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**Only Japanese text is authentic**

# Securities Inspection Guidelines

April 2015

Securities and Exchange Surveillance Commission

## Securities Inspection Guidelines

### I. Basic Issues

#### 1. Objectives of securities inspections and basic principles

The objective of securities inspections conducted by the Securities and Exchange Surveillance Commission (hereinafter, the “SESC”) is to protect the public interest and investors. The mission of the SESC is to grasp the status of business management and the operations of business operators subject to inspection accurately; provide feedback on issues identified through inspections; and request the Prime Minister (or Commissioner of the Financial Services Agency), where necessary, to take appropriate actions/measures, such as sharing information with the relevant supervisory department authorized to supervise the business operators (hereinafter, the “Supervisory Department”). The SESC does so by verifying the soundness of the business operators’ business and financial conditions based on relevant laws/regulations.

In recent years, the types of business operators subject to SESC’s inspections have become diverse and the number of such operators has increased. In addition, the scope of inspection of large-scale securities groups engaging in complex business operations is expanding. For example, it is necessary to put more weight on verifying the appropriateness of such groups’ internal control and risk management systems (hereinafter, the “internal control system”). Considering these circumstances, the SESC must implement efficient, effective and viable inspections in order to fulfill its mission appropriately. Thus, when determining inspection priorities for individual business operators, the SESC will collect and analyze a variety of information concerning them, corresponding to their business types, sizes, other characteristics and the market conditions at the time, and then utilize a risk-based approach to decide which business operators to inspect, considering their market positions and inherent problems in a comprehensive manner. It should be noted that SESC’s inspections must involve not only verification of any violation of laws/regulations, administrative actions based on the laws/regulations, articles on financial instruments firms associations or financial instruments exchanges, and other relevant rules (hereinafter, “laws/regulations”), but also verification of the appropriateness and viability of the internal control system and identification of issues. Further, the SESC must endeavor to share an awareness of operational issues with business operators subject to inspection through interactive

dialogue with them.

In light of this, in order to satisfy the public interest and investors' expectations, the securities inspections implemented should keep in mind the objectives and methods described below, taking into account the characteristics of the business operator.

*(Note) The term "internal control system" means the control system for legal and regulatory compliance, and "risk management system" refers to the management system for credit risk, liquidity risk, market risk, operational risk and other relevant risks. The same shall apply hereinafter.*

(1) Objectives of securities inspections

Securities inspections aim to:

- 1) Encourage Financial Instruments Business Operators and other business operators (hereinafter, the "FIBOs") to establish an internal control system to ensure the fairness and transparency of Japanese markets and to protect investors.
- 2) Ensure that the risk management systems of the FIBOs, including maintenance of their financial soundness, are appropriate; and
- 3) Make FIBOs aware of their responsibilities as gatekeepers.

(2) Method of implementing securities inspections

- 1) Securities inspections shall be conducted based on interactive dialogue.
- 2) In securities inspections, the SESC shall endeavor to ascertain their perception of the senior management team responsible for the development of internal control systems
- 3) Securities inspections shall take an approach in which material issues are identified through a comprehensive analysis of given situations.
- 4) Securities inspections shall be conducted in cooperation with the Supervisory Department.

2. Inspectors' stance

(1) Awareness of objectives

Inspectors shall endeavor to implement inspections with the awareness of the issues, keeping in mind the aim of protecting the public interest and investors.

(2) Efficient implementation of inspections

Inspectors shall implement inspections efficiently, based on the order and work allocation determined to take into account factors such as the importance of inspection items and the period.

(3) Due process compliance

Inspections involve the exercise of authority against private enterprises. Inspectors shall recognize this and exercise their authority following due process.

(4) Maintenance of credibility

Inspectors shall always maintain their integrity and credibility, and never leak confidential information obtained through inspections.

(5) Understanding the actual status

Inspectors shall always remain moderate and calm, listen to their counterparty's explanations/responses, obtain accurate information and clarify the facts.

(6) Self-improvement

Inspectors shall endeavor to understand the laws/regulations related to finance and securities accurately, and study any new trends in the financial market, new financial products and trading techniques.

3. Cooperation with relevant departments

(1) Local Finance Bureaus (securities business surveillance sections)

The SESC will conduct inspections efficiently and effectively through the active utilization of joint inspections and exchanges of inspectors with local finance bureaus, the local finance branch bureau, or the Okinawa General Bureau (hereinafter, the "Local Finance Bureaus"). The SESC will also work together with the Local Finance Bureaus, providing support by sharing inspection techniques and information, and assisting in processing the inspection results.

(2) Supervisory Bureau, etc.

The SESC will make efforts to cooperate with the FSA's Supervisory Bureau and supervisory departments in Local Finance Bureaus by sharing information in a timely manner through exchanges of information gained in supervision/inspection and sharing an understanding of identified issues. Further, the SESC will conduct

inspections through seamless cooperation with supervisory departments, implementing combined on- and off-site monitoring.

In addition to conducting inspections on targets within financial groups by sharing an understanding of identified issues, the SESC will further enhance its cooperation with the FSA's Inspection Bureau in determining inspection items, timing, and methodologies, etc.

#### 4. Cooperation with self-regulatory organizations

##### (1) Self-regulatory organizations

The SESC will further strengthen coordination between its inspections and audits/examinations by self-regulatory organizations (including financial instruments firms associations, financial instruments exchanges, and self-regulatory corporations; hereinafter, "SROs"), and make efforts to improve the overall surveillance function for FIBOs.

From this perspective, the SESC will promote cooperation with SROs, such as cooperation through coordination in terms of the Securities Inspection Implementation Plan (see Chapter II, Section 2), the exchange of information, and inspector training. At the same time, the SESC will contribute to reinforcing the self-regulatory function of SROs by inspecting them as necessary.

##### (2) Investigating authorities, etc.

The SESC will strengthen cooperation with investigating authorities, etc. in order to deal with fraudulent business operations by highly malicious business operators and the sale of funds by unregistered business operators.

