



The SESC's Inspection Policy and Program for 2012-13

30 Oct., 2012

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(Note) Any views of the presentation today are not the official views of the SESC and are also preliminary.

Table of Contents

1. Role of Inspection

- Mission of the SESC
- Independence and Cooperation
- Objectives of Inspection
- Notice to Inspectors

2. Change in Circumstances

- Diversification and increase of BOs
- Expansion of the Areas of verification

3. Recent Developments

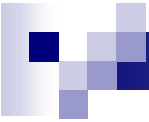
- Revelation of Serious Cases and Change in the Focus of Verification
- Rules of Conduct

4. Inspection Process

- Organization of the SESC
- The SESC's Functions and Inspection
- Communication with Other Institutions
- Inspection Process

5. Inspection Policy and Program for 2012-13

- Challenges for Securities Inspection
- Implementation Plan
- Inspection Program



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

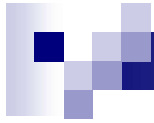
- The SESC conducts on-site inspections
 - on the financial instruments business operators, etc. (BOs),
 - as an independent authority from the FSA
 - in cooperation with off-site monitoring of the FSA

Objectives of 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 the awareness of the BOs as gatekeepers

Notice to Inspectors

- To build common understandings through interactive dialogue with officers and employees in the BOs
- To evaluate the awareness of senior management regarding internal control systems
- To review business operations from wider viewpoint and to focus on serious problems



2. Change in Circumstances



2. Change in Circumstances

Change in Circumstances

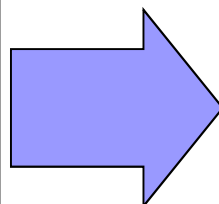
Diversification and increase of BOs

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

2. Change in Circumstances

SESC's establishment

- Domestic Securities Companies
216 (Dec.1992)
- Foreign Securities Companies
49 (Jun. 1992)
- Financial Futures Dealers
216 (May. 1993)
- Registered Financial Institutions
619 (Jul. 1993)



March 2012

1. Type I Financial Instrument Businesses Operators 315
 2. Type II Financial Instrument Businesses Operators 1,294
 3. Investment Advisories/Agencies 1,108
 4. Asset Management Firms 321
 5. Registered Financial Institutions 1,135
 6. Specially Permitted Business Notifying Firms for Qualified Institutional Investors 3,218
 7. Financial Instruments Intermediaries 705
 8. Self-Regulatory Organization 12
 9. Investment Corporation 48
 10. Credit Ratings Agencies 7
- (Unregistered Business Operators)



Traditional Focus in Inspection

Compliance with Rules of Conduct



Global Financial Uncertainties

Expansion of the Areas of Verification

- Financial soundness, the appropriateness of the internal control systems and risk management systems especially for securities groups engaging in large and complex business operations
- Intensive inspections on asset management firms (especially on discretionary investment business operators)

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

3. Recent Developments



Revelation of Serious Cases and Change in the Focus of Verification

- Importance on Protection of Personal Investors
 - Detailed Stipulations of Mandate and Prohibition in relation to transactions of stocks and investment trusts



Revelation of Recent Serious Cases among BOs and Institutional Investors

- The case of AIJ Investment Advisors Co., Ltd.
- Insider Trading related to Public Offerings of Shares
- Misconduct related to LIBOR/TIBOR Rate Offers

- More Weight on Duties as Gatekeepers
 - Duty of Due Care of a Prudent Manager
 - Principle of Suitability
 - Measures to Ensure the State of Appropriate Business Operation

Rules of Conduct ①

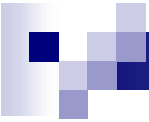
- Common Rules for All Kinds of BOs
 - ☑ Duty of Good Faith to Customers (Article 36)
 - ☐ Regulation on Advertising, etc. (Article 37)
 - ☐ Delivery of Document Prior to/upon Conclusion of Contract (Article 37-3,4)
 - ☐ Prohibited Acts (Article 38): false information, conclusive evaluation, unrequested solicitation, etc.
 - ☐ Prohibition of Compensation of Loss, etc. (Article 39)
 - ☑ Principle of Suitability (Article 40)

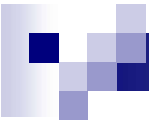
Note: Article Numbers are as of the FIEA

