

SESC's Strategy and Policy for 2017-2019

- Building on a quarter-century achievement-

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Question: What incident led to the creation of SESC?

- 1. Insider trading**
- 2. Financial fraud at listed companies**
- 3. Misconduct at securities firms**
- 4. Fraudulent schemes/products with huge losses for individual investors**
- 5. Bad loans problems of banks**



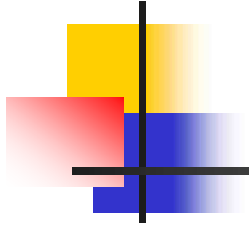
What is expected to you?

- **Understanding: new policy and strategy of SESC, in particular, role of securities firms**
- **Action: embed into your firm (business, internal control)**
- **On-going communication with SESC**



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- 2. Mission, Vision, Values and Strategic goals**
- 3. Issues for IBA members:
Monitoring of securities firms**



1. Background



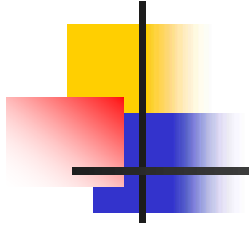
New Board member of SESC (Dec. 2017)

- **Chairman: Mr. Hasegawa,
prosecutor**
- **Commissioner: Mr. Hamada, CPA**
- **Commissioner: Ms. Indo, Financial
analyst**



Concept of Strategy

- **Environmental scan and SWOT analysis**
- **A quarter-century history**
- **Strategy looking for new stage of SESC**



2. Mission, Vision, Values and Strategic goals



Mission, Vision and Values

Strategy & Policy of the SESC 2017-2019 - Building on a Quarter-Century of Achievement -





Mission of SEESC

- 1. Market integrity and investor protection**
- 2. Contribution to sound development of markets**
- 3. Contribution to sustainable economic growth**

Note: 2 and 3 are explicitly mentioned



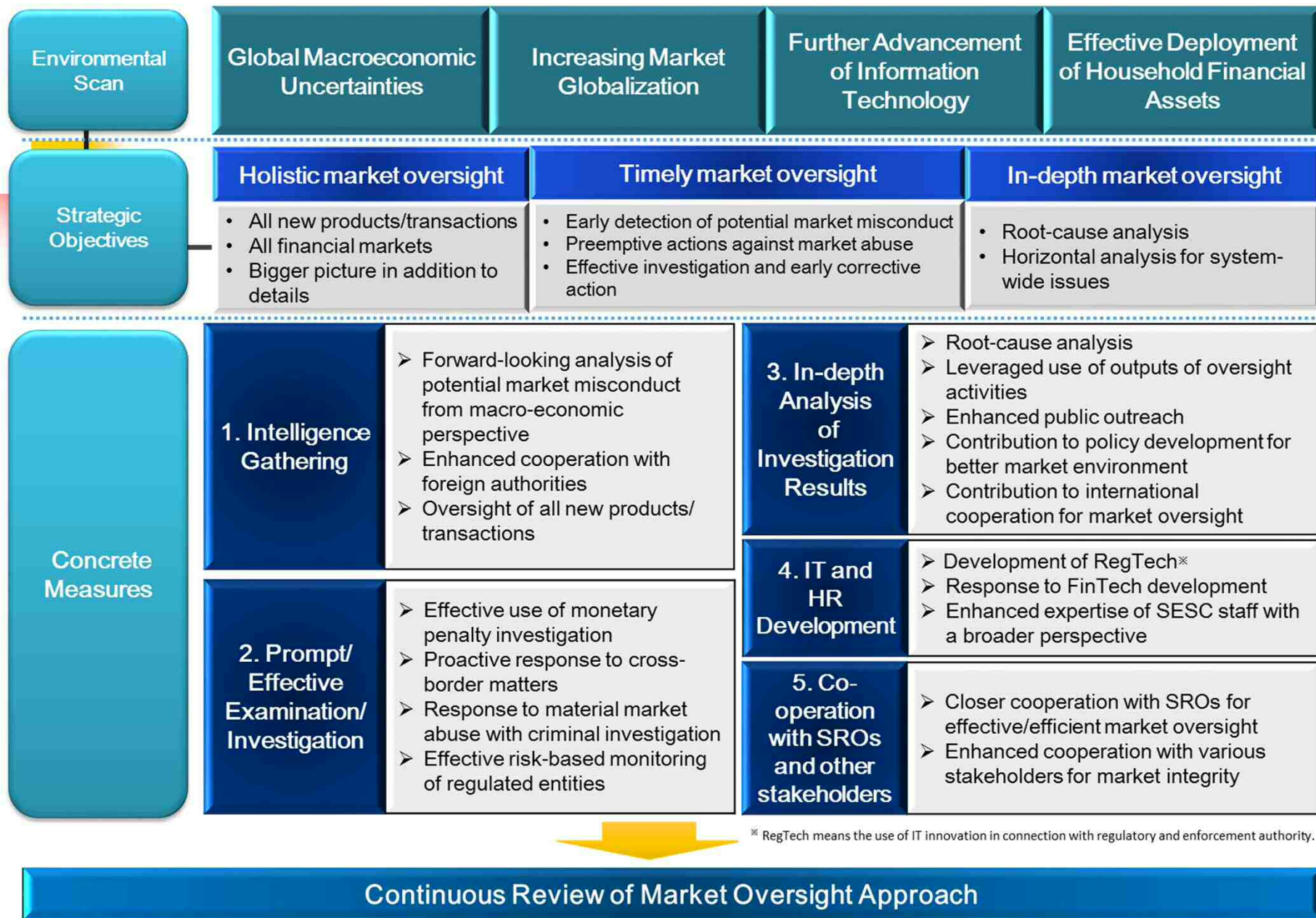
Vision on Market Integrity: compliance and trust