##### (3) Overseas securities regulators, etc.

To deal with expanding overseas/cross-border business activities, the SESC will enhance cooperation with overseas securities regulators, etc. by exchanging information utilizing the Multilateral Memorandum of Understanding (MMOU) signed among securities regulators in multiple countries, and providing mutual support when conducting inspections.

## II. Inspection Procedures

### 1. Formulation of a Securities Inspection Policy and Program

The SESC shall develop and publish a Securities Inspection Policy and Program at the beginning of each fiscal year. In order to achieve efficient and effective inspections, the SESC shall fully take into account the policies of the Supervisory Departments and any changes in the environment that may affect conditions in the financial markets.

### 2. Formulation of a Securities Inspection Implementation Program

#### (1) Formulation of a Securities Inspection Implementation Program

Based on the Securities Inspection Policy and the Securities Inspection Program, the SESC and the Local Finance Bureaus shall formulate an Annual Securities Inspection Program, together with the quarterly Securities Inspection Implementation Program.

Points to consider when developing a program are outlined below.

#### 1) Business operators subject to inspection

The SESC will collect and analyze a variety of information concerning them, corresponding to their business types, sizes, other characteristics and the market conditions at the time, and then utilize a risk-based approach to decide which business operators to inspect, considering their market positions and inherent problems in a comprehensive manner. The SESC shall make clear to the business operators selected for inspection the reasons behind their selection and the focus of inspection.

#### 2) Inspection period

The number of days required for inspection for each business operator will be determined based on factors including the scale, business profile and results of the previous inspection.

#### 3) Number of inspectors conducting on-site inspections

The number of inspectors involved in conducting an on-site inspection will be determined based on factors including each inspector's level of experience and knowledge, as well as the scale and business profile of each selected business operator.

#### 4) Branch offices subject to on-site inspections

Branch offices to be covered by on-site inspections will be determined after taking into account the selected business operator's scale, business profile,

locational distribution of branch offices, results of the previous inspection and various other information, together with the duration of the inspection.

(2) Branch-only inspections

In principle, if it is considered necessary to inspect a specific branch of a business operator as a result of a comprehensive review of various information and the inspection results of their head office, the SESC will formulate a Securities Inspection Implementation Program specifically for that branch office.

(3) Group-wide inspections

To ensure that inspections are efficient and effective, where necessary the SESC will formulate a Securities Inspection Implementation Program on a group-wide basis including the business operator's parent, subsidiary and business partner/counterparty if it is determined appropriate to inspect them as well.

(4) Special inspections

Special inspections are conducted to verify specific operational issues. The target (multiple business operators where deemed necessary) and duration of a special inspection shall be determined taking into account the scope of the issues necessitating the special inspection and the credibility of the information acquired on those issues.

It should be noted that the SESC will determine whether to implement a special inspection or an accelerated general inspection cycle, taking into account the scope of the inspection and time elapsed since the previous inspection.

3. Types of inspection

(1) As explained below, there are two types of inspection.

1) General inspections

General inspections are conducted focusing on general operational issues of the business operators, taking into comprehensive account various information, the results of the previous inspection and the inspection cycle.

2) Special inspections

Special inspections are conducted expeditiously on a part of a business operator's business operations based on information acquired.

(2) General inspections and special inspections are conducted solely by the SESC or the

Local Finance Bureaus in charge. Inspections are also conducted in the following manner.

1) Joint inspections

Joint inspections are conducted jointly by the SESC supervising the business operator being inspected and a non-supervising Local Finance Bureau or vice versa.

2) Branch-only inspections

Branch-only inspections are conducted on the branch office of a business operator by the SESC or the Local Finance Bureaus, whichever is in charge (except for joint inspections as in 1) above).

3) Simultaneous inspections

Simultaneous inspections are conducted simultaneously with an inspection led by the FSA Inspection Bureau in order to ensure the efficiency and effectiveness of the inspection process.

4. Inspection methods

In principle, securities inspections shall take an on-site inspection approach where a team of inspectors visits the head office, branch offices and other relevant offices of the business operator in question and inspects the books and records on site.

5. Inspection with prior notice

(1) In principle, there will be no prior notice for on-site inspections, except when prior notice is deemed necessary because of factors including the business characteristics of the business operator, the focus of the inspection, or the efficiency and workload imposed on the business operator by the inspection.

(2) The chief inspector will inform the person responsible for securities inspections at the business operator (hereinafter, the “Person Responsible at the BO”) of the start date of the on-site inspection together with other relevant information approximately one to two weeks prior to the start date for the inspection (see Chapter II, Section 8 (1)) by phone.

After giving prior notice, the chief inspector shall report the fact to the Executive Bureau of the SESC.



## 6. Inspection cut-off date

The “inspection cut-off date” is the date set out as the base date of each inspection and is principally the business day immediately preceding the start date of an on-going inspection (where prior notice is given, the business day immediately preceding the day when prior notice was given).

*(Note) This is not intended to mean that financial data, the state of the business, etc. must be verified strictly by the cut-off date.*

## 7. Inspection Order

Inspection Order (Form 1) shall be drafted in the name of the Chairman of the SESC when issued by the SESC, and the relevant director-general in the case of local finance bureaus, the local finance branch bureau, or the Okinawa General Bureau (hereinafter, “Directors General of the Local Finance Bureaus”).

## 8. Points of concern in relation to inspections

### (1) Presentation of the Inspection Order and provision of explanations

The chief inspector should present to the Person Responsible at the BO the Inspection Order and a document identifying him/her as an inspector, and in principle, provide explanations of the following.

- 1) The purpose and authority of the inspection (including whether general inspection or special inspection. Also refer to areas of focus of the inspection to a degree that does not adversely affect the viability of the inspection)
- 2) Request for cooperation with the inspection
- 3) Inspection process (this is only necessary for first-time inspections)
- 4) Overview of restrictions on third-party disclosures of information related to the inspection (see Chapter II, Section 8 (2)-1)
- 5) Overview of the inspection monitoring system (See Chapter II, Section 10)
- 6) Overview of the opinion submission system (See Chapter II, Section 12)
- 7) Presentation of the required submission documents (See Chapter IV, Section 2)
- 8) Other matters requiring explanation

In the case of an inspection with prior notice, the chief inspector shall (i) explain 1) and 2) above, (ii) inform the business operator of the start date of the on-site inspection, and (iii) request the safekeeping of documents from this point forward and

advise the business operator of the documents that need to be submitted promptly. In addition, the chief inspector shall make the business operator being inspected aware that if it is found that documents and emails have been destroyed in the period granted by the prior notice, the SESC will treat such action as an attempt to evade inspection, and take strict action. Remaining items shall be presented or explained by the start date of the on-site inspection.