Rules of Conduct ②

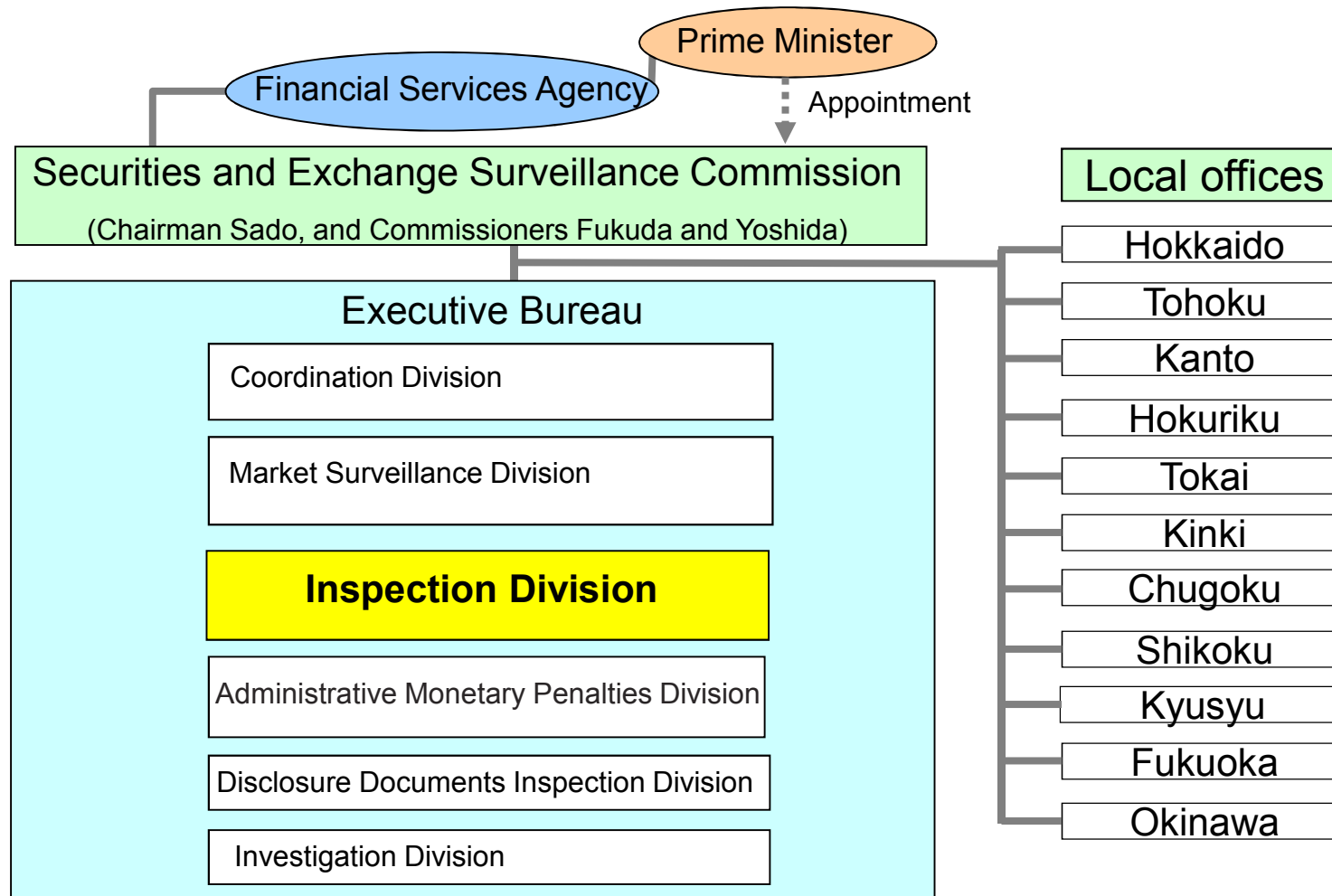
- Rules for Investment management business
 - ☑ Fiduciary Duty of Loyalty, Duty of Due Care of Prudent Manager (Article 42)
 - ☐ Prohibited Acts (Article 42-2): transactions made between investment asset accounts, transaction under terms and conditions different from ordinary terms and conditions and detrimental to the right holder's interest, etc.
 - ☐ Prohibition of Compensation of Loss, etc. (Article 39)
 - ☐ Duty of Delivery of Investment Report (Article 42-7)

