



# The SESC's Inspection Policy and Program for 2014-15

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(Note) Any personal views in the presentation today are not the official views of the SESC .

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# 1. Role of inspection



## I. Role of Inspection

# Mission of the SESC

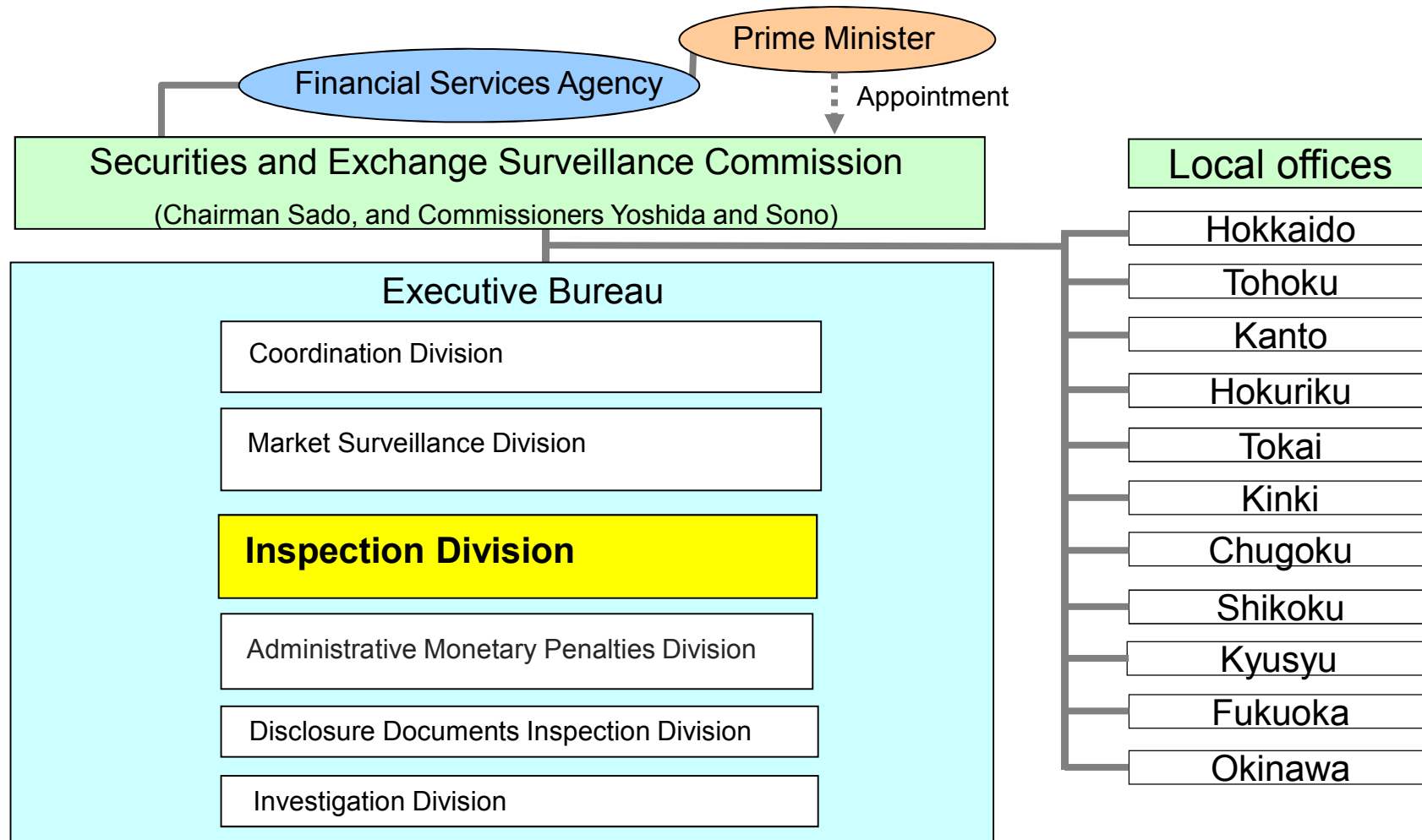
- Conduct market surveillance in order to
  - ensure integrity, fairness and transparency of capital markets, and
  - protect investors

# Independence and Cooperation

- The SESC conducts on-site inspections
  - as an independent authority from the FSA
  - in cooperation with off-site monitoring of the FSA

I. Role of Inspection

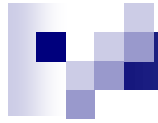
# Organization of the SESC



## Objectives of Our Inspection

- To encourage the improvement of internal control systems in the BOs\*
- To ensure the appropriateness of risk management systems including financial soundness in the BOs
- To enhance awareness of the BOs as gatekeepers