Of note, inspectors shall carry a document that identifies them as an inspector at all times so that it can be presented on request to the business operator being inspected.

(2) Restriction on third-party disclosure of Securities Inspection Information

1) Explanation at initiation of On-site Inspection

At the start of the on-site inspection (in the case of an inspection with prior notice, prior to the start date of the inspection), the chief inspector shall give the Person Responsible at the BO an overview of restrictions on third-party disclosure of Securities Inspection Information (defined as questions, indications and requests from inspectors, details of interactions between inspectors and managerial staff at the business operator during the inspection, and Notification of Completion). When doing so, the chief inspector shall include following points in the overview.

- Securities Inspection Information is highly confidential, containing information on the inspected business operator's customers and business partners. Securities Inspection Information also contains information on the specific approach used in the inspection.
- In order to ensure that the inspection is not interrupted, the business operator being inspected shall manage the information properly, and must not disclose Securities Inspection Information to third parties without the prior consent of the Director of the Inspection Division at the Executive Bureau of the SESC (hereinafter, the "Director of the Inspection Division") (or the "Director of the Securities and Exchange Surveillance Department" in the case of a Local Finance Bureau) or the chief inspector.
- Having understood the above, the business operator being inspected shall sign and affix their seal to the letter of consent to nondisclosure of Securities Inspection Information without the prior consent of the Director of the Inspection Division (or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau) or the chief inspector (hereinafter, "Letter of Consent to Nondisclosure of Securities Inspection Information to Third Parties"; see Form 2).

2) Submission of Letter of Consent on Nondisclosure of Securities Inspection Information to Third Parties

Given the sensitive nature of the information, Securities Inspection Information shall be handled in the following manner.

- A. At the start of the on-site inspection (prior to the start date in the case of an inspection with prior notice), the chief inspector shall explain to the Person Responsible at the BO that third-party disclosure of Securities Inspection Information is prohibited unless prior consent is obtained from the chief inspector if consent is being requested prior to completion of the on-site inspection, and to the Director of the Inspection Division (or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau) if requested after completion. The chief inspector shall then obtain the signature and seal of the Person Responsible at the BO.
- B. It should be noted that the relevant inspection and supervisory departments, SROs and those recognized as SRO-equivalent, and external attorneys, certified public accountants and real estate appraisers that are placed as members of committees within the business operator's organization for the purpose of internal control, are not treated as third parties.
- C. In the case where a business operator being inspected intends to disclose Securities Inspection Information and consults with experts such as external attorneys, certified public accountants and real estate appraisers during the on-site inspection, the intention to disclose shall be reported to the chief inspector. If, based on the reporting, the chief inspector considers that the reporting is sufficient and the intended disclosure will not adversely impact the viability of the inspection, a request for consent to the disclosure outlined below shall be deemed unnecessary.

3) Submitting a request for consent to the disclosure of Securities Inspection Information

- A. If a business operator requests consent for third-party disclosure of information, the chief inspector (the Director of the Inspection Division or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau if requesting after completion) shall require submission of a written request for consent to third-party disclosure (hereinafter, "Request for Consent to Third-Party Disclosure"; see Form 3). The chief inspector (the Director of the Inspection Division or the Director of the Securities and Exchange Surveillance Department in the case of a Local

Finance Bureaus after completion) shall decide whether to give consent, considering carefully factors including (i) the necessity of disclosure; (ii) any confidentiality obligations (existence of a confidentiality agreement, etc.), and (iii) any potential impact on the viability of the inspection, and inform the requesting business operator in writing of their decision.

Note that if the business operator being inspected needs to disclose the minimum required information to a third party (e.g., a contractor) to obtain the confirmation required by the chief inspector during the on-site inspection, submission of a Request to Consent to Third-Party Disclosure shall be deemed unnecessary.

B. Types of disclosure that are likely to require submission of a Request for Consent to Third-Party Disclosure are listed below.

- Disclosure to the management company, parent company, etc. of the business operator being inspected
- Disclosure to attorneys, external auditors, contractors etc. that are expected to contribute to properly maintaining the business operations of the business operator or its management company
- Disclosure to the counterparty in a corporate merger, etc. for due diligence
- Disclosure to the administrator/supervisor in a bankruptcy/civil rehabilitation process

C. If the business operator being inspected obtained consent to disclosing information to its management company in a past inspection, submission of a Request for Consent to Third-Party Disclosure is deemed unnecessary for each inspection unless the management company has changed.

### (3) Hands-on inspection

- 1) When considered necessary by the chief inspector to gain an effective understanding of the actual state of the business operator being inspected and the appropriateness of its business, inspectors will conduct a hands-on inspection, in which inspectors will directly visit the rooms, data storage sites, etc. where officers and other employees are working and randomly check through original documents, etc.
- 2) Inspectors shall conduct the hands-on inspection with the utmost care, keeping in mind the following points.
  - A. Inspectors shall conduct hands-on inspections precisely and quickly in the

presence of at least 2 personnel from the business operator being inspected (including the Person Responsible at the BO) and avoid accidents or loss of documents.

- B. Property inspected by the inspectors may include personal items belonging to officers and other employees, but the inspectors will attempt to obtain the consent of the owner.

#### (4) On-site inspections

The chief inspector shall implement on-site inspections efficiently and effectively, ensuring that inspectors under his/her control understand the purpose of each inspection.

- 1) Keeping track of the inspection progress and giving instructions on inspection techniques

The chief inspector shall require inspectors under his/her control to report on the progress of the ongoing on-site inspection, the status of verification and issues identified through the verification, and provide inspectors with appropriate instructions.

In addition, the chief inspector shall endeavor to implement efficient on-site inspections and support the work of the inspectors, where necessary, by holding a pre-inspection meeting in which each inspector can share information and discuss specific techniques for upcoming inspections.