- 1. For listed companies; proper disclosure**
- 2. For intermediaries/securities firms; appropriate conduct and practices**
- 3. For all market participants including investors; self-discipline**
- 4. For SESC and SROs; effective and professional market oversight**



Values for SESC staff

- 1. Fairness**
 - 2. Accountability**
 - 3. Forward-looking perspective**
 - 4. Effectiveness and efficiency**
 - 5. Strong collaboration**
 - 6. Commitment to excellence**
- to be embedded into business and conduct of SESC staff**





Environmental scan(1): For the past 25 years

(1992)

- **Limited power; focus on criminal investigation**
- **Limited resources; 202 staff (including local offices), 2 Divisions**
- **Less developed and global market**

(2017)

- **Expanded function with civil penalty investigation (disclosure, insider dealings, cross-border transactions)**
- **Enhanced resources; 763 staff, 6 Divisions**
- **IT development, cross-border transactions in market**



Environmental scan (2): Current

- **Global market uncertainties; Brexit, US policies, geopolitical risks**
- **Increased market globalization; interconnectedness between Japanese and global markets**
- **Further advancement of IT; HFT, Algorithm, FinTech**
- **Effective deployment of household financial assets**



Strategic Objectives of Market Oversight

1. Holistic

- **All new products/transactions**
- **All financial markets**
- **Bigger picture**

2. Timely

- **Early detection**
- **Preemptive actions**
- **Early corrective actions**

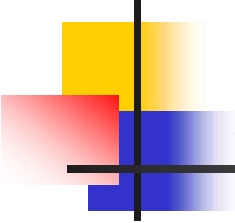
3. In-depth

- **Root cause analysis**
- **Horizontal analysis**



5 concrete measures

- 1. Intelligence gathering**
- 2. Prompt/effective examination and investigation**
- 3. In-depth analysis of investigation results**
- 4. IT and HR development**
- 5. Cooperation with SROs and other stakeholders**



Forward looking and preventive approach

(Past)

- **micro/firm specific**
- **backward looking**

(Now)

- **top down; analysis of impact of macro/system-wide developments to individual firm**
- **Forward looking and preventive approach**



Macro perspectives

- **Global and Japanese economic developments; interest rate hike in the U.S., negative interest rates in Japan, commodity prices, Chinese economy...**
- **Global political events; Brexit, Trump's policies, Elections in Europe**
- **Global regulatory environment**



Top down approach with big picture

(Past)

- **Focus on details**
- **Micro perspective**
- **Bottom up**

(Now)

- **Bigger picture**
- **Macro perspective**
- **Top down**



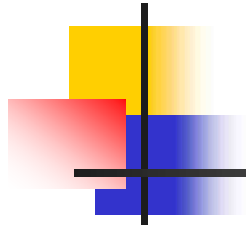
Root cause analysis

- **Deep dive analysis of root causes behind non-compliance and deficiencies**
- **Root causes; business model, governance, incentives, tone at the top, culture...**
- **Prevent recurrence of problems**
- **5 times Why?**



