

Strategy & Policy 2020-2022

- For Trusted and Attractive Capital Markets -

January 24, 2020

Securities and Exchange Surveillance Commission

Mission

Through proper and appropriate oversight, the SESC

1. Ensures market fairness and transparency, and protects investors
2. Contributes to the sound development of capital markets
3. Contributes to sustainable economic growth

SESC's Market Vision

Markets with strong confidence, where market participants share their commitment towards the sound development of capital markets and solid investor protection, fulfill their expected roles and exercise their professionalism

Philosophy

Fairness
Accountability
Forward-looking
Effectiveness and Efficiency
Close Cooperation
Commitment to Excellence

Market Environment and Challenges

In December 2019, the SESC, whose mission is to protect investors and market integrity, inaugurated its 10th term under new leadership.

Since its inception, the SESC has pursued criminal prosecutions against flawed and material market misconduct and has made recommendations for administrative monetary penalty payment orders and administrative actions for violations of securities laws. The SESC has also conducted oversight through exercising its authority over investigations and inspections in an effort to ensure the fairness and transparency of the markets and protection of investors.

At present, capital markets are undergoing substantial changes:

- Regarding structural changes, an increase in the number of offshore investments and the globalization of companies (diversifying corporate operations towards overseas subsidiaries, outsourcing, etc.) are further accelerating the globalization of capital markets and closer integration of various financial markets.
- Regarding fund flows, the global ultra-low interest rate environment is driving the flow of funds into higher-risk and lower-liquidity funds, which exacerbates the uncertainty of the global economic outlook in the face of geopolitical risks.
- Furthermore, rapid digitalization is having a significant impact on all capital markets and market participants. Financial institutions are being pressed to overhaul their business models due to progress in technology, such as AI and in the utilization of data, and the market landscape is being transformed as a result of the proliferation of high-speed algorithmic trading. In addition, new products and transactions, such as crypto-assets are emerging.

In addition, the policy priorities of the Financial Services Agency (FSA) are encouraging financial institutions to accommodate the diverse needs of users. For its part, the SESC will make a greater contribution to enabling households' stable asset building and realizing a virtuous circle of fund flow through the solid protection of investors' interests and market integrity.

Keeping up with such substantial changes in the environment, in the 10th term, the SESC will focus on achieving three goals based on its values: holistic, timely,

and in-depth oversight. In order to attain these goals, the SESC will pursue five policy priorities.

Goals

1. Holistic oversight

(1) Vigilance against new financial products and transactions

Extensive monitoring and analysis of risks relating to new products and transactions

(2) Surveillance of multiple markets and cross-market activities

Comprehensive surveillance of a wide range of market transactions, in equity/fixed-income markets, cash/derivative markets, and primary/secondary markets

(3) Protecting investors of diverse characteristics

Promoting investor protection that reflects diverse investors in terms of knowledge, experience and competence, including elderliness

(4) Holistic and comprehensive investigation of cases and cross-sectoral application of findings

Exercising holistic and comprehensive investigation referring to cross-sectorial relevant precedents and to reveal the root cause of misconduct

(5) Enhanced outreach to stakeholders

Enhancing outreach to stakeholders with the aim of preventing misconduct

2. Timely oversight

(1) Early detection of market misconduct

Early detection and timely investigation and inspection of potential misconduct in the markets

(2) Preemptive actions against market misconduct

Before identified problems are materialized, if necessary, urging entities under investigation or inspection to take necessary measures for prevention of violations

(3) Effective investigation and inspection, and swift corrective action

Early and effective identification of issues and swift responses to them

in investigation and inspection

3. In-depth oversight

(1) Identifying root causes of problems

When a violation of a securities law is identified, focusing on the substance of the problems, unravelling their root causes and engaging in an in-depth discussion with the entities involved, so that they can take actions proactively for improvements and prevent recurrences of similar violations

(2) Recognizing structural issues of the markets through in-depth and cross-sectoral analysis

Identifying structural issues in the markets and contributing to the improvement of relevant regulations through root causes analysis of the misconduct and cross-sectoral application of the findings

Five policy priorities to achieve the goals

1. Enhanced intelligence gathering

(1) Forward-looking surveillance with macro-economic perspectives

- The SESC will conduct forward-looking market oversight through constant market monitoring and industry sector analysis with macro-economic perspectives.
- Specifically, to detect clues for investigation and inspection, the SESC will analyze the sectors and companies that might have potential risks of misconduct based on its insight of macro-economic trends. The findings will be shared with relevant divisions within the SESC for their investigations and inspections.