- 2) Giving guidance by visiting each branch office undergoing on-site inspection

When there are a number of branch offices covered in an on-site inspection, the chief inspector shall visit and provide guidance to each office being inspected when necessary. The chief inspector shall endeavor to grasp the detailed status of the business operator being inspected by determining the actual status of its business operations through meetings with the person responsible at these branch offices.

- 3) Managing violations of laws/regulations or other operational issues

The chief inspector shall promptly handle issues identified during the on-site inspection in close cooperation with the Director of Inspection Management at the Executive Bureau of the SESC (hereinafter, the “Director of Inspection Management”) (or through the advising officer and screening officer in the case of a Local Finance Bureau) by investigating potential problems where necessary and keeping in mind the points listed below. The Director of Inspection Management shall endeavor to process any queries received on potential

problems promptly in cooperation with the evaluation section of the Inspection Division at the Executive Bureau of the SESC (hereinafter, the “Evaluation Section”).

- A. Accurate fact-finding regarding the issue in question
- B. Significance of the issue to the business operator being inspected
- C. Laws/regulations related to the issue
- D. Identification of causes and responsibilities for the issue
- E. Awareness of and measures taken to address the issue by the business operator being inspected

4) Guidance by the Director of Inspection Management

By the end of the inspection, the Director of Inspection Management (or the Director of the Securities and Exchange Surveillance Department, or the Securities Inspection Advisor in the case of a Local Finance Bureau) shall visit the inspection team and give guidance to ensure that the team fully analyzes the points that were confirmed and discussed as a result of the inspection before determining which points should be listed on the Summary Sheet. (See Chapter II, Section 8-(12)-1.)

(5) Consideration for the business operations of the operator being inspected

To avoid interrupting the business operations of the operator being inspected, the chief inspector shall consider the following points.

- 1) For on-site inspections of small-scale business operators, the chief inspector shall make sure that the business of the operator is not interrupted, taking into account its capability to cope with the inspection.
- 2) In principle, on-site inspections shall be conducted during the business hours of the business operator. Inspections outside of business hours require the consent of the business operator, but should not be continuous without reasonable justification.

(6) Inspections focusing on interactive dialogue

In order to implement efficient and effective on-site inspections, the chief inspector shall endeavor to focus on interactive dialogue with the business operator being inspected, taking into account the purpose and status of the on-site inspection; for example, through the following exchanges of opinions with management.

- 1) The chief inspector shall hold discussions with the management on the start date of the inspection (if unable to do so on the start date, as soon as possible

thereafter) to ascertain the management's awareness of internal control and risk management.

- 2) The chief inspector shall hold discussions with the management at the end of the on-site inspection (hereinafter, the "Exit Meeting"), and confirm their views on issues discussed during the inspection.

The Person Responsible at the BO and those responsible for compliance and risk management at the business operator being inspected are required to attend the Exit Meeting, where the chief inspector will communicate verbally his/her assessment of the issues recognized during the on-site inspection (e.g. flaws in the application of laws/regulations, internal control system, etc.). The chief inspector shall also explain that the assessment at the Exit Meeting does not represent the final opinion of the SESC or relevant Local Finance Bureaus.

If there are any changes to issues discussed at the Exit Meeting, a follow-up meeting should be held to discuss the changes where necessary.

The post on-site inspection process shall be explained again at the Exit Meeting.

- 3) If it becomes clear at the Exit Meeting that the chief inspector and the business operator being inspected have a different understanding of the facts, the chief inspector shall prepare a document clarifying the facts. A copy of the document shall be issued to the business operator being inspected if requested. Documentation is unnecessary if the above facts are outlined and clarified in the Summary Sheet confirmed by the business operator being inspected.

In addition, if necessary, the chief inspector shall discuss the progress of the on-site inspection, the business operator's response to the on-site inspection, inspection methods, etc. with the management. In the case of a first-time on-site inspection, the chief inspector shall determine the business profile and characteristics of the business operator through discussion.

- (7) Instructing the business operator during the inspection

During the on-site inspection, inspectors shall work to recognize and clarify the facts and refrain from making definitive statements on the correctness or incorrectness of the facts or requiring the business operator being inspected to take corrective action based on their own personal opinion. However, this is not intended to prevent inspectors during the fact-finding process from listening to the business operator's explanation of any voluntary actions that can be taken to improve the situation.

- (8) Use of the Securities Inspection Policy and the Inspection Manual

When conducting inspections, inspectors shall endeavor to determine the actual status of the business operator being inspected based on the Securities Inspection Policy and utilizing the Inspection Manual for Financial Instruments Business Operators (hereinafter, the “Inspection Manual”).

However, it is important to note that the check items in the Inspection Manual are samples that are considered useful in effectively capturing the actual status of the business operator being inspected. Inspectors should keep in mind the need to take into account the characteristics, business condition, product offering, etc. of the business operator and avoid using the Inspection Manual in their verification process in a mechanical or inflexible fashion.

Inspectors shall also use the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc. as a reference during the inspection.

(9) Interviews

When conducting interviews with specific officers and employees of the business operator being inspected, inspectors shall allow other officers and employees to be present if requested, as long as it does not interfere with the ongoing on-site inspection.

If it is decided not to allow other officers and employees to be present, inspectors shall justify their decision to the business operator.

(10) Requests from the business operator being inspected

If the inspectors receive a request from the business operator being inspected, they are required to report this to the chief inspector. If the chief inspector considers that the request needs careful handling, he/she shall seek the advice of the Director of Inspection Management (or the Director of the Securities Exchange Surveillance Department in the case of a Local Finance Bureau).

(11) Grasping the actual status through the use of data and figures

On-site inspections should not rely solely on verbal explanations of the business being inspected. Inspectors should attempt to grasp the actual status of the management, business operations and legal/regulatory compliance of the business accurately based on objective evidence such as data and figures.

(12) Recording facts and background information

Inspectors shall grasp the points at issue accurately through the investigation and



further analysis of the results of hearings, account books and other vouchers. They shall report to the chief inspector and request officers and other employees of the business being inspected to confirm the facts in writing or other forms.