Note: Article Numbers are as of the FIEA



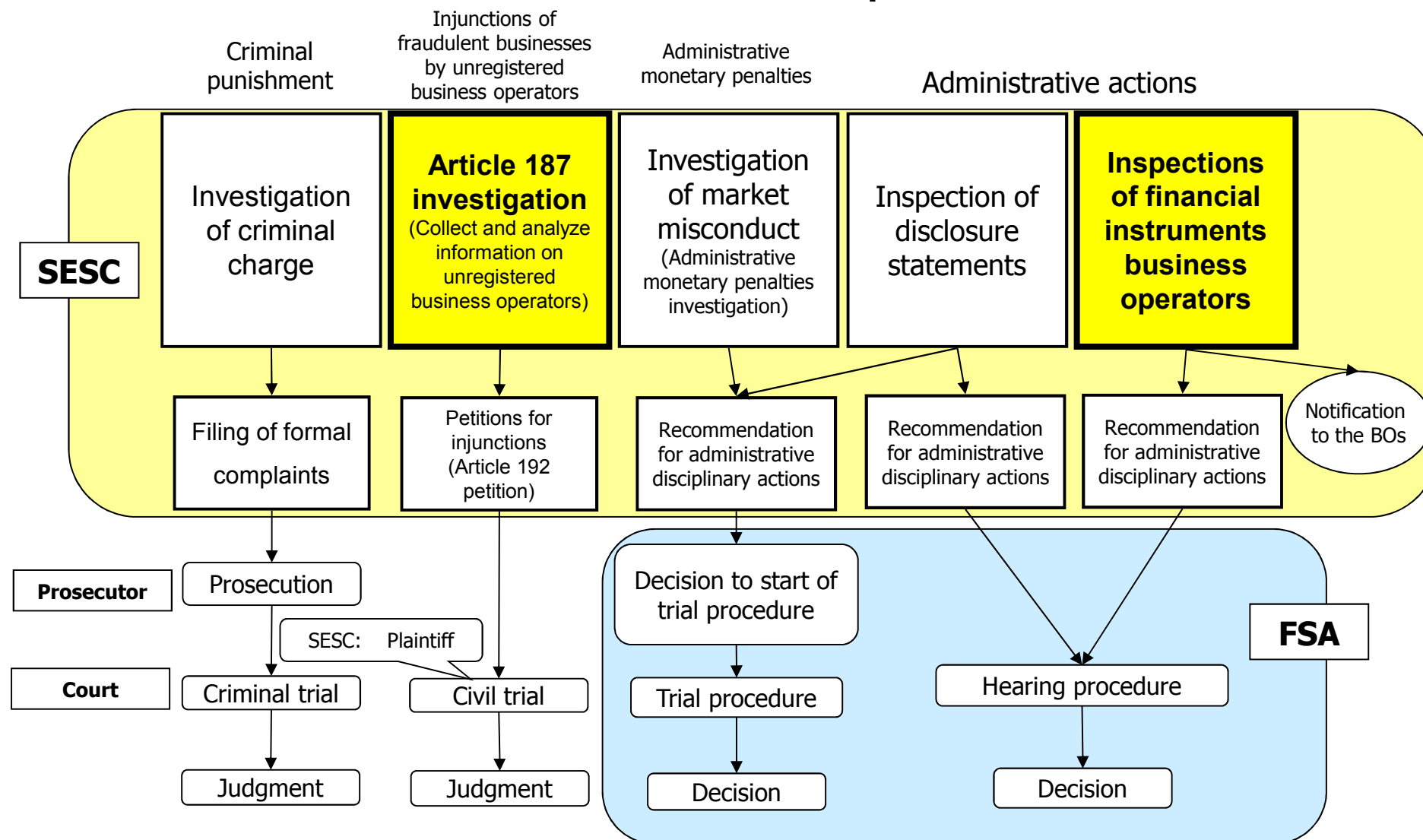


Organization of the SESC

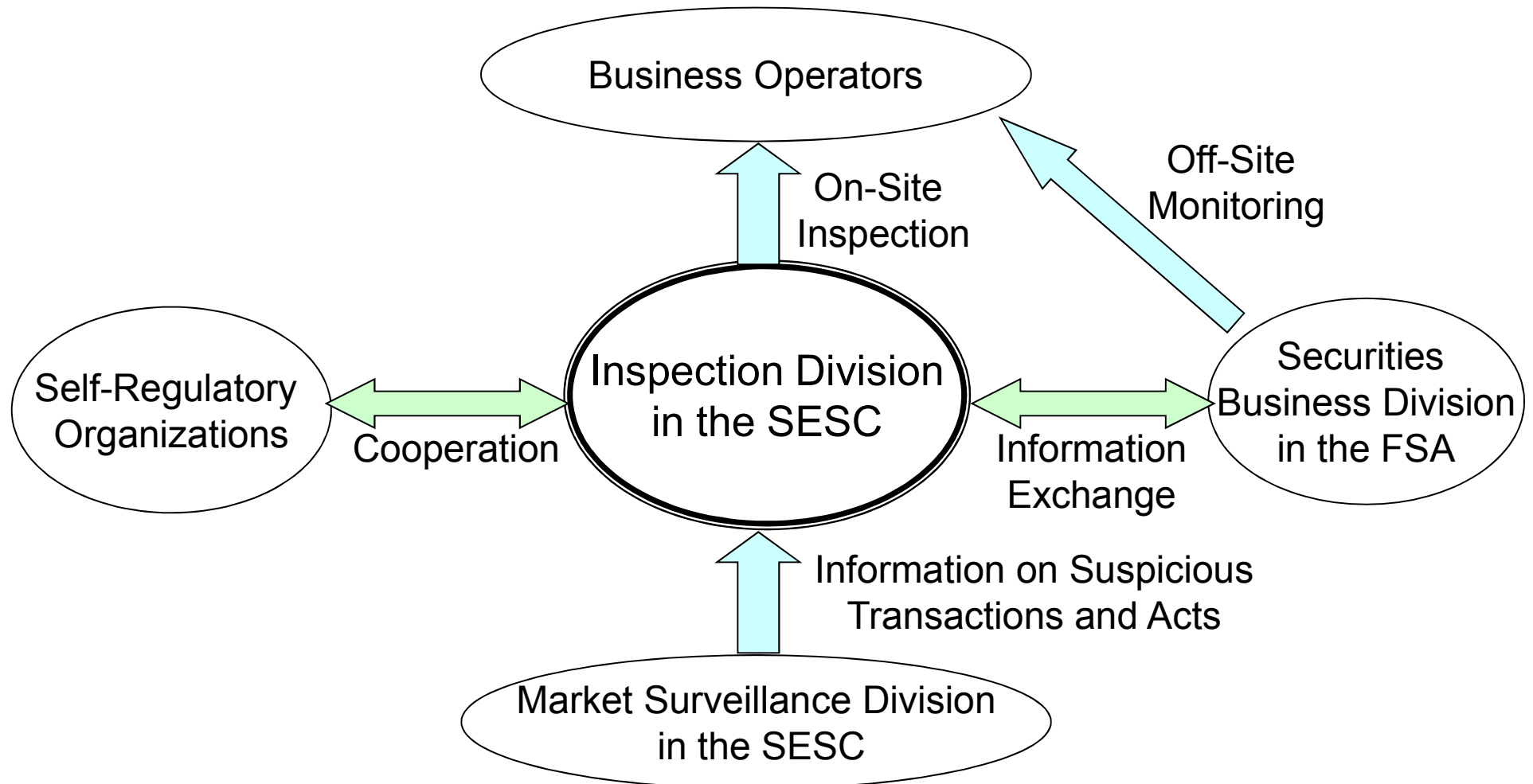


4. Inspection Process

The SESC's Functions and Inspection

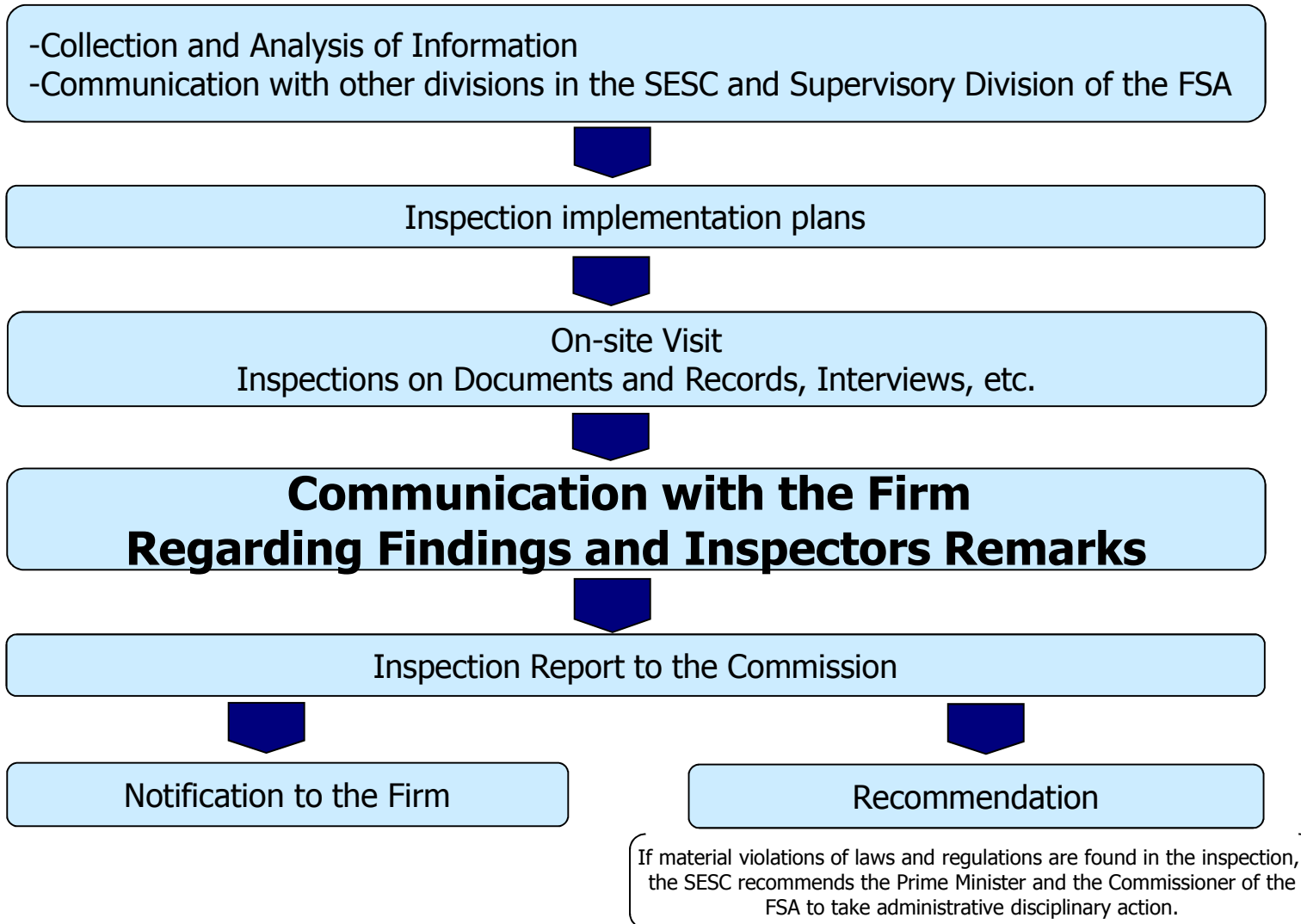


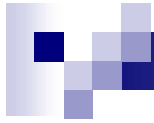
Communication with Other Institutions



4. Inspection Process

Inspection Process





5. Inspection Policy And Program for 2012-13

Inspection Policy for 2012-13

Challenges for Securities Inspection

Toward Efficient, effective and viable inspections

- Short term
 - ⇒ Focus of verification on business operations corresponding to business types, size and other characteristics at the time
 - ⇒ Select business operators to be inspected using risk-based approach, considering present market positions and inherent problems thereof
- Mid-to-Long term
 - ⇒ Raising risk sensitivity for diverse business types of business operators, for the characteristics of their customers and for increasingly complex and diverse financial instruments and transactions

