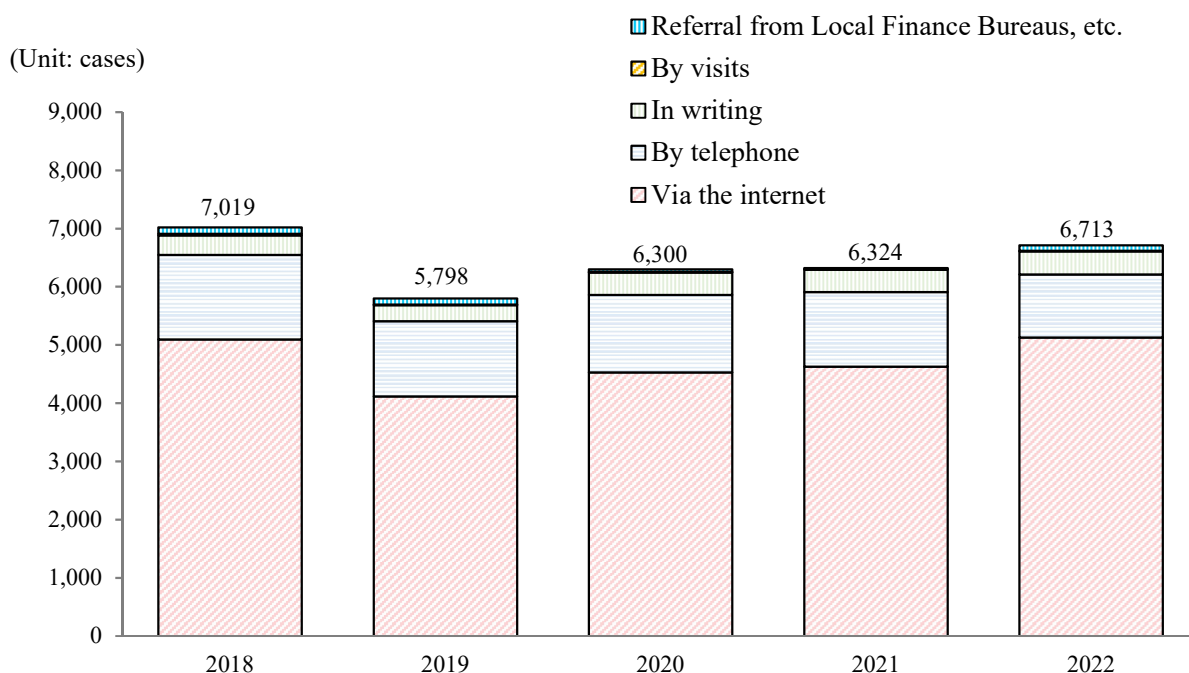
## 1. Purpose of Market Surveillance

To realize comprehensive market oversight by the SESC, market surveillance aims at detecting the beginning of any possible market misconduct through broadly gathering and analyzing information covering the entirety of the primary and secondary markets, in light of environmental changes in situations surrounding the markets and progress in a review of the systems. The SESC positions market surveillance as an entrance for information.

To this end, the SESC has established the Contact Point for Information Reporting to receive a wide range of information from general investors and other market players, and also cooperates with self-regulatory organizations (SROs) to gather a variety of market-related information. Based on these pieces of information, the SESC analyzes changes in market environments and market trends, examines transactions suspected of falling under market misconduct, and reports to the relevant divisions in the SESC if any suspicious transactions are identified.

The SESC implements effective market oversight with close cooperation among each of the functions, i.e. information gathering, market trend analysis and transaction examinations, and collaboration among the relevant divisions.

**Fig. 1-1 Number of cases of information received**



## 2. Status of Transaction Examinations

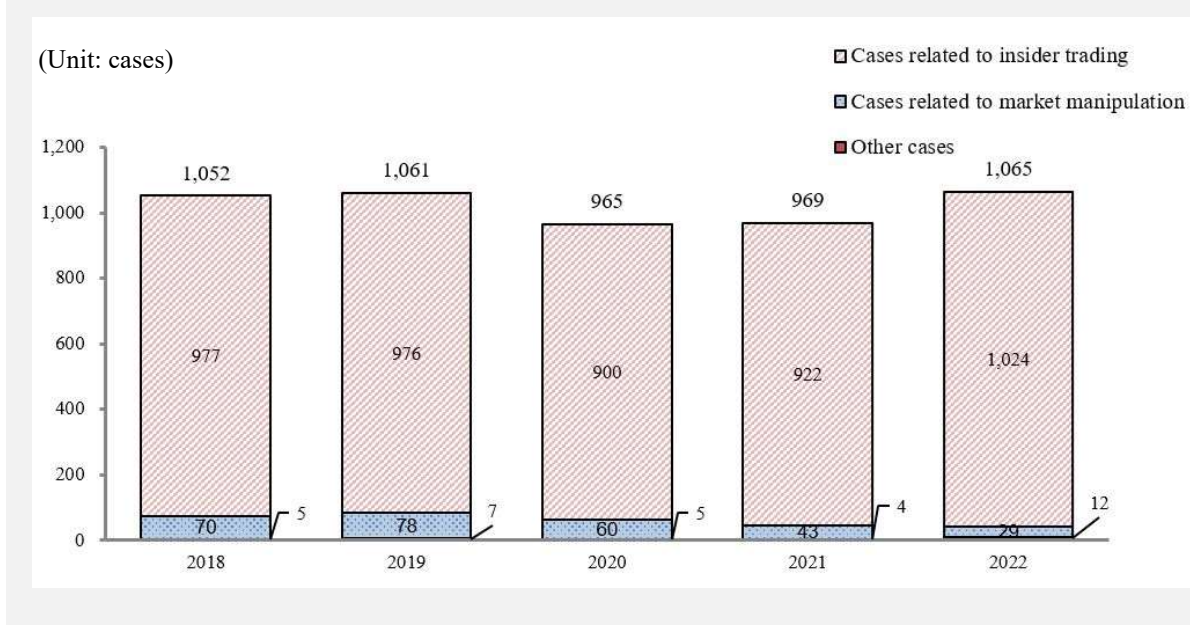
The number of cases that the SESC examined to detect suspicious market misconduct reached 1,065 in FY2022.

The breakdown by examination type of surveillance is 1,024 possible insider trading cases, 29 possible market manipulation cases, and 12 others, including the use of fraudulent means and the spreading of rumors.

With regard to transactions by high-speed trading (HST) operators, the SESC focused on fact finding by examining the status, etc. of orders placed and executed by HST operators. The SESC also examined transactions for possible market misconduct in cooperation with SROs.

Regarding customers for whom suspicion of market misconduct cannot be eliminated as a result of transaction screening, securities companies are taking required measures (calling for attention, suspension of new transactions, etc.), but the SESC's survey of securities companies' measures revealed significant gaps in individual companies' standards for suspending new transactions. Therefore, in the opinion exchange meeting with the Japan Securities Dealers Association held in January 2023, the SESC requested securities companies to conduct self-check for their trade compliance screening systems to enhance the effectiveness of the trade compliance screening system.

**Fig. 1-2 Number of examined cases for market misconduct\***



### 3. Overview of Market Monitoring

In order to achieve comprehensive oversight, the SESC gathers and analyzes a wide range of market-related information at the Office of Market Monitoring in the Market Surveillance Division.

#### **(1) Information reception and whistleblowing**

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##### (i) Efforts to gather information

In FY2022, the SESC received 6,713 information reports from the public.

Information from general investors, etc. represents candid opinions in the markets and can trigger the SESC's investigation and inspection. The SESC believes it is important to gather useful information from as many people as possible.

In FY2022, with the aim of increasing visibility of its Contact Point for Information Reporting and obtaining more useful information, the SESC posted listing advertisements in internet search websites to have the advertisement of the Contact Point for Information Reporting displayed on the screen when internet users conduct search with certain keywords, thereby broadly asking for the provision of information.

The SESC also provides preparatory consultation to whistleblowers through a dedicated Contact Point for Whistleblowing and examines information before formally accepting it. The number of whistleblower cases accepted in FY2022 was 10.

##### (ii) Receipt and use of information

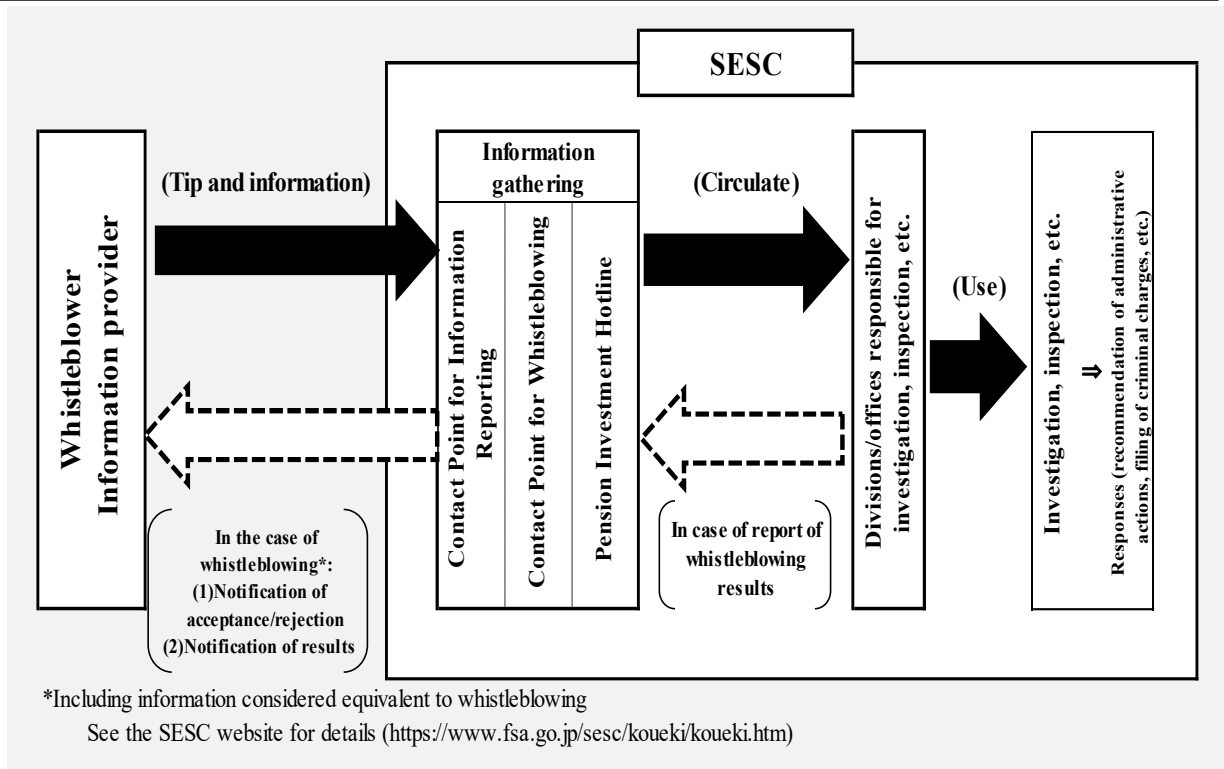
As illustrated by Fig. 1-3, information/tips provided to the SESC are forwarded to the divisions in charge of investigations and inspections within SESC after confirming the content of the information, and these divisions effectively utilize the information.<sup>1</sup>

Even an information report that does not meet the requirements of whistleblowing is accepted as information provision to the Contact Point for Information Reporting and circulated to and used effectively by relevant SESC divisions responsible for investigation and inspection.

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<sup>1</sup> The contact point for receiving information is divided by the content of information into three categories (Contact Point for Information Reporting, Contact Point for Whistleblowing, and Pension Investment Hotline).

**Fig. 1-3 Flow of information**



## (2) Market trend analysis

In addressing cases of “fraudulent finance,”<sup>2</sup> the SESC has utilized information gathered from market participants, such as investors and securities companies. The SESC has also enhanced its market monitoring by gathering and analyzing information that covers both the primary and secondary markets in close cooperation with securities exchange surveillance divisions at Local Financial Bureaus and Financial Instruments Exchanges (FIEs). As there are emerging cases of attempts to conduct market misconduct by using complex finance schemes or the issuance of shares to overseas funds, the SESC will keep paying close attention to these activities.

<sup>2</sup> “Fraudulent finance” refers to a series of fraudulent trading practices comprised of inappropriate acts in the primary or secondary securities market, including listed companies’ fund procurement through disguised additional equity issuance and in-kind contribution using overestimated real estate, as well as illegal external transfers of procured funds.



## 4. Future Challenges

### **(1) Further efforts to gather useful information**

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Information is the key for the SESC's market oversight. The SESC needs to gather a broad range of useful information on the markets as a whole through the Contact Point and SROs, etc., and to integrate, analyze and accumulate useful information and knowledge obtained in the process of market oversight and utilize in a multifaceted, dual-track manner by sharing the information with the Financial Services Agency and Local Finance Bureaus , etc. as necessary.

Therefore, the SESC will continue to promote public campaigns for the Contact Point for Information Reporting and consider measures to pave the way for citizens to provide information more easily and conveniently for the purpose of obtaining further useful information broadly from general investors, etc. Also, if information providers can be expected to have more useful materials, the SESC will encourage them to provide additional materials, thus promoting proactive information gathering.

### **(2) More efficient and sophisticated monitoring through promotion of digitalization**

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In recent years, dramatic progress in digitalization has led to the diffusion of HST using algorithms, exerting great influence on market participants as a whole. To respond to such changes in the market environment appropriately and conduct seamless market oversight, the digitalization of market monitoring must be promoted through the development of a system to gather and search massive data more efficiently and effectively to quickly confirm and analyze relevant data.

The SESC will further promote digitalization and increase the sophistication of analysis systems to achieve more efficient and sophisticated transaction examinations.



## Easily Anticipated MBO

### Message to listed companies (1)

The following notice is posted for calling attention on SESC's website.

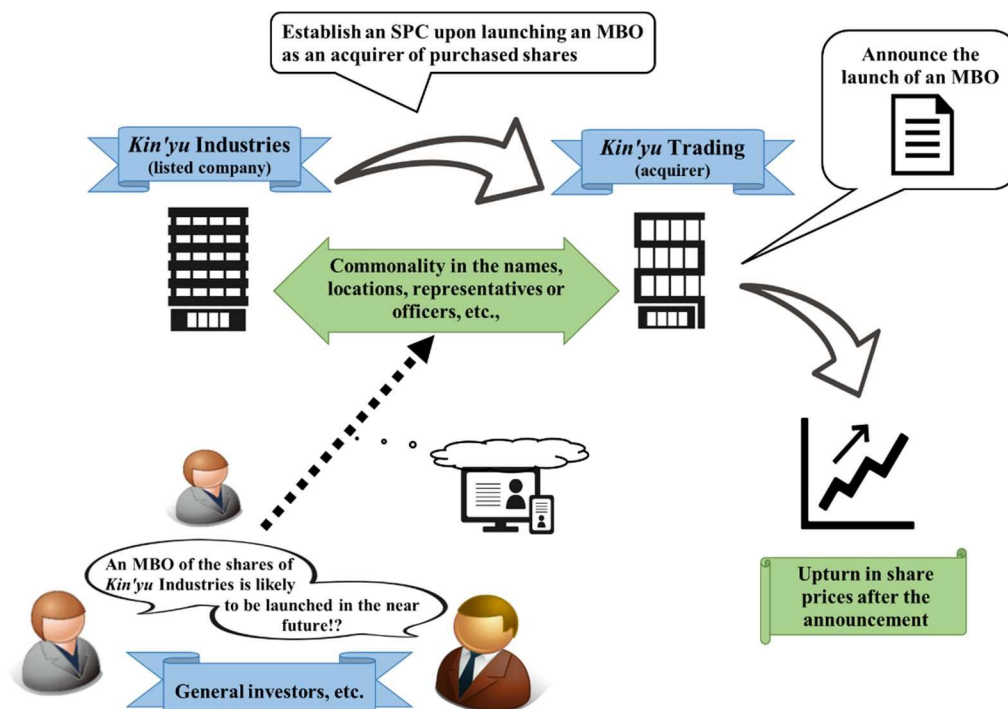
October 7, 2022  
Securities and Exchange Surveillance Commission

#### New Company (Special Purpose Company (SPC)) Established upon Management Buy-Out (MBO)

Upon launching a buy-out of a listed company's shares by its management team (so-called MBO), a new company (SPC) is sometimes established as an acquirer of purchased shares. However, there are cases where the name of the new company is easily associated with the relevant listed company or where the location, the representative and some officers of the new company are the same as those of the relevant listed company.

When establishing a new company upon launching an MBO, the new company's name, location, representative and officers, etc. (hereinafter referred to as "name, etc.") should be decided by the parties concerned, but if the relation between the new company and the listed company can be inferred relatively easily as in the cases mentioned above, it may be easy to anticipate the launch of an MBO of the listed company's shares in the near future.

If you consider establishing a new company upon launching MBO, you should discuss and decide with the parties concerned the name, etc. of the new company in consideration of the aforementioned possibility.



Please take care if you are planning to launch an MBO.

## 2 MONITORING OF FINANCIAL INSTRUMENTS BUSINESS OPERATORS, ETC.<sup>3</sup> (RECOMMENDATIONS FOR ADMINISTRATIVE DISCIPLINARY ACTIONS)

### 1. Purpose of Monitoring Securities Businesses

The SESC accurately recognizes the operational and financial status of FIBOs. If any problem regarding the adequacy of FIBOs business operations is found, the SESC, where necessary, recommends the Prime Minister and the FSA Commissioner to take appropriate measures, such as administrative disciplinary action, or provides necessary information to the supervisory departments in the FSA.

In this way, the SESC encourages FIBOs to establish proper governance and risk management systems, administer their businesses in accordance with laws, regulations and market rules, and fulfill their function as gatekeeper so that FIBOs play their role as market intermediaries appropriately and maintain a market environment in which investors are able to invest comfortably.

### 2. Achievements of Monitoring

FIBOs subject to the SESC's monitoring is a total of approximately 8,200, with different sizes, operations and lines of business. Some of these FIBOs have not had adequate understanding of legal and regulatory compliance and investor protection or systems needed to be in place. Consequently, it is important to monitor FIBOs efficiently and effectively in accordance with their respective characteristics based on the Basic Principles of Securities Business Monitoring and the annually published Monitoring Priorities for Securities Businesses so as to identify their risks at an early time. (See Figs. 2-1 and 2-2).