When requesting documents to be submitted for confirmation of the facts, the chief inspector shall consider carefully the necessity of the documents using the following process.

1) Summary Sheet (Form 4)

Prepare a Summary Sheet, if necessary, to confirm the facts which are likely to be pointed out by inspectors and the business operator's awareness of these facts.

2) Questionnaire (Form 5)

Prepare a Questionnaire, if necessary, to obtain answers to specific questions from the Person Responsible at the BO.

(13) Grasping fundamental issues regarding business operations, etc.

In addition to verifying the possibility of legal/regulatory violations, inspectors shall investigate the causes of any existing operational issues identified during the on-site inspection, taking into account the links between these issues and control issues, including internal control and risk management, through a detailed analysis of the related facts and background. Inspectors shall endeavor to determine the issues identified from a business control perspective by verifying the links between the issues identified and the business operator's management policy, and prepare a Summary Sheet, where necessary.

(14) Points of concern for third-party contact

If the chief inspector determines that it is necessary to confirm the way that the business operator does business with clients (third-party contact), the chief inspector shall seek the advice of the Director of Inspection Management (or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau).

(15) Actions when inspection of major shareholders is required

If the chief inspector determines that it is necessary to inspect the major shareholders and parent company (holding company, etc.) of the FIBO, the chief inspector shall report to the Director of Inspection Management (or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau). Inspection of the major shareholders and parent company shall be implemented according to the

required process, when the Director of the Inspection Division (or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau) determines that an inspection is needed based on discussions with the Director of Inspection Management.

(16) Actions when facing problems

When facing difficulties due to refusals, interruptions, avoidance of an on-site inspection by the business operator or other materially adverse events (hereinafter, “Refusal of Inspection”), the chief inspector shall attempt to persuade the business operator to accept the inspection and promptly seek the advice of the Director of Inspection Management (or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau) with documentation detailing the background and reason behind the Refusal of Inspection, the business operator’s behavior and other related facts.

On receiving the report, the Director of Inspection Management shall discuss possible measures to be taken against the reported Refusal of Inspection with the Director of the Inspection Division.

The chief inspector or the Director of Inspection Management (or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau) shall confirm the facts related to the reported Refusal of Inspection with the Person Responsible at the BO, and take appropriate measures, requesting a statement of reasons.

(17) Change in the duration of on-site inspections

In principle, the chief inspector shall attempt to complete the necessary verification within the given timeframe, finalize the identified issues to be included in the Summary Sheet, and conclude the on-site inspection accordingly. However, if the inspection is likely to take longer than expected, or if there is any disagreement with the business operator about serious issues even in the final stages of the on-site inspection, the chief inspector shall report to the Director of Inspection Management (or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau) before making a decision on whether the ongoing on-site inspection should be extended or suspended. If verification by the inspectors is likely to be completed earlier than the scheduled end date, the chief inspector shall also report to the Director of Inspection Management (or the Director of the Securities and Exchange Surveillance Department in the case of a Local Finance Bureau) before

making a decision on whether to reduce the inspection period.

Before briefing the chief inspector, the Director of Inspection Management shall discuss the possibility of changing the on-site inspection period with the Director of the Inspection Division.

(18) Measures in the event of a natural disaster

In the event of a natural disaster, and if the business operator being inspected is affected, the chief inspector shall seek the advice of the Director of the Inspection Division (or the Director of the Securities Exchange Surveillance Department in the case of a Local Finance Bureau). The Director of the Inspection Division (or the Director of the Securities Exchange Surveillance Department in the case of a Local Finance Bureau) shall discuss the circumstances in detail with the business operator via the chief inspector, and consider suspending or cancelling the ongoing inspection to give priority to the disaster recovery.

Even if the business operator being inspected is not affected by the natural disaster, the Director of Inspection Management (or the Director of the Securities Exchange Surveillance Department in the case of a Local Finance Bureau) shall discuss the circumstances in detail with the business operator via the chief inspector as to whether to continue the ongoing inspection.

The decision to continue, suspend or cancel the ongoing inspection shall be communicated verbally by the chief inspector to the Person Responsible at the BO.

The same shall apply to other circumstances that may interfere with the inspection, such as termination of the company, system errors, etc.

(19) Organizing the results of on-site inspections

When aggregating and summarizing the inspection results upon completion of the on-site inspection, the chief inspector shall take full account of facts, characteristics and causes of identified issues and raise them as Points at Issue.

As necessary, the above Points at Issue shall be aggregated and summarized in close cooperation with the Evaluation Section (or via the person responsible for evaluation at each Local Finance Bureau).

9. Request for materials for inspection

(1) Efficient use of existing materials

In principle, inspectors shall endeavor to utilize the available materials and reduce the

business operator's burden as a result of the inspection. Inspectors should give due consideration to the need to request materials other than those already existing.

Generally, submission of materials through digital media shall be accepted by the inspectors when requested to the extent that it does not interrupt the ongoing inspection.

(2) Expediting the process of requesting materials for inspection

In principle, inspectors shall endeavor to make requests for materials in a centralized manner via the business operator's internal control department, giving explanations of the background of the request as appropriate.

Inspectors shall request materials required for inspection promptly and precisely, in writing if necessary, taking into account factors such as the priority of the issue for which the material is being sought and the business operator's burden as a result of the on-site inspection.

The chief inspector shall always keep track of the status of the request for materials for inspection and ensure that there are no overlapping requests.

(3) Borrowing materials from the business operator being inspected

When considered necessary to grasp the business operator's status accurately and efficiently, inspectors may borrow original copies of materials.

As a general rule, inspectors shall issue a confirmation document when borrowing materials, and endeavor to manage the borrowed materials appropriately and return them promptly.

(4) Returning borrowed materials

During the on-site inspection period, inspectors shall allow the inspected business operator to carry materials out from the inspection site or return the borrowed materials if requested to the extent that the action does not interfere with the ongoing inspection.

10. Inspection monitoring system

Inspection monitoring is intended to ensure that the SESC and the Local Finance Bureaus will implement on-site inspections in an appropriate manner through interviews with business operators, and contribute to carrying out inspections that are highly efficient and viable. In principle, inspection monitoring shall take place according to the process

outlined below, taking into detailed account the purpose and period of each individual inspection.