\* "BOs" stands for Business Operators



## 2. Changes in Circumstances



## 2. Change in Circumstances

# Diversification and increase in the number of BOs

- Around 8,000 operators engage in business
- Actions have to be taken against unregistered business operators
- Financial instruments and transactions have become more diverse and complex
- Cross-border transactions are expanding



## 2. Change in Circumstances

### Business Operators

	1992	March 2007		March 2014
Domestic Securities Companies	216 *1	310	Type I Financial Instrument BOs	278
Foreign Securities Companies (June 1992)	49 *2			
Financial Futures Dealers	216 *3	196		
Registered Financial Institutions	619	1,182	Registered Financial Institutions	1,107
Investment Advisory BOs (registered only)	433 *4	959	Investment Advisories/Agencies	1,008
Investment Trust Management Firms	20 *5	123	Asset Management Firms	314
Investment Advisory BOs (approved to provide discretionary investment services)	155 *6	146		
Securities Intermediaries	unknown	591	Financial Instruments Intermediaries	791
Commodity Investment Distributors	unknown	97	Type II Financial Instrument BOs	1,272
Distributors of Beneficiary rights to the trust	unknown	597		
-			Specially Permitted Business Notifying Firms for Qualified Institutional Investors	3,022

(Unregistered Business Operators)

\*1 December 1992

\*2 June 1992

\*3 May 1993

\*4 June 1992

\*5 March 1992

\*6 June 1992



## 2. Change in Circumstances

### **Towards Enhanced Market Integrity**

- The SESC's Policy Statement for the 8th Term -

#### **Policy Directions**

- The Japanese capital markets have been experiencing dynamic changes. A series of amendments have been made to the Financial Instruments and Exchange Act (FIEA). Innovations are continuing in financial products and trading methods through the use of IT, etc. Cross-border transactions are expanding. The SESC is determined to handle issues that need to be addressed in a timely manner by constantly keeping an eye on such market trends and collecting/analyzing information with even greater sensitivity.
- (1) Market oversight with prompt and strategic actions
  - (2) Enhanced surveillance in response to the globalization of markets
  - (3) Efforts for enhanced market integrity



## 2. Change in Circumstances

### **Towards Enhanced Market Integrity**

- SESC's Policy Statement for the 8th Term -

#### Primary Measures - Excerpt of securities inspections -

- Efficient and effective inspections corresponding to the characteristics of firms to be inspected
  - **Efficient and effective inspections**
    - ⇒ Developments of capabilities and skills to collect and analyze information and establishment of know-how and inspection methods corresponding to the characteristics of firms to be inspected
  - **Forward-looking verifications for Globally active securities firms**
    - ⇒ Verifying the appropriateness of their internal control and risk management systems and utilize information that the Supervisory Bureau of the FSA collects through monitoring activities
  
- Responding to malicious business utilizing in fraudulent operations
  - **Taking rigorous actions against unregistered entities**
    - ⇒ Taking rigorous actions such as petitions for court injunctions

2. Change in Circumstances

# Expansion of the Scope of Verification

## Traditional Focus in Inspection

- Compliance with Rules of Conduct -



Global Financial Uncertainties

Rapid Changes in Instruments and Transactions

## New Areas of Verification

- The appropriateness of the internal control systems, financial soundness and risk management systems especially for securities groups engaging in large and complex business operations

