

1 Overview of activities in Fiscal Year 2020

In FY2020 (April 2020-March 2021), the economic environment surrounding Japanese securities markets went through various changes. At the beginning of the fiscal year, the Japanese economy continued to deteriorate rapidly in an extremely severe situation under the impact of the COVID-19 pandemic. While the economy is rebounding thanks to the effects of various policies and an overseas economic improvement, weakness is still increasing in some areas. It is necessary to keep a close watch on the impact of such economic situation on the financial and capital markets.

Against this backdrop, the Securities and Exchange Surveillance Commission (SESC) conducted timely market surveillance gathering and analyzing information in consideration of the domestic and overseas circumstances in FY2020. In its investigation and inspection, the SESC not only made recommendations for administrative actions and filings of criminal charges of violations of laws, but also made efforts to identify the root causes of the violations in order to prevent the recurrence.

2 Recommendations for administrative monetary penalty payment orders and filings of criminal charges of market misconduct

(1) Recommendations and filings of criminal charges of market misconduct

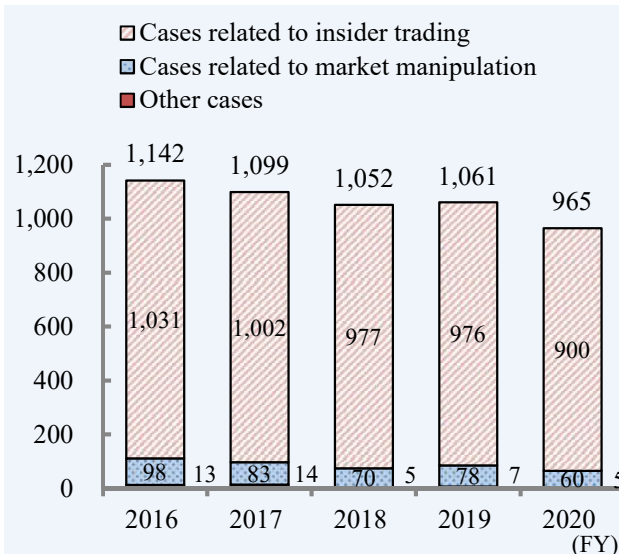
In FY2020, the SESC made recommendations for administrative monetary penalty payment orders in 14 market misconduct

cases (eight insider trading cases and six market manipulation cases) and two filings of criminal charges of market misconduct.

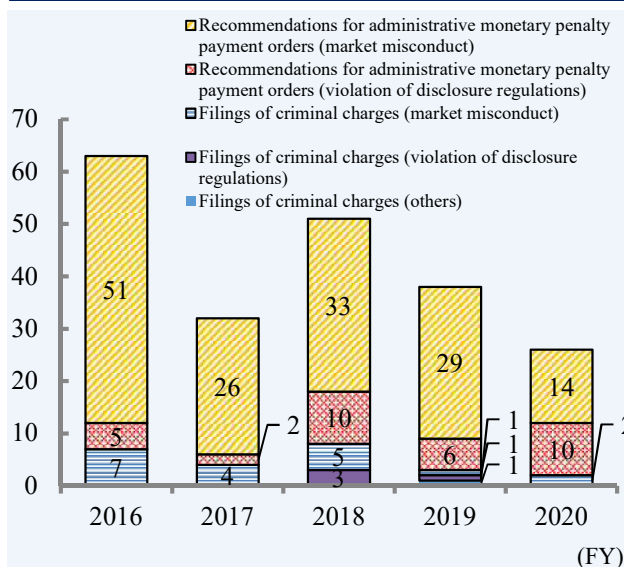
(2) Case examination for detecting market misconduct

The total number of cases examined for detecting market misconduct was 965 in FY2020.

Examined Cases for Market Misconduct



Recommendations and Filings of Criminal Charges



(3) Trends in market misconduct

With rapid changes in the business environment as a background, the SESC made recommendations in insider trading cases where material facts included tender offers, business alliances and new share issuances.

Regarding the regulations prohibiting persons from providing insider information or encouraging others to make transaction, the SESC recommended an administrative monetary penalty payment order in one insider information provision case. The offender in the case provided insider information on multiple issues. The SESC also filed the first criminal charge solely against a violation of the transaction encouragement regulation since the regulations were introduced in April 2014.

Market manipulation schemes have continuously become more complicated and sophisticated. The SESC made recommendations for administrative monetary penalty payment orders in the following cases: i) a wrongdoer artificially raised stock prices of an exchange by purchasing shares at higher prices than the prices of the exchange through a Proprietary Trading System (“PTS”), ii) a wrongdoer raised the stock prices by repeating minimum-lot purchases, and iii) a wrongdoer implemented false transactions by matching their own trading orders with opposite ones through accounts in the names of its own, relatives and acquaintances. The SESC also filed a criminal charge in a case where an offender made stabilizing transactions to artificially prevent margin requirements from being raised.

(4) Policy going forward

Going forward, the SESC will continue to study the improvement of its surveillance systems and review the methods of examination and investigation in order to respond to changes in economic situations and trading methods.

In addition to announcing recommendation cases on its website, the SESC proactively disseminates information on trends, overviews of the recommendation cases and points that can be improved in the management system for insider trading at listed companies, and messages that the SESC wants to convey to listed companies in casebooks of administrative monetary penalty and other publications to prevent the occurrence and recurrence of market misconduct.

3 Identifying and addressing violations of disclosure regulations and prevention of recurrence of violations

(1) Recommendations regarding disclosure regulations

In FY2020, the SESC made recommendations for administrative monetary penalty payment orders in 10 disclosure regulations violation cases.