(1) Explanation to business operators being inspected

As a general rule, the chief inspector shall provide an overview of the inspection monitoring system to the Person Responsible at the BO on the start date of the on-site inspection.

(2) Overview of the inspection monitoring system

Inspection monitoring will take the form of monitoring opinions (questionnaire), combined with hearings where considered necessary.

It should be noted that the monitoring is restricted to the inspection approach taken by the inspectors.

1) Monitoring opinions (Questionnaire)

A. Method of submitting opinions

Fill in the Questionnaire (Form 6) and return it via email or postal mail.

B. Addressee

The Questionnaire should be addressed to the Director of Inspection Management for inspections led by the SESC. For inspections led by the Local Finance Bureaus, the Questionnaire should normally be submitted to the Director of the Securities Exchange Surveillance Department, but it may be submitted to the Director of Inspection Management.

C. Submission period

As a benchmark, the questionnaire submission period is set from the start date of the on-site inspection to 10 days after the end date of the on-site inspection (excluding holidays of administrative organs).

2) Interviews

A. Interviewer

For the Executive Bureau of the SESC, the Secretary-General, the Deputy Secretary-General (responsible for the Inspection Division), the Director of the Coordination Division and the Director of the Inspection Division will conduct interviews.

For a Local Finance Bureau, interviews will be conducted by the Director of the Securities Exchange Surveillance Department or persons appointed by the Director of the Securities and Exchange Surveillance Department (persons designated as interviewers for the SESC as above may be appointed

where necessary).

B. Interview method

When it is determined that interviews are necessary to ensure the appropriateness of the inspection, designated interviewers shall visit the business operator being inspected and listen to the opinion of the Person Responsible at the BO on the inspection approach during the on-site inspection.

*(Note) In view of the viability of monitoring the ongoing inspection, designated interviewers shall hold meetings with the inspection team prior to the interview (and after the interview where necessary).*

3) Use of opinions

The SESC shall treat the opinion of the business operator being inspected as an indicator of the quality of its inspection and utilize it to implement appropriate and highly efficient and effective inspections. Interviewers shall give advice to the chief inspector when necessary.

11. Comments and remarks regarding on-site inspections

- (1) After the end of the on-site inspection and at completion of the process to sort out which issues to point out to the business operator (if there are no issues to point out, as soon as possible thereafter), the chief inspector shall present his/her comments and remarks regarding the on-site inspection to the Person Responsible at the BO as described below.

Note that if the Director of the Inspection Division (or the Director of the Securities and Exchange Surveillance Division in the case of a Local Finance Bureau) determines that the issues identified must be handled urgently to protect the public interest and investors, the process of presenting post- on-site inspection comments and remarks may be omitted.

*(Note) To “point out” means the de facto action of including problems identified during the inspection in the inspection results.*

- 1) Pointing out issues identified through the inspection, including violations of laws and regulations; if there are no problems, reporting this fact.
- 2) From the issues pointed out in 1), identifying those issues on which the inspection team and the business operator being inspected have different views (hereinafter, “Disputed Matters”)

- (2) If there is any change in the contents of the chief inspector's comments or remarks, he/she should hold a meeting to discuss the changes where necessary.
- (3) Attendance at the meeting for comments and remarks regarding on-site inspections
  - 1) SESC or the Local Finance Bureau.

As a general rule, the chief inspector and one or more inspectors who participated in the inspection shall attend the meeting.
  - 2) Business operator being inspected

The Person Responsible at the BO must attend the meeting. If he/she requests the attendance of other officers and employees, the request shall be accepted to the extent that the attendance will not adversely affect the meeting.
- (4) Method of communicating comments and remarks

In general, the chief inspector shall deliver his/her comments and remarks verbally to the Person Responsible at the BO. (To improve efficiency, communication by telephone may be permitted in cases where there are no problems to point out, or where telephone communication is considered appropriate by the Director of the Inspection Division or the Director of the Securities and Exchange Surveillance Department in case of a Local Finance Bureau). Considering that the post-inspection comments and remarks will form the basis of the opinion submitted by the business operator being inspected, the chief inspector shall endeavor to ensure that his/her comments and remarks are fully conveyed to the business operator.

## 12. Opinion submission system

In order to maintain and improve the standard of securities inspections by the SESC and Local Finance Bureaus and maintain the transparency and fairness of the inspection process, the opinion submission system shall operate as follows.

- (1) Explanation to business operators being inspected

Both at the start of the on-site inspection and at the post-inspection comments and remarks stage, as a general rule, the chief inspector must provide the business operator with an overview of the opinion submission system as described below.
- (2) Overview of the opinion submission system
  - 1) Submission of opinion sheet

- A. The submitter of opinions (representative of the business operator being inspected) shall record the related facts and his/her opinions on the disputed matters on the Opinion Sheet (See Form 7) together with necessary explanatory documents, and submit them to the Secretary-General of the Executive Bureau of the SESC directly or via the chief inspector.  
In order to clarify the background to the disputed matters, the submitter of opinions shall also submit a document outlining the related discussions with inspectors.
  - B. For violations of laws/regulations identified during the inspection, the opinion submission system generally covers disputed matters only.
  - C. The submission period for the Opinion Sheet is three days counting from the day immediately following the day the remarks and comments are submitted to the Person Responsible at the BO (excluding holidays of administrative organs). However, if requested within three days after the day the remarks and comments are submitted, the opinion submission period may be extended by up to two days (excluding holidays of administrative organs). In the case of delivery via postal mail, the Opinion Sheet will be accepted as long as it is postmarked on or before the end of the submission period (or extended submission period).
  - D. When the explanatory documents to be attached to the Opinion Sheet cannot be prepared and submitted on time, the Opinion Sheet shall be submitted within the relevant submission period, and the other documents can be submitted promptly at a later date.
  - E. To withdraw an Opinion Sheet after it has been submitted, the submitter should request the return of the Opinion Sheet by submitting a Request for Withdrawal of Submitted Opinions (Form 8).
- 2) Review process.
- A. Submitted opinions will be reviewed by the SESC based on the draft review document prepared by a division other than the Inspection Division within the Executive Bureau of the SESC.
  - B. Review results shall be reflected in the preliminary draft of the Notification of Completion of Inspection.
- 3) Delivering the review results
- Final review results shall be included in the final version of the Notification of Completion of Inspection.