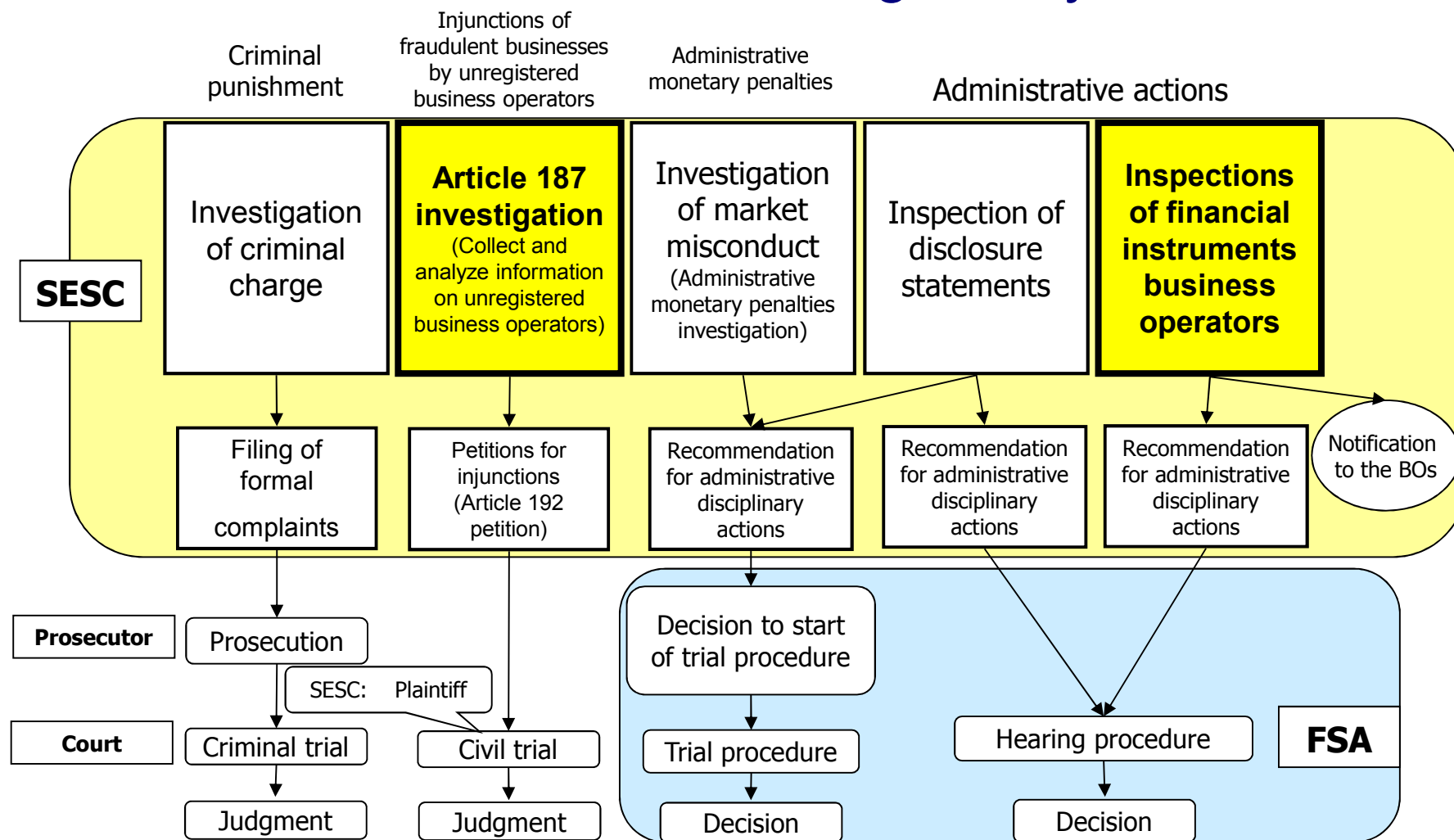
Business Management			
Internal Control on Legal Compliance			
Risk Management (including Financial Soundness)			
Risks concerning Regulations on Capital Requirements	Operational Risk	IT Systems Risk	Other Risks (e.g. Investment Risk, Funding Risk)
Internal/External Audit Function			
Crisis Management (BCP)			



# 3. Process and Practice of Securities Inspection

### 3. Process and Practice of Securities Inspection

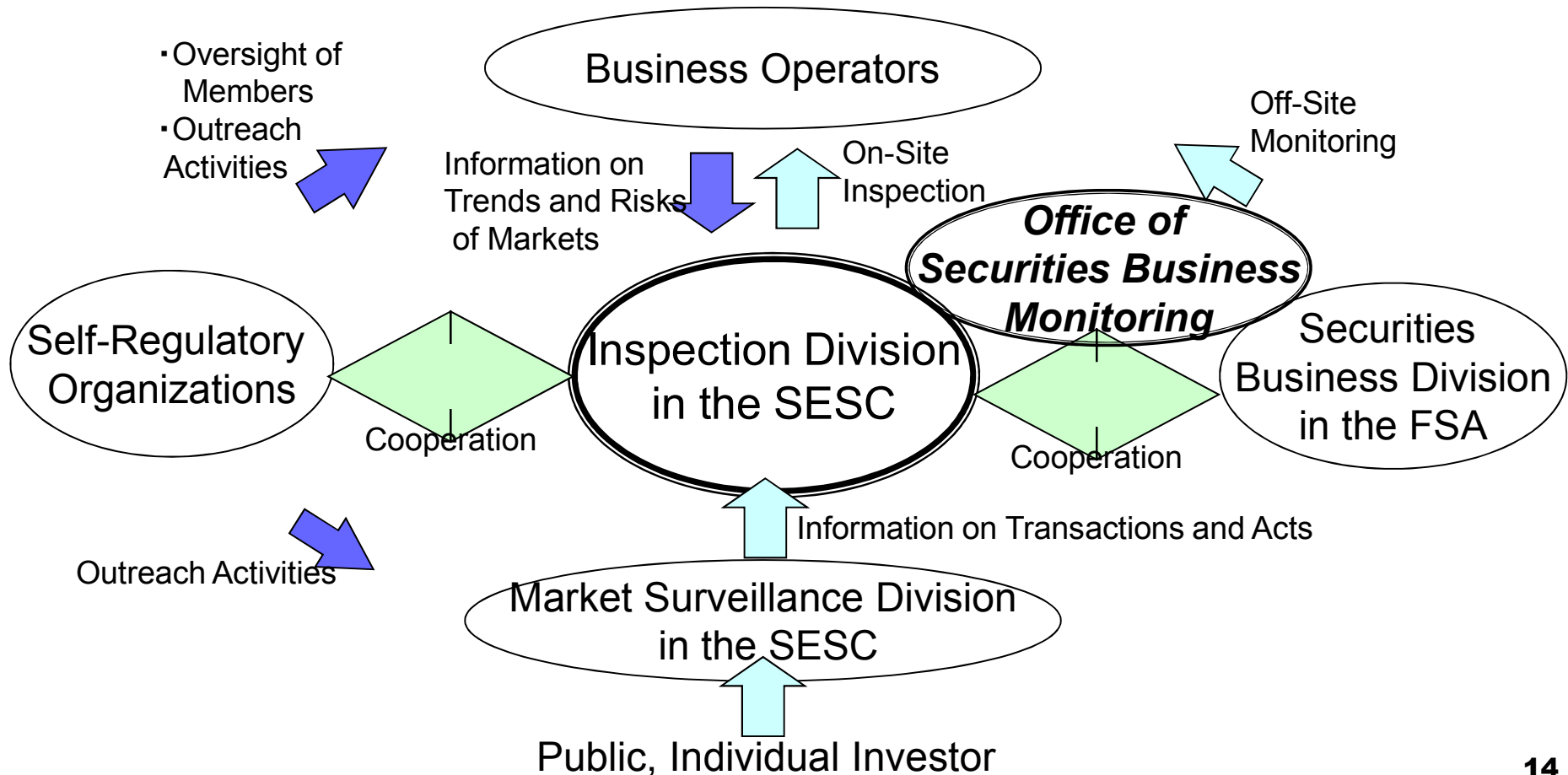
# The SESC's Functions and Regulatory Tools