Inspection Policy for 2012-13

Implementation Plan

1. Focus in verification

1) Types of business operations or other characteristics

A. Market intermediary functions

Gatekeeper functions

- Systems for preventing transactions with anti-social forces
- Examination systems for underwriting business in connection with IPOs
- Risk management and sales management systems for high-risk products

B. Management of material non-public information

Management systems as preventive measures against insider trading

- Registration of material non-public information and information barriers,
- Surveillance of transactions by insiders, officers and employees, and
- Prevention of any improper use of information within the sales divisions

Inspection Policy for 2012-13

Implementation Plan (continued)

C. Conduct that may hinder fair price formation

- Practices that could hinder the formation of fair price
- Transaction surveillance systems for preventing unfair trading
- Management systems for short selling regulations

D. Solicitation for investment

- Investment trust, OTC derivative products and complex structured bonds
 - Principle of suitability
 - Appropriateness of explanations regarding important information of risks that affects customer's decisions such as the probable maximum losses and the settlement money on cancellation

E. Legal compliance of investment management business operators

- Intensive inspections on discretionary investment management operators
 - Fiduciary duty and due care of a prudent manager
 - Systems for managing conflicts of interest
 - Due diligence

Inspection Policy for 2012-13

Implementation Plan (continued)

2) Internal control systems and financial soundness

A. Internal control systems

- Focus on large securities groups engaging in complex business operations
 - Verification from a forward looking viewpoint
 - Cooperation with monitoring office of Supervisory Bureau in the FSA
- Internal control systems and risk management systems in case that problems are found in some business operations

B. Information security management

- IT system troubleshooting and oversight of outsourcing, etc.

C. Financial soundness

- Segregated management of customer assets
- Status of net assets
- Capital adequacy ratio

Inspection Policy for 2012-13

Implementation Plan (continued)

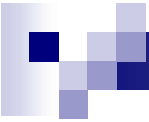
2. Priority of Inspection Coverage corresponding to operators categories

A. Coverage of regular Inspection

- Type I Financial Instruments Business Operators,
- Investment Management Business Operators
- Credit Rating Agencies

B. Inspections conducted as needed

- Type II Financial Instruments Business Operators
- Investment advisors/agencies
- Specially Permitted Business Notifying Firms for Qualified Institutional Investors



Inspection Program for 2012-13

| | |
|---|--|
| Type I financial instruments business operators (including registered financial institutions), investment management business operators, and credit rating agencies | 150 companies (including 110 to be inspected by local finance bureaus) (including intensive inspections of discretionary investment management business operators) |
| Type II financial instruments business operators, investment advisors/agencies, QII business operators, and financial instruments intermediaries, etc. | To be inspected as needed |
| SROs | To be inspected as necessary |



Activities in figures and Activities other than Inspection

Number of Inspected Entities

| Business categories | Jul-07 | Jul-08 | Apr-09 | Apr-10 | Apr-11 |
|---|--------|--------|--------|--------|--------|
| | Jun-08 | Jun-09 | Mar-10 | Mar-11 | Mar-12 |
| Financial Instruments Firms | 187 | 191 | 176 | 148 | 148 |
| Type I Financial Instruments Business | 138 | 117 | 91 | 91 | 85 |
| Type II Financial Instruments Business | 2 | 1 | 23 | 6 | 14 |
| Asset Management Firms | 26 | 15 | 18 | 15 | 9 |
| Investment Advisories/Agencies | 21 | 58 | 44 | 36 | 40 |
| Registered Financial Institution | 32 | 25 | 24 | 28 | 32 |
| Financial Instrument Intermediary Service Providers | 1 | 0 | 1 | 1 | 9 |
| Investment Companies | 10 | 7 | 9 | 6 | 2 |
| Self Regulatory Organizaitions | 1 | 5 | 5 | 1 | 0 |
| Others | 2 | - | 1 | 2 | 11 |

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

(Note 2) "Inspection only of branch" means conducting inspection only of a branch or branches of an old national securities firm out of the Type I financial instruments business.