### 13. Notification of Completion of Inspection

The Notification of Completion of Inspection (See Form 9) shall be issued after approval by the SESC (or after providing an explanation to the relevant Directors-General in the case of a Local Finance Bureau) in the name of the Chairman of the SESC (or the relevant Director-General in the case of a Local Bureau) and addressed to the Person Responsible at the BO.

On issuing the Notification of Completion of Inspection, the Person Responsible at the BO should be advised that the notification must not be disclosed to any third parties without the prior consent of the Director of the Inspection Division (or the Director of the Securities Exchange Surveillance Department in the case of a Local Finance Bureau).

In special circumstances such as cancellation of an inspection, a Notification of Completion of Inspection will not be issued, and the Person Responsible at the BO will be informed verbally by the chief inspector.

As a benchmark, Notification of Completion of Inspection shall be issued within 3 months of the end of an on-site inspection.

### 14. Recommendations

When considered necessary as a result of an inspection, a draft recommendation document outlining the facts of any legal and regulatory violations identified during the inspection, together with recommendations to the Prime Minister and the Commissioner of the FSA to take administrative and other actions, shall be prepared and must be discussed at the SESC.

Note that after the SESC has approved the proposed recommendation document, the Executive Bureau of the SESC will issue the finalized recommendation document to the relevant supervisory department.

### 15. Public disclosure of inspection results

#### (1) Public disclosure of inspection results

To maintain transparency in the SESC's operations, enforce fairness throughout the operation, and contribute to protecting investors, the SESC and the Local Finance Bureaus shall disclose the inspection results publicly, after giving due consideration to their duty of confidentiality as a national public servant. Public disclosure of the inspection results should follow the rules outlined below.

- 1) Inspection of an FIBO that results in recommendations shall be publicly disclosed immediately after completion of the inspection. In general, this type of disclosure shall include the name or trade name of the inspected FIBO.
- 2) Inspection of an FIBO that did not result in any recommendations shall also be disclosed publicly if considered necessary. In this case, the name or trade name of the inspected business operator will not be disclosed.
- 3) For inspections of persons making notification for business specially permitted for qualified institutional investors, given the limited scope of adverse disposition under the Financial Instruments and Exchange Act (hereinafter, the “FIEA”), if it considers it appropriate to disseminate the results widely in order to protect investors, the SESC shall publicly disclose the name or trade name of the operator in accordance with 1) above, in cases that the violation of the FIEA is serious and malicious,
- 4) The SESC shall publicly disclose the progress of administrative work related to the inspections conducted by the SESC on an annual basis.

Note that the SESC will refrain from public disclosure if it is deemed inappropriate in consideration of the impact that disclosure may have on the public interest and investors.

(2) Public disclosure of the names of business operators subject to inspection

In order to acquire a wide range of information on business operators to be inspected as the first step in investigating any potential legal and regulatory violations, the SESC shall, in principle, disclose on its website the names of business operators being inspected for a certain period from the start date of the on-site inspection (or from the date of prior notice, if any).

Taking into account the type and scale of the business of FIBOs, the duration of disclosure is set as below. Note that if the on-site inspection ends prior to the end of the disclosure period, the disclosure period shall end on the on-site inspection completion date.

- Type I FIBOs (those supervised by the FSA): 30 business days
- Others: 15 business days

16. Other points of concern

(1) Branch-only inspections

Branch-only inspections are intended to verify not only issues unique to a specific

branch office but also the status of improvement regarding issues pointed out at the inspection at its head office and points that are useful for the next inspection of its head office.

(2) Joint inspections and simultaneous inspections

Joint inspections shall be implemented in coordination between the SESC and the Local Finance Bureau and simultaneous inspections shall involve coordinating with the FSA's Inspection Bureau.

The chief inspector in charge of inspecting branch offices shall not give comments and remarks; instead, the chief inspector in charge at the head office will give comments and remarks to the Person Responsible at the BO.

(3) Special inspections

Special inspections are intended to be flexible and timely through the effective use of various key information, including new trends in the relevant financial markets and individual transactions. In view of this, special inspections shall be conducted in an efficient manner after narrowing down the scope.

### III. Effective Dates

These guidelines come into effect starting from inspections with a cut-off date of July 14, 2005.

(Amendment)

These amended guidelines are effective from July 3, 2006.

(Amendment)

These amended guidelines are effective from September 30, 2007.

(Amendment)

These amended guidelines are effective from August 11, 2008.

(Amendment)

These amended guidelines are effective from June 29, 2009.

(Amendment)

These amended guidelines are effective from July 29, 2010

(Amendment)

These amended guidelines are effective from November 10, 2010

(Amendment)



These amended guidelines are effective from July 4, 2011  
(Amendment)

These amended guidelines are effective from July 23, 2012  
(Amendment)

















These amended guidelines are effective from August 8, 2013  
(Amendment)

These amended guidelines are effective from April 3, 2015

#### IV. References

1. Chart of Inspection Process Flow ( PDF)
2. List of Submission Documents ( PDF)

(Attachment)

- Form 1 Inspection Order ( PDF)
- Form 2 Letter of Consent on Nondisclosure of Securities Inspection Information to Third Parties ( Word,  PDF)
- Form 3-1 Request for Consent for Third-Party Disclosure (management companies) ( Word,  PDF)
- Form3-2 Request for Consent to Third-Party Disclosure (other than management companies) ( Word,  PDF)
- Form 4 Summary Sheet ( PDF)
- Form 5 Questionnaire ( PDF)
- Form 6 Off-Site Inspection Monitoring Sheet ( Word,  PDF)
- Form 7 Opinion Submission Form ( Word,  PDF)
- Form 8 Request for Withdrawal of Submitted Opinions ( Word,  PDF)
- Form 9 Notification of Completion of Inspection ( PDF)

\*The above may be updated without prior notice.