### 3. Process and Practice of Securities Inspection

## Enhanced Communication and Cooperation with Other Institutions

- Importance of Information gathering
- Importance of Cooperation with SROs



### 3. Process and Practice of Securities Inspection

## Office of Securities Business Monitoring

- Mission is to implement seamless supervision between on-site and off-site monitoring of systemic risks for large securities groups
  - All members have dual reporting-lines to the Supervisory Bureau of the FSA and the SESC

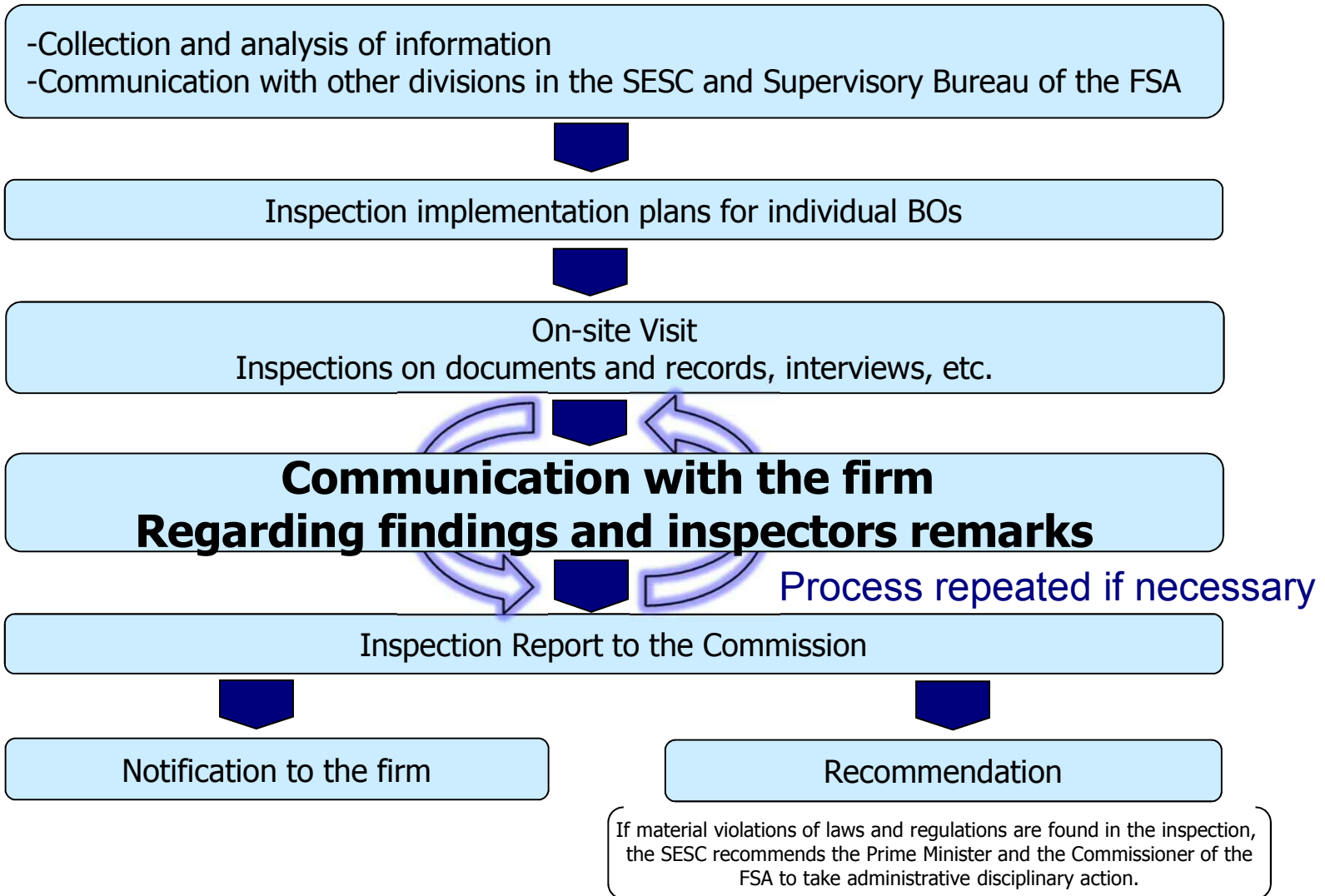
They ...