Since July 2016, in its monitoring of all FIBOs, the SESC has conducted risk assessment, focused on an analysis of business models and the appropriateness of risk management that supports the models, in collaboration with the relevant divisions of the FSA.

In FY2022, the SESC selected FIBOs for inspection based on the results of the risk assessment and closely looked at their conduct of business through inspection. In conducting inspection, the SESC scrutinized the FIBOs' products and trading schemes. When problems were detected, the SESC

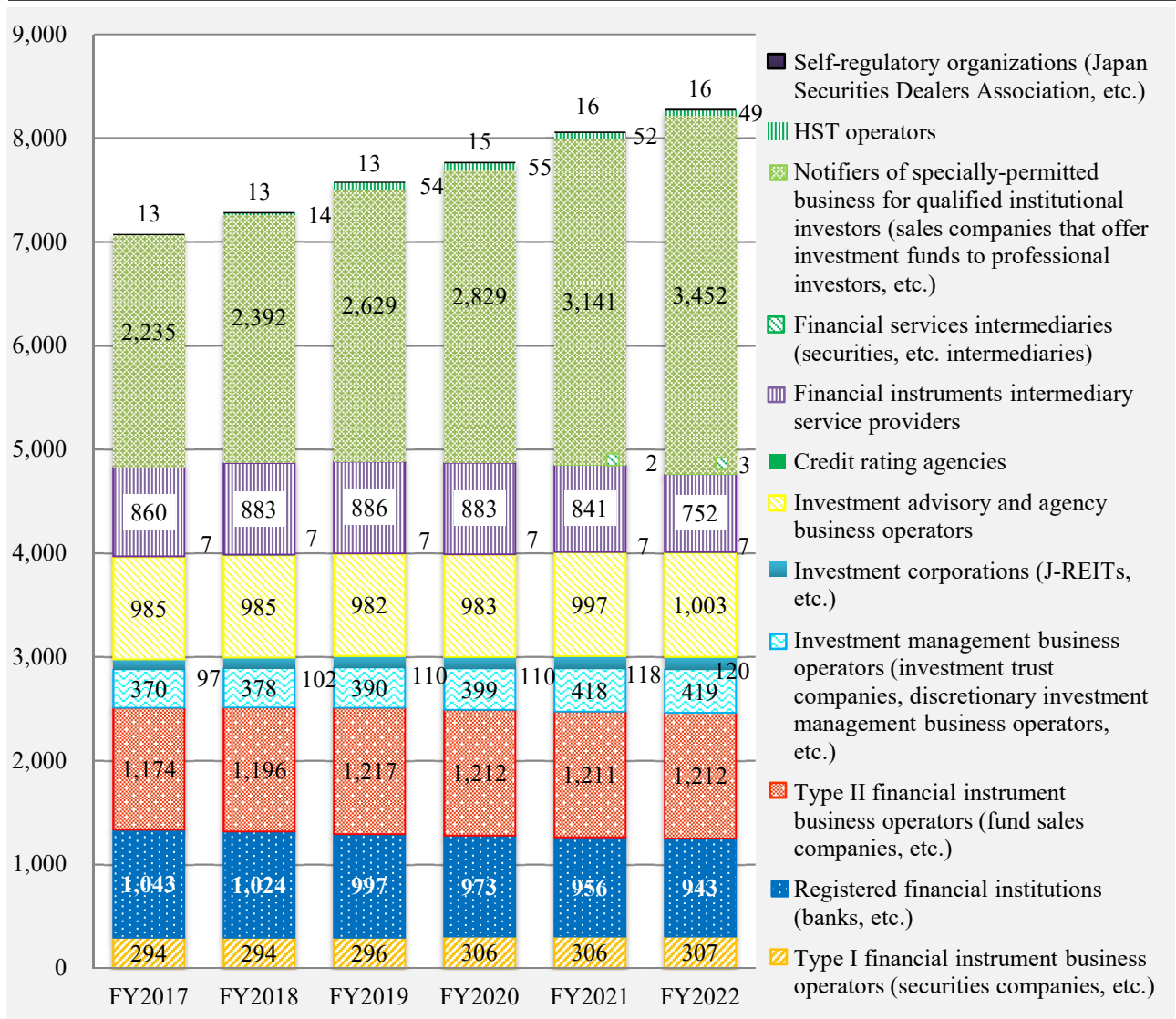
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<sup>3</sup> Financial instruments business operators (FIBOs), etc. refer to notifiers of specially-permitted business for qualified institutional investors, financial instruments intermediary service providers, and credit rating agencies, in addition to financial instruments business operators and registered financial institutions, that are subject to inspections under laws and regulations regarding SROs.

looked into their root causes and made recommendations for administrative disciplinary actions or informed the FIBOs of issues relating to their business operations.

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 inspection.

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



**Fig.2-2: Summary of Monitoring Priorities for Securities Businesses (BY 2022)<sup>4</sup>**

### Environment surrounding FIBOs

#### 1. Environment surrounding FIBOs

- Requirement for customer-oriented business conduct, progress in digitalization, increasing potential risk of cyberattacks, etc.

#### 2. Changes to regulatory frameworks for FIBOs

- (1) Revision of the firewall regulation between banking and securities businesses, (2) Review of explanations regarding solicitation for sale and switching of investment trusts, (3) Enhancement of supervisory responses to FIBOs' business acquisitions/mergers, etc.

#### 3. Findings through the securities business monitoring over the past business year

- Type I FIBOs: Inappropriate solicitation for switching investment trusts that was not economically rational, structured bond sales in a manner that did not reflect customer needs, failure to sufficiently reduce the risk of unauthorized withdrawal of customer funds through online trading, etc.

\* A large securities company was charged for suspicion of conducting market manipulation

- Investment management business operators: Movement of expanding investment in alternative assets by pension funds, etc., breach of duty of care as a prudent manager, such as insufficient due diligence, breach of duty of loyalty, such as inadequate conflicts of interest management

- Unregistered business operators: Financial instruments business operations without statutory registration (Intermediation for conclusion of discretionary investment contracts or solicitation for investment in financial instruments categorized as shares in foreign collective investment schemes)

\* Policy proposal regarding solicitation for investment in limited liability company membership rights through their employees.

### Industry-wide monitoring priorities

1. Developing internal control environments with a focus on appropriate investment solicitation based on the principle of suitability, and appropriate sales operations based on customer-oriented business conduct (In particular, sales of financial products with complex risk structures, such as structured bonds)
2. Business model changes along with progress in digitalization, etc., and the development of internal control environments in response to such changes
3. Sufficiency of cybersecurity measures, and system risk management (including those outsourced) in response to progress in digitalization
4. Firm establishment of internal control environments for AML/CFT
5. Implementation of measures to improve or prevent the recurrence of matters pointed out in internal audits or self-regulatory organization examinations

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

<sup>4</sup> BY 2022 refers to the period from July 1, 2022, to June 30, 2023.

Monitoring priorities by FIBOs' size and business type

Type I FIBOs	Major securities business groups	<ul style="list-style-type: none"> <li>Development of control environments for governance and risk management that support global business operations</li> <li>Efforts to build sustainable business models</li> <li>If necessary, the SESC will swiftly inspect relevant sales offices to examine their actual sales practices.</li> <li>Development of control environments for managing customer information and conflicts of interest in response to the revised firewall regulation between banking and securities businesses [3 mega banking groups]</li> </ul>
	Foreign securities firms	<ul style="list-style-type: none"> <li>Development of internal control environments in response to the overseas outsourcing of back-office operations and control environments for system risk management</li> <li>Development of control environments for managing sales of financial instruments to Japanese financial institutions and other investors</li> </ul>
	Online securities firms	<ul style="list-style-type: none"> <li>Development of control environments for system risk management, including cybersecurity measures</li> <li>Development of internal control environments in line with their business model changes, such as the initiatives to eliminate brokerage commissions, increases in products, and launch and expansion of face-to-face sales in collaboration with independent financial advisors</li> </ul>
	Semi-major/ regional securities firms	<ul style="list-style-type: none"> <li>Inappropriate solicitation and other conducts that are inappropriate from the viewpoint of investor protection, including whether following the principle of suitability</li> <li>Effectiveness of internal control environments at securities firms whose major shareholders or business management systems have changed, from the viewpoint of their business models or governance.</li> </ul>
	Foreign currency margin transactions business operators	<ul style="list-style-type: none"> <li>Development of control environments for system risk management, including cybersecurity measures</li> <li>Development of adequate internal control environments for relevant advertising and sales/solicitation regulations</li> <li>Disclosure of risk information, secure sufficient capital given their stress test results, and development of systems to retain and report transaction data.</li> </ul>
Investment management business operators	<ul style="list-style-type: none"> <li>Actual investment practices, development of control environments for managing investment (including those outsourced) and conflicts of interest, etc.</li> </ul>	
Investment advisors/agencies	<ul style="list-style-type: none"> <li>Misleading advertisement, solicitation through false explanation, etc.</li> </ul>	
Type II FIBOs, QII business operators, independent financial advisors, and others	<ul style="list-style-type: none"> <li>Funds claiming high returns and existence of investment projects, and as for solicitation for loan-type funds, the disclosure of information about loan borrowers and the screening of those funds, etc. [Type II FIBOs, business operators, etc., engaging in specially permitted businesses for qualified institutional investors (QII business operators)]</li> <li>Appropriateness of their investment solicitation and sufficiency of management by their entrusting FIBOs [Independent financial advisors]</li> <li>Risk-based securities businesses monitoring in light of their business characteristics [registered financial institutions, etc.]</li> </ul>	
Unregistered business operators	<ul style="list-style-type: none"> <li>Exercising investigative authority proactively to file a petition with the court for a prohibition and stay order against their illegal conduct</li> <li>Enhancing information dissemination, including the public disclosure of their and their representatives' names and illegal conduct, etc.</li> <li>Coordinating proactively with relevant JFSA divisions, Local Finance Bureaus, investigative authorities and the Consumer Affairs Agency.</li> </ul>	

\*The SESC will also verify FIBOs' response to the changes in regulatory frameworks.

### Approach to monitoring securities businesses

- The SESC will select FIBOs for inspection based on risk assessment from various viewpoints, including business models, in cooperation with relevant JFSA divisions. Inspection will be mainly conducted in cases where it is necessary to comprehend further details, such as:
  - ① a relevant law and/or regulation is breached or there is a deficiency in business operations that requires a prompt in-depth examination;
  - ② a financial instrument is offered with an unclear risk profile, necessitating an examination of its solicitation activities;
  - ③ the actual business operations are not fully comprehended from information analysis based on monitoring (including where there is a long period between examinations);
  - ④ There is a possible serious problem concerning investor protection (e.g., inadequate segregation of customer assets)
- In its inspections, the SESC will endeavor to conduct verification and point out problems in a practically meaningful manner, going further than just pointing out problems and taking actions such as making recommendation for administrative disciplinary actions, and analyzing the whole picture of the problems to identify their root causes, to help develop effective measures to prevent recurrence. Furthermore, if the SESC identifies the need to improve business operations before any potential issues materialize, it will describe such items as “Items to be noted” in the notification of completion of inspection, to share the awareness with the inspected FIBOs to encourage actions such as building effective internal control environments.

### Cooperation with relevant organizations and dissemination of inspection results

- The SESC and Local Finance Bureaus will work closely from the planning stage of monitoring and inspection and conduct joint inspection as needed.
- The SESC will continue close collaboration with self-regulatory organizations, share information with them in a timely manner, and thereby conduct its securities businesses monitoring effectively and efficiently.
- The SESC will share its inspection results also with inspected FIBOs’ audit-related staff and outside directors, and thereby encourage those FIBOs to voluntarily improve practices.

(Published in August 2022)

## (1) Type I financial instruments business operators

As for Type I financial instruments business operators (securities companies, etc.), the SESC in FY2022 verified the status of the development of internal control environments focusing on appropriate investment solicitation based on the principle of suitability, as well as the sufficiency of cybersecurity measures and the status of system risk management (including management of outsources) amid progress in digitalization.

Furthermore, the SESC proactively conducted inspection of, for example, companies that were plagued with concerns about specific cases of legal violations and business administration arrangements and needed to be subjected to in-depth investigation at an early stage and those that needed to be investigated with respect to their handling and solicitation of products with unclear risks.

Out of the 24 Type I financial instruments business operators for which inspection was completed in FY2022, the SESC notified 16 business operators of their problems found through inspection, and made recommendations for administrative disciplinary actions against two companies, including a case of making illegal purchases, etc. for the purpose of stabilizing market prices of listed shares, for their serious legal violations.

< Cases where a recommendation was made >

Company name	Overview
i SECURITIES Co., Ltd.  (Date of recommendation: Jun. 17, 2022)	The company operated a silent partnership fund without statutory registration, like made investment decisions as a substantial business operator.  Additionally, the company did not conduct screening sufficiently upon selling new financial instruments, such as publicly-offered investment trusts, and did not provide customers with material information for making investment decisions appropriately on a timely basis. The company's management structures and internal control environments were extremely sloppy.
SMBC Nikko Securities Inc.	In "block offer" deal (BO) the company illegally made a series of purchases and offers to purchase for 10 issues of listed shares for the purpose of stabilizing the market prices of these shares. And the aforementioned series of transactions was not included in the



(Date of recommendation: Sep. 28, 2022)	coverage of transaction screening and there was a deficiency in the company's control environment.  The company made an inappropriate customer solicitation which could induce short selling, such as providing a buying customer with an explanation which makes the execution date of the BO inferable. Additionally, since the time of introducing BO, the company had recognized concerns that buying customers' short selling of the issue subject to the BO would distort the price formation of the issue. However, the company conducted inappropriate business operations, such as commenced BO operations without appropriate discussions.  The company received from, or provided to the bank, which is its parent corporation, etc., undisclosed information on multiple corporate customers and shared such information within the company, despite recognizing that suspension of the information sharing was requested by those corporate customers.
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## **(2) Investment management business operators**

The SESC verified investment management business operators' investment status, and their development of control environments for investment management (including those outsourced) and conflict-of-interest management in order to fulfill their duties of loyalty to customers and of the due care of a prudent manager.

Out of the seven investment management business operators for which inspection was completed in FY2022, the SESC notified five business operators of their problems found through inspection, and made a recommendation for administrative disciplinary actions against one company that was found to have failed in engaging in investment management business faithfully on behalf of an investment corporation

< Case where a recommendation was made >

Company name	Overview
ES-CON Asset Management Ltd.	In managing assets entrusted by a real estate investment corporation, the company inappropriately urged a real estate appraisal company to raise the appraisal value of a piece of real estate owned by its

<p>(Date of recommendation: Jun. 17, 2022)</p>	<p>parent company, etc., which is an interested party, for the purpose of having the real estate investment corporation purchase the real estate at the price recommended by the parent company.</p> <p>Additionally, the company collected estimated appraisal values from multiple appraisal companies, and negotiated with the appraisal company that presented the highest amount so that the appraisal fee for the relevant appraisal company would become the lowest. Furthermore, the company hid the fact that the estimated amount of real estate appraisal of the appraisal company was the highest and selected it to entrust appraisal on the ground that its fee for appraisal was the lowest.</p>
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### **(3) Type II financial instruments business operators**

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

The SESC notified all three business operators for which inspection was completed in FY2022 of their problems found through inspection.

### **(4) Investment advisors/agencies**

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The SESC conducted monitoring of investment advisors/agencies to make sure that they were neither using advertisements that may mislead customers nor soliciting customers based on false explanations. The SESC also conducted inspection of investment advisors/agencies considered to carry high risks.

Out of the five investment advisors/agencies for which inspection was completed in FY2022, the SESC notified four of their problems found through inspection, and made a recommendation for administrative disciplinary actions against one company for its serious legal violations, such as having provided customers with false information upon concluding or soliciting conclusion of contracts for financial instruments transactions.

< Case where a recommendation was made >

Company name	Overview
Merchant Brains Investment Advisor Co., Ltd.  (Date of recommendation: Sep.30, 2022)	In mail magazines that the company delivered to likely customers who had subscribed free of charge, the company posted a statement that it had obtained some special information although it had not actually or other false information, and solicited conclusion of investment advisory contracts.  Additionally, in advertisements on the website that only likely customers can access, the company posted factually incorrect information, such as recommended dates for purchasing shares, dates on which gains by selling them are defined, and advance/decline ratios, of stocks on which the company did not provide advice, as the company's advice performance.

**(5) Petitions to the court for a prohibition order and stay order against acts in violation of the FIEA**

To prevent the spread of damage to investors from fraud caused by unregistered business operators, the SESC took rigorous actions against unregistered business operators, such as seeking the court to grant a prohibition order and stay order against their illegal acts in cooperation with the FSA, Local Finance Bureaus and other law enforcement authorities. As necessary, the SESC publicly disclosed the name of an unregistered business operator, the name of its representative, and the specifics of legal and regulatory violations.

< Cases where a petition was filed >

Respondent (Court with which the petition was filed)	Overview
Thousand Ventures Co., Ltd. and its manager <sup>5</sup>	Targeting members of the money school that the respondents organized, the respondents had (i) solicited shares in collective investment schemes, etc., (ii) engaged in intermediation for over-the-counter derivative transactions, and (iii) solicited a corporate

<sup>5</sup> See "4 INSPECTION ON VIOLATIONS OF DISCLOSURE REGULATIONS (RECOMMENDATIONS FOR ADMINISTRATIVE MONETARY PENALTY PAYMENT ORDERS)."

<p>Date of petition filing: Jun. 28, 2022 Date of injunction Order: Oct. 6, 2022 (Tokyo District Court)</p>	<p>bond issued by another company on a regular basis without statutory registration (i.e. unregistered business operation), thereby collecting around 1.7 billion yen from at least around 1,100 general investors in total. Furthermore, they made a public offering of its corporate bonds without filing a Securities Registration Statement.</p>
<p>President of Mt. light (MTL)  Date of petition filing: Dec. 9, 2022 Date of injunction Order: Feb. 28, 2023 (Tokyo District Court)</p>	<p>The respondent had OS-Laugh Marketing Ltd. located in Labuan Island, Malaysia, offer foreign exchange margin transactions (over-the-counter derivative transactions) to general investors in Japan under the name of Mt. light (MTL) on a regular basis without statutory registration (i.e. unregistered business operation), thereby collecting over 8.5 billion yen from at least around 1,950 general investors in total.</p>

## (6) Items to be noted

In conducting inspection, 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 the control environments of business operation although problems have yet to materialize, the SESC has described the situation as items to be noted in the notifications of completion of inspection to share awareness with the inspected FIBOs and urged them to build effective internal control environments.

