

Summary of Monitoring Priorities for Securities Businesses (July 2022-June 2023)

Environment surrounding FIBOs

1. Environment surrounding FIBOs

- Requirement for customer-oriented business conduct, progress in digitalization, increasing potential risk of cyberattacks, etc.

2. Changes to regulatory frameworks for FIBOs

- (1) Revision of the firewall regulation between banking and securities businesses, (2) Review of explanations regarding solicitation for sale and switching of investment trusts, (3) Enhancement of supervisory responses to FIBOs' business acquisitions/mergers, etc.

3. Findings through the securities business monitoring over the past business year

- Type I FIBOs: Inappropriate solicitation for switching investment trusts that was not economically rational, structured bond sales in a manner that did not reflect customer needs, failure to sufficiently reduce the risk of unauthorized withdrawal of customer funds through online trading, etc.
 - * A large securities company was charged for suspicion of conducting market manipulation
- Investment management business operators: Movement of expanding investment in alternative assets by pension funds, etc., breach of duty of care as a prudent manager, such as insufficient due diligence, breach of duty of loyalty, such as inadequate conflicts of interest management
- Unregistered business operators: Financial instruments business operations without statutory registration (Intermediation for conclusion of discretionary investment contracts or solicitation for investment in financial instruments categorized as shares in foreign collective investment schemes)
 - * Policy proposal regarding solicitation for investment in limited liability company membership rights through their employees.



Industry-wide monitoring priorities

1. Developing internal control environments with a focus on appropriate investment solicitation based on the principle of suitability, and appropriate sales operations based on customer-oriented business conduct (In particular, sales of financial products with complex risk structures, such as structured bonds)
2. Business model changes along with progress in digitalization, etc., and the development of internal control environments in response to such changes
3. Sufficiency of cybersecurity measures, and system risk management (including those outsourced) in response to progress in digitalization
4. Firm establishment of internal control environments for AML/CFT
5. Implementation of measures to improve or prevent the recurrence of matters pointed out in internal audits or self-regulatory organization examinations

In addition to the above, the SESC will flexibly examine other themes in response to changes in the environment surrounding FIBOs.

Monitoring priorities by FIBOs' size and business type

Type I FIBOs	Major securities business groups	<ul style="list-style-type: none"> Development of control environments for governance and risk management that support global business operations Efforts to build sustainable business models If necessary, the SESC will swiftly inspect relevant sales offices to examine their actual sales practices. Development of control environments for managing customer information and conflicts of interest in response to the revised firewall regulation between banking and securities businesses [3 mega banking groups]
	Foreign securities firms	<ul style="list-style-type: none"> Development of internal control environments in response to the overseas outsourcing of back-office operations and control environments for system risk management Development of control environments for managing sales of financial instruments to Japanese financial institutions and other investors
	Online securities firms	<ul style="list-style-type: none"> Development of control environments for system risk management, including cybersecurity measures Development of internal control environments in line with their business model changes, such as the initiatives to eliminate brokerage commissions, increases in products, and launch and expansion of face-to-face sales in collaboration with independent financial advisors
	Semi-major/ regional securities firms	<ul style="list-style-type: none"> Inappropriate solicitation and other conducts that are inappropriate from the viewpoint of investor protection, including whether following the principle of suitability Effectiveness of internal control environments at securities firms whose major shareholders or business management systems have changed, from the viewpoint of their business models or governance.
	Foreign currency margin transactions business operators	<ul style="list-style-type: none"> Development of control environments for system risk management, including cybersecurity measures Development of adequate internal control environments for relevant advertising and sales/solicitation regulations Disclosure of risk information, secure sufficient capital given their stress test results, and development of systems to retain and report transaction data.
Investment management business operators	<ul style="list-style-type: none"> Actual investment practices, development of control environments for managing investment (including those outsourced) and conflicts of interest, etc. 	
Investment advisors/agencies	<ul style="list-style-type: none"> Misleading advertisement, solicitation through false explanation, etc. 	
Type II FIBOs, QII business operators, independent financial advisors, and others	<ul style="list-style-type: none"> Funds claiming high returns and existence of investment projects, and as for solicitation for loan-type funds, the disclosure of information about loan borrowers and the screening of those funds, etc. [Type II FIBOs, business operators, etc., engaging in specially permitted businesses for qualified institutional investors (QII business operators)] Appropriateness of their investment solicitation and sufficiency of management by their entrusting FIBOs [Independent financial advisors] Risk-based securities businesses monitoring in light of their business characteristics [registered financial institutions, etc.] 	
Unregistered business operators	<ul style="list-style-type: none"> Exercising investigative authority proactively to file a petition with the court for a prohibition and stay order against their illegal conduct Enhancing information dissemination, including the public disclosure of their and their representatives' names and illegal conduct, etc. Coordinating proactively with relevant JFSA divisions, Local Finance Bureaus, investigative authorities and the Consumer Affairs Agency. 	

*The SESC will also verify FIBOs' response to the changes in regulatory frameworks.

Approach to monitoring securities businesses

- The SESC will select FIBOs for inspection based on risk assessment from various viewpoints, including business models, in cooperation with relevant JFSA divisions. Inspection will be mainly conducted in cases where it is necessary to comprehend further details, such as:
 - ① a relevant law and/or regulation is breached or there is a deficiency in business operations that requires a prompt in-depth examination;
 - ② a financial instrument is offered with an unclear risk profile, necessitating an examination of its solicitation activities;
 - ③ the actual business operations are not fully comprehended from information analysis based on monitoring (including where there is a long period between examinations);
 - ④ There is a possible serious problem concerning investor protection (e.g., inadequate segregation of customer assets)
- In its inspections, the SESC will endeavor to conduct verification and point out problems in a practically meaningful manner, going further than just pointing out problems and taking actions such as making recommendation for administrative disciplinary actions, and analyzing the whole picture of the problems to identify their root causes, to help develop effective measures to prevent recurrence. Furthermore, if the SESC identifies the need to improve business operations before any potential issues materialize, it will describe such items as “Items to be noted” in the notification of completion of inspection, to share the awareness with the inspected FIBOs to encourage actions such as building effective internal control environments.

Cooperation with relevant organizations and dissemination of inspection results

- The SESC and Local Finance Bureaus will work closely from the planning stage of monitoring and inspection and conduct joint inspection as needed.
- The SESC will continue close collaboration with self-regulatory organizations, share information with them in a timely manner, and thereby conduct its securities businesses monitoring effectively and efficiently.
- The SESC will share its inspection results also with inspected FIBOs’ audit-related staff and outside directors, and thereby encourage those FIBOs to voluntarily improve practices.