- Interview head offices of large foreign based affiliated securities groups
- Identify the best practices in risk management through Peer Reviews
- Continuously monitoring on financial institutions' PDCA cycles utilizing information gathered through both on-site and off-site monitoring



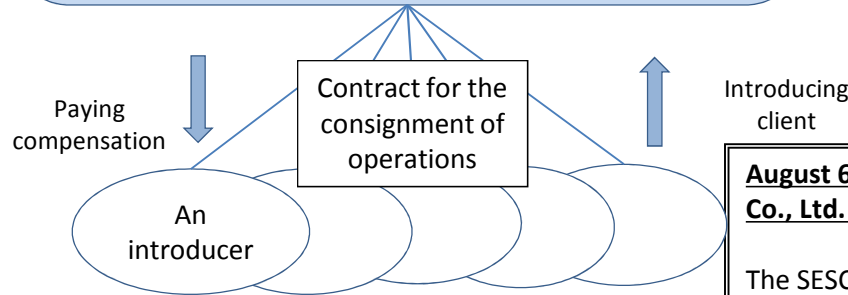
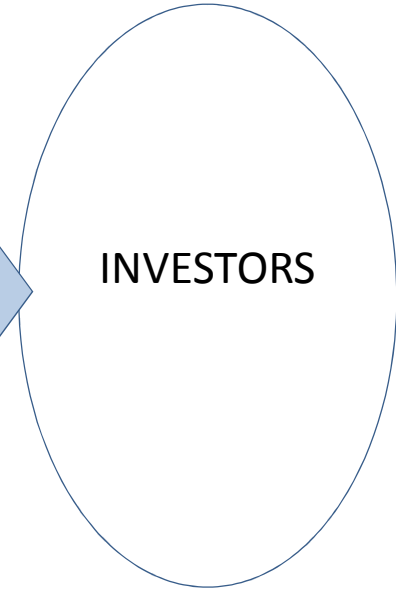
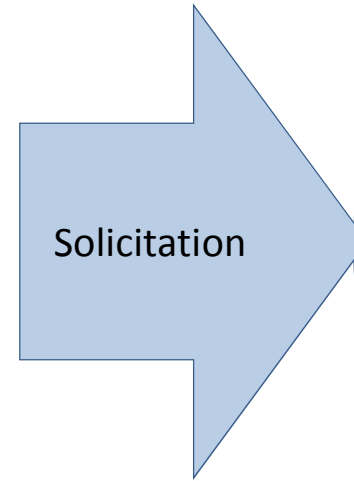
3. Process and Practice of Securities Inspection

# More In-depth Dialogues with BOs



Case: Scheme Chart of Granter's Solicitation

Granter Co., Ltd. conducted "Asset Management Seminar" in many parts of Japan, and solicited financial products to the participants.