< Concrete example >

### •Strengthening of the structure for information provision on distributors, etc.

For publicly-offered investment trusts targeting retail investors, it is required to provide information accurately in an easy-to-understand manner in accordance with the complexity of individual financial instruments and services. However, information sharing and collaboration among related departments of the company are not sufficient on providing information to investors.

From the viewpoint of retail investors, the company needs to strengthen its structure for information provision by sharing understanding of what information should be provided with investors in what manner and making collaborative efforts among related departments.

### 3. Future Challenges

#### **(1) Strengthening monitoring of securities businesses**

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While the number of business operators subject to the SESC's securities business monitoring has increased to approximately 8,200 in total, and their sizes and business details are diverse. Furthermore, there are business operators that still do not have adequate systems in place for compliance with fundamental laws and regulations or for investor protection. Therefore, it is necessary to conduct securities business monitoring of such FIBOs effectively and efficiently.

Accordingly, the SESC will continue selection of securities business monitoring targets through a risk-based approach, and will conduct monitoring flexibly and proactively, by conducting inspections that narrowing down items to be verified as necessary, thereby further strengthening monitoring of securities businesses in order to detect challenges and problems of FIBOs at an early stage.

#### **(2) Enhancing feedback**

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In conducting inspection, the SESC will not only point out problems and take actions, such as making recommendations for administrative disciplinary actions, but also analyze the whole picture of the problems and identify their root causes to provide feedback that helps FIBOs develop effective measures to prevent problems.

Furthermore, the SESC will provide feedback on the results of inspection 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.



## Beware of persons who solicit investment products without registration

### Message to investors

#### 1. Financial instruments business operators without registration (unregistered FIBOs)

Persons who conduct the following acts without statutory registration **are violating the FIEA.**

- Soliciting or arranging customers to sign contracts for investment in a project by explaining that dividends would be paid to investors from earnings from the project.
- Soliciting customers to acquire investment instruments sold by foreign business operators and arranging them to conclude contracts for the acquisition
- Providing investment advice to customers in exchange for payment, such as by offering to tell them of stock names expected to see price hikes
- Offering or intermediating FX trading by foreign business operators to/with Japanese resident customers
- Foreign business operators' activities, such as conducting asset management entrusted by Japanese resident customers (\*management of customer assets from an overseas business base is prohibited) or managing partnership-type funds in which multiple Japanese resident customers invest, etc.

⇒ Persons who conduct these acts on a regular basis are required to be properly registered with the national government under the FIEA.

Investors, before making an investment, should sufficiently consider from various viewpoints for example, by checking the FSA's website in advance whether or not a solicitor is registered. It is legally prohibited to use any trade name, etc. similar to those of a registered FIBO.

#### 2. Unregistered FIBOs causing damage to investors

**Fraudulent** cases leading to damage to investors and their **troubles** with unregistered FIBOs **occur frequently.**

\*Unregistered FIBOs are beyond authorities' supervision or administrative disciplinary actions under the FIEA.

- An investor conducted FX trading with a foreign business operator as recommended by a person with whom he/she had become acquainted via social media, but failed to obtain realized profits as the business operator insisted on the need to pay tax for withdrawal, and later the investor lost contact with the business operator and the acquaintance.
- An investor paid a high price to buy a USB memory stick from a friend, who claimed that the memory stick contained knowhow for secure money-making transactions. The investor made transactions with a foreign unregistered FIBO as recommended but incurred massive losses.
- An investor was recommended to invest in membership rights of a limited liability company by a colleague, who explained that they are highly profitable and safe based on their past performance, that a refund would be available at any time, and that he/she had already invested in them. The investor successfully received refunds as requested for some time but became unable to do so later.

- An investor became interested in binary option transactions when seeing blog and SNS posts including successful investment experiences and started transactions with a foreign business operator. Later, even though the investor should have been making a profit on the transactions, the foreign business operator rejected the investor's request for withdrawals.

There are many fraudulent business operators who conduct little business but solicit investment by vowing to guarantee principal repayment and profit, causing damage to many investors.

They may repay the principal or pay dividends to some investors **depending on investment from other investors** in order to **pretend** to be doing business. **Even if they pay dividends one or two times, investors should be aware that they may be taking advantage of such payments in order to simply appear to be doing business.**

## **3 INVESTIGATION INTO MARKET MISCONDUCT (RECOMMENDATIONS FOR ADMINISTRATIVE MONETARY PENALTY PAYMENT ORDERS)**

### **1. Purpose of Investigation into Market Misconduct**

The SESC investigates insider trading, market manipulation, the spread of rumors, the use of fraudulent means and other suspected market misconduct subject to an administrative monetary penalty payment order, pursuant to the FIEA.

Keeping in mind timely market oversight is required in response to changes in market environment, the SESC conducts prompt and efficient investigation with the possibility of issuing recommendations for administrative monetary penalty payment orders, in order to deter misconduct, ensure the fairness and transparency of markets, and protect investors.

### **2. Overview of Cases in FY2022**

The SESC promptly and efficiently investigates suspected market misconduct cases through the active use of the administrative monetary penalty system. In FY2022, there were 14 cases of market misconduct (eight cases of insider trading and six cases of market manipulation) for which the SESC made recommendations for administrative monetary penalty payment orders.

#### **(1) Insider trading**

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In FY2022, there were eight cases of insider trading for which the SESC made recommendations for administrative monetary penalty payment orders (see Fig. 3-1).

Of the six violators who engaged in insider trading, three individuals (50.0%) were corporate insiders and the other three (50.0%) were primary recipients of information from corporate insiders. The three corporate insiders included an employee of a listed company and two in the category of contract negotiators with listed companies or such negotiators' director or employee. Of the three primary recipients of information, two were relatives and one was an acquaintance of information providers (See Fig. 3-2).

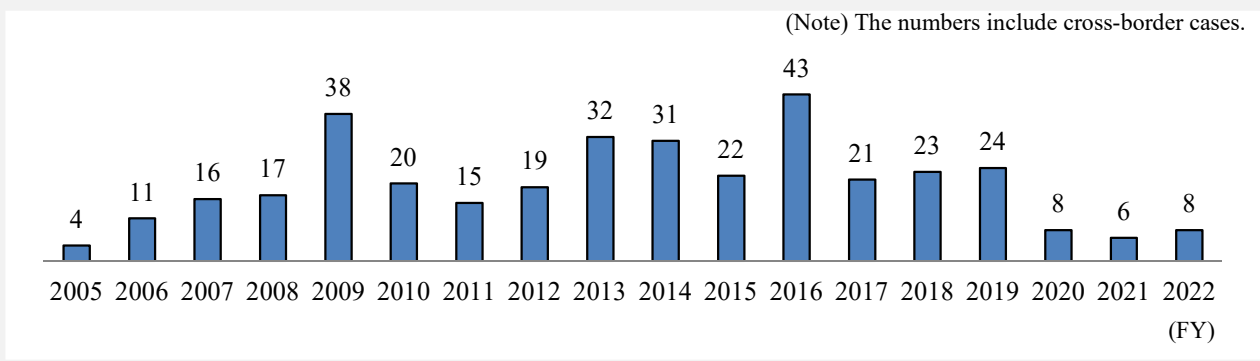
There were no cases of insider trading and information provision by directors of listed companies, but there were three cases of insider trading through information provision by employees of listed companies (of which, one was a case of violation of the regulations on the provision of insider information). Listed companies are required to develop a structure for managing insider information,



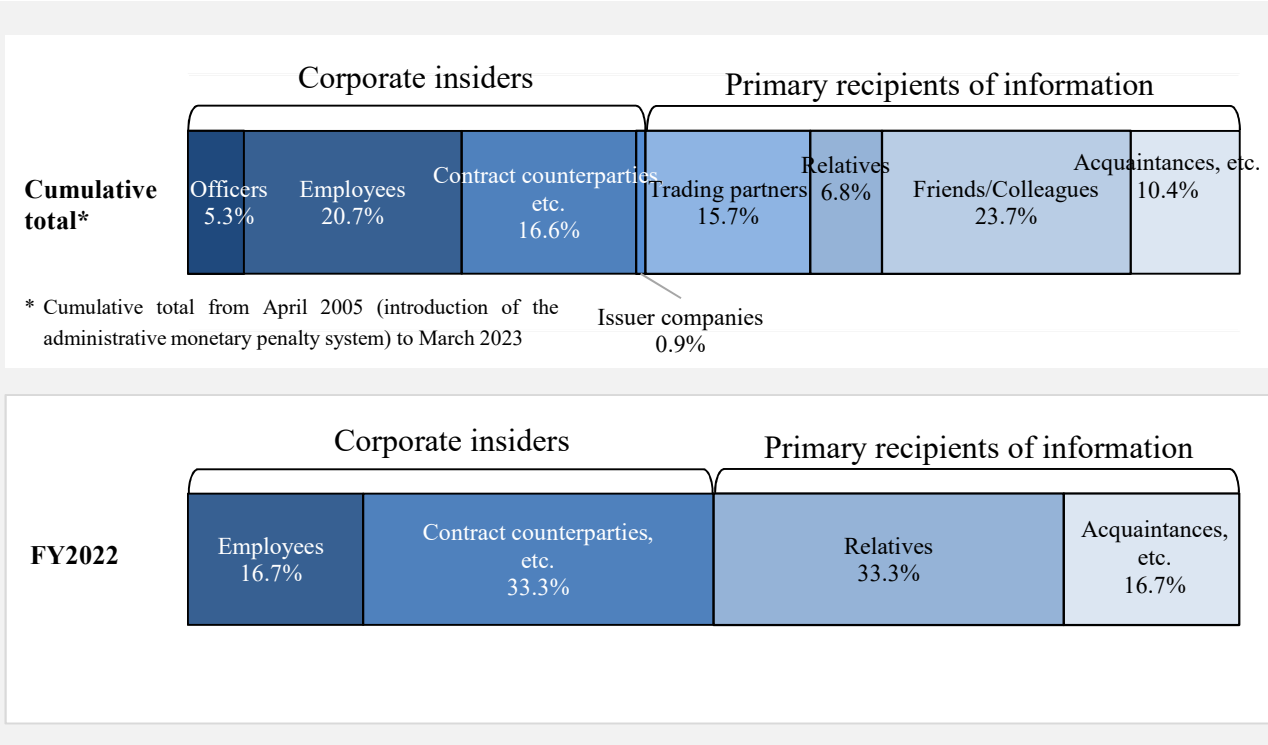
but it was found that insider trading was caused by employees' provision of insider information to others even without the need to do so in the course of duties.

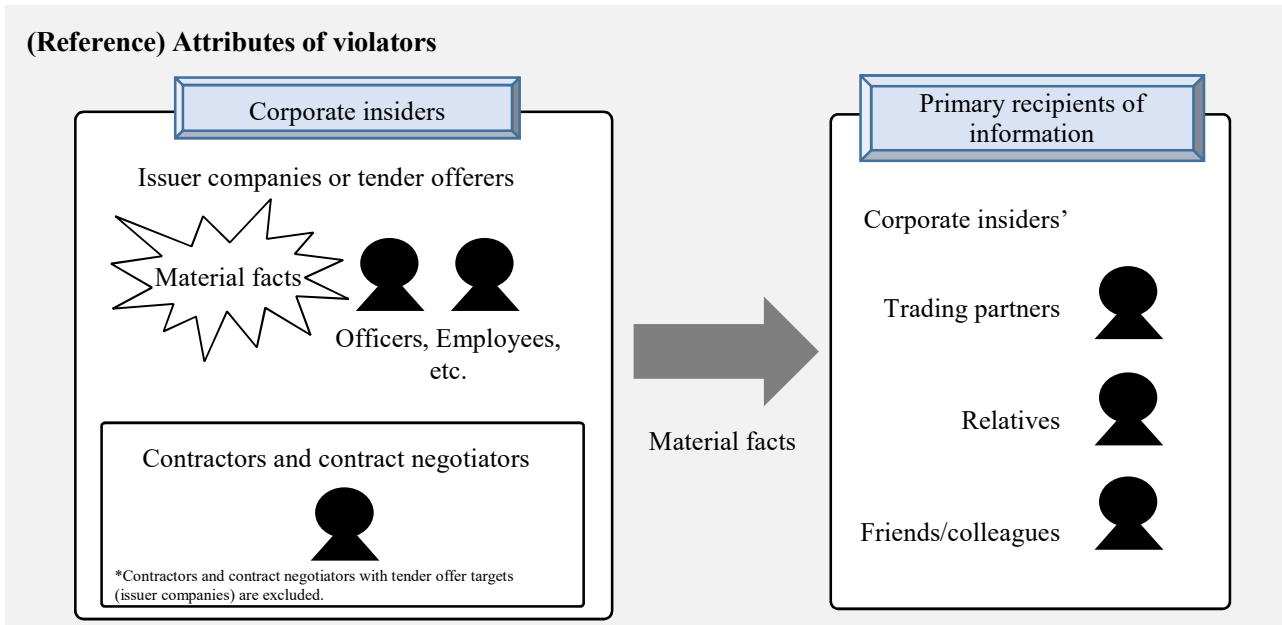
There was one case of violation of the regulations on the provision of insider information and there were three cases of violation of the regulations on transaction encouragement. In two of those three cases, the violators themselves engaged in insider trading in addition to encouraging others to do so.

**Fig. 3-1: Changes in the numbers of insider trading cases for which recommendations for administrative monetary penalty payment orders were made**



**Fig. 3-2: Attributes of violators of insider trading regulations**

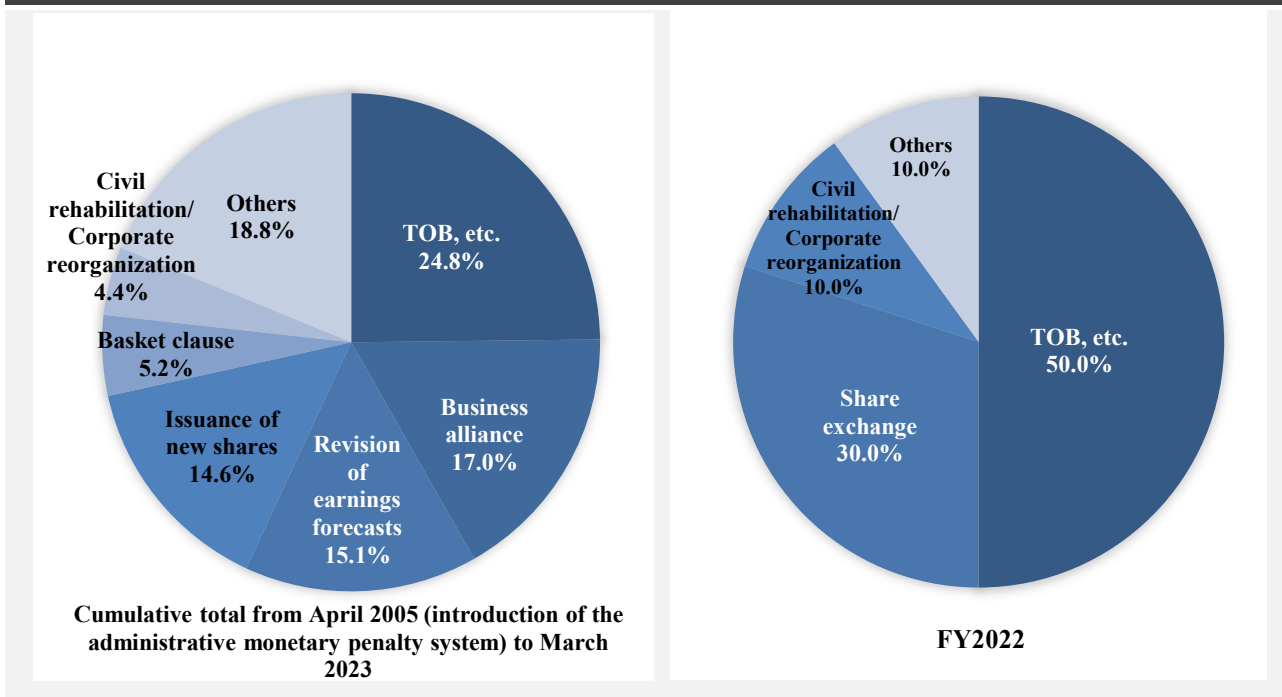




In FY2022, the SESC made a total of eight recommendations concerning 10 material facts (the number of recommendations and the number of material facts do not match because there were cases in which those aware of multiple unpublished material facts conducted insider trading). The 10 material facts included five related to tender offers (50.0%), three related to share exchange (30.0%), and one related to the revision of earnings forecasts (10.0%). The shares for tender offers remained high (See Fig. 3-3).

In general, when negotiating tender offers or other deals with various outside parties, the time from the decision-making on material facts to their publication is apt to be prolonged. Corporate insiders therefore need to keep confidentiality more carefully.

**Fig. 3-3: Breakdown of insider trading cases by material fact**



Through its insider trading investigation, the SESC found that although listed companies had established internal rules for preventing insider trading, some of them failed to have the rules fully understood within the company or otherwise failed to prescribe internal rules to prevent insiders from encouraging the purchase and sale of their securities to others.

< Major case of insider trading >

Case	Date of recommendation Amount of administrative monetary penalty	Overview and key points
An employee of a financial institution had obtained a material fact, etc. in the course of duties and purchased relevant shares prior to the announcement of the fact, etc. and also encouraged his relative to purchase them for the purpose of letting the relative earn profits.	Sep. 2, 2022 1,630,000 yen	<ul style="list-style-type: none"> <li>▪ A violation by an employee of a financial institution</li> <li>▪ The wrongdoer used a securities account under another person's name.</li> <li>▪ The SESC made a recommendation for the violation of the insider trading regulations and the regulations on transaction encouragement.</li> </ul>

< Major case of transaction encouragement >

Case	Date of recommendation Amount of administrative monetary penalty	Overview and key points
An employee of a listed company had come to know of a planned tender offer in the course of duties and encouraged his acquaintance to purchase relevant shares for	Sep. 9, 2022 210,000 yen	<ul style="list-style-type: none"> <li>▪ Internal rules of the company did not contain the regulations on encouragement of trading, and the illegality had not been broadly disseminated in internal training or on other occasions.</li> </ul>

the purpose of letting the acquaintance earn profits.