Focus on corporate governance

- **Board of Directors**
- **Audit Committees**
- **Internal audit**
- **External audit**
- **Focus on their effectiveness/implementation, not just formalities (policies, procedures, organizations...)**



3. Issues for IBA members: Monitoring of securities firms



Continuous monitoring

- **Seamless process for off-site and on-site monitoring (inspection)**
- **Forward looking and preventive approach**
- **Top down approach with big picture**
- **Root cause analysis**
- **Thematic/horizontal approach**



3 Lines of defense

- **Focus on 1st line of defense; changes and sustainability of business models**
- **2nd line of defense; risk management, compliance**
- **3rd line of defense; internal audit**
- **Regular and continuous discussions with three lines of defenses**



Focus on 1st line of defense

- **Business models and strategies**
- **Changes; products, services, organizations**
- **Sustainability of business models**
- **Corporate governance**
- **More frequent discussions with top/senior management and business lines**



2nd Line of defense

- **Internal control in line with business models/strategies and their changes**
- **Compliance**
- **Risk management**



3rd line of defense

- **Heightened expectation for internal audit**
- **Review of upgraded internal audit**
 - **preventive and forward looking audit; continuous monitoring and dynamic risk assessment**
 - **Focus on risk appetite and risk culture rather than compliance audit, root cause analysis**
 - **higher position of internal audit**



Increased attention to corporate governance of financial institutions

- **Regular meetings with board members, in particular, external independent directors and audit committee members**
- **Review quality of discussions of the board and support functions for the board members**
- **Regular review of internal audit; risk assessment and audit planning**
- **Discussion with external audit firm**



Issues of Board of Directors

- **Effectiveness of external and independent directors**
 - **nomination and qualification**
 - **support function**
 - **executive session**
- **Oversight of managements, in particular, CEO**
 - **succession planning**
- **Regular self-assessment of effectiveness of board; internally and externally**



Issues of Audit Committee

- **Capacity and skillset of members**
- **Cooperation with internal audit function**
- **Relation with external audit firm; collaboration and review effectiveness of external audit firm and audit quality**
- **Interaction with supervisors; discussion with audit committee members (in particular, chairman) with supervisors both domestic and overseas**



Culture

- **Hard to define**
- **Indicators of culture**
 - **Tone at the top**
 - **Management awareness**
 - **Whistleblowing**
 - **Escalation of issues**
 - **Remedial actions**
- **Root cause analysis**



Conduct risk

- **Concept of Conduct Risk**
 - 1. Clients: Poor client outcomes; fiduciary duty, suitability, fair and transparent pricing, conflicts of interests**
 - 2. Markets: Damage to market integrity; market misconducts, bribery, anti-competition**
 - 3. Reputation**
- **Conduct risks vs compliance and risk management; forward looking, principle based**



Principles of Fiduciary duty (Mar. 2017)

- **7 Principles for fiduciary duty, including**
 - **best interests of clients**
 - **conflicts of interest control**
 - **transparency of costs**
 - **fair and clear disclosure**
 - **suitability**
- **Comply or explain approach**
- **Monitoring of compliance/explain with principles**



Market misconducts

- **Surveillance and control function against misconducts**
 - **insider dealings, market manipulations**
 - **conflicts of interests**
 - **other market abuses**
- **Horizontal review of surveillance function (ongoing 2017)**



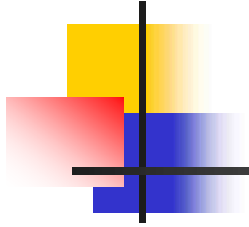
Other horizontal/thematic issues

- **Local governance and accountability**
- **Local compliance**
- **Balance between global/matrix management and local management**
- **AML/CFT**
- **Outsourcing outside Japan**
- **Cybersecurity**



IFIAR Permanent Secretariat in Tokyo (April 2017)

- **IFIAR(International Forum of Independent Audit Regulators); created in 2006, 52 members**
- **Mission; upgrade audit quality of audit firms**
- **First international financial organization with head office in Tokyo**
- **Office in Otemachi**



Thank you