An Introducer introduces clients by the collecting information on the participants of "Asset Management Seminar"

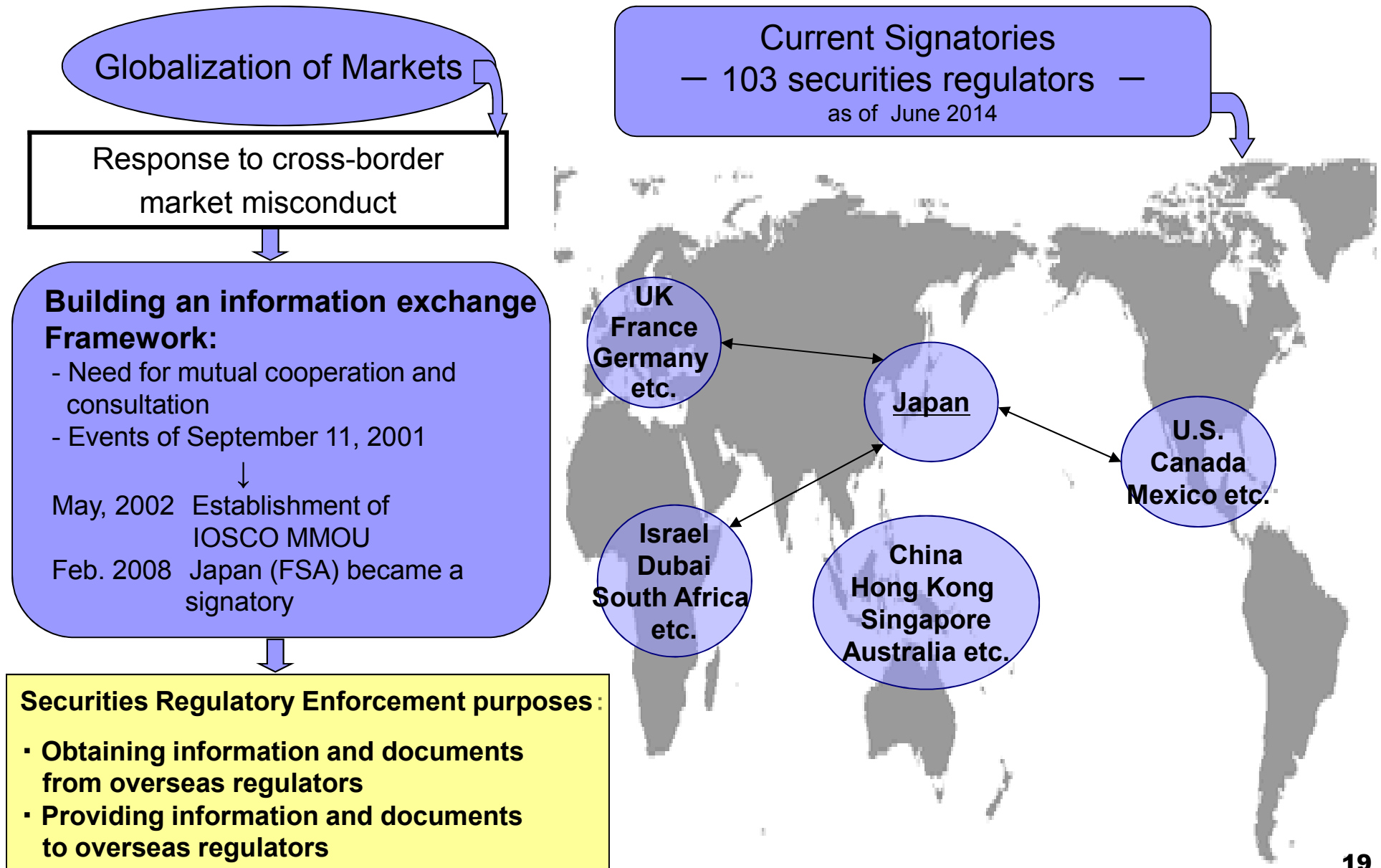
**August 6, 2014: Petition for a court injunction against Granter Co., Ltd. and its two managers.**

The SESC filed a petition with the Tokyo District Court for an injunction against Granter Co., Ltd. ("the Company") and its two managers to prohibit and suspend its acting as a broker for discretionary investment contracts, and its solicitation of membership rights of a limited liability company and shares in foreign collective investment schemes. Based on an investigation of the Company, the SESC identified that it acted as a broker for discretionary investment contracts, and solicited membership rights of a limited liability company and shares in foreign collective investment schemes without statutory registration.

## Response to the globalization of markets

- Closer cooperation with overseas regulators to conduct market oversight on a global basis
  - IOSCO MMoU; Global information-sharing arrangement for securities regulators adopted by the International Organization of Securities Commissions (IOSCO)
  - Bilateral information exchange frameworks  
CSRC (China), MAS (Singapore), SEC (U.S.), CFTC (U.S.), ASIC (Australia), SFC (Hong Kong) and SC (New Zealand)
- More effective inspections of globally active and large-scale securities firms, utilizing the international supervisory frameworks