## (2) Market manipulation

In FY2022, the SESC made recommendations for administrative monetary penalty payment orders for six cases of market manipulation, including one cross-border case.

In recent years, market manipulation schemes have become increasingly complicated and sophisticated. In FY2022, a wrongdoer repeated cross trades accompanied with share price hikes while supporting lower price levels by increasing buy orders by the use of multiple securities accounts, including those under other persons' names, thereby inducing transactions of third parties; and another wrongdoer engaged in spoofing in Japanese Government Bond (JGB) Futures while trading Options whose underlying assets were JGB Futures.

< Major case of market manipulation >

Case	Date of recommendation Amount of administrative monetary penalty	Overview and key points
A retail investor repeatedly pushed up prices and conducted cross trades for shares of listed companies to manipulate market prices.	Jun. 28, 2022 4,150,000 yen	<ul style="list-style-type: none"> <li>The wrongdoer used three accounts under his name and one account under a name of his relative.</li> </ul>

< Case of cross-border market manipulation >

Case	Date of recommendation Amount of administrative monetary penalty	Overview and key points
An overseas corporation engaged in market manipulation known as spoofing in JGB Futures.	Jun. 21, 2022 42,850,000 yen	<ul style="list-style-type: none"> <li>Traders, who worked for a registered High-Speed Trader, manually placed large orders without intent to execute them.</li> </ul>

### 3. Future Challenges

#### **(1) Appropriate application of laws and regulations**

There were many cases of insider trading by persons who were informed of material facts, etc. or were encouraged to engage in trading by corporate insiders, such as employees of listed companies. When telling a material fact to another person or encouraging another person to engage in trading for the purpose of letting other person earn profits, such act of the information provider falls under violation of the regulations on the provision of insider information or violation of the regulations on transaction encouragement even if the information provider him/herself does not engage in trading. The SESC will appropriately apply laws and regulations to information provision and transaction encouragement by such insiders of listed companies.

In many of the market manipulation cases, market manipulation was conducted using multiple securities accounts under the wrongdoers' names and those under other persons' names. The SESC cooperates with exchanges, securities companies and other market stakeholders to persistently monitor markets. Even if wrongdoers use accounts under borrowed names in an attempt to avoid detection by authorities, the SESC will analyze transaction data, etc. in detail to identify persons who conducted problematic transactions at an early stage, and appropriately apply laws and regulations.

#### **(2) Scrutiny into cross-border transactions**

With respect to market misconduct involving cross-border transactions, the SESC will find facts through extensive collaboration and information exchange with foreign authorities in an effective and efficient manner under the Multilateral Memorandum of Understanding Concerning Consultation and

Cooperation and the Exchange of Information (MMoU) formulated by the International Organization of Securities Commissions (IOSCO).

### **(3) Enhancing dissemination of information**

As a means of enhancing market discipline, the SESC appropriately distributes information<sup>6</sup> after making recommendations by website posting, press briefings and “Message to the Markets.”<sup>7</sup> The SESC also gives lectures, contributes articles on a variety of topics and publishes “Casebook of Administrative Monetary Penalties.” The SESC will continuously endeavor to enhance its external communications and provide easy-to-understand explanations of cases for administrative monetary penalty order recommendations. The SESC will also use various opportunities to tell investors and company officials that violation of the FIEA can occur not only in relation to their insider trading, but also in relation to their provision of information on unpublished material facts to others and their encouragement of others to make transactions based on such material facts. These efforts are intended to forestall market misconduct.

### **(4) 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, such as SNS, have become diverse, and the volume of data contained by such tools has expanded. In response, the SESC will work to further improve its digital forensics technology.

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<sup>6</sup> For example, the FSA and the SESC have published "FAQ Regarding Insider Trading Regulation" to allow ordinary people to make fair investment in stocks and other products without worries.

<sup>7</sup> In April 2019, the SESC email newsletter was revamped and renamed “Message to the Markets”  
<https://www.fsa.go.jp/sesc/message/index.html>

## 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—

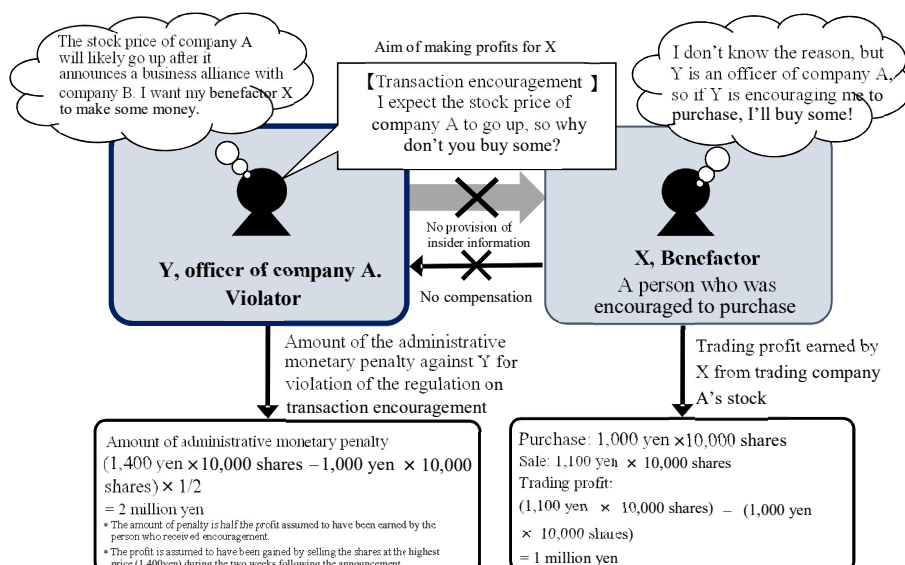
### Message to company insiders and person affiliated with Tender Offer

Since the regulations on the provision of insider information and on transaction encouragement were introduced in April 2014, the SESC has made recommendations for a total of 29 cases of the violation of the relevant regulations. In FY2022, the SESC made recommendations for one case of the violation of the regulations on the provision of insider information and three cases of the violation of the regulations on transaction encouragement.

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, the SESC recognizes that some companies do not have rules that prescribe 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.



## Watching derivatives transactions

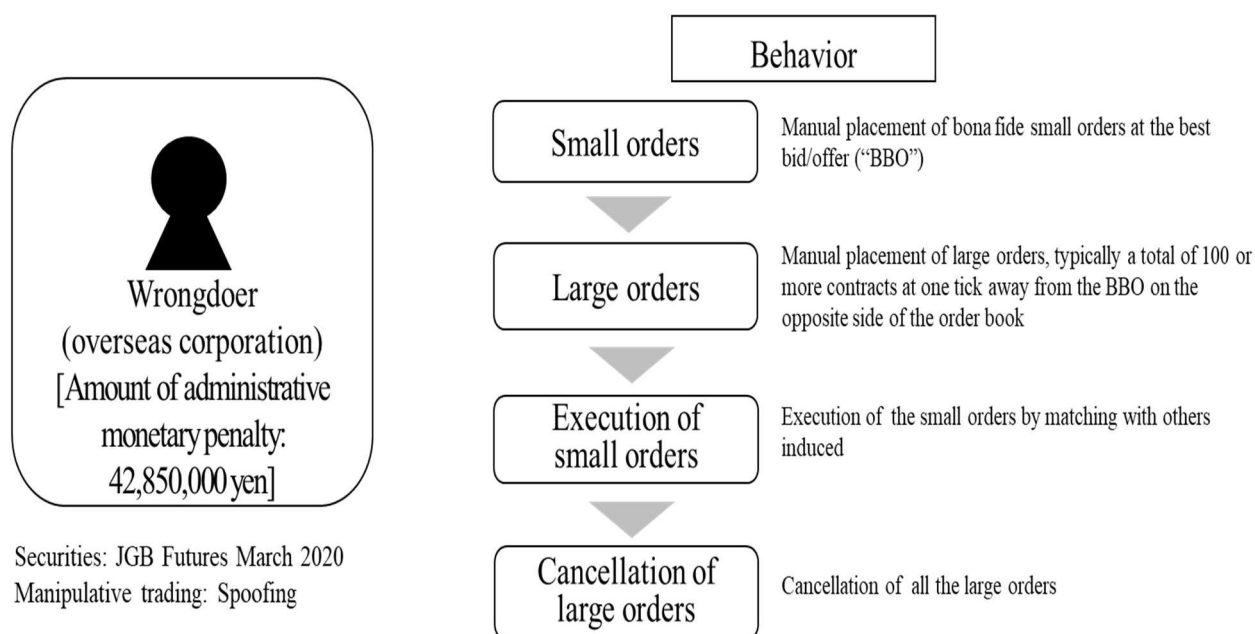
### Message to market participants

The SESC also monitors transactions of derivatives such as stock price index futures and long-term government bond futures, and has made recommendations for administrative monetary penalty payment orders in the matters of market manipulation in TOPIX Futures and Japanese Government Bond (JGB) Futures by domestic and foreign institutional investors.

In FY2022, the SESC made a recommendation for administrative monetary penalty payment order against an overseas corporation trading **Options on JGB Futures (Options)**, whose underlying assets were **JGB Futures (Futures)**. For the purpose of hedging a risk such as delta<sup>\*1</sup> at trading Options, the corporation engaged in market manipulation known as “spoofing”<sup>\*2</sup> in Futures while trading them. See the following chart.

\*1 Delta is a risk indicator at trading options in general, which represents the rate of change of an option value relative to a change in the price of the underlying assets.

\*2 Spoofing is a manipulative trading to place orders without intent to execute them for the purpose of inducing others, thereby manipulating supply and demand, and taking advantage of induced others' orders to execute one's own orders at an advantageous price on the opposite side of the order book.



In cooperation with the Japan Exchange Regulation and foreign regulatory authorities, the SESC is conducting surveillance on financial derivatives markets.



## **4 INSPECTION ON VIOLATIONS OF DISCLOSURE REGULATIONS (RECOMMENDATIONS FOR ADMINISTRATIVE MONETARY PENALTY PAYMENT ORDERS)**

### **1. Purpose of Disclosure Statements Inspection**

The FIEA's disclosure regulations are aimed at protecting investors by providing them with material information for making appropriate investment decisions in primary and secondary markets. Specifically, issuers of securities are required to submit disclosure documents, such as Securities Registration Statements and Annual Securities Reports, which provide details on their business profiles and financial conditions, among others. The Prime Minister makes these disclosure documents available for public inspection, allowing such information to be disclosed to investors.

Investors are thus enabled to make investment decisions based on the disclosure documents submitted by the issuers of securities. If such documents contain false information or lack information that should have been included, investors who base their investment decisions on such documents may unexpectedly suffer losses.

To avoid such a situation, the SESC inspects disclosure statements. If the submitted documents contain false statements, the SESC requires those submitters to make corrections for the purpose of providing correct information to investors and makes recommendations for administrative monetary penalty payment orders against securities issuers who have violated disclosure regulations by including materially false information in the documents. The SESC is also engaged in various initiatives to prevent occurrences or recurrences of violations of disclosure regulations.

### **2. Disclosure Statements Inspection and Trends of Violations in FY2022**

In FY2022, the SESC collected and analyzed information with a focus on the risk of listed companies violating disclosure regulations and identified suspected violators at an early time, conducting flexible and multi-faceted disclosure statements inspection.

Through these activities in FY2022, the SESC conducted 24 cases of disclosure statements inspection, including those continued from FY2021, and completed 11 cases. In seven of the completed cases, the SESC found material misstatements and other violations in disclosure statements, such as securities reports, and made recommendations for administrative monetary penalty payment orders. Additionally, for one case in which a wrongdoer was found to have violated the FIEA by conducting public offering without submitting a securities registration statement, the SESC filed a petition with the court for the issuance of a prohibition order, etc.

In addition, for the inspection cases where disclosure documents needed to be amended, the SESC encouraged the submitters of these documents to voluntarily file amended reports

In cases where violations of disclosure regulations were identified through inspection, the SESC discussed with the management of the listed companies the background and causes of such violations, regardless of whether the violations resulted in recommendations for administrative monetary penalty payment orders. By sharing awareness of the issues with them, the SESC encouraged them to develop internal systems for proper information disclosure, in order to prevent recurrences of violations. Concerning listed companies that were not very active in developing and operating such internal systems, the SESC cooperated with relevant organizations (FIEs, audit firms and others) in preventing recurrences of similar violations of disclosure regulations.

**(1) Cases where a recommendation for administrative monetary penalty payment order was made**

< Major cases where a recommendation was made >

Overview	Date of recommendation Amount of administrative monetary penalty	Background and cause of inappropriate accounting practices
<ul style="list-style-type: none"> <li>▪ The company conducted inappropriate accounting practices, such as the advanced booking of sales and booking of fictitious sales, etc.</li> <li>▪ Transactions with a company for which a majority of its voting rights is held by a person who is substantially a major shareholder of the company and who is equivalent to an officer were not disclosed in the Notes on "Transactions with Related Parties."</li> </ul>	<p>Apr. 26, 2022 46,050,000 yen</p>	<ul style="list-style-type: none"> <li>▪ The solar power generation business was considered a sanctuary.</li> <li>▪ Officers shared the awareness of placing importance on business performance.</li> <li>▪ Critical operations were executed without going through resolutions of the board of directors or board resolutions were otherwise neglected.</li> <li>▪ The effectiveness of internal audits was not secured sufficiently.</li> </ul>

4 INSPECTION ON VIOLATIONS OF DISCLOSURE REGULATIONS (RECOMMENDATIONS FOR ADMINISTRATIVE MONETARY PENALTY PAYMENT ORDERS)

<ul style="list-style-type: none"> <li>▪ The company conducted inappropriate accounting practices, such as the overstatement of sales by fictitious deals, understatement of selling expenses and general and administrative expenses, and overstatement of software in progress.</li> </ul>	<p>Jun. 23, 2022 69,250,000 yen</p>	<ul style="list-style-type: none"> <li>▪ Top management lacked a sense of compliance and an attitude to disregard compliance had prevailed in the company. Thus, the compliance did not function well.</li> <li>▪ Internal control had been made invalid.</li> <li>▪ Authority was concentrated solely in the company's former director.</li> <li>▪ Top management that should take charge of governance got involved in the misconduct and the auditors' audits did not function well. The company utterly failed to make corporate governance function properly.</li> </ul>
<ul style="list-style-type: none"> <li>▪ The company conducted inappropriate accounting practices, such as the overstatement of sales to overseas subsidiaries that should be included in the scope of consolidation and understatement of the provision for allowance for doubtful accounts.</li> <li>▪ The existence and the details of a material event, etc.<sup>8</sup> were not disclosed in annual securities reports, etc.</li> </ul>	<p>Dec. 9, 2022 205,730,000 yen</p>	<ul style="list-style-type: none"> <li>▪ The company's business attitude represented by its former chairman, who insisted on drawing up unrealistic sales budgets, put pressure on officers and employees under his control to achieve those sales budgets.</li> <li>▪ Strongly motivated to avoid disclosing the material event, the former chairman himself concealed the fact regarding companies over whose decision-making bodies he had effective control and excluded those companies from the scope of consolidation, booked sales to those companies or otherwise made the</li> </ul>

<sup>8</sup> A material event, etc. refers to an event or a situation that gives rise to any material doubt as to the assumption that the company will continue its business activities in the future.

<ul style="list-style-type: none"> <li>Upon amending the aforementioned inappropriate accounting treatment and non-disclosure of the material event, the company filed the amendment report, etc. containing many false statements, such as inconsistencies between the balance sheet and profit-and-loss statement.</li> </ul>		<ul style="list-style-type: none"> <li>company appear to have achieved profitability.</li> <li>Internal control and internal audits did not function well.</li> <li>The company did not have personnel with the capacity to prepare amendment reports, and therefore submitted an amendment report, etc. containing many false statements, without verifying the content sufficiently.</li> </ul>
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## (2) Petitions to the court for the issuance of prohibition orders, etc. against public offering of securities without statutory notification

In order to prevent the spread of damage to investors caused by persons who conduct public offering of securities without statutory notification, the SESC has responded harshly by properly exercising its investigation authority to file petitions with the court for the issuance of prohibition orders, etc. against violations, in cooperation with the FSA, Local Finance Bureaus, etc. and investigative authorities, and by publishing the names of persons who conduct public offering without statutory notification, the names of their representatives, and the details of the violations, etc. as needed.

< Case where a petition was filed >

<b>Respondent</b> (Court with which the petition was filed)	<b>Overview</b>
Thousand Ventures Co., Ltd. and its manager <sup>9</sup>  Date of petition filing: Jun. 28, 2022 Date of injunction Order: Oct. 6, 2022 (Tokyo District Court)	When issuing the company's bonds (with the same maturity period and interest rates) targeting general investors in Japan, the company and its manager conducted solicitation for acquisition of securities (the company's bonds) without submitting a securities registration statement (violation of Article 4, paragraph (1) of the FIEA). Additionally, they had customer investors acquire the securities

<sup>9</sup> In this case, a petition was also filed against unregistered business operation (see "2 MONITORING OF FINANCIAL INSTRUMENTS BUSINESS OPERATORS, ETC. (RECOMMENDATIONS FOR ADMINISTRATIVE DISCIPLINARY ACTIONS)").

before the effectuation of the notification (violation of Article 15, paragraph (1) of the FIEA).

### **(3)Others**

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Even in cases where findings of inspections were not to the point of material misstatements that could affect investment decisions in companies in question, the SESC encourages the submitters of these disclosure documents to voluntarily file amended reports to provide accurate information to investors.

In cases where defects in internal control are identified through inspection of a company's disclosure statements, the SESC discusses corrective measures and improvement plan with the management of the company to forestall violations of disclosure regulations.