(Note 3) "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-09 | Apr-10 | Apr-11 |
|-----------------------------|--------|--------|--------|
| | Mar-10 | Mar-11 | Mar-12 |
| Recommendation | 21 | 18 | 16 |
| Firms with problems found | 123 | 101 | 85 |
| Unfair transactions | 12 | 9 | 7 |
| Lack of investor protection | 57 | 45 | 46 |
| Financial soundness | 27 | 18 | 31 |
| Other business activities | 58 | 67 | 56 |

Note) "firms with problems found" shows the number of the firms for which we pointed out some issues in the notification.



Review of the Regulation and Supervision regarding Asset Management building on the Experience from the case of AIJ Investment Advisors Co., Ltd. (draft)

1. Developing a mechanism for third party oversight (e.g. by domestic trust banks) to function effectively

- (1) Developing a mechanism for domestic trust banks to directly obtain “net asset value” and “audit report” from the reporting source
- (2) Requiring domestic trust banks to perform double-checks of the “net asset value”

2. Developing a mechanism for customers (e.g. pension funds) to better detect problems

- (1) Expanding information provided in Investment reports
- (2) Increasing the issuance frequency of Investment reports
- (3) Stricter eligibility requirements for pension funds to be authorized as “professional investors”
- (4) Introducing check mechanisms by Discretionary investment managers

3. Strengthening disincentives to fraud

Introducing stricter penalties toward Discretionary investment managers for (i) making false statements in investment reports delivered to customers, (ii) making fraudulent statements in the course of solicitation, and (iii) executing Discretionary investment contracts using fraudulent means.

4. Reviewing the regulation, supervision, and inspection systems regarding investment management businesses

- (1) Expanding information provided in Business reports submitted to the FSA
- (2) Strengthening supervision of Discretionary investment managers
- (3) Strengthening inspection of Discretionary investment managers
- (4) Reinforcing the authorities’ capacity for strengthening inspection and supervision

Measures against Insider Trading related to Public Offerings of Shares

Cases of “Insider Trading related to Public Offerings of Shares”

| | Issuance of SESC's recommendation | Administrative monetary penalty payment Order | Listed Company | Announcement of public offering | Violator | Amount of administrative monetary penalty | Unfair profit obtained by funds |
|---|-----------------------------------|---|--|---------------------------------|---|--|---------------------------------|
| ① | March 21 2012 | June 27 2012 | INPEX CORPORATION | July 8 2010 | Chuo Mitsui Asset Trust and Banking Company, Limited | JPY 50,000 | JPY 14.55 million |
| ② | May 29 2012 | June 26 2012 | Nippon Sheet Glass Co. Ltd. | August 24 2010 | Asuka Asset Management Co., Ltd. | JPY 130,000 | JPY 60.51 million |
| ③ | May 29 2012 | June 27 2012 | Mizuho Corporate Bank, Ltd. | June 25 2010 | Chuo Mitsui Asset Trust and Banking Company, Limited | JPY 80,000 | JPY 20.23 million |
| ④ | June 8 2012 | — | Tokyo Electric Power Company, Incorporated | September 29 2010 | <ul style="list-style-type: none"> ▪ First New York Securities LLC ▪ Individual | <ul style="list-style-type: none"> ▪ JPY 14.68million ▪ JPY 60,000 | — — |
| ⑤ | June 29 2012 | — | Nippon Sheet Glass Co. Ltd. | August 24 2010 | Japan Advisory Limited Liability Company | JPY 370,000 | JPY 16.24 million |



Measures against Insider Trading related to Public Offerings of Shares

Review of securities companies' systems for managing material non-public information
(Announced by the Financial Services Agency on July 3, 2012)

1. Outline

In light of the series of insider information leakage at major securities companies, the FSA ordered 12 major securities companies that recently played an important role in the underwriting of large-scale public offering of new shares to conduct a review of their systems for managing material non-public information

2. Securities companies covered by the review

Securities companies that participated in the recent, large public offerings of new shares as lead managing Underwriters SMBC Nikko, Goldman Sachs, Citigroup Global Markets Japan, JP Morgan Securities Japan, Daiwa, Deutsche Securities, Nomura, Mizuho Securities, Mitsubishi UFJ Morgan Stanley, Merrill Lynch Japan Securities, Morgan Stanley MUFG Securities, UBS Securities Japan