# - IOSCO Multilateral Memorandum of Understanding (MMoU) -



## - Current Signatories of the IOSCO MMOU (as of June 2014) -

Europe (43)	Greece	Portugal	France	Jersey	United Kingdom	Spain	Hungary	Lithuania	Italy
	Poland	Germany	Slovak Republic	Belgium	Isle of Man	Malta	Denmark	Norway	Czech Republic
	Luxembourg	Finland	Netherlands	Romania	Guernsey	Montenegro	Albania	Croatia	Slovenia
	Cyprus	Srpska	Austria	Bulgaria	Serbia	Switzerland	Iceland	Macedonia	Estonia
	Liechtenstein	Sweden	Bosnia and Herzegovina	Ireland	Latvia	Andorra	Gibraltar		
North America Central and South America (18)	Ontario (Canada)	US SEC	Quebec (Canada)	US CFTC	Mexico	Alberta (Canada)	British Columbia (Canada)	British Virgin Islands	Bermuda
	Cayman Islands	Brazil	Uruguay	Colombia	Peru	El Salvador	Bahamas	Trinidad and Tobago	Argentina
Asia (19)	Hong Kong	India	Sri Lanka	Singapore	Malaysia	China	FSA (Japan)	Thailand	Maldives
	Korea	Pakistan	Chinese Taipei	METI (Japan)	MAFF (Japan)	Labuan	Vietnam	Bangladesh	Indonesia
	Mongolia								
Oceania (2)	Australia	New Zealand							
Middle East (11)	Turkey	Israel	Dubai	Bahrain	Jordan	Saudi Arabia	Syria	Oman	United Arab Emirates
	Qatar	Palestine							
Africa (10)	South Africa	Nigeria	Morocco	Kenya	WAEMU *	Tunisia	Tanzania	Egypt	Mauritius
	Malawi								

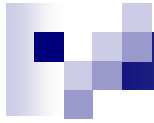


Excerpt from  
“Japan day by day, 1877, 1878-79, 1882-83”  
by Edward Sylvester Morse

While in Osaka a Japanese invited me to go with him to the rice exchange, as I would see a very curious sight. As I approached the building I heard a curious babel of shouts which reminded me of the corn exchange in Chicago. As we entered the building there was the same turbulent crowd of brokers and speculators gesticulating, flinging up their hands, and shouting at the top of their voices. In amazement I asked of my Japanese when the custom was imported, and he in turn was amazed when I told him that just such gatherings might be seen in Chicago, New York, and Boston, and other large cities. These men were rice brokers, and identical conditions and demands had resulted in identical behavior.

<source>

Full text of "Japan day by day, 1877, 1878-79, 1882-83; with illustrations from sketches in the author's Journal" ([http://archive.org/stream/japandaybyday18702morsuoft/japandaybyday18702morsuoft\\_djvu.txt](http://archive.org/stream/japandaybyday18702morsuoft/japandaybyday18702morsuoft_djvu.txt))



# 4. Inspection Policy And Program for 2014-15

# Main points of Inspection Policy for 2014-15

## 《Basic Direction》

### **Role of inspections**

- To take rigorous actions against illegal activities and play a role in sending alerts to the markets
- To ensure investor confidence in the markets by enhancing self-discipline of BOs

### **Change in Circumstances**

- Diversification and increase in the number of BOs (Around 8,000 operators engage in business)
- Financial instruments and transactions have become more diverse and complex

### **Current Challenges**

- Revelation of serious cases
- To restore investors' confidence by not only verifying the compliance but also urging BOs to improve compliance posture and professional ethics

## < Efforts toward efficient, effective and viable securities inspection corresponding to the diverse characteristics of the BOs >

- Strengthening the capabilities to collect and analyze information by enhancing the capacity of the SESC to identify potential problems with consideration given to the characteristics of business types, customers types, and types of financial instruments and transactions.
- Utilizing a risk-based approach to decide which BOs to inspect by considering their business types, sizes, other characteristics and other information in a comprehensive manner.

## 《Inspection Implementation Policy》

- ◆ Conducting on-site inspections and off-site monitoring on large-scale securities groups
- ◆ Enhancement of cooperation with FSA for inspections of Type I FIBOs
- ◆ Conducting regular inspections on Type II FIBOs, particularly on those which sell funds to a large number of individual investors
- ◆ Conducting regular inspections on investment management business operators
- ◆ Conducting concise inspection of registered information on Type II FIBOs and investment advisors/agencies
- ◆ Rigorous actions against fund related business operators engaging in illegal activities and unregistered business operators

## < Implementation Plan and Focus in Verification >

- Establishment of systems for properly soliciting and explaining to aged customers or customers utilizing the NISA
- Management of material non-public information
- Organizational actions to block relations with anti-social groups
- Financial soundness of BOs
- Due diligence, monitoring and customer solicitation activities by fund related business operators selling overseas instruments



# Inspection Policy for 2014-15

## Implementation Policy (1)

### On large-scale securities groups

- Conducting on-site inspections and off-site monitoring on large-scale securities groups
- Conducting inspection by putting weight on the appropriateness of the internal control system and monitoring the status of the group`s business operation and financial situation
- Identifying problems and risks common to the industry by fully monitoring the actual consideration with the supervisory department and implement more effective and efficient on-site inspections by focusing on specific examination themes

