

# Summary of Monitoring Priorities for Securities Businesses (July 2023-June 2024)

## Environment surrounding FIBOs, etc.

1. Environment surrounding FIBOs
  - Requirement for customer-oriented business conduct, progress in digitalization, increasing risk of cyberattacks, etc.
2. Changes to regulatory frameworks for FIBOs
  - (i) Moves of measures for ensuring customer-oriented business conduct; (ii) Moves of response to the progress in digitalization, etc.; (iii) Development of provisions concerning ESG investment trusts; (iv) Clarification of trustee responsibilities of investment management business operators, etc.
3. Findings through the securities business monitoring over the past business year
  - Type I FIBOs: Violation of the principle of suitability, insufficient management of financial instruments intermediary services, deficiencies in trade screening, and violation of firewall rule
  - Investment management business operators: Deficiencies in management systems for outsourced investment assets, violation of the duty of diligence (inappropriate property surveys or property earnings management), and deficiencies in conflict-of-interest control systems
  - Investment advisors and type II FIBOs: False notification, etc.
  - Unregistered business operators: Financial instruments business operations without statutory registration (Over-the-counter derivatives transactions, public offering, or private placement of foreign bonds)



## Industry-wide monitoring priorities

1. Development of 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 (For instance, sale of complex or highly-risky products, not limited to 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 (including countermeasures against unauthorized access in online trading), and system risk management (including management of system development and operation and management of trustees) 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 accordance with concrete efforts being made in light of the environment surrounding FIBOs, such as the implementation of the "Doubling Asset-based Income Plan" and fundamental reform of the asset management business, etc., as well as in response to changes in the relevant environment.

## Monitoring priorities by FIBOs' size and business type

<b>Type I FIBOs</b>	Major securities business groups	<ul style="list-style-type: none"> <li>• Development of control environments for governance and risk management that support global business operations</li> <li>• Efforts to build sustainable business models</li> <li>• Development of internal control environments, including those for detecting and preventing market misconduct.</li> <li>• If necessary, the SESC will swiftly inspect relevant sales offices to examine actual sales practices there.</li> <li>• Development of control environments for managing customer information in line with their promotion of bank-securities business relationships [3 mega banking groups]</li> </ul>
	Foreign securities firms	<ul style="list-style-type: none"> <li>• Development of internal control environments in response to the overseas outsourcing of back-office operations and control environments for system risk management</li> <li>• Development of control environments for managing sales of financial instruments to Japanese financial institutions and other investors</li> </ul>
	Online securities firms	<ul style="list-style-type: none"> <li>• Development of control environments for system risk management, including cybersecurity measures</li> <li>• Development of management of outsourcing contractors, in line with their business model of using financial instruments intermediary service providers to expand face-to-face sales activities, and internal control environments, including effective trade management that can deal with rapid increases in newly opened accounts and transaction volume.</li> </ul>
	Semi-major/regional securities firms, etc.	<ul style="list-style-type: none"> <li>• Inappropriate solicitation and other forms of conduct that are inappropriate from the viewpoint of investor protection, including whether following the principle of suitability</li> <li>• Development of internal control environments at those securities firms whose major shareholders or business management systems have changed, from the viewpoint of their business models or governance.</li> </ul>
	Foreign currency margin transactions business operators	<ul style="list-style-type: none"> <li>• Development of control environments for system risk management, including cybersecurity measures</li> <li>• Development of adequate internal control environments for relevant advertising and sales/solicitation regulations</li> </ul>
<b>Investment management business operators</b>	<ul style="list-style-type: none"> <li>• Actual investment practices, development of control environments for managing investment (including those outsourced) and conflicts-of-interest, etc.</li> </ul>	
<b>Investment advisors/agencies</b>	<ul style="list-style-type: none"> <li>• Misleading advertisement, solicitation through false explanation, etc.</li> </ul>	
<b>Type II FIBOs, QII business operators, independent financial advisors, and others</b>	<ul style="list-style-type: none"> <li>• Funds claiming high returns and existence of investment projects [Type II FIBOs, business operators, etc., engaging in specially permitted businesses for qualified institutional investors (QII business operators)]</li> <li>• Appropriateness of their investment solicitation and sufficiency of management by their entrusting FIBOs [Financial instruments intermediary service providers]</li> <li>• Monitoring in light of their business characteristics [registered financial institutions, etc.]</li> </ul>	
<b>Unregistered business operators</b>	<ul style="list-style-type: none"> <li>• Exercising investigative authority proactively to file a petition with the court for a prohibition and stay order against their illegal conduct</li> <li>• Enhancing information dissemination, including the public disclosure of their and their representatives' names and illegal conduct, etc.</li> <li>• Coordinating proactively with relevant JFSA divisions, Local Finance Bureaus, investigative authorities and the Consumer Affairs Agency.</li> </ul>	

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

## Approach to the securities business monitoring

- The SESC will continue to collaborate with relevant JFSA divisions to identify and assess risks at FIBOs for risk-based inspection, and it will continue to be proactive in ascertaining their actual situation through inspections mainly for the following cases. Also, the SESC will conduct inspections in a flexible manner, including by narrowing down items for verification as necessary.
  - ① an FIBO has breached a relevant law and/or regulation or has concerning business operations, which necessitates prompt in-depth verification;
  - ② an FIBO offers a financial instrument with an unclear risk profile, which necessitates an examination of its solicitation activities;
  - ③ an FIBO's actual business operations can not be fully comprehended through monitoring-based information analyses alone (including where it has been long since the last time the FIBO was inspected);
  - ④ an FIBO poses a possible serious problem in terms of 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 a recommendation for administrative disciplinary action, 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.
- With regard to security tokens, the SESC will analyze information, including how they are issued and distributed, in collaboration with relevant JFSA divisions.
- 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 inspection results also with their audit-related staff and outside directors, and thereby encourage those FIBOs to voluntarily improve practices.