(2) Cross-sectoral surveillance across financial markets

- The SESC will exercise multi-dimensional monitoring and conduct cross-sectoral surveillance of equity/fixed-income markets, cash/derivative markets, and primary/secondary markets.

(3) Intelligence gathering through closer cooperation with foreign authorities

- The SESC will further strengthen fostered relationships with foreign

authorities, especially among enforcement divisions, and bolster cooperation in the surveillance, investigations and inspections, and enforcement. The SESC will leverage information obtained from foreign authorities, such as insights on enforcement and regulatory frameworks, in its own oversight activities.

2 . In-depth analysis and swift and effective investigations and inspections

(1) Multi-directional/dimensional analysis and review

- Transactions are increasingly complex, corporate operations are more globalized, and the business models of financial firms are undergoing structural transformation. In these circumstances, untraditional and new types of violations of securities laws are emerging. The SESC will be attentive to potential risks to investors and respond to them without being fixed to the past precedents¹.

(2) Swift recommendation for administrative monetary penalty payment orders

- As the nature of violations becomes more varied and complex, the SESC will proactively and flexibly conduct investigations and inspections, so that it can swiftly bring recommendations for an administrative monetary penalty payment order. By doing so, the SESC will also reveal the facts of market misconduct and disclosure violations and contribute to their prevention.

(3) Effective and efficient investigations and inspections of cross-border cases

- The SESC will actively pursue cases involving cross-border transactions as well as misstatements of multi-national corporations through working with foreign authorities. Through those operations, the SESC will perform effective and efficient investigations and inspections corresponding to the nature of respective cases.

¹ Notably, in the term 2017-2019, the SESC pursued a case of unique method of spoofing (as "the use of fraudulent means" specified in Article 158 of the Financial Instruments and Exchange Act), cases of manipulation in listed derivative markets, cases of false statements in non-financial information, and cases of exaggerated or false claims in website advertisements.

(4) Rigorous enforcement of criminal investigation against market misconduct

- Serious cases of insider trading, market manipulation, spreading rumors, fraudulent means and false statements in financial reporting can be subject to the criminal penalties. The SESC will take rigorous enforcement actions against material and egregious violations by exercising its powers of criminal investigation. In such instances, the SESC will cooperate with criminal investigators and prosecutors as well as foreign authorities in order to effectively reveal the facts, including who is to blame.

(5) Risk-based examination of financial instruments business operators

- The SESC will conduct risk-based and integrated examination of financial instruments business operators (FIBOs).
- Regarding off-site examination, the SESC will work with supervisory divisions of the FSA and the Local Finance Bureaus to assess risks of violations of securities laws by FIBOs, taking into account not only business types and scales of the FIBOs, but also their business models, group-wide strategies and management policies. Based on the risk assessments, the SESC will select entities for on-site inspection.
- Regarding on-site inspection, the SESC will perform in-depth analysis of the products and transaction schemes offered by the FIBOs. To ensure such products are provided to investors appropriately, the SESC will review the appropriateness of the FIBO's business operation from the viewpoint of investor protection, including compliance with rules and customer-oriented business conduct.

(6) Proactive response to cases where investors are harmed

- The SESC will identify and respond to the FIBOs' inappropriate selling and promotion of financial products as well as insufficient internal management systems that could harm investors. Also, in the case of unregistered business operators, the SESC will actively file petitions with the courts to issue prohibition orders. In this way, the SESC will proactively fulfill its mission of investor protection.

3. Effective measures for strengthened market discipline

(1) Multi-dimensional/directional use of insights from investigations and inspections

- In its investigations and inspections, the SESC will not limit itself to narrowly defined "exits," such as recommendations for administrative actions or criminal prosecutions. Rather, the SESC will make full use of all intelligence² gathered from each case in its oversight activities and engagement with stakeholders.
- The SESC will conduct investigations and inspections based on extensive perspectives. If the findings of investigations and inspections suggest structural problems in the markets, the SESC will take actions to realize better market environments through providing inputs to relevant policymaking.