(2) Trends and causes of the violations of disclosure regulations

In the cases where the SESC made recommendations for administrative monetary penalty payment order, there were cases of inappropriate accounting practices, such as understating the cost of sales by long-term record-

ing of fictitious year-end inventory and understating the cost of sales at overseas subsidiaries in order to overstate net income. In addition, there was a case of false statements in annual securities reports, such as failing to disclose the related transactions in the "Notes on Transactions with Related Parties."

(3) Policy going forward

Transactions are increasingly complex, corporate operations are more globalized, and the business models are diversifying and transforming. In these circumstances, early detection and early corrective actions against violations of disclosure regulations are essential. For that purpose, the SESC will continue to gather information on listed companies and conduct analysis with a focus on the risk of the violations, as well as conduct timely and multifaceted inspections of disclosure statements.

In addition, the SESC will engage in dialogues and enhance mutual understanding on the background and causes of violations with the management and outside directors of listed companies that have committed violations of disclosure regulations, to assist them in building internal systems for proper information disclosure. The SESC will also proactively communicate with listed companies and their audit firms regarding the details of the actual violations of disclosure regulations detected in inspections of disclosure state-

ments. Such efforts will collectively contribute to preventing the occurrence and recurrence of violations of disclosure regulations.

4 Implementing integrated on-site and off-site monitoring of FIBOs¹

(1) Basic monitoring policy for securities business

Since the 2016 business year,² the SESC has been conducting risk assessments of all FIBOs through off-site examination involving analyses of the business environment, including economic and industrial trends, as well as FIBOs' business models. Based on the respective risk assessments of FIBOs in off-site examination, the SESC has selected entities for on-site inspections in collaboration with the Local Financial Bureaus.

In carrying out on-site inspections, the SESC aims not only to point out legal problems and make recommendations for administrative actions, but also to assess the problems in a holistic manner and pursue the root causes to assist FIBOs in preventing the recurrence of the problems.

In cases where the SESC identifies issues in business control environments that need to be improved but that have yet to become serious problems, the SESC has shared its views on the issues with the management of the FIBOs under inspection to encourage them to build effective internal control environments.

¹ In this document, "FIBOs" refers to any business operator subject to securities monitoring, including Financial Instruments Business Operators, Registered Financial Institutions, Financial Instruments Intermediary

Service Providers, Qualified Institutional Investor Business Operators, and credit rating agencies.

² The 2016 business year refers to the period from July 1, 2016, to June 30, 2017.

(2) Recommendations regarding FIBOs

In FY2020, the SESC made recommendations for administrative actions against FIBOs in five cases.

These cases involved FIBOs that engaged in gravely problematic operations as they lacked awareness in complying with the law and investor protection: i) a foreign exchange margin trader that illegally failed to confirm customers' willingness to accept solicitation and violated the prohibition of re-solicitation, ii) an investment management firm that failed to faithfully conduct investment management business for beneficiary owners of an investment trust with the due care of a prudent manager, and iii) an investment adviser/agent that provided false information to customers in relation to solicitation for the conclusion of financial instruments contracts.

(3) Policy going forward

While the number of business operators subject to the SESC's monitoring total approximately 7,700, whose sizes, business operations and products are diverse, there are business operators that are still lacking awareness and controls for basic compliance with the law and investor protection. The SESC will endeavor to accurately identify potential risks through its effective and efficient monitoring based on the annual "Monitoring Priorities for Securities Businesses."

The SESC will also keep a close watch on the impact of the COVID-19 pandemic on FIBOs' business environments and operations. Especially in cases where the SESC

identifies the necessity for early, in-depth examinations with regard to possible violations of relevant regulations or problems related to business operations, the SESC will conduct on-site inspection to verify the problems.

5 Response to the advance of digitalization

(1) Further promotion of digitalization in market surveillance

In recent years, rapid digitalization has been having a significant impact on all capital markets and market participants. For example, 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. The SESC has enhanced the functions of the trading surveillance system to keep up with such rapid changes in the market environment and implement more effective and efficient market surveillance. The SESC has also established the IT Strategy Office to further promote digitalization in market surveillance operations strategically in a cross-sectoral manner.

(2) Policy going forward

The SESC will continue discussions to further promote digitalization in market surveillance operations strategically in a cross-sectoral manner to keep up with changes in the market environment and implement more effective and efficient market surveillance.

6 Cooperation with relevant organizations and proactive communication with stakeholders

(1) Cooperation with relevant organizations

The SESC works with self-regulatory organizations (e.g., Financial Instruments Firms Associations, Financial Instruments Exchanges, and Self-Regulation Organization; hereinafter “SROs”) on a daily basis in examining market transactions and in monitoring the appropriateness of members’ operations. The SESC further strengthened its cooperative relationship with SROs through periodic discussions to share emerging issues related to market surveillance. In FY2020, the SESC had such periodic discussions with SROs 13 times as well as discussions with FIBOs and other organizations to exchange views.

Regarding cooperation with foreign authorities, the SESC participates in various multilateral discussions at International Organization of Securities Commissions (“IOSCO”) and actively engages in exchanges of views on a bilateral basis. In addition, for investigations into market misconduct cases using cross-border transactions, the SESC made a total of 33 requests for information to foreign authorities pursuant to the IOSCO MMoU (Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information) in FY2020.

(2) Proactive communication with stakeholders

The SESC publicizes information on individual cases at the time of recommendations. In addition, for the purpose of enhancing self-discipline in the market, the SESC continuously endeavors to enhance its communications with retail investors and other market participants with respect to the significance, details and root causes of the cases and to let

them know the activities of the SESC, through the publication of various casebooks, contribution of articles, and holding of lectures. In FY2020, the SESC proactively conducted external outreach through its website, media outlets and a total of 30 seminars to market participants, certified public accountants, lawyers, and other stakeholders.