## **3. Future Challenges**

### **(1) Upgrading analysis capabilities**

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The SESC will gather and analyze information on listed companies with a focus on the risks of violating disclosure regulations which are triggered by the growing complexity of transactions, increasingly globalized companies, and diversification and transformation of business models. The SESC will also conduct flexible and multi-faceted disclosure document inspection in order to detect and correct violations of disclosure regulations at an early time

### **(2) Actions to prevent occurrence or recurrence of violations of disclosure regulations**

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#### (i) Sharing awareness with management

If listed companies violate disclosure regulations, the SESC will discuss the background and causes of such violations and share awareness with the companies' management, to encourage them to develop and operate systems for adequate information disclosure to prevent the occurrence or recurrence of such violations. If listed companies are not active in developing and operating such information disclosure systems, the SESC will share information on such listed companies with FIEs and relevant audit firms as necessary.

#### (ii) Enhancing dissemination of information

In an effort to prevent violations of disclosure regulations, the SESC has always delivered as clear explanations as possible when providing information on cases where recommendations for monetary penalty payment orders were made (on the SESC's website, at media briefings,

etc.). By annually publishing a case book presenting actual cases of violations identified through inspections, the SESC also promotes listed companies' internal discussions towards appropriate information disclosure and dialogue between listed companies and their certified public accountants/audit firms. Through active communications with stakeholders, the SESC will continue its efforts to prevent the occurrence or recurrence of violations of disclosure regulations.

### **(3) Strengthening of the capability to address non-traditional and new types of violations**

In consideration of changes in the environment surrounding the markets, the SESC will also take proactive actions against non-traditional and new types of violations that may threaten market fairness (such as legally-evasive large volume holding and purchase, and specified involvement<sup>10</sup>), while continuously addressing types of violations seen in the past cases of making recommendations for administrative actions.

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<sup>10</sup> An act which facilitates the submission, etc. of fake disclosure documents, etc. or an act which incites the former act

## Are your internal control and governance systems okay?

### Message to listed companies (2)

In cases where materially false statements that could affect investors' decisions were found in disclosure documents through our recent disclosure documents inspection, we identified the following backgrounds and causes, including the management's lack of compliance consciousness and dysfunctional internal control and governance systems:

- Top managing leaders' corporate cultures that give top priority to earnings in defiance of compliance with law were dominant.
- The management lacked a sense of compliance as seen in a case where a director him/herself got involved in a misconduct, and a corporate culture of disregarding compliance has been developed.
- The management lacked awareness of operational risks, and a monitoring system by the board of directors, etc. was insufficient.
- One director hold key authority over a company's finance and accounting and personnel appraisal except sales activities and his/her instruction had strong coercive force backed by his/her dominant position in the company.
- A company did not check the appropriateness of daily accounting procedures of overseas subsidiaries and also failed to develop a system to enable easy checking.
- Arrangements to check responsible persons' business practices in an organized manner were absent.
- Internal control and audit systems were dysfunctional, as officials in charge of internal control worked for other departments to be audited and internal control rules failed to be established clearly.
- Inside and outside auditors were dysfunctional, failing to make important points or questions while attending board of directors meetings.

Given the above, listed companies are required to develop arrangements for appropriate information disclosure to prevent and forestall disclosure regulation violations.

To this end, administrators (including management executives) and others at listed companies are required to be highly conscious of compliance and check if governance of their companies is substantial, rather than nominal, if effective internal control is secured, and if arrangements for appropriate information disclosure are working.

We believe that auditors and non-executive directors should fulfill their essential role of checking directors' business conduct independently to prevent corporate scandals, including disclosure regulation violations.

Furthermore, we believe that sufficient communication becomes more important, including one between listed company and their accounting auditor, i.e. certified public accountant and

auditing firm, as well as constructive dialogue between investor and listed company as investee.

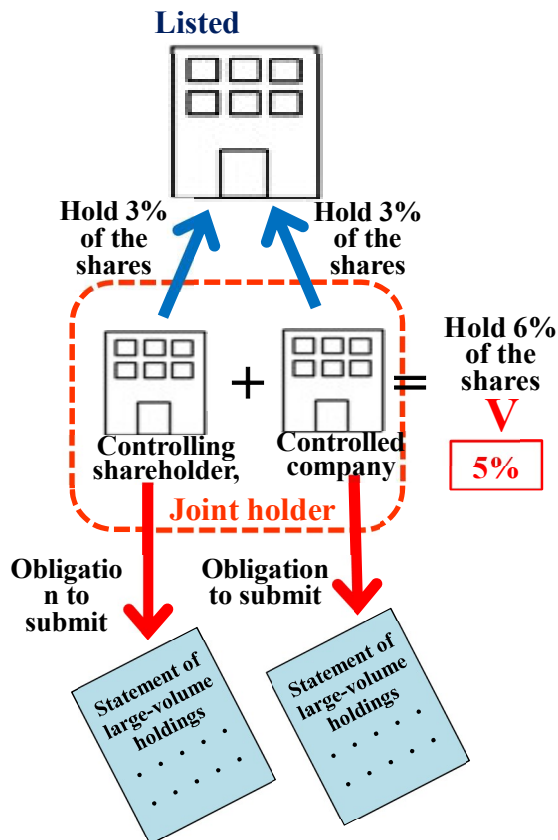
(Note) The Internal Control Standards and Practice Standards were revised in April 2023. In the new standards, when the evaluation of the effectiveness of internal control needs to be corrected ex post facto, the company is required to describe the how and why it came to correction of the evaluation in an amended internal control report. The revision in standards becomes effective from the business year starting on April 1, 2024.



## Do you properly submit statements of large-volume holdings and statements of changes?

### Message to investors (2)

Under the large-volume holdings system prescribed in the FIEA, corporations and individuals must submit a statement of large-volume holdings if their holding ratio of listed companies' share exceeds 5%, and must submit a statement of changes if such holding ratio changes by 1% or more. The outline of this system is illustrated below.



○Who assumes the obligation to submit those statements?

A holder (irrespective of being a corporation or an individual) of share issued by a listed company must submit a statement of large-volume holdings, in principle within five business days from the day on which his/her holding ratio has exceeded 5%. Thereafter, the holder must submit a statement of changes, in principle within five business days from the day on which his/her holding ratio has changed by 1% or more.

○Who falls under a "holder"?

Holders of share include not only those who hold the share in their own names, but also those who hold it in the names of other persons (or under fictitious names). Therefore, holders of share include a person who substantially owns the share and calculation results belong to him/herself by using other persons' names or fictitious names for transaction accounts and nominee of sharee. Holders of share also include a person holding share in the name of the former holder because the shareholder's name has not been transferred.

○The holding ratio of share certificates, etc. should be calculated by including shares held jointly with joint holder(s)!

The holding ratio of share must be calculated by adding the number of shares held jointly with joint holder(s) to the number of shares held solely by the relevant holder.

A joint holder is a person who has agreed to acquire or transfer the relevant share or to exercise voting rights and other rights jointly with other holders. Even if such agreement has not been made, a person that holds shares that constitute over 50% of the total voting rights (a "controlling shareholder, etc.") and that company (a "controlled company") (= the parent company and a subsidiary) are deemed as joint holders. Controlled companies that have the same controlling shareholder, etc. (= fellow subsidiaries) are also deemed as joint holders (so-called "deemed joint holder").

## 5 INVESTIGATION OF CRIMINAL CASES (FILING OF CRIMINAL CHARGES)

### 1. Purpose of Criminal Investigation

It is important to respond strictly to serious and malicious market misconduct in order to secure fairness and transparency in markets and build market participants' confidence in the markets in order to maintain financial and capital markets in which investors and other participants are able to participate with a sense of security. In order to uncover the core of the case of malicious market misconduct that would damage the integrity of financial markets and to protect investors, the authority to investigate criminal cases involving market misconduct was given as a unique power of the SESC staff<sup>11</sup> upon the SESC's establishment in 1992. At present, some of the acts prescribed in the Financial Services Act for regulating financial services intermediaries and the Anti-Criminal Proceeds Act for regulating cross-border money laundering are additionally subjected to the SESC staff's criminal investigation.<sup>12</sup>

### 2. Overview of Criminal Cases in FY2022

Under circumstances where financial activities are becoming increasingly globalized, complex and sophisticated, the SESC has been flexibly investigating criminal cases in both primary and secondary markets. In FY2022, the SESC filed criminal charges in eight cases (including seven insider trading cases and one market manipulation case). These include a market manipulation case where suspects conducted transactions of shares that fall under an illegal stabilization operation in an attempt to avoid a significant decline primarily in the closing price of the day of a "block offer" (BO) handled by the suspected company (filed a criminal charge on April 12, 2022), and a case of insider trading by a related party of a private equity (PE) fund operator (filed a criminal charge on March 3, 2023).

Case	Date of criminal charge filing	Filed with
Market manipulation by SMBC Nikko Securities Inc. (2)	Apr. 12, 2022	Public prosecutor of the Tokyo District Public Prosecutors Office

<sup>11</sup> Article 210, FIEA

<sup>12</sup> Article 102 Financial Services Act; Article 32, Anti-Criminal Proceeds Act

Insider trading of the shares of SOFTBRAIN Co., Ltd.	Jun. 3, 2022	Public prosecutor of the Tokyo District Public Prosecutors Office
Insider trading of the shares of Tohto Suisan Co., Ltd.	Dec. 1, 2022	Public prosecutor of the Hakodate District Public Prosecutors Office
Insider trading of the shares of Aiming Inc. (1)	Dec. 6, 2022	Public prosecutor of the Tokyo District Public Prosecutors Office
Insider trading of the shares of Aiming Inc. (2)	Dec. 6, 2022	Public prosecutor of the Tokyo District Public Prosecutors Office
Insider trading of the shares of Ateam Inc. (1)	Dec. 26, 2022	Public prosecutor of the Tokyo District Public Prosecutors Office
Insider trading of the shares of Ateam Inc. (2)	Dec. 26, 2022	Public prosecutor of the Tokyo District Public Prosecutors Office
Insider trading of the shares of SOGO MEDICAL HOLDINGS CO., LTD. and the shares of SPACE VALUE HOLDINGS Co., Ltd.	Mar. 3, 2023	Public prosecutor of the Tokyo District Public Prosecutors Office

### 3. Notable Criminal Charges Filed in FY2022

#### (1) Charges in the case of market manipulation by SMBC Nikko Securities Inc. (2)<sup>13</sup>

The SESC filed criminal charges against a suspected company and four suspects with the Tokyo District Public Prosecutors Office for violation of the FIEA (stabilizing transaction) on April 12, 2022.

(Case overview)

Suspects, who are officers and employees of SMBC Nikko Securities Inc. (the suspected company), conspired to conduct transactions of shares that fall under an illegal stabilization operation multiple times from October 2020 to April 2021, with regard to five issues listed on the securities market of the Tokyo Stock Exchange, in an attempt to avoid a significant decline primarily in the closing price of the day of a BO handled by the suspected company, which was the basis for the deal price, compared to the closing price of the previous day. Considering the positions of the suspected company and the suspects, the impact of the case on market fairness and other relevant factors, the

<sup>13</sup> The SESC also filed criminal charges for the related case on March 23, 2022.

SESC concluded that the suspects' acts were highly serious and malicious and filed the criminal charges.

## **(2) Charges in the case of insider trading of the shares of SOFTBRAIN Co., Ltd.**

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The SESC filed criminal charges against four suspects with the Tokyo District Public Prosecutors Office for violation of the FIEA (insider trading and providing of insider information) on June 3, 2022.

(Case overview)

Suspect A, who was a manager of the internal audit office of SOFTBRAIN Co. Ltd. (SOFTBRAIN), came to know in the course of duties a fact concerning the launch of a tender offer for the company's shares, and: (i) Suspect A told this fact to Suspect B around mid-July 2020 prior to the announcement of the fact for the purpose of enabling him/her to make a profit and Suspect B purchased the shares of SOFTBRAIN around late July 2020 prior to the announcement of the fact; (ii) Suspect A, in conspiracy with Suspect C, purchased the shares of SOFTBRAIN under the name of Suspect C between around late July and around mid-August 2020 prior to the announcement of the fact; (iii) Suspect A told the fact to Suspect D around late July 2020 prior to the announcement of the fact for the purpose of enabling him/her to make a profit and Suspect D executed part of the order for purchasing the shares of SOFTBRAIN under the name of Suspect D for him/herself around early August 2020 prior to the announcement of the fact; and (iv) Suspect A, in conspiracy with Suspect D, executed part of the order for purchasing the shares of SOFTBRAIN under the name of Suspect D on behalf of Suspect A around early August 2020 prior to the announcement of the fact. Considering the impact of the case on market fairness and other relevant factors, the SESC concluded that the suspects' acts were highly malicious and filed the criminal charges.

## **(3) Charges in the cases of insider trading of the shares of Aiming Inc. (1) and (2)<sup>14</sup>**

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The SESC filed criminal charges against three suspects with the Tokyo District Public Prosecutors Office for violation of the FIEA (insider trading and providing of insider information) on December 6, 2022.

(Case overview)

Suspect A and Suspect C came to know in the course of duties a material fact concerning the operations, business, or assets of Aiming Inc. (Aiming), that has a significant influence on investors' investment decisions, such as that the development of a new game for mobile phones that Aiming had jointly been promoting with another company, had progressed to a stage where distribution would be expected to begin. Suspect A purchased the shares of Aiming between around early December

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<sup>14</sup> The SESC filed criminal charges for the related cases on December 26, 2022.

2019 and around early February 2020 prior to the announcement of the fact and Suspect C purchased the shares of Aiming around late January 2020 prior to the announcement of that fact. Additionally, Suspect A told this material fact to Suspect B around late December 2019 prior to the announcement thereof for the purpose of enabling Suspect B to make a profit, and Suspect B purchased the shares of Aiming between around late December 2019 and around early February 2020 prior to the announcement of the fact. Considering the impact of the cases on market fairness and other relevant factors, the SESC concluded that the suspects' acts were highly malicious and filed the criminal charges.

#### **(4) Charges in the case of insider trading of the shares of SOGO MEDICAL HOLDINGS CO., LTD. and the shares of SPACE VALUE HOLDINGS Co., Ltd.**

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The SESC filed a criminal charge against one suspect with the Tokyo District Public Prosecutors Office for violation of the FIEA (insider trading) on March 3, 2023.

(Case overview)

The suspect who used to work for Polaris Capital Group Co., Ltd., which is a private equity (PE) fund operator, came to know in the course of duties the facts concerning the launch of tender offers for (i) the shares of SOGO MEDICAL HOLDINGS CO., LTD. (SOGO MEDICAL) and for (ii) the shares of SPACE VALUE HOLDINGS Co., Ltd. (SPACE VALUE), and purchased the shares of SOGO MEDICAL and the shares of SPACE VALUE (i) between around mid-January and around early February 2020 and (ii) between around early November and around mid-November 2021, respectively, prior to the announcement of those facts. Considering the impact of the cases on market fairness and other relevant factors, the SESC concluded that the suspect's acts were highly malicious and filed the criminal charge.

## **4. Future Challenges**

The SESC exercises its authority for criminal investigation and filing criminal charges in cooperation with criminal prosecutors and other relevant authorities to appropriately take rigorous actions against serious and malicious market misconduct. In this respect, it is important for the SESC not only to take actions against frequently occurring misconduct that can be easily categorized into typical types of violations, such as insider trading and market manipulation, but also to keep an eye on various sorts of market misconduct, including atypical and new types of cases.

It is also essential for the SESC to flexibly respond to changes in the environment surrounding financial transactions. For example, the recent advancement of digitalization has made it easier for anyone to use advanced communication devices and the arrival of SNS and other types of communication tools was not anticipated when regulations on insider trading and other market misconduct were originally introduced. In addition, increasing market globalization is heightening

the need for international cooperation in market oversight. To adapt to such changes in the environment, the SESC will continue efforts to enhance fairness and transparency in the markets by developing human resources with expertise in criminal investigations, while upgrading various tools used in criminal investigations and further strengthening cooperation with relevant institutions, including foreign authorities.

## **6 DEVELOPMENT OF INFRASTRUCTURE THAT SUPPORTS MARKET OVERSIGHT (UTILIZATION OF DIGITAL TECHNOLOGY AND HUMAN RESOURCES)**

### **1. Adapting to Information and Communications Technology Progress**

As information and communications technology progresses rapidly and dramatically, the environment surrounding markets are changing greatly. Due to the impacts of COVID-19, people's working styles are also changing enormously. Based on these market environment and working style changes, financial technological trends at home and abroad, and digitalization trends for regulatory and law enforcement authorities, the SESC has been working to increase the sophistication of market oversight and enhance its efficiency through the use of digital technology and to further improve digital forensics technology.

In FY2022, the SESC formulated a plan for the development of a new market oversight system and defined the system requirements, including improvement of its operations and enhancement of security, and also made preparation for the commencement of the use of digital online deposit account inquiry services provided by private business operators to financial institutions. Furthermore, the SESC expanded its analysis functions of the digital forensics system to enable prompt and efficient investigations of a massive amount of electronic data.

### **2. Future Challenges for Further Promoting Digitalization**

#### **(1) Study on further promotion of digitalization for market oversight**

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To respond to market oversight environment changes, the SESC will review and develop relevant infrastructure to sophisticate and streamline market oversight. For instance, the SESC will study such specific measures as the development of functions for analyzing massive order and trade data efficiently and tools for finding signs of market misconduct in various SNS and Internet data, as well as the further utilization of digital online deposit account inquiry services provided by private business operators to financial institutions to further promote the digitalization of market oversight operations.

#### **(2) Promoting information sharing with market participants and foreign authorities**

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The SESC is required to closely share information on the use of technologies and data in the field of market oversight with self-regulatory organizations, financial institutions and other market participants, and foreign authorities, and to continuously review existing infrastructure.

For instance, in addition to opinion exchange with self-regulatory organizations, financial institutions, and IT businesses, the SESC will proactively participate in international conferences sponsored by the IOSCO and other entities to share information with foreign authorities on digitalization responses to enhance cooperation.

### **(3) Further improving digital forensics technology and sophisticating systems**

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As digital technology advances, smartphones, tablet computers and other electronics subject to digital forensics, various services provided by cloud business operators, and cybersecurity measures for protecting these services have become diverse and complicated, while data for acquisition and analysis have rapidly increased. The environment surrounding digital forensics has thus been changing significantly.