(2) Root-cause analysis and engagement with stakeholders to prevent recurrence of market abuse

- When the SESC identifies a violation of a securities law during its investigation or inspection, it will not only pursue administrative actions or monetary penalty payment orders, but will also assess the problem in a holistic manner and pursue the root causes. Thus, the SESC will engage in in-depth discussions with the management of the entities under investigation or inspection and prevent recurrence of violations.
- When the SESC identifies potential market abuse during its investigation or inspection before it is materialized, the SESC will share its view on the issue with the management of entities under investigation or inspection to prevent violations from occurring.

(3) Enhanced outreach domestically and globally as pre-emptive measures against market misconduct

- The SESC will highlight the significance, focus and details of the case in the press release of specific cases at the time of the recommendations as well as in the casebooks it publishes³. The aim is to strengthen market integrity through providing information that is both concrete and comprehensive.
- To prevent investors from being harmed by market misconduct, the SESC will enhance issuance of warnings, such as investor alerts.

(4) Extensive measures for seamless surveillance

- The SESC will always keep a close eye on developments in the markets,

² Information which could have add-value for other cases

³ "Casebook of Administrative Monetary Penalties Imposed under the Financial Instruments and Exchange Act – Market Misconduct Section," "Casebook of Inspection of Disclosure Documents," and "Securities Monitoring Overview and Casebook"

including emerging products and transactions as well as those that might be outside its surveillance. Through outreach and policy proposals, the SESC will take necessary actions in order to conduct seamless surveillance.

4. Response to digitalization and strategic HR development

(1) Advanced and efficient surveillance with digitalized technologies

- The SESC will develop a more effective and efficient surveillance mechanism in light of technological advancements in markets and the use of digitalized technologies for the surveillance activities by other regulatory authorities and enforcement organizations. To this end, the SESC will work with its peer organizations to leverage digitalization in its market surveillance systems.

(2) In-time response to rapid digitalization in the capital market

- To achieve comprehensive market surveillance, the SESC will analyze and respond in a timely manner to new products and transactions that emerge as a result of rapid progress in digitalization.
- To adapt to the rapid progress of digitalization and increases in the volume of handled data, the SESC will further utilize digital forensics technology⁴ in its overall technological environment.

(3) Strategic HR development

- As digitalization is advancing, transactions are more complex, and companies are significantly globalizing, the SESC will work to equip its human resources with specialized skills and broad perspectives in market surveillance so that the SESC can duly fulfill its mission.

5. Cooperation with various stakeholders

(1) Closer collaboration with SROs

- To support proactive oversight by self-regulatory organizations (SROs), the SESC will share its intelligence with them in a timely manner and reinforce the self-disciplinary mechanism of the market.
- In order to realize more effective and efficient market surveillance, the SESC will also continue to review the way it cooperates with the SROs.

⁴ Technology for analyzing electronic data and preserving it as evidence

- To keep up cross-sectoral surveillance that covers multiple financial markets, the SESC will work with the width and quality of its market monitoring.

(2) Enhanced cooperation with stakeholders

- To reinforce its existing cooperative relationship with SROs, foreign authorities and peer organizations, the SESC will expand its coordination with other stakeholders, including those involved in market fairness/transparency and investor protection, and thereby strengthen overall surveillance functions.

(3) Enhanced contribution to global market oversight

- As for oversight issues relating to cross-border transactions, the SESC will raise and share emerging issues both at the bilateral and multilateral venues with foreign authorities by proactively participating in the discussions at, for example, the International Organization of Securities Commissions. By doing so, the SESC aims to contribute to global market surveillance and international cooperation.
- By being closely involved in global market surveillance activities among regulators, the SESC will be attentive to emerging issues and major market developments, including key enforcement cases by other regulators. The SESC will apply those insights to its market oversights.

Moving forward

The SESC keeps its initiative towards “holistic, timely and in-depth” oversight.

This paper is based on our current observation on the capital market conditions and, in view of the rapidly evolving market environment, the SESC will review its Strategy & Policy through the PDCA cycle⁵, for accurately identifying challenges and proactively taking necessary actions. The SESC will continue to closely engage with outside advisors and other stakeholders to fulfill its mission.

⁵ A method for continuous improvement by repeating the “Plan, Do, Check, Act” cycle