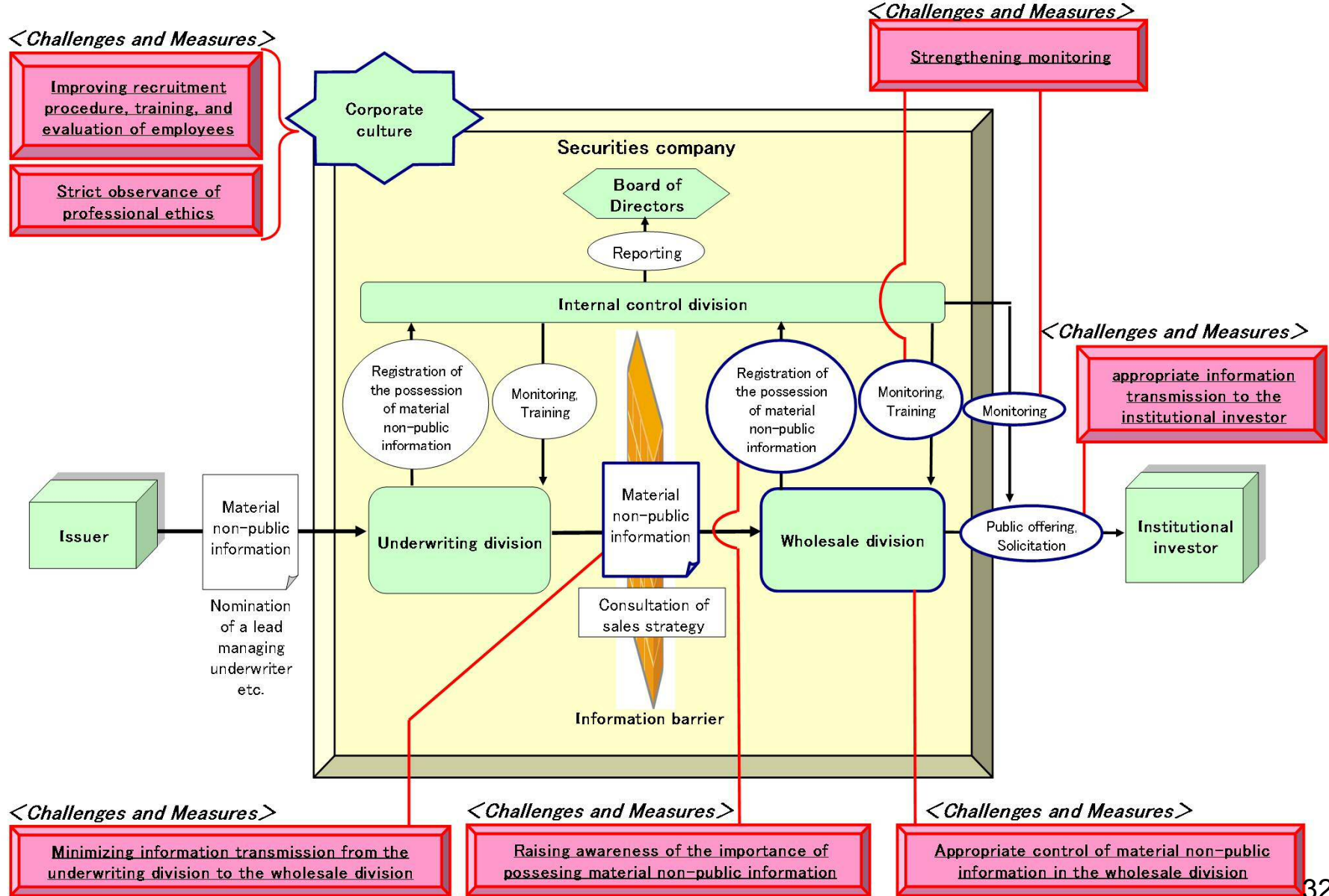
3. Scope of the review

- (1) Internal organizational structure
 - Underwriting division, wholesale division, internal control division
- (2) Status of material non-public information management
 - Internal rules, information barrier
 - Monitoring by internal control division
- (3) Challenges and measures with regard to (1) and (2)

4. Schedule

July 3, 2012 Issuance of the reporting order
August 3, 2012 Reporting deadline

Measures against Insider Trading related to Public Offerings of Shares



Thank you



"for investors, with investors"