In order to respond to such environmental changes, the SESC has been making efforts to enhance information systems for digital forensics necessary for acquiring, analyzing, and recovering data. The SESC will continue to implement digital forensics tools required for strengthening its digital forensics capabilities and further improving the skills of its staff.

## **3. Utilization of Human Resources**

### **(1) Human resources development**

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To develop human resources with expertise and a broad perspective on market oversight, the SESC provides various training programs for its staff to learn about information technology and the methodologies for conducting inspection and investigation.

In FY2022, the SESC invited information technology company experts to study meetings to lead its staff to acquire the latest digital technology and IT-related knowledge, and it provided digital forensics training and OJT programs to develop human resources engaging in digital forensics and related practices.

In addition, the SESC positively participated in seminars, etc. organized by the IOSCO or foreign authorities with the aim of ascertaining monitoring, investigation and inspection techniques of foreign authorities and enhancing its capability to handle international cases (the improvement of skills to analyze and investigate market misconduct using cross-border transactions).



## (2) Recruitment of personnel with expertise

In order to realize professional market oversight in response to changes in the environment surrounding the SESC, the SESC is strengthening its 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 in criminal investigations targeting serious and malicious violations of laws and regulations. In addition, personnel with IT expertise play active roles in digital forensics operations.

**Fig. 6-1: Activities of outside experts**

(Unit: Persons)

	As of April 2022	As of April 2023	
Attorneys	9	10	
Certified public accountant	19	18	
Real estate appraisers	1	2	
Information processing engineers	6	7	
Personnel with practical financial experience	13	14	
<b>Total</b>	<b>48</b>	<b>51</b>	

## 7 EFFORTS TO ENHANCE MARKET DISCIPLINE

### 1. Enhancing Dissemination of Information

#### (1) Dissemination of information through various channels

When having made recommendations or having filed criminal charges as a result of its inspection or investigation, the SESC broadly disseminates the significance and details of the cases through briefings for media organizations including newspapers and TV. Additionally, the SESC actively responds to requests for interviews from media organizations from the perspective of encouraging them to disseminate information based on proper analyses of individual cases. In FY2022, in addition to briefings on individual cases, the SESC held a press conference by the former and new Chairmen and also gave a press briefing on the "Strategy & Policy 2023-2025."

Furthermore, the SESC annually formulates and publishes casebooks<sup>15</sup> that compile individual cases involving recommendations, etc., outlining the implications and drawings of the cases, issues identified by the SESC, and matters to note for market participants. It also actively provides lectures to market participants (13 times in FY2022) and contributes commentaries to relevant journals (17 times in FY2022) with the aim of preventing occurrence and recurrence of violations and misconduct and thereby enhancing market discipline.

The SESC posts up-to-date information on its activities, such as summaries of cases involving recommendations, etc., and details of given lectures and published commentaries on its website, while also utilizing X (formerly Twitter). Additionally, the SESC periodically releases "Message to the Market", which summarizes individual cases and significance of them, and also contributes to ACCESS FSA (a newsletter from the FSA). In FY2022, the SESC posted articles of the interviews with the former and new Chairmen on ACCESS FSA.

The SESC will continue to actively enhance external communications in order to further strengthen market discipline.

#### (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 oversight. Given that cases of market misconduct can take place throughout Japan due to the widening

<sup>15</sup> The SESC is calling attention of market participants by fully utilizing "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, as well as "SESC Column" in its Annual Reports.

range of activities by problematic business operators and the prevalence of the Internet, it is necessary for the SESC to enhance its presence across Japan.

In this respect, the SESC has held its meetings at Local Finance Bureaus since FY2015. In FY2022, however, the SESC held no such meetings, in consideration of the impacts of 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 that undertake the practice of market oversight.

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

## **2. Active Contribution to the Enhancement of Market Environment**

To establish highly fair and transparent financial markets and maintain investors' confidence in the markets, market rules should be aligned with changes in the environment surrounding the markets. To ensure fairness in transactions, investor protection and public interests, under Article 21 of the FSA Establishment Act, the SESC makes policy proposals to the Prime Minister, the FSA Commissioner or the Minister of Finance in order to facilitate the appropriate development of rules that reflect the status of markets, if they are considered necessary as a result of its inspection or investigation.

The policy proposals are intended to incorporate the SESC's views regarding laws and regulations as well as SROs' rules formed through comprehensive analyses of the outcomes of its inspection and investigation into various measures to be taken by the government and SROs. Thus, the SESC's proposals are regarded as key information when regulatory authorities and SROs formulate their policy measures.

Specifically, when the SESC recognizes room for improvement in current laws and regulations or SROs' rules considering actual trading activities, the SESC points out its findings and, from the perspective of ensuring fair trading, investor protection or public interests, it presents issues to be discussed with respect to how laws and regulations as well as SROs' rules should be enforced, and requests the revision of existing laws and regulations or SROs' rules.

In FY2022, the SESC made a policy proposal regarding solicitation of offers to acquire the membership rights of a limited liability company. Based on this policy proposal, the FSA amended the Cabinet Office Order on Definitions under Article 2 of the Financial Instruments and Exchange Act and the amended Cabinet Office Order came into effect on October 3, 2022.

The SESC will continue making policy proposals proactively for measures that are considered to be necessary.

< Policy proposal >

Case	Overview
Solicitation of offers to acquire the membership rights of a limited liability company  (Date of policy proposal: Jun. 21, 2022)	Recently, numerous inquiries and complaints have been received from outside sources that limited liability companies with unknown business conditions solicit investments from a large number of investors in an inappropriate manner, by asking them to invest in the membership rights of those companies, through a large number of employees/hired persons who do not always understand their business. Considering the situation, the SESC submitted a policy proposal to take appropriate measures, such as expanding the requirements for registration as a financial instruments business operator, to cover solicitation to acquire a limited liability company's membership rights by persons other than its executives, such as employees and hired persons.

### 3. Cooperation with Relevant Organizations

#### (1) Cooperation with SROs

SROs, such as Financial Instruments Firms Associations, Financial Instruments Exchanges, and Self-Regulatory Organization, are engaged in their own daily market monitoring activities, such as the examination of market surveillance, the management of listed companies, and checks on the adequacy of their members' operations. The SESC works closely with SROs from the perspective of efficient and effective market oversight. Specifically, the SESC seeks further cooperation towards enhancing market discipline and market oversight functions, and regularly holds meetings to exchange views on various issues in markets to share issues of mutual interest. In FY2022, the SESC held such meetings 12 times and had active discussions on challenges and issues regarding market oversight.

Believing that these efforts will further promote the sharing of views between the SESC and SROs and contribute to enhancing market discipline functions through voluntary initiatives, the SESC will continue its active exchange of information and communicate its perceptions to achieve closer collaboration.

**(2) Cooperation with relevant authorities (public prosecutors, police, etc.)**

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In cases where the SESC identifies unregistered financial instruments business operators selling fraudulent financial instruments or finds activities that may be associated with anti-social forces in investigations into cases of market misconduct, etc., 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 the public prosecutors with whom the SESC files criminal charges, 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 the daily exchange of information and meetings, sharing awareness and information from a broad perspective and knowhow related to the collection and analysis of evidence.

To reinforce the functioning of market discipline in financial markets through voluntary efforts by market participants, the SESC proactively dialogues and shares awareness with market participants by offering lectures at and exchanging views with the Japan Audit and Supervisory Board Members Association and other organizations.

## 8 CONTRIBUTING TO GLOBAL MARKET OVERSIGHT

### 1. International Market Oversight Cooperation Initiatives

As the internationalization and sophistication of financial transactions have made progress in recent years, international cooperation in addressing market misconduct has grown even more important. Given such market environment, the SESC, in its 11th medium-term activity policy titled "Strategy & Policy 2023-2025" that was formulated in January 2023, calls for strengthening international cooperation as one of the measures for "Information Gathering and Analysis for Comprehensive Market Oversight," thus demonstrating its plans to step up cooperation with foreign authorities.

The SESC has so far exchanged information with overseas authorities based on the MMoU and taken proactive law enforcement actions against violations through cross-border transactions.

The SESC has been enhancing intelligence-gathering capabilities through the promotion of information exchange based on the IOSCO MMoU and trying to build confidence with foreign authorities through its proactive participation in IOSCO activities and personal exchange with foreign authorities. Based on confidence built with foreign authorities, the SESC has also promoted the sharing of the latest trends, knowledge and experiences regarding market oversight and cooperation in investigation, inspection and law enforcement. For market oversight in Japan, furthermore, the SESC has tried to utilize useful intelligence gained through exchange with foreign authorities on their law enforcement actions and legal systems.

Regarding challenges for market oversight involving cross-border transactions, the SESC proactively raises issues and shares information at IOSCO and other multilateral meetings. In this way, the SESC is seeking to enhance cooperation with foreign authorities through contributions to global market oversight.

**Fig. 8-1: Changes in the numbers of information exchange cases under MMoU**

	FY2020	FY2021	FY2022
<b>Cases of receiving information from foreign authorities</b>	<b>64</b>	<b>64</b>	<b>76</b>
Requests to foreign authorities for the provision of information	32	22	20
Voluntary provision of information from foreign authorities	32	42	56
<b>Cases of providing information to foreign authorities</b>	<b>9</b>	<b>8</b>	<b>4</b>
Requests from foreign authorities for the provision of information	7	6	1
Voluntary provision of information to foreign authorities	2	2	3

(\*1) Excluding the number of cases of information provision pertaining to inquiries for eligibility screening by the authorities (regarding persons who assume important positions in financial institutions or local corporations that file applications for approval, etc.)

(\*2) The numbers of cases may change in the future as a result of alteration of tabulation methods or screening of the details of exchanged information.

## 2. Activities at the IOSCO

The IOSCO is an international organization that aims to internationally harmonize securities regulations and promote cooperation between securities regulators. It is comprised of 237 member organizations from various countries and regions, including 131 ordinary, 34 associate, and 72 affiliate members (all figures as of the end of April 2023). The SESC joined the IOSCO as an associate member in October 1993.<sup>16</sup>

The IOSCO holds its Annual Meeting, where top officials from various countries' securities regulatory authorities discuss and exchange views on the current state and issues of securities regulations. Every year, SESC Commissioners and senior officials participate in the meeting. The 2022 Annual Meeting which took place in October of the year was attended by the SESC deputy secretary general. In addition to the Annual Meeting, the IOSCO holds meetings of the Asia-Pacific Regional Committee (APRC) to discuss region-wide securities-related issues, including market oversight. In February 2023, the SESC participated in a working-level conference for law enforcement officials from the APRC member authorities. At the conference, participants exchanged information on investigations of social media-led market manipulation cases and applications of technologies for market oversight. Through these IOSCO meetings, the SESC endeavors to enhance cooperation with foreign authorities.

Within the IOSCO, key regulatory issues for international markets are discussed and practical solutions to them are proposed at the IOSCO Board, which consists of regulators from various countries and regions. Under the board, there are eight Policy Committees discussing specific policy issues. The SESC has been a member of Committee 4 to discuss law enforcement and information sharing. The SESC participated in Committee 4 meetings in June and November 2022 and March 2023. Participants in these meetings shared individual countries' responses to illegal investment solicitation being conducted online and discussed how to effectively deter them. In addition, the SESC took part in an IOSCO conference on the utilization of digital tools for law enforcement activities, which was held in September 2022.

The SESC has also been a member of the IOSCO Screening Group, which screens applications submitted by regulators to become signatories to the MMoU and the Enhanced MMoU (EMMoU). The Group's meetings are held in combination with Committee 4 meetings. As a result of screening

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<sup>16</sup> The FSA upon its establishment took over the position of an ordinary member from the Ministry of Finance.

in FY2022, the MMoU was newly signed by four regulators, including the Financial Activities Supervisory Commission of Monaco and the Securities and Exchange Commission of Ghana.

### 3. Cooperation with Foreign Authorities

#### **(1) Providing training to personnel of foreign authorities**

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The SESC continuously provides training on Japan's market oversight and investigation of market misconduct to emerging economies' financial regulators as part of human resource development programs organized by the FSA and the Japan International Cooperation Agency (JICA). In FY2022, SESC officials served as lecturers for the FSA's professional seminar attended by securities market regulations from emerging economies and the JICA's upskilling program for Vietnamese regulators in pursuit of fairer and more transparent stock markets in Vietnam, thereby helping their human resource development and capacity building effort.

#### **(2) Other personnel exchanges**

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In FY2022 as in the previous year, the IOSCO and foreign authorities held various technical workshops and awareness-raising events in a virtual format. The SESC participated in the programs provided by the French Autorité des Marchés Financiers (Financial Markets Authority) and the U.S. Securities and Exchange Commission.

The SESC has sent staff members as secondees to the U.S. Securities and Exchange Commission, the U.S. Commodity Futures Trading Commission, the U.K. Financial Conduct Authority, the Hong Kong Securities and Futures Commission, the Thailand Securities and Exchange Commission, the Malaysia Securities Commission, and the Monetary Authority of Singapore. The secondment aims to have them learn about and analyze foreign authorities' methodologies in oversight, investigation and inspection, and introduce Japanese methods and knowledge to foreign authorities. In FY2022, as in the previous year, the SESC refrained from sending staff members to foreign authorities due to the prolonged COVID-19 pandemic.

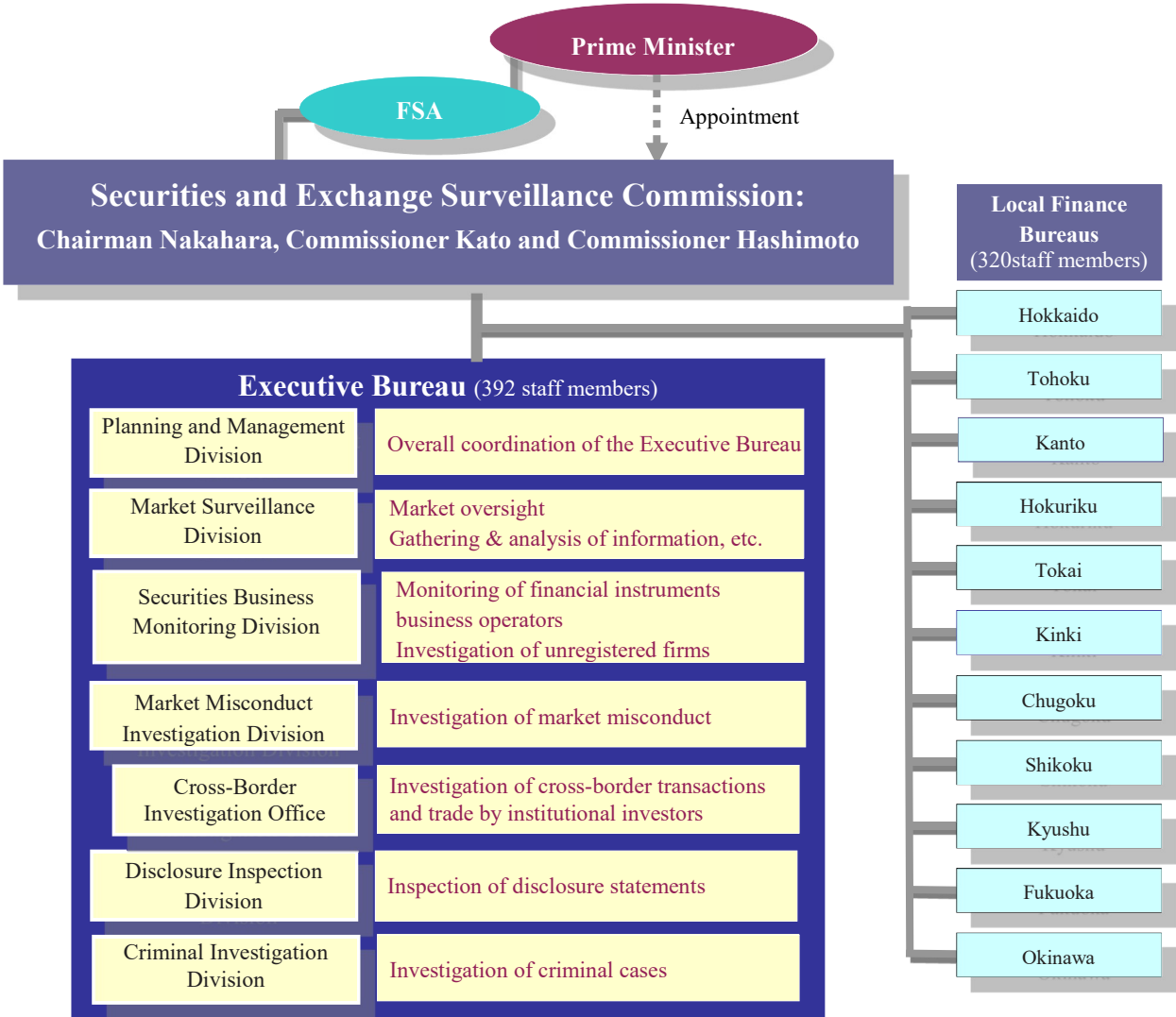
In the future, the SESC will further enhance cooperation with foreign authorities and contribute to global market oversight through information and personnel exchanges with foreign authorities.