- Business operators subject to securities inspections
  - (1) Financial Instruments Business Operators, etc. (Article 56-2 (1) and Article 194-7 (2) (i) and (3) of the FIEA)
  - (2) Major Shareholders of Financial Instruments Business Operators, etc. (Article 56-2 (2) through (4) and Article 194-7 (2)(i) and (3) of the FIEA)
  - (3) Subsidiaries of Special Financial Instruments Business Operators, etc. (Article 57-10 (1) and Article 194-7 (3) of the FIEA)

- (4) Designated Parent Companies (Article 57-3 and Article 194-7 (3) of the FIEA)
- (5) Major Shareholders of Designated Parent Companies (Article 57-26(2) and Article 194-7(3) of the FIEA)
- (6) Authorized Transaction-at-Exchange Operators (Article 60-11 and Article 194-7(2)(ii) and (3) of the FIEA)
- (7) Specially Permitted Business Notifying Persons (Article 63(8) and Article 194-7 (3) of the FIEA)
- (8) Financial Instruments Intermediary Service Providers (Article 66-22 and Article 194-7(2)(iii) and (3) of the FIEA)
- (9) Credit Rating Agencies (Article 66-45(1) and Sections Article 194-7(2)(iii)(b) and (3) of the FIEA)
- (10) Authorized Financial Instrument Firms Associations (Article 75 and Article 194-7 (2)(iv) and (3) of the FIEA)
- (11) Authorized Financial Instrument Firms Associations (Article 79-4 and Article 194-7(2)(v) and (3) of the FIEA)
- (12) Investor Protection Funds (Article 79-77 and Article 194-7(3) of the FIEA)
- (13) Submitters of Notifications of Holding Subject Voting Rights of Stock Company-Type Financial Instruments Exchanges (Article 103-4 and Article 194-7(3) of the FIEA)
- (14) Major Shareholders of Stock Company-Type Financial Instruments Exchanges (Article 106-6 and Article 194-7(3) of the FIEA)
- (15) Submitters of Notifications of Holding Subject Voting Rights of Financial Instruments Exchange Holding Companies (Article 106-16 and Article 194-7(3) of the FEIA)
- (16) Major Shareholder of Financial Instruments Exchange Holding Companies (Article 106-20 and Article 194-7(3) of the FIEA)
- (17) Financial Instruments Exchange Holding Companies (Article 106-27 and Article 194-7(3) of the FIEA)
- (18) Financial Instruments Exchanges (Article 151 and Article 194-7(2)(vi) and (3) of the FIEA)
- (19) Self-Regulation Organizations (Article 151 as applied mutatis mutandis pursuant to Article 153-4, and Article 194-7(2)(vi) and (3) of the FIEA)
- (20) Foreign Financial Instruments Exchanges (Article 155-9 and Article 194-7(2)(vii) and (3) of the FIEA)
- (21) Submitters of Notifications of Holding Subject Voting Rights of Financial Instruments Clearing Organizations (Article 156-5(4) and Article 194-7(3) of the

FIEA)

- (22) Major Shareholders of Financial Instruments Clearing Organizations (Article 156-5(8) and Article 194-7(3) of the FIEA)
- (23) Financial Instruments Clearing Organizations (Article 156-15 and Article 194-7(3) of the FIEA)
- (24) Foreign Financial Instruments Clearing Organizations (Article 156-20-12 and Article 194-7(3) of the FIEA)
- (25) Securities Finance Companies (Article 156-34 and Article 194-7(3) of the FIEA)
- (26) Designated Dispute Resolution Organizations (Article 156-58 and Article 194-7(3) of the FIEA)
- (27) Trade Repositories, etc. (Article 156-80 and Article 194-7(3) of the FEIA)
- (28) Investment Trust Management Companies (Article 22(1) and Article 225 (3) of the Act on Investment Trusts and Investment Corporations or the “Investment Trust Act”)
- (29) Organizers of Investment Trusts (Article 213-1 and Article 225 (2) and (3) of the Investment Trust Act)
- (30) Investment Corporations (Article 213(2) and Article 225 (3) of the Investment Trust Act)
- (31) Asset Custody Companies of Investment Trusts (Article 213(3) and Article 225 (3) of the Investment Trust Act)
- (32) Corporate Officers of Investment Corporations (Article 213(4) and Article 225 (3) of the Investment Trust Act)
- (33) Specified Transferors (Article 217(1) as applied mutatis mutandis pursuant to Article 209(2)(i), and Article 290(2)(i) and (3) of the Act on the Securitization of Assets (hereinafter, the “SPC Act”)
- (34) Special Purpose Companies (Article 217(1) and Article 290 (3) of the SPC Act)
- (35) Originators of Special Purpose Trusts (Article 217(1) as applied mutatis mutandis pursuant to Article 209(2) as applied mutatis mutandis pursuant to Article 217(1), and Article 290(2)(ii) and (3) of the SPC Act)
- (36) Institutions for Book-entry Transfers (Article 20(1) and Article 286 (2) of the Act on Book-Entry Transfers of Company Bonds, Shares, etc.)
- (37) Other organizations that are specified as the target of securities inspections in the laws listed in (1) through (36) above

It should be kept in mind that when the organizations listed below become subject to securities inspections, the inspection must be conducted in sync with the inspection under

the authority delegated to the SESC based on the Act on the Prevention of the Transfer of Criminal Proceeds.

- A. Financial Instruments Business Operators (except for exempted operators based on relevant laws and regulations) and Business Operators Registered for Specially Permitted Businesses (Article 15 (1) and Article 21 (6)(i) of the Act on the Prevention of the Transfer of Criminal Proceeds)
- B. Registered Financial Institutions (Article 15(1) and Article 21(6)(ii) of the Act on the Prevention of the Transfer of Criminal Proceeds)
- C. Securities Finance Companies, Institutions for Book-entry Transfers, and Account Management Institutions (Article 15(1) and Article 21 (7) of the Act on the Prevention of the Transfer of Criminal Proceeds)

*(Note) Statements in brackets indicate stipulations regarding the inspection authority of and the authority delegated to the SESC.*