## Inspection Policy for 2014-15

### Implementation Policy (2)

#### Enhancement of cooperation with the FSA (supervisory dept.) for Inspections of Type I FIBOs

- Verification of management of internal control systems and financial soundness
- Verification of management of IT system risk

## Inspection Policy for 2014-15

### Implementation Policy (3)

Conducting regular inspections on  
Type II BOs, particularly on those which sell  
funds to a large number of individual investors

- Funds invested by customers were used to pay dividends and redemptions to other customers
- Making false statements to customers in relation to the conclusion of financial instrument transaction contracts and their solicitation

4. Inspection Policy and Program for 2014-15

# Inspection Policy for 2014-15

## Implementation Policy (4)

### Conducting regular inspections on investment management business operators

- Based on analyzing and examining problems discovered in the course of intensive inspections conducted since FY2012.

### Conducting inspections registered information

- Type II and Investment advisors/agencies

## Inspection Policy for 2014-15

### Implementation Policy (5)

Rigorous actions against fund related business operators engaging in illegal activities and unregistered business operators

- Filing petition for court injunction
- Publicizing the name of unregistered BOs, its representatives, facts of violation of laws and regulations, and other relevant information

## Inspection Policy for 2014-15

### Implementation Plan and Focus in Verification (1)

Establishment of systems for properly soliciting and explaining to elderly customers or customers utilizing the NISA

- Verifying whether FIBOs have established systems for soliciting and explaining to elderly customers or those customers with less knowledge of and experience with investment who utilize the Nippon Individual Savings Account (NISA)
- Verifying whether FIBO makes false statements to customers in relation to the conclusion of financial instrument transaction contracts and their solicitation

## Inspection Policy for 2014-15

### Implementation Plan and Focus in Verification (2)

#### Management of material non-public information

- Amendments to Insider Trading Regulations of the Financial and Exchange Act

#### Organizational actions to block relations with anti-social groups

- Examine whether FIBOs have established an internal system to prevent new transactions with anti-social groups and to address dissolving existing transactions with them

## Inspection Policy for 2014-15

### Implementation Plan and Focus in Verification (3)

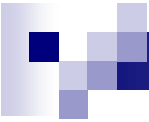
#### Financial soundness of BOs

- Segregated management of customer assets
- Status of net assets and capital adequacy ratios

#### Due diligence, monitoring and customer solicitation activities by fund related business operators selling overseas instruments

- Customers' knowledge, experience, assets and investments purpose





#### 4. Inspection Policy and Program for 2014-15



## Inspection Program for 2014-15

Type I FIBOs (including Registered Financial Institutions), Type II FIBOs, IMBOs, and CRAs	150 companies (110 out of 150 to be inspected by Local Finance Bureaus)
Investment Advisories/Agencies, QII Business Operators, and Financial Instruments Intermediaries, etc.	To be inspected based on individual information and conditions
Inspection of Registered Information	To be inspected depending on the number of registrations, etc.
SROs etc.	To be inspected as necessary
Unregistered Bos	To be inspected as necessary

Note: The above numbers of inspections are subject to change due to revisions of the Inspection Program within the year and/or implementations of special inspections.



# Activities in figures and Activities other than Inspection

# Number of Inspected Entities

Business categories	Apr.-9	Apr.-10	Apr.-11	Apr.-12	Apr.-13
	Mar.-10	Mar.-11	Mar.-12	Mar.-13	Mar.-14
Financial Instruments Firms	176	148	148	153	222
Type I Financial Instruments Business	91	91	85	57	69
Type II Financial Instruments Business	22	6	14	20	108
Asset Management Firms	18	15	9	36	16
Investment Advisories/Agencies	45	36	40	40	29
Registered Financial Institution	24	28	32	28	9
Financial Instrument Intermediary Service Providers	1	1	9	9	8
Investment Companies	9	6	2	0	3
Self Regulatory Organizaitions	5	1	0	0	3
Others	1	2	11	24	26

(Note 1) The number above is that of inspections undertaken.

(Note 2) "Investment management business" and "Investment advisory and agency business" are "Former management business of investment trust" and "Former investment advisor," respectively, in and before business year 2006.

# Findings from Inspections

Category	Apr.-11	Apr.-12	Apr.-13
	Mar.-12	Mar.-13	Mar.-14
Recommendation	16	18	18
Firms with problems found	87	102	118
Unfair transactions	7	6	5
Lack of investor protection	46	52	65
Improper financial soundness	31	11	9
Others	58	71	69

Note) “firms with problems found” shows the number of the firms for which we pointed out some problems in the inspection.

Thank you



*"for investors, with investors"*