# Appendices

Chart 1

Organization Chart

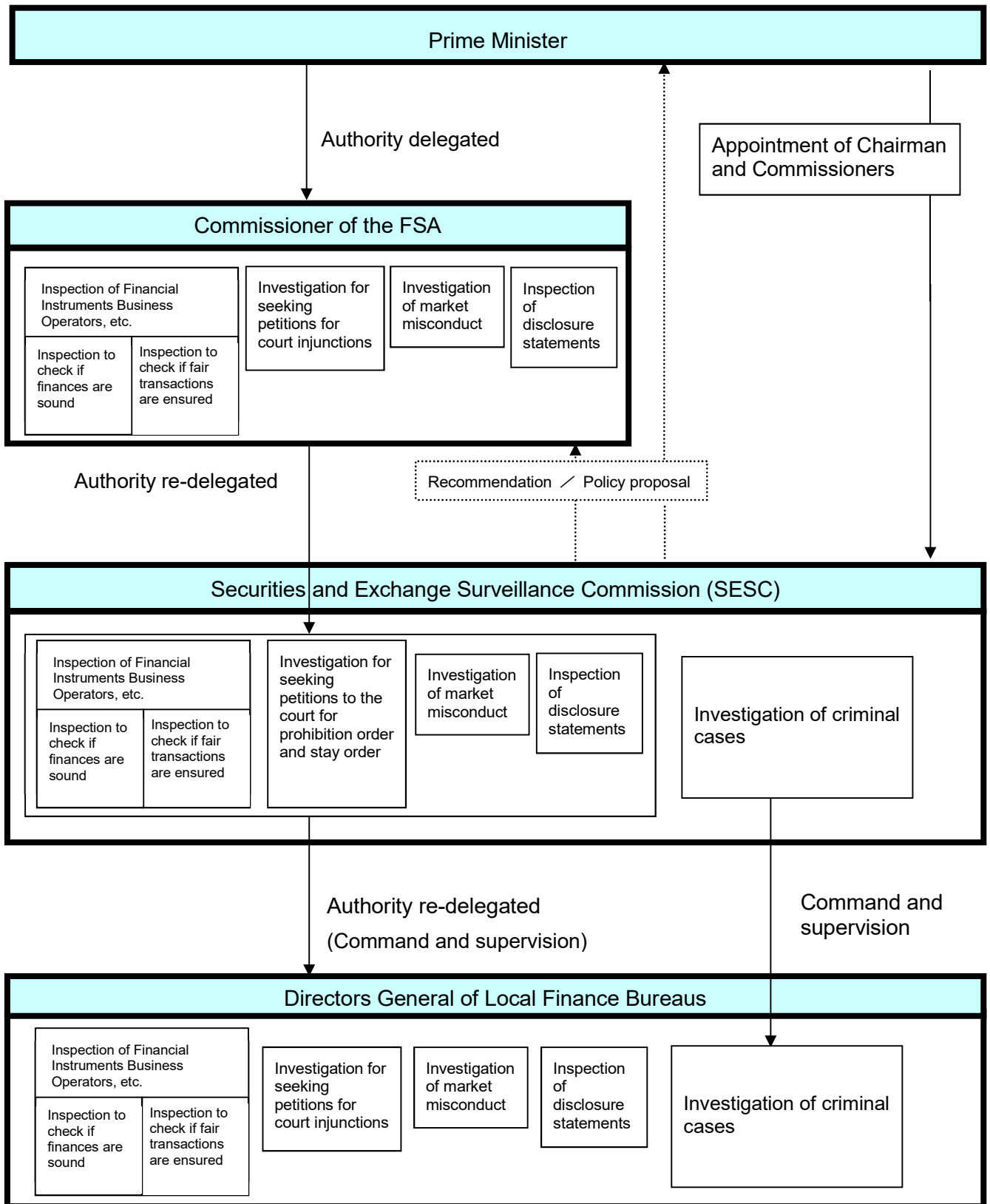


Note1: Staff members of Executive Bureau are quota as at the end of FY2022.

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



(Note 1) For the authority that the SESC delegates to Director General of Local Finance Bureau or the Director of its branch office, the SESC directs and supervises Director General of Local Finance Bureau or the Director of its branch office. (FIEA: Article 194-7 (8))

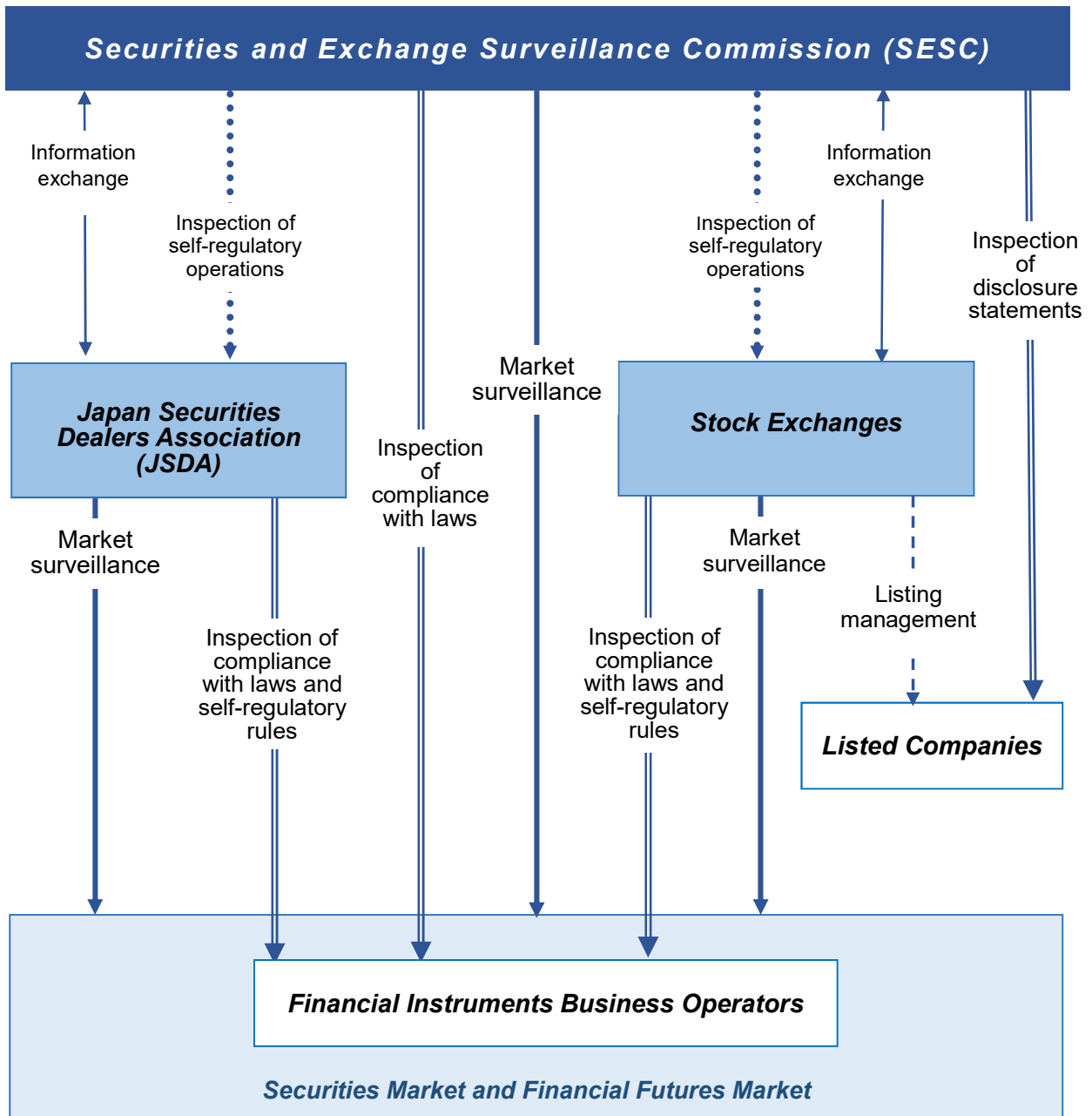
(Note 2) For an investigation of a criminal offence, the SESC directs and supervises the Director General of a Local Finance Bureau or the Director of its branch office. The SESC may, deeming it necessary for investigating a criminal offence, direct and supervise firsthand an official of a Local Finance Bureaus or the Director of its branch office. (FIEA: Article 224(4) and (5))

(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 following 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



Table

## Activities in Figures

### Table of Summary

Unit: Number of cases

Fiscal year		1992 to 2017	2018	2019	2020	2021	2022	Total
Category								
Criminal charges		192	8	3	2	8	8	221
Recommendations		1,028	54	49	29	20	26	1,206
	Recommendations based on securities inspections	559	11	14	5	2	5	596
	Recommendations for administrative monetary penalty payment orders (market misconduct)	364	33	29	14	12	14	466
	Recommendations for administrative monetary penalty payment orders (false statements in disclosure statements, etc.)	101	10	6	10	5	7	139
	Recommendations for order to submit correction report, etc.	4	0	0	0	1	0	5
	Announcement of results of inspection of persons making notification for business specially permitted for qualified institutional investors	86	0	2	0	0	1	89
	Petition to the court for prohibition order and stay order, etc., against unregistered business operator or solicitation without the filing of securities registration statements	20	2	3	1	1	2	29
	Proposals	24	2	0	0	0	1	27
Securities inspections	Financial instrument businesses operators	3,078	55	64	41	37	42	3,317
	Type I financial instrument businesses operators	2,230	35	44	34	28	23	2,394
	Type II financial instrument businesses operators	287	7	4	1	1	3	303
	Investment management firms Investment advisories/agencies	561	13	16	6	8	16	620
	Registered financial institutions	346	3	2	0	2	6	359
	Persons making notification for business specially permitted for qualified institutional investors	134	4	0	2	0	3	143
	Financial instruments intermediaries	70	4	2	2	2	4	84
	Credit rating agencies	9	0	1	1	0	0	11
	Self-regulatory organizations	32	0	2	0	2	0	36
	Investment corporations	49	1	1	0	2	2	55
	Other	14	1	1	1	1	2	20
	Total	3,732	68	73	47	46	59	4,025
Transaction examinations		17,057	1,052	1,061	965	969	1,065	22,169

## Notes

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

August 2, 2022

Securities and Exchange Surveillance Commission

## Monitoring Priorities for Securities Businesses (July 2022 - June 2023)

Based on the recent environment surrounding financial instruments business operators (FIBOs), the Securities and Exchange Surveillance Commission (SESC) has compiled the priorities for its securities business monitoring<sup>1</sup> for Business Year 2022.<sup>2</sup>

Given the repeated spread of COVID-19 infections, the SESC will continue to closely monitor the situation, and take appropriate measures as necessary when conducting inspections.

### 1. Environment surrounding FIBOs

#### (1) Environment surrounding FIBOs

In order to pass on the fruit of economic growth to households for their stable asset formation, it remains important for FIBOs, at each stage of origination, distribution and management of financial instruments, to ensure customer-oriented business conduct for acting in the best interests of their customers.

As the business environment significantly changes along with progress made in digitalization and other factors, FIBOs are developing sustainable business models, including through partnering with other securities and financial companies, promoting digitalization to meet the changing market environment and customer needs, and reviewing existing businesses.

As warnings have been issued to financial institutions to call for enhancements of cybersecurity measures amid the increasing potential risk of cyber-attacks in Japan and overseas, FIBOs are continuously required to strengthen their system risk management, including cybersecurity.

International interest has remained high in Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) measures. Based on the results of the 4th Mutual Evaluation of Japan by the Financial Action Task Force (FATF) and looking

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<sup>1</sup> "Securities business monitoring" in this document covers both inspection and monitoring. "Inspection" means activities based on Article 56-2 of the Financial Instruments and Exchange Act, while "monitoring" refers to activities other than inspection.

<sup>2</sup> Business Year 2022 is from July 2022 to June 2023

ahead to the 5th Mutual Evaluation, FIBOs are continuously required to take AML/CFT measures, including ongoing customer due diligence.

(2) Changes to regulatory frameworks for FIBOs

There have been the following changes to regulatory frameworks for FIBOs over the past business year:

(i) Revision of the firewall regulation between banking and securities businesses

Based on discussions at the Working Group on Capital Market Regulations of the Financial System Council, the Cabinet Office Order on Financial Instruments Business, etc. (hereinafter, "Cabinet Office Order") and the Comprehensive Guidelines for Supervision of FIBOs, etc. (hereinafter, "Supervision Guidelines") were partially revised. As a result, when banks and securities companies within the same financial groups share information of certain types of customers, such as listed companies, prior consent from and individual notice to those customers are no longer required in principle. In response to this partial deregulation, those banks and securities companies are required to sophisticate their internal control.

(ii) Review of explanations regarding solicitation for sale and switching of investment trusts

In light of requests in the report of the "Working Group on Reviewing Self-regulatory Rules from the Principle-based Approach" published by a self-regulatory organization (hereinafter, "SRO"), the Supervision Guidelines were partially revised. Through this revision, points of attention upon solicitations for the sale and switching of investment trusts and other matters were reviewed from the principle-based approach, so as to ensure that explanations are provided truly in accordance with customers' investment objectives and levels of understanding. FIBOs are thus required to provide appropriate explanations that meet customers' situations.

(iii) Enhancement of supervisory responses to FIBOs' business acquisitions/mergers or suspensions

The Supervision Guidelines were partially revised to clarify the supervisory focus on ascertaining the appropriateness of FIBO's actual business operations, where they have undergone material changes in their shareholder composition due to business acquisitions/mergers, or have suspended business operations for an extended period of time, etc. FIBOs are thus required to develop appropriate business execution systems according to the nature of their

business, including when there are changes in their board composition or management policies, etc. due to acquisitions/mergers, etc.

(3) Findings through the securities business monitoring over the past business year

Through its securities business monitoring over the past business year, the SESC found that some FIBOs were transforming their business models or internal control environments in response to the changes in their business environment.

(i) Type I FIBOs

While the promotion of customer-oriented business conduct is making progress, the SESC found that a Type I FIBO with insufficient internal control environments to follow the principle of suitability was soliciting customers to switch investment trusts in a manner that was inadequate from the viewpoint of economic rationality. It also found that some Type I FIBOs were selling structured bonds, including through outsourcing to independent financial advisors and other financial institutions, in a manner that did not reflect customer needs.

While those securities companies with many online trading accounts are making some progress in their compliance with the “Guidelines to Prevent Unauthorized Access and Other Incidents in Online Trading” formulated by an SRO, the SESC found that some of them failed to sufficiently reduce the risk of unauthorized withdrawal of customer funds.

In addition, the SESC identified issues with Type I FIBOs’ compliance and governance, as in the case where a large securities company was charged for suspicion of conducting stock transactions, etc. categorized as illegal stabilizing transactions, which is a type of market manipulation.

(ii) Investment management business operators

In recent years, Japanese asset owners with massive investment assets, such as pension funds, are moving to expand their investment in alternative assets, including private equities. It is necessary for the investment management business operators to identify risks associated with alternative and other investment assets, through due diligence in accordance with product characteristics.

Nevertheless, the SESC found that an investment management business operator failed to properly manage its investment assets, including insufficient



due diligence in accordance with product characteristics, with respect to discretionary investment contracts covering funds managed by an external asset management company or investment trusts established in the form of fund of funds.

In addition, the SESC identified that an investment corporation asset management business operator failed to conduct its investment management business faithfully on behalf of the investment corporation in transacting with its parent company and other interested parties, such as by giving priority to the interests of the parent company, etc. over the real estate investment corporation and making inadequate requests that undermined the independence of real estate appraisers.

(iii) Unregistered business operators

The SESC found that some business operators were, without being registered as FIBOs, intermediating conclusion of discretionary investment contracts or soliciting investment in financial instruments categorized as shares in foreign collective investment schemes.

In addition, the SESC is aware that some limited liability companies are soliciting investment in the membership rights through their employees, which could cause damage to investors. However, except for particular cases, such solicitation does not fall under the current regulatory definition of financial instruments business. The SESC thus has not been able to exercise its investigative authority to file a petition with the court for a prohibition and stay order against such solicitation. Therefore, the SESC has submitted a policy proposal to the Prime Minister and the Financial Services Agency (JFSA) Commissioner to take appropriate measures, such as expanding the scope of activity that requires registration as a financial instruments business operator.

## 2. Industry-wide monitoring priorities

Considering the environment surrounding FIBOs, and the JFSA's policies, such as "*The JFSA Strategic Priorities*," the SESC will examine the following industry-wide themes in cooperation with relevant JFSA divisions:

- (i) Developing internal control environments with a focus on appropriate investment solicitation based on the principle of suitability, and appropriate sales operations based on customer-oriented business conduct

For instance, with regard to the sale of products with complex risk structures, such as structured bonds, the SESC will verify whether FIBOs develop and appropriately implement internal rules concerning customer targeting and explanation, and whether FIBOs' actual sales operations are consistent with their business policies on the principle of customer-oriented business conduct.

- (ii) Business model changes along with progress in digitalization, etc., and the development of internal control environments in response to such changes

For instance, the SESC will examine the impacts of business model changes, such as the expansion of non-face-to-face sales and the provision of new products and services, on FIBOs' business management, and will verify that they have appropriate internal control environments in response to these changes.

On the other hand, as for those FIBOs that remain dependent on traditional face-to-face sales, the SESC will examine the sustainability of the business model and impact of the changes in market conditions and customer needs on management, including financial aspects.

- (iii) Sufficiency of cybersecurity measures, and system risk management (including those outsourced) in response to progress in digitalization
- (iv) Firm establishment of internal control environments for AML/CFT
- (v) Implementation of measures to improve or prevent the recurrence of matters pointed out in internal audits or SRO examinations

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

### 3. Monitoring priorities by FIBOs' size and business type

Considering each FIBO's size and business type, as well as the environment surrounding them, the SESC will focus its examination on the following items where they could violate relevant laws and regulations or harm investor protection, such as with inadequate segregation of customer assets.

- (1) Major securities business groups<sup>3</sup>

Given the complaints about solicitation for sales of products with complex risk structures, such as structured bonds, and the governance and risk management issues identified through the default of a U.S. investment fund, the SESC will verify that the major securities business groups have appropriate control environments

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<sup>3</sup> Major securities business groups: Japanese securities companies with global operations

for governance and risk management that support global business operations, and that they are working to build sustainable business models, taking into account each group's business environment.

If necessary, the SESC will swiftly inspect relevant sales offices to examine their actual sales practices.

As for the three mega banking groups' securities companies, in addition to the above, the SESC will coordinate with relevant JFSA divisions in verifying that they have appropriate control environments for managing customer information and conflicts of interest in response to the revised firewall regulation between banking and securities businesses.

#### (2) Foreign securities firms

The SESC will verify that the foreign securities firms have appropriate internal control environments in response to the overseas outsourcing of back-office operations as part of their group strategies, and that they have appropriate control environments for system risk management. In light of the prolonged low interest rate environment, the SESC will also verify that they have appropriate control environments for managing sales of financial instruments to Japanese financial institutions and other investors.

#### (3) Online securities firms

Given the recent increasing potential risk of cyber-attacks and previous cases of unauthorized access, the SESC will verify that the online securities firms have appropriate control environments for system risk management, including cybersecurity measures.

The SESC will also verify that they have appropriate internal control environments in line with their business model changes, such as the initiatives to eliminate brokerage commissions, increases in products, and launch and expansion of face-to-face sales in collaboration with independent financial advisors.

#### (4) Semi-major/regional securities firms (including regional bank-affiliated securities companies)

The SESC found in its inspections that, amid the severe business environment, including the outflow of customers' assets through aging and inheritance, as well as the impact of intensifying fee competition and digitalization, some semi-major/regional securities firms were engaging in problematic practices regarding

investor protection, such as inappropriate investment solicitation. Given the complaints about their sales and solicitation of structured bonds that are increasingly complex, the SESC will verify whether they are following the principle of suitability.

As for those regional bank-affiliated and other securities firms that sell structured bonds to customers introduced by registered financial institutions within the same financial groups, the SESC will verify that they have appropriate control environments for such sales.

The SESC will also verify the effectiveness of internal control environments at securities firms whose major shareholders or business management systems have changed, from the viewpoint of their business models or governance.

(5) Foreign currency margin transactions business operators

Given the recent increasing potential risk of cyber-attacks and previous cases of unauthorized access, the SESC will verify that the foreign currency margin transaction business operators have appropriate control environments for system risk management, including cybersecurity measures.

The SESC will also verify that they comply with relevant advertising regulations and have appropriate internal control environments for sales and solicitation.

In addition, in light of the sharp fluctuations in the exchange rates, the SESC will verify that they provide appropriate risk disclosure, secure sufficient capital given their stress test results, and have appropriate systems to retain and report transaction data.

(6) Investment management business operators

The SESC will conduct risk-based examinations on the investment management business operators' actual investment practices and control environments for managing investment (including those outsourced) and conflicts of interest.

(7) Investment advisors/agencies

The SESC will verify whether the investment advisors/agencies are avoiding problematic practices concerning investor protection, such as misleading advertisement and solicitation through false explanation.

(8) Type II FIBOs, and business operators, etc. engaging in specially permitted businesses for qualified institutional investors

The SESC will conduct risk-based examinations, including through analysis of information from investors, focusing on funds claiming high returns and the existence of investment projects.

As for Type II FIBOs' solicitation for loan-type funds, the SESC will verify that they appropriately disclose information about loan borrowers and screen those funds.

(9) Independent financial advisors and other securities businesses subject to monitoring

Considering that some online securities firms are launching and expanding face-to-face sales activities in cooperation with independent financial advisors, the SESC will verify that their investment solicitation is conducted appropriately, and managed sufficiently by their entrusting FIBOs.

As for other securities businesses, including registered financial institutions, credit rating agencies, securities finance companies and SROs, the SESC will conduct its risk-based monitoring in light of their business characteristics.

(10) Unregistered business operators

To prevent the expansion of damage to investors caused by unregistered business operators, the SESC will proactively exercise its investigative authority to file a petition with the court for a prohibition and stay order against their illegal conduct. The SESC will also enhance information dissemination, including the public disclosure of their and their representatives' names and illegal conduct, as well as the issuance of alerts and messages to investors regarding transactions with unregistered business operators. In addition, the SESC will proactively coordinate with relevant JFSA divisions, Local Finance Bureaus (LFBs), investigative authorities and the Consumer Affairs Agency.

In addition to the above, the SESC will examine FIBOs' response to the changes in regulatory frameworks cited in 1. (2).

#### 4. Approach to monitoring securities businesses

(1) Inspection

Securities businesses subject to the SESC monitoring currently total approximately 8,000. These firms widely differ in size, services and products, and

some of them have yet to introduce adequate basic control environments for compliance and investor protection. Therefore, it is important for the SESC, with its limited human resources and based on *“the Basic Principles of Securities Business Monitoring,”* to conduct effective, efficient monitoring of securities businesses according to their risk characteristics and promptly identify risks.

The SESC will continue to select FIBOs for inspection based on risk assessment from various viewpoints, including business types and sizes as well as business models, in cooperation with relevant JFSA divisions. Inspection will be mainly conducted in cases where it is necessary to comprehend further details, such as:

- (i) a relevant law and/or regulation is breached or there is a deficiency in business operations that requires a prompt in-depth examination;
- (ii) a financial instrument is offered with an unclear risk profile, necessitating an examination of its solicitation activities;
- (iii) the actual business operations are not fully comprehended from information analysis based on monitoring (including where there is a long period between examinations); or
- (iv) there is a possible serious problem concerning investor protection (e.g., inadequate segregation of customer assets).

In its inspections, the SESC will endeavor to conduct verification and point out problems in a practically meaningful manner, and will conduct in-depth verification by using digital forensics according to each FIBO’s characteristics and issues.

Rather than merely pointing out problems and taking such actions as making recommendation for administrative disciplinary actions, the SESC will analyze the whole picture of the problems to identify their root causes, to help develop effective measures to prevent recurrence. Furthermore, if the SESC identifies the need to improve business operations before any potential issues materialize, it will describe such items as “Items to be noted” in the notification of completion of inspection, to share the awareness with the inspected FIBOs to encourage actions such as building effective internal control environments.

## (2) Cooperation with relevant organizations

To make maximum use of their respective functions, the SESC and LFBs will work closely from the planning stage of monitoring and inspection, including information sharing and exchange of opinions, and conduct joint inspection as needed.

The SESC, relevant JFSA divisions and LFBs will collaborate to share

information and conduct simultaneous inspection regarding the inspection of financial service intermediary businesses as well as cryptocurrency exchange service providers trading in over-the-counter cryptocurrency derivatives.

The SESC will continue close collaboration with SROs, share detected matters and awareness in a timely manner, and thereby conduct its securities business monitoring effectively and efficiently, to ensure market fairness and transparency, and investor protection.

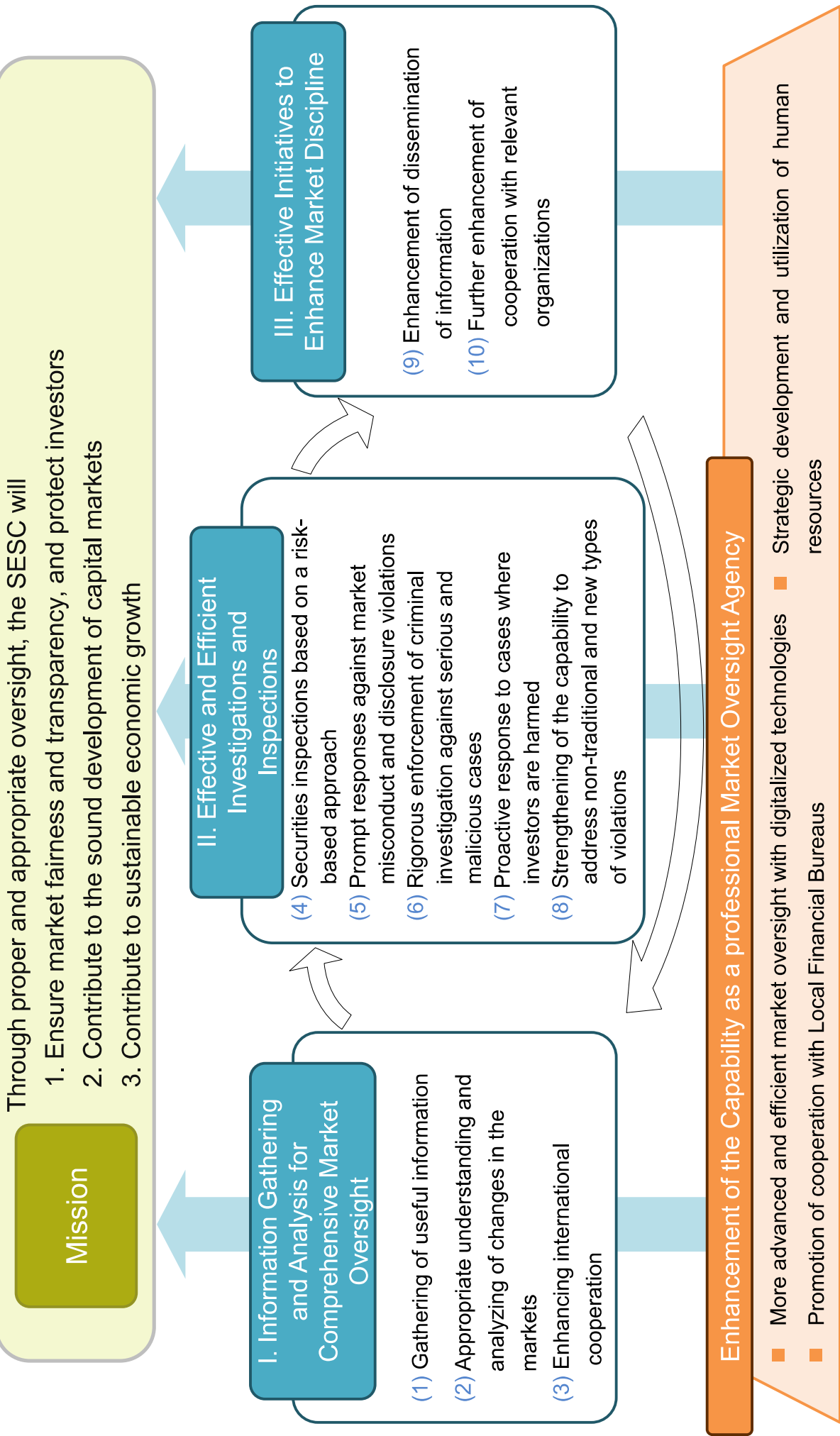
#### 5. Dissemination of inspection results and other initiatives

The SESC will encourage voluntary improvement efforts, including, as necessary, by providing FIBOs with feedback on problems and root causes found in its inspections, and by sharing its inspection results also with inspected FIBOs' audit-related staff and outside directors at review meetings.

The SESC will also endeavor to provide information about the SESC's perspectives in a specific and straightforward manner, including through the *“Overview of Securities Business Monitoring and Case Studies.”*

# Strategy & Policy of the SESC 2023-2025

## - For Trusted, Fair and Transparent Markets in Response to the Changing Times -





## **Strategy & Policy 2023-2025**

### **- For Trusted, Fair and Transparent Markets in Response to the Changing Times -**

January 27, 2023

Securities and Exchange Surveillance Commission

#### **Mission**

Through proper and appropriate market oversight,<sup>1</sup> the SESC will

1. Ensure market fairness and transparency, and protect investors
2. Contribute to the sound development of capital markets
3. Contribute to sustainable economic growth

The SESC, which was established in 1992 with the aim of ensuring fairness in transactions and maintaining investors' trust in the markets, has entered its 30th year and inaugurated its 11th term.<sup>2</sup>

For these years, the SESC's authority of market oversight has been enhanced and strengthened through several system reforms. New financial instruments and new forms of transactions have emerged and oversight targets have expanded and become increasingly complicated, sophisticated and globalized. In addition, environmental changes surrounding the markets have emerged, such as the spread of COVID-19, heightening geopolitical risks, and recent circumstances concerning economic security. New environmental changes may occur even during the SESC's 11th term.

Amid such significant environmental changes, the SESC will continue to fulfill its mission by utilizing its functions properly on a timely basis. The SESC's functions include broad market monitoring, prompt exercise of administrative functions to conduct investigations and inspections for administrative monetary penalties as well as securities inspections, and strict enforcement against serious and malicious cases.

More specifically, as explained below, the SESC will make efforts for achieving a virtuous cycle of "I. Information Gathering and Analysis for Comprehensive Market Oversight," "II. Effective and Efficient Investigations and Inspections," and "III. Effective

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<sup>1</sup> Oversight refers to the entirety of the SESC's activities, including market monitoring, examination of transactions, securities inspection, investigation of market misconduct, inspection of disclosure statements for administrative monetary penalties, criminal investigation, etc.

<sup>2</sup> The term of office for the chairman and members of the SESC is stipulated as three years (Article 13, paragraph (1) of the Act for Establishment of the Financial Services Agency), and this period of three years is called "a term."



Initiatives to Enhance Market Discipline." The SESC will further enhance its ability as a professional market oversight agency to make it the basis for achieving a virtuous cycle of market oversight.

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## Concrete Measures

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### I. Information Gathering and Analysis for Comprehensive Market Oversight

#### (1) Gathering of useful information

- Information is the key to the SESC's market oversight activities. The SESC will collect and utilize a wide range of useful information about the entire market through various information sources, such as the SESC's contact point for providing information and self-regulatory organizations.
- The SESC will integrate, analyze and accumulate useful information obtained in the process of market oversight. If necessary, the SESC will share information with the Financial Services Agency, Local Finance Bureaus, etc. The SESC will utilize the information in a multifaceted and multi-linear manner in its general market oversight activities.

#### (2) Appropriate understanding and analyzing of changes in the markets

- The SESC will keep an eye on a wide range of market transactions in equity/fixed-income markets, cash/derivative markets, and primary/secondary markets. The SESC will ascertain and analyze changes in domestic and overseas market environments on a timely basis, leading to preventive measures and early detection.
- In light of changes in the environment surrounding the markets and listed companies, as well as the progress in reviews of systemic issues, the SESC will take necessary actions in order to conduct seamless market oversight by appropriately addressing the emergence of new financial instruments and new forms of transactions and those beyond the reach of its oversight, and furthermore, by making responses to listed companies' initiatives for improving their information disclosure.

#### (3) Enhancing international cooperation

- The SESC will promote information sharing through international frameworks, such as the International Organization of Securities Commissions (IOSCO) to enhance global market oversight, and will exchange information on law enforcement cases and awareness of issues concerning market oversight through active cooperation with foreign authorities to utilize the results in its market oversight activities.

## **II. Effective and Efficient Investigations and Inspections**

### **(4) Securities inspections based on a risk-based approach**

- In collaboration with supervisory departments and Local Financial Bureaus, etc., the SESC will select financial instruments business operators for inspection based on risk assessment and endeavor to conduct verification and point out problems in a practical and meaningful manner. When any problem is found, the SESC will analyze the whole picture of the case, identify its root causes, and encourage voluntary improvement efforts to contribute to its prevention.

### **(5) Prompt responses against market misconduct and disclosure violations**

- The SESC will conduct prompt investigations and inspections so that it can swiftly make recommendations for an administrative monetary penalty payment order. The SESC will reveal the actual state of market misconduct and disclosure violations, and after ascertaining the whole picture of each case and searching for root causes, the SESC will have in-depth discussions with the related parties to prevent the occurrence and recurrence of violations.
- Regarding cross-border cases of legal violations and disclosure violations by global companies, the SESC will conduct investigations and inspections based on the characteristics of individual cases in collaboration with foreign authorities.

### **(6) Rigorous enforcement of criminal investigation against serious and malicious cases**

- Against serious and malicious violations, the SESC will take rigorous enforcement actions by exercising its powers of criminal investigation. In such instances, the SESC will cooperate with criminal investigators, prosecutors and foreign authorities in order to effectively reveal the facts, including who is to blame.

### **(7) Proactive response to cases where investors are harmed**

- From the perspective of protecting diverse investors through ensuring customer-oriented business conduct, the SESC will proactively take action against cases where investors are harmed, by such activities as conducting securities inspections against financial instruments business operators' inappropriate selling and promotion of financial instruments or filing petitions with the courts to issue prohibition and stay orders against unregistered business operators with offices in and outside Japan and entities that conduct the public offering of securities without notification, etc.

#### **(8) Strengthening of the capability to address non-traditional and new types of violations**

- The SESC will also take proactive actions against non-traditional and new types of violations that may threaten market fairness (such as legally-evasive large volume holding and purchase and new-type of usage of fraudulent means) in light of changes in the environment surrounding the markets, while continuously addressing types of violations seen in the past cases of making recommendations for administrative actions or filing criminal charges.

### **III. Effective Initiatives to Enhance Market Discipline**

#### **(9) Enhancement of dissemination of Information**

- In order to prevent investors from being harmed by market misconduct, the SESC will enhance dissemination of information, such as investor alerts.
- The SESC will highlight the significance, focus and details of cases in the press release of specific cases at the time of issuing recommendations, as well as in the casebooks it publishes. Through such efforts, the SESC will prevent market misconduct: including unintended ones, and further gather information through various information sources, such as the SESC's contact point of providing information and self-regulatory organizations.

#### **(10) Further enhancement of cooperation with relevant organizations**

- When 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.
- In order to ensure that self-regulatory organizations, which have common objectives with the SESC, fulfill their further proactive roles, the SESC will share its intelligence and awareness with them in a timely manner and reinforce the effectiveness of market oversight.

## Enhancement of the Capability as a professional Market Oversight Agency

### ○ More advanced and efficient market oversight with digitalized technologies

- In order to achieve advanced and efficient market oversight, the SESC will promote further digitalization and enhancement of data processing capacity of its market oversight systems, development of digital forensics technology, and sophistication of its information systems.

### ○ Strategic development and utilization of human resources

- The source of power of the SESC's activities is its human resources. The SESC will develop its working environment so that all staff members can work actively and perform at their potential.
- The SESC will work to equip its human resources with specialized skills and broad perspectives on market oversight so that the SESC can duly fulfill its mission.
- By aggregating the enhanced capabilities of its human resources and knowledge of diverse experts specialized in law, accounting, IT, real estate, and financial engineering, etc., the SESC will respond to changes in the markets, which are becoming increasingly complicated and sophisticated, in cooperation with relevant organizations.

### ○ Promotion of cooperation with Local Financial Bureaus

- In order to ensure fairness and transparency in the markets and properly protect investors, cooperation with Local Financial Bureaus, which play roles in market oversight in respective areas, is indispensable. The SESC will further promote information sharing in diverse fields, such as securities inspections and ensure communications with Local Financial Bureaus to achieve integrated business operation.

**SESC's Contact Point for Providing Information**

<https://www.fsa.go.jp/sesc/watch/>

< For information provision by phone or FAX >

SESC Providing Information



Direct line: Call 0570-00-3581 (or +81-(0)3-3581-9909 when using an IP phone, etc.)

FAX [only for the elderly and people with disabilities]: +81-(0)3-3506-6699 (Clearly enter "To SESC's Contact Point of Providing Information.")

- ◆ The SESC encourages the public to submit any tips and information such as "accounting fraud (recording of fictitious sales or fictitious profits, etc.)," "problems relating to investor protection (financial instruments with an extremely high yield, etc.)," "market misconduct (insider trading, market manipulation, etc.)."



*"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.